

Benchmarking the BBC's overhead rate

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Contents

Disclaimer	i
1. Introduction	2
2. Methodology	5
3. Findings	7
4. Conclusion	9

1. Introduction

1.1 Background

The BBC serves the UK public through its mission to “*enrich people's lives with programmes and services that inform, educate and entertain*”¹. In order to deliver its mission, it fulfils its purposes to provide impartial news and information, to support learning for all generations, to entertain with the most creative and highest quality content, to represent the nations and regions of the UK, and to reflect UK culture and values to the rest of the world.

The BBC occupies a unique position in the UK broadcasting sector due to its television (“TV”) licence fee funding model. Established by a Royal Charter, and operating under its Agreement with the Secretary of State for Digital, Culture, Media and Sport, the majority of the BBC’s services are funded by the TV licence fee. The current Royal Charter, effective from 1 January 2017, ensures the continuance of the TV licence fee funding mechanism until 31 December 2027.

The BBC has successfully delivered savings and improved efficiency in order to ensure that TV licence fee funds are primarily spent on services that enable the BBC to deliver its mission and purposes. For example, in the five years up to 31 March 2017 – during a period in which the TV licence fee was held flat and the BBC therefore had to absorb inflation – the BBC has delivered £700m of annual recurring savings². The BBC aims to minimise spend on support functions and maximise the amount of money invested in content. To support this, the BBC tracks how its overhead costs compare to industry-leading levels.

During its last review (which occurred in 2014/15), the BBC’s overhead rate of 7.6% compared favourably against other organisations³ – this rate indicated that the BBC was more efficient than the average organisation within the benchmark group, but that the BBC sat just below the top quartile⁴. The BBC continues to regularly track progress in this area, and this report has reviewed the BBC’s 2017/18 overhead rate alongside comparable organisations⁵.

1.2 The BBC’s overheads

In its Annual Report and Accounts, the BBC classifies total controllable expenditure for the Public Service into the following categories:

¹ BBC website. See http://www.bbc.co.uk/aboutthebbc/insidethebbc/howweare/mission_and_values

² BBC Annual Plan for 2018/19, Pg.4

³ In 2014/15, the BBC’s overhead rate was benchmarked against a selection of international telecommunications companies, regulated utilities, and Government departments.

⁴ A quartile is a statistical term which describes one of four equal groups into which a population can be divided according to the distribution of a particular variable – with each quartile containing 25% of the total observations. In this context, the particular variable is the overhead rate or indirect cost rate; a lower percentage score represents better organisational efficiency. The most efficient 25% of entities within the distribution are referred to as being within the top quartile.

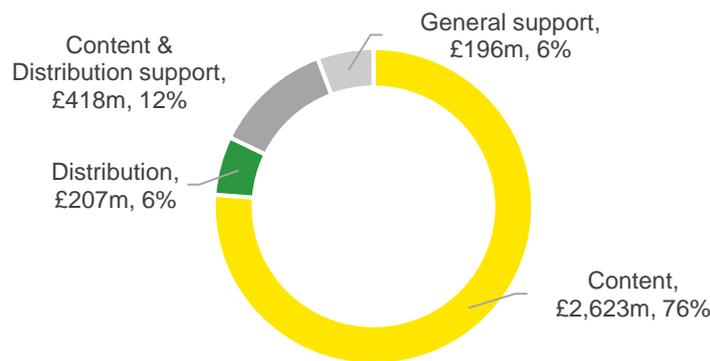
⁵ The comparator organisations used for this analysis differ to those used for the 2014/15 analysis. This is primarily due to data availability, as some organisations have changed how they report costs.

Table 1: BBC's categorisation of its controllable costs

Direct costs	Content	These are costs incurred to acquire and produce programming and content for the BBC's TV, radio and online services.
	Distribution	These are costs incurred to deliver the BBC's content to audiences.
Indirect costs	Content and distribution support	These are costs which directly support the delivery of the BBC's audience-facing activities. For example, divisional finance functions which manage the commissioning, production, and distribution of content.
	General support	These are indirect costs which cannot be attributed to the BBC's audience-facing activities. For example, central HR, corporate finance and regulatory functions.

Figure 1 below shows how the total service spend (the cost to the TV licence fee payer of providing the BBC's television channels, radio stations, and online services) in 2017/18 was split across the four categories. Direct costs accounted for 82% of total spend, with the majority focused on content (76%). Indirect costs accounted for 18% of the total spend, with 12% associated with support costs that were required to deliver the BBC's audience-facing activities, and 6% which supported the running of the whole organisation.

Figure 1: Total controllable service spend, FY2017/18⁶



The BBC defines its overhead costs as controllable costs which do not directly support the delivery of public services. As such, its overhead costs consist solely of the 'general support' costs, and its overhead rate is calculated by dividing the general support costs by total controllable costs.

The BBC separately identifies costs that it considers non-discretionary, and therefore not within the BBC's direct control. This includes TV licence fee collection costs, pension deficit reduction costs and Government imposed funding commitments, such as for S4C and BBC Monitoring. We reviewed these costs to confirm the appropriateness of the exclusions from the controllable cost, and considered the exclusions to be appropriate. These non-controllable costs are excluded from Figure 1, and from the analysis in this report.

The BBC's Annual Reports and Accounts show the overhead rate was 7.6%⁷ (£279.3m) in 2014/15, 6.1%⁸ (£213.5m) in 2015/16, 5.2%⁹ (£183.9m) in 2016/17, and 5.7%¹⁰ (£196.1m) in 2017/18. As the overhead rate is a function of both support costs and the BBC's total controllable expenditure, it will naturally vary over time in line with the BBC's other costs. For example, the cost of sports coverage varies significantly year on year, due to the major sporting

⁶ BBC Annual Report 2017/18, Pg.194

⁷ BBC Annual Report Financial Statements 2014/15, Pg.14

⁸ BBC Annual Report 2015/16. Pg. 108

⁹ BBC Annual Report 2016/17, Note B3.1, Pg. 135

¹⁰ BBC Annual Report 2017/18, Pg.194

events occurring in even-numbered years. Exchange rate gains and losses from hedging are also captured in support costs, so foreign currency movements can also impact the overhead rate. Such variations help to explain why overhead rates vary year on year; although the overall trajectory (both in nominal values and as a proportion of total expenditure) remains downwards, and none of the fluctuations are large enough to affect our overall findings.

1.3 EY's scope of work

EY's scope of work is to develop benchmarks to determine how the BBC's overhead costs compare to those of comparator organisations. In order to deliver this scope of work, EY's approach was to:

- ▶ Identify the BBC's overhead costs and total costs, and calculate the corresponding overhead rate¹¹;
- ▶ Define comparator organisations based on a set of characteristics, including sector, revenue, and geography; and
- ▶ Identify the overhead costs and total costs of the comparator organisations, in order to calculate overhead rates to benchmark against the BBC's.

The remainder of this document is structured as follows:

- ▶ Section 2 sets out our approach to benchmarking the BBC's overheads; and
- ▶ Section 3 summarises our findings and conclusions.

¹¹ We relied upon the information provided to us by the BBC, which is audited and ultimately published in its Annual Report. We have not sought to verify the BBC's classification of direct and indirect costs.

2. Methodology

The BBC aims to secure transparency in its reporting of costs by defining and disclosing its overhead costs as that portion of controllable costs which do not directly support the delivery of its audience-facing activities. This is described in more detail in Section 1.2. It is not common practice for other organisations to report detailed breakdowns of overhead costs, which allow identification of the proportion of indirect costs that do not directly support the organisation's main activities. As such, comparable overhead data was not available for all organisations.

We therefore developed two sets of benchmarks based on two comparator groups:

- ▶ We benchmarked the total indirect costs (a measure that is widely reported) of commercial Telecommunications and Media companies; and
- ▶ We benchmarked overhead costs for a smaller set of organisations, which report costs comparable to the BBC's general support costs.

Our approach comprised three steps, which we describe below.

2.1 Step 1: Calculating the BBC's cost rates

We used information from the BBC which relates to 2017/18 to calculate two rates:

- ▶ **Indirect cost rate:** We identified the BBC's total indirect costs, by adding together the 'content and distribution support' costs and 'general support' costs. Dividing this by the total controllable costs results in an indirect cost rate of 17.8%; and
- ▶ **Overhead rate:** We divided the 'general support' costs by the total controllable costs to calculate the BBC's overhead rate of 5.7%.

We reviewed the costs excluded from the BBC's definition of controllable costs to confirm the appropriateness of the exclusions, and to enable us to ensure that the relevant costs for comparator organisations are assessed on a like-for-like basis. We considered the exclusions to be appropriate.

2.2 Step 2: Defining comparator organisations

We formed two groups of comparator organisations:

- ▶ **Telecommunications and Media group:** This group contains 51 companies for which total indirect cost information is available, namely selling, general and administrative ("SG&A") costs. This group consists of private sector telecommunications, broadcast and media companies. The rate calculated for these companies is compared to the BBC's indirect cost rate for 2017/18 of 17.8%.
- ▶ **Regulated and non-profit group:** This group contains 26 organisations for which more directly comparable overhead data is available, namely general support costs. This group consists of 15 regulated companies and 11 non-profit organisations, and includes the electricity distribution network operators that report business support costs to Ofgem, regulated water companies, Government departments, and charities. The overhead rate calculated for the companies in this group is compared to the BBC's overhead rate for 2017/18 of 5.7%.

We reviewed the accounts of several regulated Telecommunications and Media companies, with the intention of including them in the 'Regulated and non-profit' group. However, the reporting of their cost bases did not enable us to identify costs equivalent to the BBC's general support costs. As explained in Section 3, the BBC performs favourably against each of the comparator groups – both when compared against Telecommunications and Media companies on a total indirect cost basis, and when compared against different organisations on a general support costs basis. As such, we do not consider the absence of Telecommunications and Media companies in the latter group to affect our conclusions.

2.3 Step 3: Benchmarking the BBC's overhead costs

In order to obtain benchmarks for the companies included in our comparator groups, we extracted cost information from the Capital IQ platform (as described below), and conducted desk-based research.

2.3.1 Capital IQ

Capital IQ is a platform owned by S&P Global that combines global financial data with company and industry research. EY holds a subscription to this platform, which provides high-quality financial information covering both public and private capital markets.

- ▶ We used Capital IQ to benchmark indirect cost rates for the Telecommunications and Media comparator group. This tool extracts financial information about specific companies from a large database, and we used it to provide revenue and cost information for a list of specified companies.
- ▶ We created our sample of companies by including relevant FTSE 350 Telecommunications and Media companies, and other relevant UK, European and US Telecommunications and Media businesses.
- ▶ We checked the values produced by the platform against the relevant annual reports for a large proportion of the sample, in order to ensure the values generated were accurate.
- ▶ We calculated the indirect cost rate for each company by dividing the indirect costs by the total operating costs.
- ▶ We reviewed the resulting cost rates, investigated any outlier values and benchmarked the BBC's value of 17.8% against these values.

2.3.2 Desk-based research of comparable overhead rates

- ▶ We used desk-based research to benchmark overhead rates for the regulated and non-profit comparator group. Through our desk-based research we found comparable cost information for regulated utilities, charities and industry bodies.
- ▶ We reviewed statutory and regulatory accounts for the regulated and non-profit group to identify costs that are comparable to the BBC's general support costs.
- ▶ We reviewed the 'Notes to the Accounts' included in each of the annual reports to ensure the values we were using are comparable to the BBC's overhead costs.
- ▶ We calculated a benchmark range that we consider to be directly comparable to the 5.7% overhead rate reported by the BBC.

3. Findings

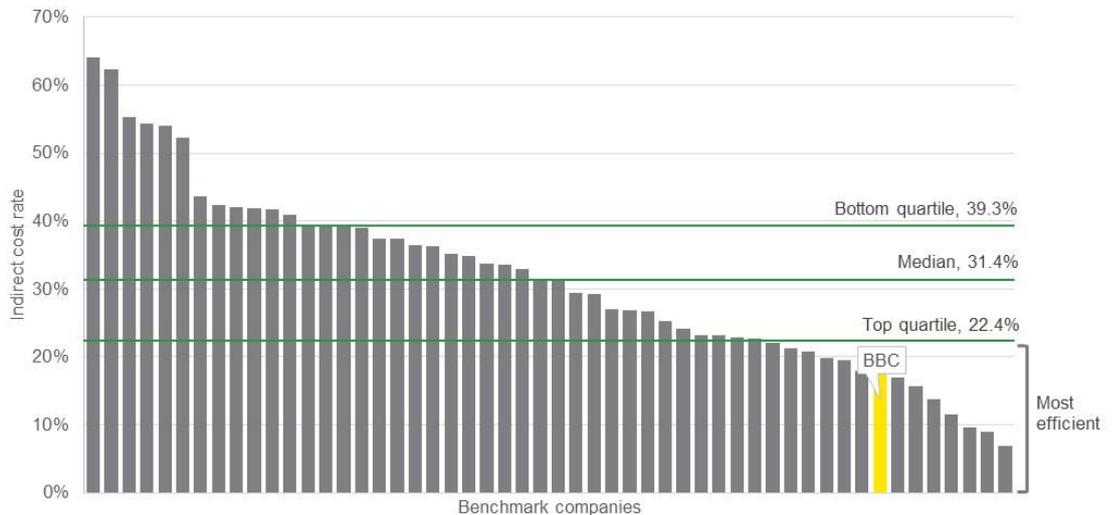
Overall, we found that the BBC compares favourably against other organisations, both in terms of its total indirect costs and its general support costs. Our analysis indicated that the BBC is more efficient than the average organisation within the benchmark, falling within the top quartile for both measures.

We did not include costs relating to any of the BBC’s commercial subsidiaries (as were operational in 2017/18), as this exercise focused solely on the Public Service. However, we reviewed cost information for the BBC’s commercial subsidiaries to identify whether the results differed significantly to those for the BBC Public Service. Our analysis confirmed that, if the analysis was carried out at the BBC Group level, our conclusions of top quartile performance would be unchanged.

3.1 Telecommunications and Media group

This group is compared against the BBC’s indirect cost rate of 17.8%. The results of the first benchmark exercise are shown in Figure 2, where the BBC is among the most efficient companies of the selected sample; benchmark companies with indirect cost rate percentages in the most efficient 25% of distributed percentage scores within the observed sample are considered top quartile.

Figure 2: BBC indirect cost rate compared against the Telecommunications and Media companies



Source: EY analysis using Capital IQ data

To further illustrate this result, Table 2 shows the quartile information for the sample of 51 companies included in this group. This analysis shows that the BBC, with an indirect cost rate of **17.8%**, is within the most efficient companies from the Telecommunications and Media sample, as it is within the top quartile of this first benchmark.

Table 2: Sample distribution for the Telecommunications and Media companies

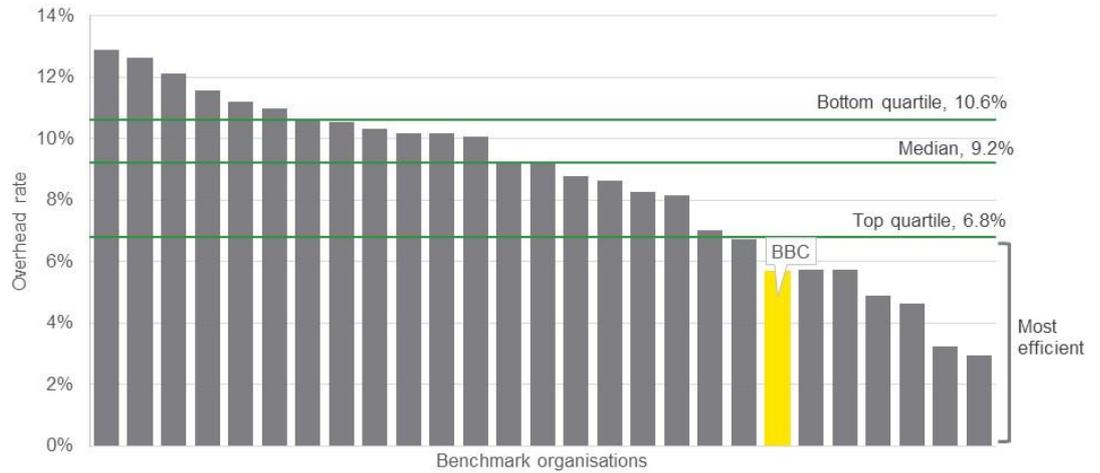
Most efficient	6.9%
Top quartile	22.4%
Median	31.4%
Bottom quartile	39.3%
Least efficient	64.0%

3.2 Regulated and non-profit group

After analysing the BBC’s total indirect costs, we developed benchmarks for the regulated and non-profit group. This group consists solely of organisations that report their general overheads in a way that we consider to be consistent with the BBC’s definition.

The overhead rate for each company in this group was compared against the BBC’s overhead rate of 5.7% for 2017/18. The results of this analysis can be found in Figure 3, which shows that the BBC’s overhead rate is one of the lowest of the sample; benchmark companies with overhead rate percentages in the most efficient 25% of distributed percentage scores within the observed sample are considered top quartile.

Figure 3: BBC overhead rate compared to the regulated and non-profit organisations



Source: EY analysis using data from annual reports

Similar to the previous section, we also analysed the distribution of the sample to better understand whether the BBC is in the top quartile of this comparator group. Table 3 shows the quartile information for the 26 regulated and non-profit organisations. Similar conclusions were drawn from this analysis: the BBC, with an overhead rate of **5.7%**, is within the top quartile of the comparator group benchmark.

Table 3: Sample distribution for the regulated and non-profit organisations

Most efficient	2.9%
Top quartile	6.8%
Median	9.2%
Bottom quartile	10.6%
Least efficient	12.9%

4. Conclusion

Our findings support the conclusion of the previous 2014/15 report, and additionally demonstrate that the BBC is in the most efficient quartile of the sample. Given that the BBC is in the top quartile in terms of overhead efficiency, we consider that opportunities for additional efficiency savings may be limited by the need for upfront investment to realise them. Furthermore, the BBC's Distribution Strategy states that the BBC is "*preparing for a future where all content experiences are delivered over the internet*"¹² – in this context, we note that it will be challenging to maintain the current level of overheads whilst the BBC moves its audiences from linear to digital services; for example, because of the additional organisational complexity that will be required to manage this transition.

¹² BBC's Distribution Strategy, published 12 February 2018. Paragraph 30. Available at: http://downloads.bbc.co.uk/aboutthebbc/insidethebbc/howwework/accountability/consultations/bbc_distribution_strategy.pdf

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