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## **BBC Studios' lines of business**

Assessment of BBC Studios' changes to its lines of business

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[BBC Studio's lines of business](#) – Welsh overview

### **CONSULTATION:**

Publication date: 9 October 2020

Closing date for responses: 4 December 2020

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# 1. Overview

**This consultation sets out our views on BBC Studios' changes to its lines of business and proposes some changes to the BBC's Trading and Separation Requirements.**

The BBC undertakes commercial activities to generate a return, which can be reinvested in BBC programmes and services and supplement income from the licence fee. These activities will need to adapt to the changing environment and respond to opportunities as they arise. Our role as regulator is to ensure that the relationship between the licence fee funded part of the BBC (the Public Service) and the commercial activities does not distort the market or create an unfair competitive advantage. We support the need for the BBC to innovate, grow and change as long as this is done fairly.

BBC Studios produces and distributes content, owns and operates channels (e.g. UKTV), a joint venture international subscription video on demand service (BritBox in the US and Canada), sells programme formats and consumer products such as DVDs and merchandise.

The Requirements state that the BBC must earn a commercial rate of return for its commercial subsidiaries and lines of business. It also needs to set lines of business that are appropriate. In 2019, BBC Studios decided to reduce its lines of business from five to two; and, in particular, to combine the production and distribution activities into a single line of business. This consultation assesses these changes to BBC Studios' lines of business as part of a broader programme of work to review the interaction between BBC Studios and the Public Service more generally.<sup>1</sup>

## **What we have found – in brief:**

*We consider that BBC Studios' changes to its lines of business are appropriate*

We have provisionally found that production companies of a similar size and scope to BBC Studios also have an integrated distribution arm. This has become more important as producers and distributors are expected to help fund the costs of making programmes.

## **What we are proposing – in brief:**

*We are proposing some changes to the BBC's requirements to protect fair and effective competition*

The production and distribution line of business, with its extensive back catalogue of Public Service content, has some activities that the BBC's competitors of similar size and scope are unlikely to be able to replicate to the same extent. We are therefore proposing to require BBC Studios to provide additional information, but only to Ofcom, as it is commercially confidential. This will allow us to monitor more closely the activities of its production and distribution line of business.

Given the significant changes that BBC Studios has made to its lines of business since its inception in 2017, we are also proposing further changes to its Trading and Separation Requirements. We

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<sup>1</sup> [Review of the interaction between BBC Studios and the BBC Public Service: call for evidence](#), 9 October 2020.

propose to require the BBC to give Ofcom three months' notice of any future changes to its lines of business. If we consider the BBC's changes to be inconsistent with its Requirements, or the Charter and Agreement, we would, subject to consultation, be able to step-in to prevent them.

We welcome views and evidence from interested or affected parties on our views of BBC Studios' changes to its lines of business, and our proposals to change the Requirements and guidance in this area. The deadline for responses to this consultation is 4 December 2020. We aim to publish our statement in early 2021.

## 2. Background

### Regulating the BBC's commercial activities

- 2.1 Under the Agreement,<sup>2</sup> Ofcom must set requirements in relation to the BBC's commercial activities. We set Requirements<sup>3</sup> that we considered appropriate to ensure that the BBC's commercial activities do not, as a result of their relationship with the Public Service, trading activities or non-service activities, distort the market or create an unfair competitive advantage.
- 2.2 One of our Requirements is that each subsidiary that carries out commercial activities and each line of business within the subsidiaries must earn a commercial rate of return over an appropriate period of time. The BBC must notify us and take appropriate steps where it fails to meet this Requirement. The BBC must also publish the revenues, costs and rate of return for all its subsidiaries and lines of business.

### BBC Studios' lines of business

- 2.3 In 2018, ahead of the merger between BBC Studios (production activities) and BBC Worldwide (channels and distribution activities), the BBC Board gave commitments to Ofcom which included an assurance that it would not change its lines of business following the merger. In particular, it committed to keep reporting on its production and distribution activities separately. This preservation of transparency was a factor in Ofcom's decision that the merger was not a material change to the BBC's commercial activities.
- 2.4 A line of business is a group of activities that the BBC combines for target setting and reporting purposes, they provide visibility of whether the activities are able to make a commercial rate of return over a suitable period of time. The Requirements state that the BBC must set appropriate lines of business. Effective oversight of BBC Studio's lines of business is important to ensure that its commercial activities do not, as a result of their relationship with the Public Service, distort the market or create an unfair competitive advantage. Ofcom and other stakeholders need visibility that the BBC is generating a commercial rate of return over an appropriate period of time as would any other commercial entity.
- 2.5 In March 2019, the BBC informed us of its intention to change the lines of business within BBC Studios from five to two (see Figure 1 below). It subsequently withdrew the

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<sup>2</sup> The "Agreement" we refer to in this document is the [Agreement between the Secretary of State for Culture, Media and Sport, and the BBC](#).

<sup>3</sup> [The BBC's commercial and trading activities: requirements and guidance: Ofcom's requirements and guidance](#), 11 February 2019.

commitment it gave Ofcom during the merger between BBC Studios and BBC Worldwide to retain the existing five-lines of business.

**Figure 1: Changes to the BBC's Lines of Business within BBC Studios**

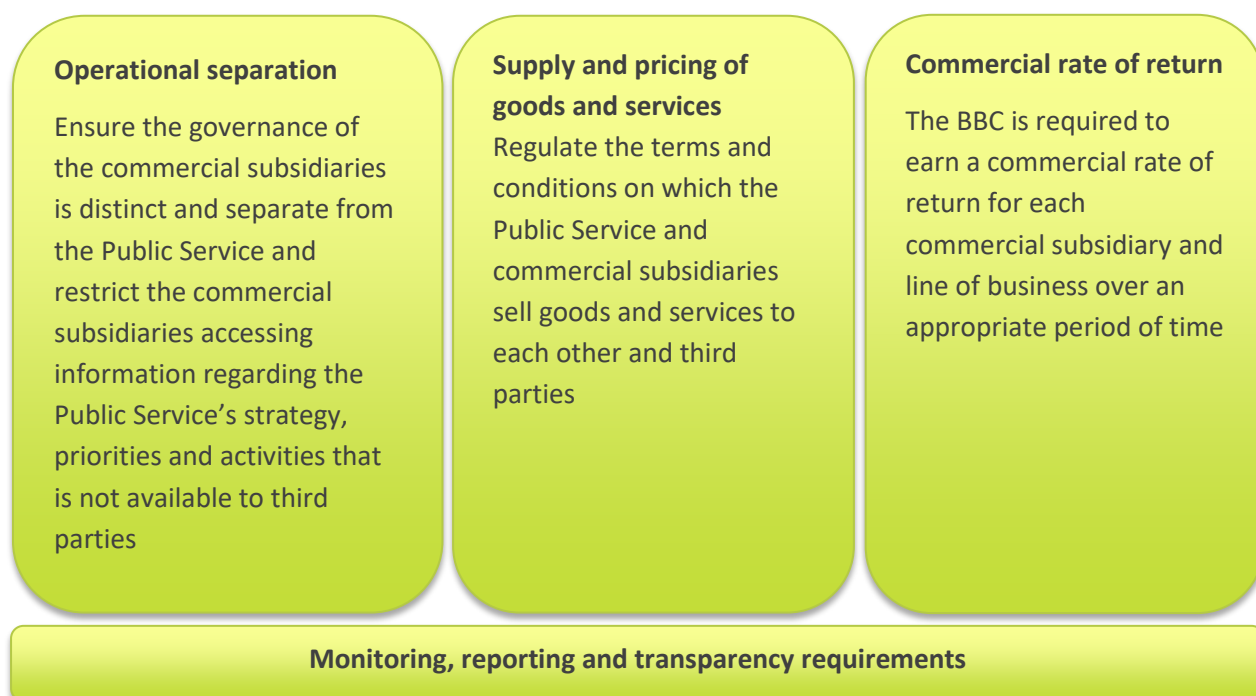
Previous lines of business	New lines of business
UK television production (making television programmes)	Production and distribution (including consumer products and international production)
International production and formats (production of programmes for international markets)	
Content sales (selling or the licensing of both BBC content and content made by other producers)	
Consumer products (activities such as live events and the sale of programme related goods such as DVDs)	
Branded services (BBC channels and digital platforms including ventures such as BBC America and BritBox US and Canada)	Branded services

## Legal framework and our role in relation to the BBC commercial activities

- 2.6 Ofcom's role in relation to the BBC's commercial activities is to ensure that they do not distort the market or create an unfair competitive advantage as a result of their relationship with the Public Service. We therefore focus on issues concerning the separation of the Public Service from the commercial activities carried out by the commercial subsidiaries.
- 2.7 Under the Agreement, Ofcom must set the requirements it considers appropriate to ensure separation between the Public Service and the commercial subsidiaries, which may include requirements to ensure that:
- the commercial subsidiaries operate at arm's length from the Public Service on commercial terms;
  - the commercial activities are carried out in accordance with normal market principles, including making a commercial rate of return; and
  - the relationship between the Public Service and the commercial subsidiaries is appropriately transparent, including providing Ofcom with financial reports and the publication of information.

- 2.8 As part of the Agreement, Ofcom must also set out how it will regulate the trading activities and the procedures to be followed, including such requirements as Ofcom considers appropriate to protect fair and effective competition.
- 2.9 We have put in place requirements and guidance (Requirements)<sup>4</sup> to ensure that the BBC's commercial activities do not distort the market or create an unfair competitive advantage as a result of the relationship with the Public Service. In February 2019, we revised the rules (which were introduced in 2017) following work undertaken to understand the process and practices around the operation of the BBC's commercial subsidiaries and their relationship with the Public Service.

**Figure 2: A brief summary of the Requirements:**



## Current rate of return requirements

- 2.10 The main rate of return requirement is that the BBC must earn a commercial rate of return over an appropriate period of time both for each subsidiary, and for each line of business. To determine what a commercial rate of return should be for a line of business and subsidiary, the BBC should monitor and research the relevant markets, including using benchmark rates of return.

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<sup>4</sup> [The BBC's commercial and trading activities: requirements and guidance](#), Ofcom's requirements and guidance, 11 February 2019.

- 2.11 These requirements help to ensure that the Public Service acts like a rational private investor, on the basis that if a commercial rival was engaged in activities that were not expected to generate sufficient returns to justify the risks associated with those activities, it would take steps to modify or stop those activities. This would suggest that it was instead using its position as a public funded entity to sustain an activity that would not usually be considered sufficiently profitable. There is a risk that without appropriate safeguards, the BBC's public funding could be used to subsidise or benefit its commercial subsidiary. This has the potential to distort the market in which the subsidiary operates or create an unfair competitive advantage for the BBC subsidiary.
- 2.12 Even if a BBC subsidiary as a whole was making a commercial rate of return over an appropriate period of time, we might still be concerned if a particular line of business was not making a commercial rate of return as this could potentially distort the market and impact fair and effective competition. This is because market conditions and the potential to affect the ability of rivals to compete may vary by business activity. To safeguard against this potential negative impact on competition, the rate of return requirements apply to individual lines of business as well as the subsidiaries.

## The merger of BBC Studios and BBC Worldwide

- 2.13 In November 2017, the BBC announced a proposed change to its commercial activities by merging two of its commercial subsidiaries, BBC Studios and BBC Worldwide into a single entity, also named BBC Studios. The proposed merger brought together the BBC's commercial production, sales and distribution activities which were carried out by BBC Studios and BBC Worldwide under a shared management and leadership structure. The BBC planned to implement this new structure from the beginning of April 2018.
- 2.14 In conducting a materiality assessment of the proposed merger of BBC Studios and BBC Worldwide, the BBC Board took the following into account in concluding that the proposed change was not material:
- “BBC Studios will continue to operate, and report on, production and sales & distribution activities as separate lines of business. As such each will continue to target commercial rates of return. This was one of the additional safeguards to ensure that the relationship between these two activities was aligned with the market when BBC Studios was originally set up as a commercial subsidiary, and will not be weakened by this change”.<sup>5</sup>
- 2.15 This was captured in Commitments which the BBC Board gave to Ofcom in March 2018, which included commitments that:
- “6. The BBC Board will set commercial rates of return (informed by market norms) for all lines of business within the new BBC Studios. The BBC Board will review the performance

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<sup>5</sup> BBC Studios materiality assessment, November 2017.



of new BBC Studios against these targets and report to Ofcom in accordance with the requirements set out in Ofcom's trading and separation rules. The lines of business in new BBC Studios will be consistent with the current lines of business in BBC Studios and BBC Worldwide. For the avoidance of doubt, the BBC will therefore set targets for the following lines of business with the new BBC Studios:

- UK television production;
- International production and formats;
- Content sales;
- Branded services; and
- Consumer products...

10. The BBC commits to no lessening of transparency in financial reporting by the BBC's commercial subsidiaries as a result of this change:

- The lines of business in new BBC Studios will be consistent with the existing lines of business in BBC Studios and BBC Worldwide (see paragraph 6 above).
- The BBC will report to Ofcom in line with Ofcom's trading and separation rules ... for each line of business in new BBC Studios.
- ... the BBC will provide to Ofcom an explanation of how the BBC has set its commercial rate of return targets for each line of business in new BBC Studios
- Annually, and no later than by 1 April each year, the BBC will provide to Ofcom an explanation of how the BBC has set its commercial rate of return targets for each line of business, including an explanation of how market norms have informed the targets set by the BBC. The BBC will provide Ofcom all relevant evidence.
- The BBC will also provide more detailed information as necessary when formally requested by Ofcom and required to carry out Ofcom's regulatory functions.
- The BBC will also publish each year at the same time as the BBC's Annual Report and Accounts financial and performance information for new BBC Studios, including details of the performance of each line of business approved by the BBC Board.
- The BBC commits to publishing by 30 April 2018 a structure chart of the new BBC Studios, including the divisional structure and all lines of business comprised within it.”<sup>6</sup>

2.16 We subsequently decided that the merger itself did not constitute a material change and therefore we did not conduct a formal assessment of the proposed change under the Agreement. Our decision was influenced by the characteristics of the BBC's proposed change, our trading and separation requirements and the commitments provided by the BBC.

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<sup>6</sup> [The BBC's commitments](#), pages 5-6.

- 2.17 In our July 2018 Consultation on the Requirements, we explicitly referenced the need to understand the performance of production and distribution activities separately given their different cost and profit drivers.<sup>7</sup>

## Changes to the lines of business within BBC Studios post-merger

- 2.18 In September 2019, the BBC announced that it had made some changes to the lines of business within BBC Studios. It went from five lines of business to two – Production and distribution, and Branded services.
- 2.19 As a result of the changes to the lines of business, the BBC withdrew commitment number 6 (as above) and replaced it with a revised commitment:
- “the BBC Board will set commercial rates of return (informed by market norms) for all lines of business within BBC Studios. The BBC Board will review the performance of new BBC Studios against these targets and report to Ofcom in accordance with the requirements set out in Ofcom’s trading and separation rules. The lines of business will be determined by market norms and shall only be changed in accordance with Ofcom’s trading and separation rules.”
- 2.20 The BBC stated that these changes to the lines of business were in response to Ofcom’s regulation and the findings of the BBC’s Commercial Review (published in December 2018).<sup>8</sup> It said that following the March 2018 merger, it had carried out work to re-evaluate what it considered the appropriate lines of business to be within BBC Studios and that this work had been undertaken by both BBC Studios and the Public Service as a shareholder.
- 2.21 The BBC cited Chris Saul’s BBC Commercial Transparency Review which found the lines of business disclosure in BBC Worldwide and BBC Studios’ financial statements were more granular than peer businesses.<sup>9</sup> It also cited EY’s report for the BBC Board’s Commercial Review, which found that it was only possible to benchmark meaningfully at a combined Production and Distribution level.<sup>10</sup>
- 2.22 Finally, the BBC stated that due to the ongoing integration of the production and distribution business, it was increasingly important for BBC Studios and the BBC Group to track performance of production and distribution as a whole. The BBC stated it considered that the existing BBC Studios reporting was not at the level of detail consistent with BBC Studios’ commercial peers and as such this affected the ability of the BBC Board to effectively hold BBC Studios to account for its commercial performance, as well as to set meaningful targets. The BBC argued that its regulatory obligations to earn at least a

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<sup>7</sup> [The BBC’s commercial and trading activities: requirements and guidance](#). A consultation on proposed modifications to Ofcom’s requirements and guidance, July 2018, Page 36.

<sup>8</sup> [BBC commitments for BBC Studios-Worldwide merger](#) – version 2, updated on 27 September 2019.

<sup>9</sup> [BBC Commercial transparency review](#), Christopher Saul, December 2018.

<sup>10</sup> [A review of the BBC’s commercial subsidiaries](#), December 2018.

commercial rate of return across all lines of business, which rest on being able to accurately benchmark against commercial peers, meant that the misalignment between BBC Studios and the market was problematic.

- 2.23 This new structure was reflected in the 2018/19 BBC Studios financial statements and subsequently in the 2019/20 financial statements, where it split its activities into two main categories:
- a) **Production and distribution:** The production and distribution of scripted and unscripted programmes to broadcasters and platform owners, including BBC Studios' share of the results of joint ventures and associate production companies, format sales and other content and brand-associated licensing and merchandise; and
  - b) **Branded services:** The activities of the BBC-branded channels and digital consumer propositions, including the share of results from joint venture and associate operations in BBC America, BritBox (non-UK), and UKTV, BBC Earth with Sony and those of digital branded services including BBC Player in Asia.<sup>11</sup>

## Purpose and scope of consultation

- 2.24 The BBC has modified its lines of business, and as such we need to consider whether the BBC's new lines of business continue to allow us to address our competition concerns.

## Impact assessment

- 2.25 Ofcom has a legal duty to carry out impact assessments where our policy decisions are likely to have a significant effect on businesses or the public, or when there is a major change in Ofcom's activities.<sup>12</sup> The analysis set out in this document includes such an impact assessment for the purposes of the relevant duties imposed on Ofcom.<sup>13</sup>

## Equality impact assessment

- 2.26 Section 149 of the Equality Act 2010 (the "2010 Act") imposes a duty on Ofcom, when carrying out its functions, to have due regard to the need to eliminate discrimination, harassment, victimisation and other prohibited conduct related to the following protected characteristics: age; disability; gender reassignment; marriage and civil partnership; pregnancy and maternity; race; religion or belief; sex and sexual orientation. The 2010 Act also requires Ofcom to have due regard to the need to advance equality of opportunity

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<sup>11</sup> Page 6 <http://downloads.bbc.co.uk/aboutthebbc/reports/reports/commercial-holdings-annual-report-2019.pdf>

<sup>12</sup> Section 7 of the Communications Act 2003 (the Act).

<sup>13</sup> For further information about our approach to impact assessments, see the guidelines, [Better policy-making: Ofcom's approach to impact assessment](#), which are on our website.

and foster good relations between persons who share specified protected characteristics and persons who do not.

- 2.27 Section 75 of the Northern Ireland Act 1998 (the “1998 Act”) also imposes a duty on Ofcom, when carrying out its functions relating to Northern Ireland, to have due regard to the need to promote equality of opportunity and regard to the desirability of promoting good relations across a range of categories outlined in the 1998 Act. Ofcom’s Revised Northern Ireland Equality Scheme explains how we comply with our statutory duties under the 1998 Act.
- 2.28 To help us comply with our duties under the 2010 Act and the 1998 Act, we assess the impact of our proposals on persons sharing protected characteristics and in particular whether they may discriminate against such persons or impact on equality of opportunity or good relations.
- 2.29 We do not consider that our proposals have equality implications under the 2010 Act or the 1998 Act.

## Structure of this consultation and next steps

- 2.30 The remainder of this document is organised as follows:
- Section 3 sets out our analysis and proposals in relation to lines of business;
  - Annex 1, published separately, also sets out our proposed modified Requirements and guidance and shows stakeholders what changes we are proposing compared with the existing Requirements and includes a draft Template 9;
  - Annexes 2-4 set out information about how to respond to this consultation; and
  - Annex 5 sets out our consultation questions.
- 2.31 We welcome any views and comments which respondents may have on the issues raised in this document. This consultation closes on 4 December 2020. We will consider stakeholder responses to our proposals and expect to publish our decisions early in 2021.
- 2.32 We propose that the modified requirements will take effect from the date of publication of our final decision. The Requirements remain in force until such time. When we issue our final statement, we will also publish accompanying sections of the revised requirements and guidance such as details of the legal framework.<sup>14</sup>
- 2.33 We will continue to keep the Requirements under review and amended as appropriate in light of further experience and any changes to our powers and responsibilities.

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<sup>14</sup> We plan to publish sections including: an introduction, legal framework and competition concerns related to the trading and commercial activities as well as the requirements and guidance, material changes to commercial activities section and a list of the trading activities.

## 3. Our analysis and proposals

- 3.1 This section sets out our analysis of the changes to BBC Studios' lines of business. Specifically, we have considered whether the new production and distribution line of business<sup>15</sup> gives sufficient transparency to us and stakeholders on the performance of these activities and is an appropriate combination of activities to meet BBC Studios' requirement for all lines of business to earn a commercial rate of return over an appropriate period of time.
- 3.2 To assess this question, we have considered:
- a) The current structure of the sectors in which BBC Studios operates including how this might change over time;<sup>16</sup> and
  - b) Whether there are some activities within the new production and distribution line of business that BBC Studios' competitors would not be able to undertake and may therefore impact the comparability of this rate of return with its competitors.
- 3.3 In summary, we have found that nearly all production companies of a similar size and scope to BBC Studios also have an integrated distribution arm and this has increasingly become more important as deficit funding of programmes becomes more common. While there is a significant number of small production-only companies, they are not likely to be good comparators for BBC Studios production activities and it will therefore be difficult for the BBC to determine what a commercial rate of return should be for these activities. We have also found that there are appropriate comparators to BBC Studios branded services (i.e. channels) business. We therefore provisionally consider BBC Studios new lines of business to be appropriate.
- 3.4 However, we recognise that the production and distribution arm of BBC Studios with its extensive back catalogue of Public Service content does have some activities that other integrated producer distributors are unlikely to be able to replicate to the same extent. We are therefore proposing to require BBC Studios to provide additional confidential reporting to Ofcom to allow us to monitor more closely the activities comprised within the line of business.
- 3.5 Given the significant changes BBC Studios has made to its lines of business since its inception in 2017, we are also proposing to require the BBC to give Ofcom three months' notice of any future changes to the lines of business. If we consider the BBC's changes to

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<sup>15</sup> Which combines production, content sales, international production and formats and consumer product activities.

<sup>16</sup> Although it is important to note that it is not yet clear how all of the sectors will recover from the current public health crisis.

be inconsistent with the Requirements, or the Charter and Agreement, we would, subject to consultation, be able to step-in to prevent them.<sup>17</sup>

## Our analysis

- 3.6 In determining whether BBC Studios' changes to its lines of business are appropriate, we have considered what activities other businesses that operate in the same sectors as BBC Studios undertake and whether the changes are consistent with how these firms are structured. To the extent possible we have also considered how these markets might evolve in the future. The recent Covid-19 pandemic has made this assessment more complicated as it is not yet clear what the sectors might look like once we have come out the other side of the public health crisis. For example, whether this is likely to exacerbate existing trends from linear to on-demand content or the consolidation of production companies that we have already seen.
- 3.7 In addition, we have also considered whether there are some activities within the new production and distribution line of business that BBC Studios' competitors would not be able to replicate (at least to the same extent). If this is the case, we might be concerned about how comparable the production and distribution rate of return is with its competitors.
- 3.8 We discuss our analysis in these two areas below.

### Are the lines of business consistent with the sectors BBC Studios operates in?

- 3.9 In order to better understand the sectors that BBC Studios operates in and how they might evolve over time, we commissioned Mediatique to look at the wider market.<sup>18</sup> This work has helped us to understand whether BBC Studios' changes to its lines of business are consistent with the sectors in which it operates.
- 3.10 Mediatique analysed the following sectors:
- a) UK and international production;
  - b) Content sales and distribution;
  - c) Consumer products; and
  - d) Branded services including TV channels and SVoD.
- 3.11 The report looks at how these sectors have developed over time and as far as possible how they might evolve in the future. Mediatique has updated the report to take account of recent developments to the extent possible but we recognise that there may be some

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<sup>17</sup> Where we consider changes are consistent with the Requirements or the Charter and Agreement we would not consult.

<sup>18</sup> Mediatique, [State of the markets in which BBC Studios operates](#), 9 October 2020.

changes to the sectors that are not yet clear.<sup>19</sup> We discuss the main findings of this report with respect to market structure and our views on how this impacts BBC Studios' changes to its lines of business below.

- 3.12 The sectors Mediatique looked at broadly map to BBC Studios' old lines of business i.e. before it combined the different production and distribution activities. To show the scale of the different activities, Figure 3 below sets out the 2018/19 revenues and EBITDA for the previous lines of business.

**Figure 3: BBC Studios 2018/19 revenue and EBITDA**

Previous lines of business	Revenues (£m)	EBITDA (£m)
UK television production	602	83
International production and formats	142	3
Content sales	404	12
Consumer products	108	(2)
Branded services	161	71

### UK and international production

- 3.13 Mediatique estimates that there are around 450 independent production companies in the UK. The majority (c.300) of these have a turnover of less than £1m and only around six have revenues greater than £70m per annum. All the 'super indies' that are of a similar size and scope to BBC Studios and ITV Studios also have or are affiliated with a distribution arm.
- 3.14 As a result of this increased competition for original content from international SVoDs and large UK and international channel groups there has been production cost inflation in key genres in recent years. Mediatique considers that this has led to increased reliance on co-productions<sup>20</sup> and deficit financing<sup>21</sup> for certain types of productions as the primary commissioners could no longer afford to fund the entire cost of production. Mediatique argues that these trends favour a model with production and distribution under the control of a single corporate entity as such a model allows these integrated players to optimise returns across the value chain.
- 3.15 Covid-19 has had a huge impact on the production sector which initially led to the shutdown of production around the world with a significant short-term impact on output,

<sup>19</sup> Ofcom originally commissioned the report for March 2020 but we asked Mediatique to update it to reflect market conditions in light of the Covid-19-pandemic.

<sup>20</sup> Involving more than one commissioning broadcaster or platform.

<sup>21</sup> In this context deficit financing means the primary commissioners only pay part of the cost of making the programme with the rest funded by producers and distributors (in lieu of the revenue they will receive from secondary sales) and for high end dramas (over £1m per hour) tax credits.

revenue and jobs. Many productions have resumed in the UK, with social distancing measures in place, which is driving up costs and lead-times have lengthened. It may take some time to catch up following the shutdown (and much depends on whether subsequent lockdowns are imposed).

### Content sales and distribution

- 3.16 Having a strong content pipeline is key to the success of distributors in secondary markets. Mediatique found that the UK distribution market is dominated by a small number of large international players that, as discussed above, typically also have a production arm. Smaller production companies do not generally have the commercial and management resources to sell their content in secondary markets and rely on one of the large or specialist distributors to undertake these activities on their behalf.
- 3.17 Mediatique considers that in the medium term the strongest market position will be held by distributors that have both production and distribution capabilities, access to capital and where there is an English language or genre advantage.
- 3.18 Content sales saw a spike given Covid-19 as broadcasters and streamers purchased secondary content to fill their schedules as production was halted. This spike in demand is likely to be temporary as normal production resumes. However, it is expected that the price of some content will remain higher in the longer-term.

### Consumer products

- 3.19 The consumer products sector includes the creation and sale of merchandise, games, magazines and other products and services associated with the underlying media rights (such as theme parks). BBC Studios main activities in this area are physical product sales via DVDs, retail apparel, board games, gifts, figures, stationery and other merchandise.
- 3.20 Mediatique considers that the DVD market is likely to continue to decline over the next five years as consumers increasingly switch to on-demand content including SVoD, a trend likely to have been made worse by Covid-19. This market may still remain relevant due to inertia, demographics and the enduring role of gifting. Mediatique argues that other consumer product segments have specialised appeal (books, gaming, merchandising) and are likely to continue to perform in line with (moderate) historical rates and margins.

### Branded services

- 3.21 BBC Studios' branded services line of business includes the key consumer-facing activities and the sector includes pay and free-to-air channel brands, broadcaster-VoD services and SVoD services from global players. As noted by Mediatique, these services are at the forefront of changes to technology and consumer behaviour. The global decline in consumption of linear TV channels (pay and free to air) has been driven by increased broadband connectivity, the growing scale of connected device ownership and shifts in audience behaviours. Mediatique considers that the emergence of SVoD and spectacular



growth of the streaming model was the most significant development in this sector. During Covid-19, SVoD services have enjoyed a spike as consumers (many with additional time on their hands) look for new content to consume.

- 3.22 In terms of linear TV, the impact of Covid-19 has been mixed, there was initially more viewing as audiences were more available (particularly for news and daytime viewing), however, given the lack of new productions, broadcasters have been filling their schedules with repeats (and cheaper acquired programmes) and this may accelerate the pace of linear TV decline, at least in the short term.
- 3.23 Advertising has been severely affected by Covid-19 with significant declines in April and May following the national lockdown and an overall impact of between 10 to 20% expected for this year. It is unlikely that the advertising market will recover to pre-Covid levels in real terms even after five years.
- 3.24 Mediatique argues that content providers need to be flexible as markets (and consumer preferences) shift but considered that BBC Studios was in a good position to change its strategy from branded channels (e.g. UKTV) to potentially its own branded SVoD<sup>22</sup> service (or supplying other SVoDs) or ensuring the channels remain in smaller Pay TV bundles.

#### **Our view on the changes to the lines of business given the sectors BBC Studios operates in**

- 3.25 BBC Studios' decision to combine its production and distribution activities appears to be consistent with the sector – particularly for production companies of a similar size and scope. We recognise that this combination reduces transparency for the majority of small production companies who do not distribute their own content. However, due to the lack of suitable comparators it may be very difficult for BBC Studios to benchmark its production and distribution activities separately and determine what might represent a commercial rate of return.
- 3.26 The sale of consumer products and formats is in effect a form of distribution and the value of these activities is directly linked to production and the ownership of the underlying rights. We therefore consider that BBC Studios' decision to include these within the combined production and distribution line of business is likely to be in line with market practice.
- 3.27 However, it is not consistent with market practice for production and distribution activities to be combined with branded services/ channel activities. There are a number of competitors that BBC Studios can use as comparators for the branded services activities and therefore it should be able to benchmark its own rate of return to ensure it is within a commercial range. If this line of business was combined with production and distribution,

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<sup>22</sup> SVoD means subscription video on demand.

then there would be a risk that the current high level of returns in branded services would mask low returns in other areas which could impact fair and effective competition.

### **Is the rate of return from the new line of business comparable with BBC Studios' competitors?**

- 3.28 As set out above, we consider that an integrated producer distributor is the model used by BBC Studios' closest competitors. However, we have also considered whether there is potential for the new production and distribution line of business to undertake activities that its competitors are unable to replicate (at least to the same extent). This might be a concern if any profits associated with these activities could impact the reported rates of return for the line of business. If this were the case, it might make direct comparison between BBC Studios' lines of business and its competitors less meaningful.
- 3.29 We do not consider there is likely to be a consumer product activity that BBC Studios undertakes which its competitors would not be able to replicate (if they chose to do so) or that would impact the overall production and distribution rate of return.<sup>23</sup> It is also unlikely that as long as the Public Service follows its commissioning guidelines, BBC Studios' production activities would give it an advantage over its competitors – it competes against other production companies for an increasing number of Public Service commissions over the course of this Charter period. It also competes against other production companies to make programmes for third parties.
- 3.30 However, it is worth considering in more detail BBC Studios' distribution activities. This includes licensing the secondary rights for the significant majority of programmes commissioned by the Public Service and some programmes commissioned by third parties. These programmes are made by BBC Studios and third party production companies (including independent ones) who have contracted BBC Studios to distribute their content (either because they do not have their own distribution arm or BBC Studios' has expertise in licensing the specific type of content). BBC Studios is the largest third-party distributor in the UK.<sup>24</sup>
- 3.31 In addition to licensing content produced by BBC Studios' production arm, the distribution function also licenses legacy Public Service productions (i.e. those made prior to the establishment of the commercial production company) and returning series where the Public Service still owns the Intellectual Property (IP) rights even where the more recent series were made by BBC Studios production.
- 3.32 Other distribution companies licence content that is created by their own production arm. Therefore, the revenue BBC Studios receives from selling BBC Studios owned IP will be able

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<sup>23</sup> Given revenues and returns from the sale of consumer products are small and declining.

<sup>24</sup> Mediatique Report, Figure 25, Page 47.

to be replicated by its competitors. In addition, other distributors should be able to compete to distribute third party content.

- 3.33 However, we have a question about the rights BBC Studios distribution holds for legacy and returning series Public Service IP. Some of these returning series (e.g. Top Gear, Doctor Who) have the potential to generate significant profits and when BBC Studios acquires the distribution rights for new series, the rights deals for preceding series are also extended so that they end at the same time as the new series (we understand this is in line with market practice). In many cases BBC Studios, or its predecessor BBC Worldwide, would have made substantial investments as distributor into these legacy series.
- 3.34 Further, for those programmes that are not returning series but from the BBC Rights Archive, BBC Studios can negotiate to extend all distribution deals when they expire (under a commercial agreement with the Public Service), without the rights being re-tendered. In addition, consistent with market practice, BBC Studios retains all distribution revenue on all BBC PS owned legacy IP into which BBC Worldwide had previously invested (this is also the case for the programmes funded by BBC Studios) with profits then returned to BBC via dividend.
- 3.35 In the year ending 31 March 2019 the majority of BBC Studios' revenue from content sales ([§<]) came from programmes where the Public Service owns the IP (i.e. they were originally produced by Public Service or a returning series where the first series was created before production was taken out of the Public Service).<sup>25</sup> This was also highlighted in the recent NAO report on BBC Studios where the NAO noted that BBC Studios' current performance relies significantly on some long-standing brands with only four of its forecast top 16 revenue-generating in-house produced shows in 2019-20 having been made after 2010.<sup>26</sup>
- 3.36 Given a significant proportion of BBC Studios' content sales comes from IP owned by the Public Service, there is a risk that this will impact the returns of the production and distribution line of business as no other distributor is likely to have a profitable back catalogue the extent of the Public Service owned IP BBC Studios has access to.<sup>27</sup> We would also be concerned if the profits from the Public Service owned IP were being used to prop up BBC Studios' production activities (and for example BBC Studios was able to price lower than its rivals for new business or mask its under-performance).
- 3.37 We therefore consider that there are some activities that BBC Studios undertakes that its competitors will not be able to replicate to the same extent. It may therefore be appropriate for the production and distribution activities to be in separate lines of

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<sup>25</sup> Ofcom analysis of BBC response dated 20 December 2019 to Ofcom information request dated 3 December 2019.

<sup>26</sup> [BBC Studios report, NAO, January 2020, Page 32.](#)

<sup>27</sup> As the acquisition costs of this archive Public Service content have been amortised, the accounting return on the sale of this back catalogue is likely to be higher than for a corresponding new production.

business. This would ensure that Ofcom and stakeholders had visibility of the rate of return for these separate activities and the BBC would be required to earn a commercial rate of return for both the production and distribution activities. Below we consider whether this would be appropriate and proportionate.

## Proposed additional reporting to Ofcom

- 3.38 One method to ensure that the requirements we have in place remain appropriate for highlighting a potential unfair advantage or market distortion within the production and distribution line of business is to require BBC Studios to separately report the distribution revenues and costs associated with programmes where the Public Service owns the underlying IP. Removing these returns from the combined production and distribution business would make it more comparable with those commercial rivals the BBC benchmarks itself against.
- 3.39 However, this would require BBC Studios to make significant judgements on allocations to split the costs between the different types of content. In addition, it would require separate reporting of the returns from the Public Service owned IP. We therefore consider requiring BBC Studios to separately report content returns from Public Service owned IP could be onerous and disproportionate and without clear cost allocation rules might not provide an accurate view of the individual rates of return.
- 3.40 We understand BBC Studios internally monitors the profitability of its production and distribution activities in its management accounts. This includes the allocation of content sales revenue to the other activities. In 2018/19, the allocation from distribution to production represented a material amount ([X]) of the revenue reported by the content sales line of business.<sup>28</sup>
- 3.41 As BBC Studios collects and reports this information internally, we propose to require it to provide to Ofcom in line with the other Trading and Separation Reporting Requirements its management accounts and the total amount of revenue which has been allocated from distribution to production in the financial year to which the achieved rates of return relate.<sup>29</sup> We consider this would be justified and proportionate given the BBC already produces this information for its own use and it would allow us to monitor returns within the new line of business.
- 3.42 In addition, we are also proposing that BBC Studios should provide a breakdown of the total revenue allocated from distribution to production split by each individual title. This will allow us to make adjustments so we can closely monitor a production only rate of

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<sup>28</sup> Ofcom analysis of BBC response dated 28 July 2020 to Ofcom information request dated 6 July 2020.

<sup>29</sup> Production activities means all activities associated with production of content which are carried out both domestically and internationally. Distribution activities means all activities associated with sale of formats, content and consumer products which are carried out both domestically and abroad.

return. As set out in Annex 1,<sup>30</sup> we are proposing to amend Requirement D.14 to include this additional reporting and add a further template the BBC would be required to complete as part of its reporting to Ofcom (proposed Template 9 – which forms an attachment within Annex 1). We also propose to require the BBC to explain as part of its submissions any material change in the total amount of allocated revenue.

- 3.43 Although we do see some value regarding publication of the production rate of return, particularly for smaller producers who do not have their own distribution activities, this is likely to be commercially confidential (and competitors of a similar size and scope to BBC Studios do not publish this level of information). As such we propose to receive this information on a confidential basis annually, and Ofcom would continue to monitor returns within the line of business. If we have ongoing concerns regarding the actual production rate of return over an appropriate period of time, we would highlight this as part of our Annual Report on the BBC.

## Conclusion and our proposal

- 3.44 We consider that BBC Studios' decision to combine its UK production and distribution lines of business (content sales, international production & formats and consumer products) is consistent with market practice for competitors of a similar size and scope and will allow it to determine a benchmark commercial rate of return. However, we consider that competitors might not be able to replicate the size and value of the programmes that the Public Service owns the underlying rights for. We are therefore proposing to require some additional reporting so that we can monitor returns within the new line of business.
- 3.45 Given the commercial sensitivity of this information, we consider it is appropriate for this information to be provided to Ofcom on a confidential basis so that we can detect any issues regarding returns of activities within the line of business. If we identify any such issue, we would highlight this in our Annual Report on the BBC.
- 3.46 We are therefore proposing to amend the reporting requirements to include the submission of BBC Studios' management accounts to us on a confidential basis. We are also proposing that BBC Studios provides the content sales revenue allocated to the different activities for each programme so that we can monitor the production rate of return.
- 3.47 We propose that the BBC should provide this on an annual basis when it provides the annual submission (at the same time as the publication of its annual report). We do not consider it necessary or proportionate to request the information biannually as the performance of the combined production and distribution rate of return should be

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<sup>30</sup> [Proposed modified requirements and guidance](#), including Template 9.

sufficient for us to monitor BBC Studios' progress against target rates of return in a timely manner.

Question 1: Do you agree with our analysis that the BBC Studios decision to combine its production and distribution activities is consistent with market practice for competitors of a similar size and scope? Please provide reasons and evidence to support your answer.

Question 2: Do you agree with our proposals to amend the monitoring, reporting and transparency requirements? Please provide reasons and evidence to support your answer.

## Notification of changes to the lines of business

- 3.48 As set out in Section 2, there have been significant changes in the composition of both BBC Studios and the individual lines of business since it was incorporated in 2017. This has made it difficult for us and stakeholders to understand how the performance of the different lines of business is changing over time and how it compares with its rivals.
- 3.49 In our Requirements, we explicitly allowed for the BBC to set appropriate lines of business and required it to notify us of any changes. This is what BBC Studios did when it decided to move from the five lines of business to two in March 2019 (and subsequently withdrew the relevant commitment). Given the significant number of changes that BBC Studios has implemented to its lines of business over the last three years, we have considered whether the current requirements remain appropriate.
- 3.50 It will be important for BBC Studios to change its operations and reporting to respond to changes in the market. We therefore consider that it is important that BBC Studios has the flexibility to change the composition of the lines of business as required to meet the needs of the business. However, we also consider it is appropriate for the BBC to be required not to implement a particular change if, following consultation, we direct the BBC not to proceed with that change. For example, this could occur if we considered that the proposed change was inconsistent with the Requirements, the Charter or the Agreement.
- 3.51 Having considered the effectiveness of the current Requirements, we think that the BBC's ability to proceed with significant changes without us being able to intervene in advance in concerning cases could be problematic given that once such changes have been implemented, it would be costly and burdensome to unravel them. To allow us to assess the change before it is implemented, we therefore consider it is appropriate for the BBC to notify us of changes to the composition of the commercial subsidiaries and/or lines of business three months in advance. This notification should include a description of the change, the reason and impact of the change. This would allow us to assess whether the changes are appropriate and consistent with the Charter and Agreement prior to their implementation. We would only consult on a direction not to implement the changes if our investigation raised concerns that were not able to be addressed through discussions with the BBC.

3.52 This proposal, if implemented, would provide transparency of any concerns that we have that changes to the composition of the commercial subsidiaries and/or lines of business are not consistent with the Requirements, Charter or Agreement and give stakeholders including the BBC, the opportunity to comment on our views. The BBC has only made one notification to Ofcom to change the lines of business since 2018 (which is the subject of this consultation) and it will likely take them some time to implement changes in any event. We do not therefore consider that the advance notification would likely involve a significant, additional administrative cost or cause disproportionate delay. We encourage the BBC to discuss with us changes that it is considering making to the composition of the subsidiaries and the lines of business informally in advance so that we can complete our assessment as quickly as possible. If we have no concerns, we would inform the BBC as soon as possible that we do not propose to issue a direction.

3.53 Our proposed changes to the Requirements are set out in track in Annex 2, and in summary require the BBC to:

- a) Notify Ofcom three months in advance of any changes to the commercial subsidiaries and the lines of business;
- b) Provide the following information to Ofcom as part of this notification:
  - i) A description of the proposed change;
  - ii) The BBC's reasons and justifications for the change; and
  - iii) The impact of these changes for the lines of business reporting.
- c) Not to implement any changes that where so directed by Ofcom.

Question 3: Do you agree with our proposals to amend the commercial rate of return requirements and guidance? Please provide reasons and evidence to support your answer.

Question 4: Our changes will take affect from the date of our statement, are there any reasons to delay implementation?

## A1. Proposed modified Requirements and guidance, including Template 9

- A1.1 Annex 1 has been [published separately](#) on our website. New additions are [underlined and highlighted](#) and any wording we are proposing to remove is ~~struck through~~. The annex is not fully accessible, including to those using screen readers. However, we have also published a clean version of the annex on the [webpage for this consultation](#).



## A2. Responding to this consultation

### How to respond

- A2.1 Ofcom would like to receive views and comments on the issues raised in this document, by 5pm on 4 December 2020.
- A2.2 You can download a response form from <https://www.ofcom.org.uk/consultations-and-statements/category-2/bbc-studios-lines-of-business>. You can return this by email to [BBC.studiosreview@ofcom.org.uk](mailto:BBC.studiosreview@ofcom.org.uk).
- A2.3 If your response is a large file, or has supporting charts, tables or other data, please email it to [BBC.studiosreview@ofcom.org.uk](mailto:BBC.studiosreview@ofcom.org.uk), as an attachment in Microsoft Word format, together with the [cover sheet](#).
- A2.4 We welcome responses in formats other than print, for example an audio recording or a British Sign Language video. To respond in BSL:
- Send us a recording of you signing your response. This should be no longer than 5 minutes. Suitable file formats are DVDs, wmv or QuickTime files. Or
  - Upload a video of you signing your response directly to YouTube (or another hosting site) and send us the link.
- A2.5 We will publish a transcript of any audio or video responses we receive (unless your response is confidential)
- A2.6 We do not need a paper copy of your response as well as an electronic version. We will acknowledge receipt if your response is submitted via the online web form, but not otherwise.
- A2.7 You do not have to answer all the questions in the consultation if you do not have a view; a short response on just one point is fine. We also welcome joint responses.
- A2.8 It would be helpful if your response could include direct answers to the questions asked in the consultation document. The questions are listed at Annex 5. It would also help if you could explain why you hold your views, and what you think the effect of Ofcom's proposals would be.
- A2.9 If you want to discuss the issues and questions raised in this consultation, please contact [BBC.studiosreview@ofcom.org.uk](mailto:BBC.studiosreview@ofcom.org.uk)

### Confidentiality

- A2.10 Consultations are more effective if we publish the responses before the consultation period closes. In particular, this can help people and organisations with limited resources or familiarity with the issues to respond in a more informed way. So, in the interests of transparency and good regulatory practice, and because we believe it is important that

everyone who is interested in an issue can see other respondents' views, we usually publish all responses on [the Ofcom website](#) as soon as we receive them.

- A2.11 If you think your response should be kept confidential, please specify which part(s) this applies to, and explain why. Please send any confidential sections as a separate annex. If you want your name, address, other contact details or job title to remain confidential, please provide them only in the cover sheet, so that we don't have to edit your response.
- A2.12 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and try to respect it. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A2.13 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's intellectual property rights are explained further in our [Terms of Use](#).

## Next steps

- A2.14 Following this consultation period, Ofcom plans to publish a statement in early 2021.
- A2.15 If you wish, you can [register to receive mail updates](#) alerting you to new Ofcom publications.

## Ofcom's consultation processes

- A2.16 Ofcom aims to make responding to a consultation as easy as possible. For more information, please see our consultation principles in Annex 3.
- A2.17 If you have any comments or suggestions on how we manage our consultations, please email us at [consult@ofcom.org.uk](mailto:consult@ofcom.org.uk). We particularly welcome ideas on how Ofcom could more effectively seek the views of groups or individuals, such as small businesses and residential consumers, who are less likely to give their opinions through a formal consultation.
- A2.18 If you would like to discuss these issues, or Ofcom's consultation processes more generally, please contact the corporation secretary:  
Email: [corporationsecretary@ofcom.org.uk](mailto:corporationsecretary@ofcom.org.uk)

## A3. Ofcom's consultation principles

### Ofcom has seven principles that it follows for every public written consultation:

#### Before the consultation

- A3.1 Wherever possible, we will hold informal talks with people and organisations before announcing a big consultation, to find out whether we are thinking along the right lines. If we do not have enough time to do this, we will hold an open meeting to explain our proposals, shortly after announcing the consultation.

#### During the consultation

- A3.2 We will be clear about whom we are consulting, why, on what questions and for how long.
- A3.3 We will make the consultation document as short and simple as possible, with a summary of no more than two pages. We will try to make it as easy as possible for people to give us a written response. If the consultation is complicated, we may provide a short Plain English / Cymraeg Clir guide, to help smaller organisations or individuals who would not otherwise be able to spare the time to share their views.
- A3.4 We will consult for up to ten weeks, depending on the potential impact of our proposals.
- A3.5 A person within Ofcom will be in charge of making sure we follow our own guidelines and aim to reach the largest possible number of people and organisations who may be interested in the outcome of our decisions. Ofcom's Consultation Champion is the main person to contact if you have views on the way we run our consultations.
- A3.6 If we are not able to follow any of these seven principles, we will explain why.

#### After the consultation

- A3.7 We think it is important that everyone who is interested in an issue can see other people's views, so we usually publish all the responses on our website as soon as we receive them. After the consultation we will make our decisions and publish a statement explaining what we are going to do, and why, showing how respondents' views helped to shape these decisions.

## A4. Consultation coversheet

### BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

### CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing

Name/contact details/job title

Whole response

Organisation

Part of the response

If there is no separate annex, which parts? \_\_\_\_\_

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If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

### DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

## A5. Consultation questions

A5.1 We have posed four consultation questions in section 3 of this document. We would like to hear from stakeholders in response to these questions, where appropriate providing supporting evidence to substantiate any views.

Question 1: Do you agree with our analysis that the BBC Studios decision to combine its production and distribution activities is consistent with market practice for competitors of a similar size and scope? Please provide reasons and evidence to support your answer.

Question 2: Do you agree with our proposals to amend the monitoring, reporting and transparency requirements? Please provide reasons and evidence to support your answer.

Question 3: Do you agree with our proposals to amend the commercial rate of return requirements and guidance? Please provide reasons and evidence to support your answer.

Question 4: Our changes will take effect from the date of our statement, are there any reasons to delay implementation?