

BBC Trust

Strategic Framework for the BBC's Commercial Services – Final Report

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Annex 1: Strategic Framework for the BBC's Commercial Services

1. Background

1.1. Overview

- 1.1.1. The purpose of the BBC Trust is to get the best out of the BBC for licence fee payers. The Trust sets the strategic direction of the BBC, holds the Executive to account for its performance of its functions, and for its compliance with the law, with regulatory requirements, and with the policies, guidelines and codes that we set.
- 1.1.2. At the end of 2013 the BBC Trust and BBC Executive published the conclusions of their joint review of BBC governance and announced a series of changes to the working relationship between the Trust and the Executive.
- 1.1.3. As part of a package of measures aimed at making the distinction between the roles of the Trust and the Executive clearer and achieving greater separation between them, we decided that the Trust should put in place a high level framework to clarify its remit and its priorities in respect of the BBC's commercial activities.
- 1.1.4. While the BBC as a corporation is not permitted to provide directly any commercial services, it may do so indirectly through commercial subsidiaries. The purpose of these commercial services is to generate a return which can be reinvested in the BBC's public service activities to the benefit of licence fee payers. Commercial service activities must fit with the BBC's public purpose activities, must exhibit commercial efficiency, must not jeopardise the good reputation of the BBC or the value of the BBC brand, and must not distort the market. The BBC currently has three commercial services; BBC Worldwide, BBC Global News and BBC Studios and Post Production.

1.2. Public consultation

- 1.2.1. In June we published our proposed framework and invited comments from industry and interested parties. We received a small number of responses from industry representative bodies, from individual businesses and from the BBC Executive. Some of these were submitted to us on a confidential basis but in those cases where we have the respondent's permission, we are publishing their submissions alongside this report. We also received around 50 identical emails to our consultation address which concerned a specific editorial matter. These were handled through the Trust's separate arrangements for considering editorial complaints.
- 1.2.2. We have taken account of the responses we received in the final Commercial Framework which is attached as Annex 1.
- 1.2.3. This covering report sets out the issues raised during the consultation process. Where we have accepted points and reflected them in our final Commercial Framework text, this is explained. Where we have considered but not accepted comments made in the consultation responses, this is also explained.

2. Consultation responses

2.1. Overall approach

- 2.1.1. There was broad support for the idea of a Commercial Framework which would set out clearly the respective roles of the BBC Executive and Trust in overseeing the BBC's commercial services, and which would set out the Trust's requirements and principles for the operation of these services.
- 2.1.2. One respondent, while not opposing a framework in itself, took the view that too much responsibility was being left with the BBC Executive to 'self-regulate' and that the Trust should play a greater role in overseeing and scrutinising the BBC's commercial activities than was being proposed. The respondent considered that the Trust should be more directly involved in decisions relating to acquisitions and partnerships, complaints and redress, commercial target setting, performance reporting, setting cost recovery rules, assessing individual commercial service proposals and their cumulative effects over time, and commercial subsidiary board composition.
- 2.1.3. We address some of these specific issues in more depth later in this report, but we have considered whether the overall level of Trust oversight proposed under our framework is consistent with the respective roles of the BBC Executive and Trust set out in the BBC's Charter and Agreement.
- 2.1.4. The BBC's Charter¹ does not make any specific reference to the BBC's commercial services beyond establishing that it may have them. The Agreement² sets criteria with which commercial services must comply and requirements for approval of changes in the commercial services. While it tasks the Trust with holding the BBC's Executive Board to account for ensuring that these criteria are adhered to, it makes the Executive Board responsible for overseeing the activities of the BBC's commercial services and for exercising the BBC's functions in relation to the commercial subsidiaries. These functions include approving budgets and targets, ensuring compliance with the Charter, Agreement and the general law, setting high standards of management control, and public reporting. The Charter makes clear that the Trust must not exercise, or seek to exercise, the functions of the Executive Board.
- 2.1.5. Our aim in drawing up the framework has been to ensure that the BBC's commercial services are subject to a similar level of oversight from the Trust to that which exists for the BBC's public service activities. With that in mind, the level of detail and specificity in the framework is broadly in line with what has been established in the service licences through which the Trust oversees the BBC's public services. We have set out more clearly than previously what our expectations and requirements are for the BBC's commercial activities, and have increased the overall level of Trust scrutiny by imposing a new requirement that BBC compliance with the Commercial Framework must be subject to formal review by the Trust at least once every five years. Subject to these new provisions and other specific changes reflected elsewhere in this report, we are satisfied that the distinction we have drawn between the Trust's responsibilities and those placed on the BBC Executive is

¹ http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/about/how_we_govern/charter.pdf

² http://downloads.bbc.co.uk/bbctrust/assets/files/pdf/about/how_we_govern/agreement.pdf

appropriate and consistent with the respective remits for those bodies as set out in the Charter and Agreement.

- 2.1.6. Some respondents drew a distinction between setting the framework (for which there was broad support) and ensuring compliance with it, where there was general concern to ensure that the Trust had sufficient information to oversee compliance effectively and the ability to take appropriate action in the case of non-compliance. We address compliance concerns in sections 2.3 and 2.4.
- 2.1.7. One respondent expressed concern that the framework did not capture the ways in which BBC commercial services might have a significant market impact. They were particularly concerned that BBC Store had been approved without any formal consultation with industry despite both the BBC and Ofcom acknowledging potential market impact.
- 2.1.8. To respond to these concerns it is important to be clear about the different regulatory and legal requirements that apply in the case of the BBC's public services and commercial services. In the case of the public services, market impact is a relevant consideration because these services represent a publicly funded intervention in the market. The Trust's procedures for assessing public service proposals make proper provision for the assessment of market impact including, in cases deemed to be significant, the conduct of a Public Value Test through which market impact is assessed by Ofcom and industry has two separate opportunities to submit evidence.
- 2.1.9. There is no problem in principle with the BBC's commercial services having an impact in the market. They do not represent a publicly funded intervention in the market in the way that the BBC's public services do, so the regulatory framework is a different one. For the commercial services the critical requirement is that they must not distort the market. This is why, when assessing proposals for BBC Store, the Trust focused in particular on ensuring that BBC Store was making appropriate payment for any benefits received through its links with the public services. The Trust does not consult on commercial service proposals because it would be impractical to do so without putting at risk the commercial proposition by revealing details to competitors in the market.

2.2. Remit for commercial services

- 2.2.1. The draft framework proposed that the remit for BBC commercial services should be to generate profit which may be used to supplement the licence fee so that the BBC may promote its public purposes.
- 2.2.2. Some respondents observed that some BBC commercial subsidiaries are expected to contribute in some way to the delivery of the public purposes (for example, Global News Ltd might contribute to the BBC public purpose 'bringing the UK to the world, and the world to the UK'). We accept that this may be the case. Indeed, this is anticipated in the Agreement which says that something can be a commercial service even if it also promotes the public purposes, if it is done with a view to generating profit rather than in order to achieve that promotion.
- 2.2.3. Some respondents questioned the basis on which certain of the BBC's subsidiaries fit with the remit. One respondent, having examined the published accounts for BBC Studios and Post Production, said that it was clearly not contributing to the licence fee income of the BBC and questioned how the proposed remit could be satisfied. Another respondent had examined the published accounts for BBC Global News Ltd

and commented that it had been operating for many years without making a viable return and in a commercial environment would have been closed long ago.

- 2.2.4. The Trust's expectations in terms of the financial returns generated by each commercial subsidiary are set out in more detail where we discuss the Trust's commercial efficiency principle. This is where we set out the Trust's proposed baseline test for commercial efficiency which will apply to both existing and any new commercial services. These new arrangements should help the Trust to determine more clearly than in the past whether the commercial services are fulfilling their remit and operating in a commercially efficient manner. If the Trust was to conclude that an existing commercial service showed no prospect of being able to fulfil the remit, its status as a commercial subsidiary would be called into question. Similarly, the Trust would be unlikely to give approval to the BBC to launch any new commercial venture unless it was satisfied, through consideration of a business plan or other evidence, that the remit could be met.
- 2.2.5. Our consultation identified potential for confusion between our proposed remit and our proposed principle that commercial activities should generate a return for licence fee payers. We have clarified our final framework by drawing these requirements together under the remit.

2.3. The Trust's principles

- 2.3.1. The Trust proposed five high level principles that all of the BBC's commercial subsidiaries would be expected to comply with:
- a) Strategic alignment of public service and commercial service activities
 - b) How, where and when commercial business can be conducted
 - c) Generating a return for licence fee payers
 - d) Commercial efficiency
 - e) Separation between publicly funded BBC activity and its commercial services
- 2.3.2. We comment on the consultation feedback we received on each of these proposed principles below.

Strategic alignment of public service and commercial service activities

- 2.3.3. We drew together two separate requirements set out in the Agreement (one requiring a fit with the BBC's public purposes, the second concerning the BBC's reputation and brand) to establish the principle of strategic alignment which we considered should apply both at the level of the commercial subsidiary overall but also in terms of each activity it undertakes.
- 2.3.4. This proposed principle attracted very little comment from respondents to the consultation beyond some general endorsement. It is retained unaltered in our final framework.

How, where and when commercial business can be conducted

- 2.3.5. Under this principle we set out our requirements concerning the use of BBC content and brands, the kinds of business activities that might be conducted, our requirements for when the commercial subsidiaries wish to work with partners, geographic considerations relating in particular to differences of approach to activity

in the UK as against international markets, and special considerations applying to 'direct to consumer' commercial offers in the UK.

- 2.3.6. One respondent considered it fundamental that any BBC commercial activities have a close connection in all respects to BBC content. We support the view that there should be a strong link here, and include in our principle the requirement that the BBC's commercial service activities should be based primarily on securing a return from BBC content and brands. However, extending this requirement to the extent proposed by the respondent appears to preclude some activities that we consider beneficial to the interests of licence fee payers and to the wider UK creative industry. It would be a mistake in our view to prevent the commercial subsidiaries from engaging in activity such as selling and distributing content not made by the BBC alongside its own where being able to offer a broader catalogue of programmes enhances the potential value of BBC content. Similar arguments apply in the case of BBC branded channels, which may be stronger and more effective if BBC content is supplemented with appropriate types of content from others. We acknowledge a risk that associating inappropriate content with the BBC brand could be damaging, but our framework contains a clear requirement that the commercial services should uphold the good reputation of the BBC and the value of its brand. It also requires that BBC content should represent a majority of the overall content wherever the BBC brand is being used. Overall, we are satisfied that our framework strikes an appropriate balance between commercial freedom and protection of the BBC's reputation and brands.
- 2.3.7. The BBC Executive expressed concern that our requirement that commercial activity must be based principally on securing a return from BBC content was too narrow to encompass the activities of BBC Studios and Post Production. Reflecting further on this, we acknowledge that there is a case for broadening our requirement so that it allows for commercial activity that contributes to the creation of BBC content as well as securing a return from it. We have amended our framework to reflect this.

Generating a return for licence fee payers

- 2.3.8. As explained above, our consultation identified potential for confusion between our proposed remit for the commercial services and our proposed principle that commercial activities should generate a return for licence fee payers. We have clarified our final framework by drawing these requirements together under the remit.

Commercial efficiency

- 2.3.9. Our framework makes clear that the BBC's commercial services must be commercially efficient. It requires that commercial efficiency be assessed at the level of each commercial service and acknowledges that what constitutes commercial efficiency will vary according to the market that each service operates in. We proposed that the Trust should set a baseline requirement that each BBC commercial service must generate a long-term return on investment which is considered appropriate to the relevant market. The framework also required the BBC Executive to set sufficiently challenging commercial targets for each business. The framework required the Executive to monitor performance against the targets set, keeping any businesses that, for whatever reason, were not generating profit in the short term under particularly close review. The framework also required the Executive to provide sufficient information for the Trust to satisfy itself that the baseline commercial efficiency requirement for each service was being met.

- 2.3.10. There was support for the requirement set out in the framework that business plans should clearly project profitability when viewed over an appropriate period provided that both the appropriate period and the level of profitability were judged against market norms. One respondent considered it abnormal for the Trust not to require that commercial services generated profits every year. We do not agree with this view, noting that it is commonplace for businesses to experience peaks and troughs, and for shareholders to take a view over an appropriate term about the future prospects for the business. Another respondent suggested that in circumstances where a BBC commercial service failed to return a profit in a given year then the BBC should be required to give a clear account to the Trust as to why and a commitment made to address the situation within a fixed period of time.
- 2.3.11. One respondent was concerned that the way in which the Trust baseline was defined would permit the BBC to enter and operate in markets that were low return, potentially distorting the market further through subsidised competition. They argued that there was no point in the BBC's commercial services operating in such markets if their stated purpose was to maximise value for licence fee payers.
- 2.3.12. We think there are two separate issues to be considered here. First, the framework is clear that market distortion is not permitted. It is not the Trust's intention that any of the BBC's commercial services should benefit from any subsidy or other benefit from the public service. This issue is addressed in more detail under the principle of separation below. Second, the Trust does not agree that it will only be in the interests of licence fee payers for the BBC's commercial services to operate in high return markets. There may, for example, be circumstances where establishing a presence in an emerging market where high returns have yet to be achieved is a course of action that could serve the best interests of licence fee payers in the longer term.
- 2.3.13. One respondent thought the Trust's proposal that commercial efficiency should be addressed at the level of each commercial service rather than at the level of individual commercial activities within those businesses 'alarming'. They believed the approach would allow the BBC to conceal inefficient or loss-making activities within otherwise profitable businesses and could incentivise the development of deliberately loss-making activities within the BBC which could be subsidised by other operations. They argued that commercial rivals could not rationally behave in the same way.
- 2.3.14. We disagree with this view. Few businesses operate on the basis that every element must maximise short term profit. Many commercial strategies depend on balancing out those areas of activity where it makes sense to maximise short term returns with investments in the longer term which may take time and resource to develop before future returns are secured. Further, given the constraints on the BBC's licence fee resources and the importance of commercial revenue in enabling those resources to stretch further, it is difficult to see what incentive the BBC might have to diminish commercial returns in the long term through such actions.
- 2.3.15. The BBC Executive supported the measures taken by the Trust to provide further clarity with respect to commercial efficiency, but was concerned that the process for setting the baseline measure was unclear. They questioned the use of market benchmarks in setting the baseline, suggesting that there was a lack of comparable market benchmarks for the BBC's commercial services and that market based measures were unlikely to reflect the limitations that the commercial framework placed on the BBC's commercial services.

- 2.3.16. The Executive also considered that the roles of the Trust and the Executive could become blurred if the Trust set the baseline hurdles. They said that each commercial subsidiary was already providing three year rolling forecasts on an annual basis and that these plans reflected economic conditions, competitor activities and market benchmarks.
- 2.3.17. Since the Trust's oversight and assessment of commercial efficiency was a concern shared by several respondents, we have given further thought to these issues. For the reasons set out above, we believe that our approach concerning the term over which commercial efficiency is viewed, and our proposal that the assessment should take place at the level of each commercial service, remain valid. But we have concluded that our framework needs to be clearer about:
- a) The purpose of the baseline measure and the commercial targets
 - b) Who is responsible for setting the baseline measure and for monitoring performance against it, and
 - c) Evidence required to underpin the baselines that are set.
- 2.3.18. We have also considered whether more information can be put in the public domain concerning the setting of these baselines without compromising the commercial sensitivity for the businesses concerned.
- 2.3.19. The Trust's commercial efficiency baseline is not intended to be a measure that stretches the commercial services to maximise their profitability. The Executive Board will set its own commercial targets to serve that purpose and we are satisfied that the need to secure the best return to the BBC to reinvest in public service content creation is an appropriate incentive for them to do this. The purpose of the Trust's baseline will be to determine the level of commercial performance below which the BBC's commercial services cannot fall without giving rise to concern that they might be being supported by the public service and therefore potentially distorting the market. The normal expectation therefore will be that the Executive Board is setting targets for the commercial services that are above the Trust's baseline. The Trust will not be able to endorse targets that fall below the baseline.
- 2.3.20. On the question of who is responsible for the baseline measure, we have concluded that the Executive Board should be responsible for proposing the commercial efficiency baseline to the Trust and for providing sufficient evidence to justify this. Commercial efficiency baselines will be subject to approval by the Trust, and the Trust will only give such approval where it is satisfied with the underpinning evidence provided.
- 2.3.21. We have concluded that the process for setting commercial efficiency baselines should be built in to the BBC's existing annual process for budget setting. As part of that process the Executive Board provides the Trust with rolling 3 year business plans for each commercial service. Those plans must include cost, revenue and profit forecasts for each year, along with sufficient narrative to explain the projections. Alongside this, they must include the Executive's assessment of the commercial efficiency baseline to which each service should be held. These baseline proposals must be underpinned with sufficient evidence to demonstrate that the proposals are consistent with market norms. If expectations have been adjusted to take account of any constraints on the businesses that arise from the parameters for commercial activity set by the Trust through this framework, these must be clearly set out and the extent of any discount applied must be clear.

- 2.3.22. The BBC Executive's existing quarterly performance reporting arrangements include reports on each commercial service. The Trust will use these as the primary means of assessing compliance with the commercial efficiency baseline. The Executive must include in this reporting its assessment, supported with sufficient evidence for the Trust to be able to form a view on compliance with the baseline.
- 2.3.23. The Trust's protocols also include a requirement for a more formal and more public statement about compliance each year as part of the annual report process. The BBC's published annual report and accounts includes a formal statement by the Executive Board on compliance with the criteria that apply to the commercial services, including commercial efficiency. This statement, and the work leading to it, is subject to independent external audit.

Separation between publicly funded BBC activity and its commercial services

- 2.3.24. The Trust's proposals concerning separation were founded from the need to maintain appropriate separation between publicly funded BBC activity and its commercial services in order to comply with state aid law and to avoid distorting the market through any cross-subsidy.
- 2.3.25. The proposed framework considered both financial and operational separation. In terms of financial separation we emphasised the importance of transparency around financial separation and the pricing and terms of asset transfers or service charges. The proposed framework required that all transactions between the commercial services and the BBC must be conducted at arm's length on commercial terms with reference wherever appropriate to market pricing. It went on to specify that the BBC must have in place the necessary systems and checks to be satisfied that its commercial services pay the market rate, benchmarked or otherwise tested, for any assets transferred or for services provided by the BBC.
- 2.3.26. The framework provided for the BBC to be able to negotiate 'first look' or exclusive arrangements with its commercial services provided that fair trading policy requirements were adhered to and the market was not distorted. Our proposals required some element of market benchmarking to ensure that appropriate transfer prices would be paid.
- 2.3.27. In terms of operational separation the Trust's concern was to strike an appropriate balance so that strategic alignment between the BBC's public and commercial services could be achieved while ensuring that the commercial services did not gain any unfair advantage in the market as a consequence of their links to the BBC. We emphasised the requirement that the commercial services must operate as separate companies with their own boards of directors, distinct from the BBC's Executive Board. We considered it acceptable for a director serving on the board of a commercial service also to serve on the BBC's Executive Board (or vice-versa) as long as careful consideration had been given to any potential conflicts of interest that might arise and formal arrangements were in place for managing any such conflicts.
- 2.3.28. Respondents focused in the main on the Trust's proposals relating to financial separation, and on transfer pricing arrangements in particular. While respondents all agreed that separation was important, some were concerned about the adequacy of the proposals set out in our draft framework. Others questioned whether the requirements on separation were being adhered to in practice.

- 2.3.29. One respondent raised a specific question about whether the arrangements under which two of the BBC's commercial subsidiaries will lease space at Television Centre once the refurbishment project is complete had been negotiated on an arm's length basis and whether the subsidiaries would bear the full cost of these arrangements. Another respondent called on the Trust to include a requirement that all co-development, co-production, co-funding and first look deals between the BBC public service and commercial parties (including the BBC's own commercial services) should be competitively tendered.
- 2.3.30. Several respondents believed that commercial services were benefitting from subsidy from the licence fee in one form or another that commercial businesses would not enjoy.
- 2.3.31. Several respondents were concerned about lack of transparency. One considered that the Trust's framework did not go far enough to address the potential for the BBC's commercial activities to be cross-subsidised through licence fee funds. They asserted that there was a total lack of clarity about how the transfer pricing arrangements operate, arguing that almost no information was published and that the market could not make any assessment of transfer pricing arrangements. They believed that certain inputs such as the use of the BBC's brand and goodwill were not explicitly charged for by the BBC or otherwise recovered through overhead charges or higher than industry levels of profit returned to the BBC. They considered that the BBC's commercial services were able to outbid or undercut commercial rivals and/or pursue uneconomic 'strategic' initiatives which made it harder for market competitors to compete and included reference in their submission to specific recent instances³.
- 2.3.32. Some respondents made reference to the BBC's recently announced 'compete or compare' plans and were particularly concerned that any new BBC production business should fully comply with legal and fair trading requirements and the Trust's framework. One commented that should the BBC wish to proceed with moving in-house production into a commercial service, it was vitally important that details were published so as to enable the BBC Trust and others to ensure that the commercial service would always pay market rate and that, where a concern was raised, there should be a formal system for issues or concerns to be raised with the Trust.
- 2.3.33. Some respondents raised points concerning the operational separation between the BBC and its commercial services. One respondent called on the Trust to set a limit on the number of BBC Executives who can serve on the board of a BBC commercial service. The BBC Executive considered the Trust's principles as drafted to be unclear on specific boundaries and recommended that the Trust's framework be more explicit on when co-operation between public and commercial services might risk undermining operational separation.
- 2.3.34. We believe that we have made provision in our framework proposals for those issues identified in the consultation responses concerning separation requirements, but we comment below on the main areas of concern and how we believe they are addressed.
- 2.3.35. Our framework is clear about the need for transactions between the BBC public service and its commercial subsidiaries to take place at market rates and for such

³ Not described further here because we would be unable to do so without breaching the respondent's request for confidentiality

rates to be determined using benchmarking. We do not, however, consider that competitive tendering is necessary in every case to achieve those goals.

- 2.3.36. It is clear from the strength and tone of the responses on these issues that separation and transfer pricing within the BBC is viewed with considerable suspicion and that, in the absence of any external assurance to the contrary, some respondents believe that the requirements are not being applied properly and that cross subsidy between the BBC's commercial and public service activities exists.
- 2.3.37. We have considered whether it would be possible to introduce greater transparency here. Clearly, making public the details of transactions between the BBC and its commercial services would be difficult to achieve without compromising either the BBC's or the services' position in the market. We think that our framework sets out clearly enough the relevant principles and we will consider, as part of the fair trading policy review we are currently conducting, whether the Trust's fair trading policy and associated public documents contain sufficient detail to ensure that the all the requirements are clear.
- 2.3.38. We understand, however, the desire for the BBC to be seen to demonstrate that the separation requirements are being applied in practice. The main message we take from the consultation responses on this issue is not that the Trust has misunderstood the separation requirements, but that there is doubt across industry as to compliance, so we acknowledge the need to do more to demonstrate that the BBC is adhering to the Trust's requirements. The Trust is consulted when the terms of reference are set for the annual audit of fair trading compliance. One step we will take is to ensure that the auditors are directed to pay particularly close attention to separation and transfer pricing in the course of the annual audit.
- 2.3.39. Further, compliance with all aspects of the commercial framework, including the requirements on separation and transfer pricing, will fall within the scope of the periodic review that the Trust is proposing must take place at least once every five years. Noting the level of concern from industry expressed through this consultation and taking into account that the first such review has yet to be timetabled and would be unlikely to take place before the new framework had been given sufficient time to bed in, the Trust has concluded that it should commission an independent review of the BBC's separation and transfer pricing practices as part of its work plan for 2015/16 and that it should publish its findings.
- 2.3.40. Turning to operational separation, while we do not think it appropriate for the Trust to impose a specific cap on Executives serving on commercial boards, we have amended our proposed framework to require that the boards of the commercial services maintain a reasonable balance between their own directors and those who also serve in BBC public service roles.
- 2.3.41. Responding to the BBC's request for greater clarity about our requirements for operational separation, we have included some more detail in the final framework but we cannot cover each individual circumstance and have tried instead to identify the key principles as clearly as possible. We would expect the BBC to take appropriate advice in reaching its own view as to whether it has complied with the principles we have set, and compliance with operational separation requirements will fall within the scope of the periodic reviews that we have written in to the framework.
- 2.3.42. On stakeholder concerns about the 'compete or compare' initiative, while the Trust will not be in a position to determine what clearance procedures might be applicable

to the BBC's proposals until it receives them, any proposals that involved activities currently undertaken within the public service being undertaken in the future as commercial services would be subject to the requirements of this framework.

2.4. Clarity of roles in overseeing commercial service activities

- 2.4.1. Being clearer about the roles of the Trust and the Executive Board in relation to commercial services was an important objective for the Trust's commercial framework. To a large extent those roles are set in the Agreement, but we set out in more detail in our framework how the different duties of the Trust and Executive Board would apply in practice to strategy setting, performance and compliance oversight, and approval for changes to the commercial services.
- 2.4.2. Our framework made clear that the Executive Board was responsible for determining commercial strategy. In setting a strategic framework, the Trust was putting in place parameters within which any Executive strategy must fit. The framework reserved rights for the Trust to call for proposals should it consider that there was no suitable strategy in place or that any strategy was not consistent with the strategic framework it had set.
- 2.4.3. The framework made provision for performance reporting to the Trust covering each commercial service through the existing quarterly performance reporting arrangements, and also set out public reporting duties.
- 2.4.4. We did not propose any change to the thresholds or tests that determine whether changes to commercial services require Trust approval or are matters for the Executive.
- 2.4.5. Finally, the framework introduced a new periodic review, akin to a service review, of the operation of the commercial services and compliance with the Trust's framework.
- 2.4.6. One respondent considered that the Trust's oversight was being set at far too high and general a level, with too much decision making being left in the hands of the BBC Executive. Their submission included a schedule of specific matters on which they considered more of the decision-making should rest with the Trust. This included acquisitions, partnership deals, complaint and redress mechanisms, target setting, and performance and compliance reporting. They also considered that the Trust should have a role in assessing the cumulative impact of incremental changes to commercial services.
- 2.4.7. One respondent considered that the Trust should have a clearer role in approving the commercial strategy set by the Executive. They did not consider it sufficient for the Trust to deem strategies to be approved if they were consistent with the framework.
- 2.4.8. Some respondents argued for greater transparency, including public consultation, when the Trust is considering commercial service proposals.
- 2.4.9. Our aim in drawing up the framework has been to ensure that the BBC's commercial services are subject to a similar level of oversight from the Trust to that which exists for the BBC's public service activities. With that in mind, the level of detail and

specificity in the framework is broadly in line with what has been established in the service licences through which the Trust oversees the BBC's public services.

- 2.4.10. We have looked again at whether our proposed approach in terms of Trust oversight of BBC commercial strategy is appropriate, and have concluded that it is. When the Trust considers the budget and strategy for the BBC as a whole on an annual basis, that process extends not just to the public services but takes into account the plans of the commercial subsidiaries. Our framework strengthens that strategic oversight by establishing a clearer frame of reference against which to judge the Executive's plans, and by introducing more clarity on how commercial efficiency is to be assessed. Similarly, the performance of the commercial services is covered in the Trust's recently introduced quarterly reporting arrangements. This means that the Trust is able to track progress against the approved plans and budgets for the commercial services through the year. In terms of individual transactions the financial threshold above which commercial proposals require Trust approval remains at £30m, considerably lower than the £100m threshold set for public service matters.
- 2.4.11. Responding to the point made about complaints and appeals, the activities of the commercial services and the transactions that take place between them and the BBC fall within the ambit of the Trust's fair trading policy which has its own clearly documented arrangements for considering complaints and appeals. We have included a reference to this in our final framework.
- 2.4.12. We do not agree with those respondents seeking to apply the levels of transparency that the Trust adopts when assessing the BBC's public services to the commercial services. Unlike the public services, the BBC's commercial service activities do not involve the use of licence fee resources so are subject to different oversight and approval arrangements. The provisions in the Charter, Agreement and this framework are intended to ensure that the BBC's commercial services do not have any unfair advantage over their competitors. Building public consultation into our approvals procedures for commercial services could place the BBC's commercial services at a disadvantage to their competitors who would know their commercial plans before they had clearance to implement them.
- 2.4.13. We have set out more clearly than previously what our expectations and requirements are for the BBC's commercial activities, and have increased the overall level of Trust scrutiny by imposing a new requirement that BBC compliance with the Commercial Framework must be subject to formal review by the Trust at least once every five years. Subject to these new provisions and other specific changes reflected elsewhere in this report, we are satisfied that the distinction we have drawn between the Trust's responsibilities and those placed on the BBC Executive is appropriate and consistent with the respective remits for those bodies as set out in the Charter and Agreement.

3. Implementation

- 3.1.1. The Framework we are publishing here will come into effect on 1 April 2015. Ahead of that, the Trust will review the Trust Protocol covering the BBC's commercial services to ensure consistency with the new framework. If, as we anticipate, amendments are required, the revised protocol will be published on the Trust's web site.

Annex 1

Strategic Framework for the BBC's Commercial Services

1 - Introduction

The purpose of this Framework document is to set out publicly the Trust's requirements, boundaries and expectations for commercial services. This Framework does not replace the specific compliance requirements set out elsewhere⁴.

The BBC's commercial services are subject to different regulatory and legal requirements than those that apply in the case of its public service activities. In the case of the public services, market impact is an important consideration because these services represent a publicly funded intervention in the market. The Trust requires that such impact is minimised and its procedures for assessing public service proposals make proper provision for the assessment of market impact including, in cases deemed to be significant, the conduct of a Public Value Test through which market impact is assessed by Ofcom and industry has two separate opportunities to submit evidence.

There is no requirement that the market impact of the BBC's commercial services must be minimised. It is, however, necessary to ensure that the BBC's commercial services do not distort the market by receiving any unfair benefit from the BBC.

2 - Remit for BBC commercial services

The justification for the BBC operating commercial services is to generate profit which may be used to supplement the licence fee so that the BBC may further promote its public purposes⁵. The Trust considers this rationale for BBC commercial services to be important in maximising the benefits that can be delivered for licence fee payers. This may be achieved through an appropriate mix of 'up-front' commercial investments made by BBC commercial services in content commissioned by the BBC to fulfil its public purposes, and a dividend stream for the BBC to reinvest in the promotion of its public purposes.

3 - The Trust's principles for the BBC's commercial services

(a) - Strategic alignment of public and commercial service activities

There must be clear strategic alignment between the public and commercial services activities of the BBC necessary to ensure that the commercial activities support the fulfilment of the public purposes, both at the level of each commercial service overall but also in terms of each activity it undertakes. In line with the Agreement⁶, the principal ways for assessing strategic alignment shall be:

⁴ Principally in the BBC Charter and Agreement, the Trust Protocol and the Trust Fair Trading Policy

⁵ BBC Agreement, Clause 101 (1)

⁶ BBC Agreement, Clause 69

1. The BBC's commercial services must fit with the BBC's public purpose activities. More specifically they should both be appropriate to be carried on in association with the public purposes and should be connected, otherwise than in merely financial terms, with the ways in which the BBC promotes its public purposes.
2. The BBC's commercial services should uphold the good reputation of the BBC and the value of its brand.

(b) - How, where and when commercial business can be conducted.

BBC Content and Brands

The BBC's commercial service activities must be based principally on securing a return from BBC content and brands or contributing to their creation.

There may in some cases be reasons (such as scale of business or fit with specific market needs) where exceptions to this principle may be justified. Where the Executive Board considers this to be the case, it must have a clear rationale. In any event BBC content must always represent a majority of the overall content where the BBC brand is being used.

Business activities

Business activities likely to be in keeping with this principle might include sales and distribution, channels, local content production and licencing arrangements for the development and distribution of BBC content and brands. However, where acquisitions and equity investments are proposed, the Executive Board must be satisfied that the acquisition is necessary to meet agreed business objectives and to ensure that all other strategic options - such as in-house development or licensing of rights - have been carefully considered and dismissed before any proposal is approved. Larger or more significant proposals remain subject to approval from the Trust⁷.

Working with commercial partners

The Executive must pay particular regard to the Agreement requirement that the commercial services must not jeopardise the good reputation of the BBC or the value of the brand when determining, for example, which commercial partners the BBC may work with and what type of third party content is shown on a BBC branded channel. Reaching a view on whether an activity might jeopardise the good reputation of the BBC has a wide application and must be assessed not only within the commercial service but also within the BBC Executive to ensure that any broader effects on the BBC's good reputation are taken into account.

Geographic considerations

BBC commercial service activities may take place in any geographic area.

⁷ BBC Protocol C4 – Commercial Services

When considering what constitutes strategic alignment the Executive Board must consider in particular the distinction between commercial services offered in the UK and those only accessible to international audiences. For example, a channel that uses the BBC brand (e.g. BBC America, BBC Entertainment) may be considered entirely appropriate for an international audience but use of the BBC brand for commercial activities in the UK requires special attention to avoid any risk of confusion between what is covered by the licence fee and what requires an additional commercial payment.

Direct to consumer commercial offers

BBC commercial services may offer products and services direct to UK consumers. However the Executive Board must ensure that all commercial and public service direct to consumer activity is carefully co-ordinated. A clear policy on when and where primary (public service) and secondary (commercial service) content is available is required and must be communicated to the BBC's audiences.

(c) - Commercial efficiency

Consistent with the underpinning financial rationale for the BBC operating commercial services, commercial efficiency (which in its broadest interpretation means behaving as a market operator would to deliver financial return and strategic value) must be a prerequisite for BBC commercial services. The BBC should be able to demonstrate this first, before seeking wider strategic benefits for the Corporation as a whole. The fact that a commercial service can deliver strategic benefits or public service value can never be treated as a substitute for commercial efficiency⁸.

The Agreement includes the requirement that the BBC's commercial services must 'exhibit commercial efficiency'⁹. The definition of commercial efficiency is a matter of judgement for the Trust.

Commercial efficiency will be assessed at the level of each commercial service rather than on individual commercial activities within those businesses, and rather than based on cumulative performance across them all¹⁰.

Commercial services operate in different markets where the expectations of market operators in terms of the timeframes over which returns are generated, as well as the level of those returns, vary. As part of the annual budget setting process the Trust therefore requires the BBC Executive Board to propose a baseline requirement for commercial efficiency for each commercial service which takes into account such market variations.

⁸ BBC Agreement, Clause 101

⁹ BBC Agreement, Clause 69

¹⁰ Other than when assessing a specific new service proposal

The purpose of the Trust's commercial efficiency baseline is to determine the level of commercial performance below which the relevant commercial service cannot fall without giving rise to concern that it might be being supported by the public service and therefore potentially distorting the market. The baseline requirement is that each BBC commercial service must generate a long-term return on investment to the BBC which is considered appropriate to the relevant market. Such returns may be delivered in the form of a dividend or other revenue stream to the BBC.

The Trust requires that these proposals are underpinned with sufficient evidence to demonstrate that they are consistent with market norms. If expectations have to be adjusted to take account of any constraints on the businesses that arise from the regulatory framework under which they operate, these must be clearly set out. The Trust will only approve baselines where it is satisfied with the underpinning evidence provided.

The baseline requirement does not mean that each of the commercial services must be profitable each year. There may be periods (for example when businesses are in their early stage of development, or undergoing significant transition) where year on year profitability is not a realistic commercial expectation. In such cases the Executive Board must have approved business plans which clearly project a return which is considered appropriate to the relevant market when viewed over an appropriate period. The Executive Board must keep the commercial performance of such businesses under careful review, reporting as required under this framework.

The Executive Board is also responsible for setting commercial targets for each commercial service. These fulfil a different purpose to the Trust's baseline. They are intended to ensure that the BBC secures the best return for licence fee payers from its commercial services. The targets must, as a minimum, meet the Trust's baseline requirements and must be set at level that ensures that each commercial service is sufficiently challenged. In taking a view of commercial efficiency, the Trust will take into account both its own baseline requirement and the performance of each business against the commercial targets set for it by the Executive Board.

New commercial service proposals are subject to approvals requirements set out in the Agreement and in Trust protocols¹¹. Where new commercial service proposals are subject to scrutiny in their own right under these arrangements (by the commercial service itself, the Executive Board or the Trust), the decision-making body must be satisfied as to the commercial viability and levels of commercial risk relating to that particular activity.

The Executive Board is responsible for approving business plans for each commercial service and for monitoring the performance of each service against them. The Executive Board is also responsible for ensuring that the Trust has access to sufficient performance reporting

¹¹ BBC Protocol C4 – Commercial Services

material (primarily through quarterly reporting) to satisfy itself that its baseline commercial efficiency requirement is being assessed and met.

(d) - Separation between publicly funded BBC activity and its commercial services

The BBC must maintain appropriate separation between publicly funded BBC activity and its commercial services¹². This is necessary in order for the BBC to comply with state aid law.

The BBC's commercial services must also comply with the Trust's fair trading requirements and must not distort the market¹³. The Trust's fair trading policy focuses in large part on ensuring that the BBC's commercial services do not gain any unfair advantage in the market as a consequence of their links to the BBC. There are two different dimensions to this – financial separation and operational separation.

Financial separation

The Trust considers the most effective way to ensure the necessary separation between the public and commercial parts of the BBC is through focus on and transparency around financial separation and the pricing and terms of asset transfers and service charges. Commercial services must not gain any unfair financial benefit from the BBC. All transactions between the commercial services and the BBC must be conducted at arm's length on commercial terms with reference wherever appropriate to market pricing.

Where the BBC has assets (such as TV programmes) created using public funds, others in the market must not be unfairly disadvantaged when those assets transfer to a BBC commercial service. The BBC must have in place the necessary systems and checks to be satisfied that its commercial services pay the market rate, benchmarked or otherwise tested, for those assets. Similarly, where the BBC provides any services (such as accommodation) to a commercial service it must ensure that a market rate is charged for those services.

The BBC's commercial services must operate as separate companies following the normal requirements in terms of statutory accounts. This will ensure that any financial transactions that take place between the BBC and one of its companies are properly recorded and subject to audit.

The BBC may negotiate, 'first look' or exclusive arrangements between itself and its commercial services provided that the Trust's fair trading policy requirements are adhered to and any such arrangements do not distort the market. Where rights or assets are sold to a commercial service some element of market benchmarking must be built in to ensure that an appropriate transfer price is paid.

Operational separation

¹² BBC Agreement, Clause 68

¹³ BBC Agreement, Clause 69

Operational separation must be sufficient to ensure that the BBC's commercial services do not gain any unfair advantage in the market as a consequence of their links to the BBC but should not inhibit any strategic alignment between the BBC's public and commercial services that is necessary to maximise the benefit to licence fee payers.

Operational separation is in part achieved through the requirement that the BBC's commercial services operate as separate companies. Commercial services must be run by boards of Directors who have specific fiduciary responsibilities, which are distinct from the responsibilities of the BBC Executive Board. The boards of the commercial services may include directors who serve in BBC public service roles, but each board must contain a reasonable balance between its own directors and those who also serve in BBC public service roles.

Wherever a director serves both in a BBC public service role and on the board of a commercial service, the BBC's Executive Board must give careful consideration to any potential conflicts of interest that might arise and must have in place formally recorded arrangements for managing these.

Other than at board level, staff should normally be clearly accountable either to the BBC public service or to a commercial service. If, in exceptional circumstances, any staff are fulfilling both a public service and commercial role, the BBC's Executive Board must give careful consideration to any potential conflicts of interest that might arise and must have in place formally recorded arrangements for managing these.

4 - Clarity of roles in overseeing commercial service activities

Trust and Executive Roles

The roles of the Trust and Executive Board in relation to commercial services are set out in the Charter and Agreement, and in more depth in the Protocol¹⁴.

Setting strategy

The Executive Board must have in place arrangements for adopting and reviewing strategy and business plans for each of its commercial services. Strategies covering a number of years of operation may be adopted, but the Executive Board must revisit these annually both to review progress against them and to update them where necessary.

Strategies and business plans deemed by the Executive Board to comply with all regulatory and legal requirements and to comply with the requirements set out in this strategic framework are deemed to be approved by the Trust.

¹⁴ BBC Protocol C4 - Commercial Services

Decisions on timing and handling for the development of strategies for each commercial service are matters for the Executive Board, but the Trust retains a right to call for proposals should it consider that there is no suitable strategy in place or that any strategy is not consistent with this Framework.

Performance and compliance oversight

The Executive Board must ensure that the BBC's commercial services are operated in a way which complies with the four criteria set for the commercial services in the Agreement. The Chief Executive of each of the commercial services must take steps to satisfy themselves that their businesses remain compliant with the four criteria and must submit a compliance report each year to the Executive Board. The Executive Board must ensure that reports and accounts covering the commercial services are published each year and that these include all the information specified in the Agreement as being required¹⁵.

The Executive Board must, through its performance reporting arrangements, report quarterly to the Trust in an agreed format which must cover the financial performance of each commercial service (including identifying any activities within each business which are consistently performing below the financial targets set for them), compliance with the four criteria and other requirements, key risks and mitigations and major projects.

Changes to commercial services (including additions and removals)

Detailed requirements concerning approvals for commercial services are set out in the relevant Trust protocol¹⁶. In most cases responsibility for assessing the compliance of new commercial service proposals sits with the Executive Board. In some cases the Executive Board must seek approval from the Trust. The Protocol explains how the Trust will take any approval decisions which are referred to it. This includes the procedures it will follow and any criteria it will apply over and above those criteria set in the Agreement, or the factors it will have regard to in deciding whether to give approval.

The Executive Board must ensure that the BBC's commercial services are operated in a way which complies with these rules.

Complaint handling arrangements

The activities of the BBC's commercial services and any transactions that take place between them and the BBC fall within the ambit of the Trust's fair trading policy and the procedures for handling complaints and appeals¹⁷.

Review

¹⁵ Clause 74

¹⁶ BBC Protocol C4 - Commercial Services

¹⁷ http://www.bbc.co.uk/bbctrust/contact_us/complaints/appeal_trust.html

The Trust will review this Framework, including consideration of the BBC's compliance with the Framework in its operation of commercial services, at least once every five years. These reviews will be published.