



Prime Minister

We shall be meeting on 13 March to discuss the BBC licence fee settlement. I hope this minute will assist our discussion.

The BBC's proposals may be briefly summarised as follows. Using their own figures:

- (a) the cost of providing existing services for 3 further years without a change, and without inflation, requires a colour licence fee of £51/52
- (b) if, however, costs rise to the extent the BBC assumes, the provision of those services without change for 3 years would require a colour licence fee of £59
- (c) the addition of the cost of new and enhanced services, increased capital expenditure, and the inflation associated with both, brings the BBC claim to £64.6

The BBC's application assumes a 1% per annum improvement in labour productivity.

I should explain that the previous settlement was reached on 2 December 1981, when the BBC were in deficit by about £30m.

Under it, the BBC were required to pay off their deficit and live within the income provided by the new fees until 31 March 1985. Implicit in a settlement for a fixed period of years, where the annual income remains more or less constant but prices rise, is that spending cannot match income in each year (assuming no significant change in the level of service). The BBC's expenditure plan for the period 1982/83 to 1984/85 therefore showed them spending less than their income at the beginning of the period and using the surplus to fund their spending at the end. This pattern has been followed and the BBC will break even as at 31 March 1985, spending in 1984/85 a total of £771m. This is what was envisaged when the settlement was made in December 1981, it is for this reason that the BBC is currently spending at a rate equivalent to a £51 fee.

It will of course be for the BBC and not the Government to decide how to allocate their total licence fee income; and they may decide to do so in different ways when they know they will not get £65. But it is convenient to consider the various components of the application separately and we need to ask:-

- (a) could the improvement in productivity assumed in the application be increased, so that existing services could be provided for less than is assumed?
- (b) to what extent should the BBC's inflation assumptions be accepted?
- (c) what extent, if at all, should money be provided

for the cost of new and enhanced services and increased capital expenditure?

With regard to productivity, the position is that the BBC originally assumed a 0.3% annual improvement in productivity, but adjusted the assumption in the application to 1% in the light of the Peat Marwick Mitchell report. The report does, however, suggest a substantial number of ways in which management procedures and management culture could be improved. Some of the most critical points are set out in Appendix A. The difficulty, however, is that Peats do not give a figure for the amount of money that could be saved by changes of the kind that they imply are necessary, and some of the changes are of such a fundamental kind that they are unlikely to yield results for some time. Consequently, it would be very difficult to know what assumptions it would be reasonable to make for the improvements that could properly be expected in the coming years, which would lead to a further reduction in cost. Nonetheless, I do think that it is reasonable to make some such assumption, however arbitrary it may seem, and no doubt we will wish to discuss its extent.

With regard to the inflation assumptions, the position is that the BBC have calculated, by reference to past experience and with some assistance from Peat Marwick Mitchell and other forecasters about future trends, different inflation rates for different elements of their expenditure. On capital expenditure they suggest a rate of 7%, but Peats think this should be 5.5%. On operating costs they suggest a number of rates which aggregate at 8.4%.

This includes 8% for staff costs, with basic pay increasing at 5% a year. (The Treasury of course expects earnings to rise by 7.5% this year.) In the case of a Government Department it would be regarded as wholly unacceptable to assume inflation rates so much above the GDP deflator. But the BBC contend that they are a price taker, rather than a price maker, as they have to compete with the ITV system for labour and are already paying 30% below ITV rates. (A note giving details of the BBC's inflation assumptions is at Appendix B.) Although it is undoubtedly true that ITV have until recently been extremely unheroic in their attitude to trade union pressure, and have agreed to inordinately high wage increases and manning levels, I still do not think that we could possibly agree to the assumed BBC cost increases to anything approaching the extent that they suggest. Again, we will want to discuss how far it would be reasonable to go.

The nature of the new enhanced services, that the BBC wish to provide is set out in summary in Appendix C. The bid for £249.9m for new and improved services includes £47.1m which the BBC says is better regarded as essential expenditure on existing services which, because of state of the art improvements in technology, has an unavoidable element of improvement. I think we should regard this item as the residual one, to be provided for only to the extent that there is room for it within what we would regard as the overall acceptable fee.

You will also of course need to consider the period of the settlement. In 1981 we made a great virtue of a 3 year settlement,

and since then statements have been made about its desirability, but not to the extent of this amounting to any sort of commitment. I do not think that a one year settlement would make sense in the light of the financing review. We certainly want the review to be crisp and businesslike, and carried out in a reasonable time scale, but it is bound to take a little more time to find the members of the inquiry and set it up. In addition we must remember that the inquiry is designed to produce options, rather than a single recommendation, and this means that we in Government will have to make up our mind on exactly how to proceed after the results of the inquiry are to hand. Moreover, even if income from licence fees is to form only part of the BBC's income as a result of the study, some time would still be needed to reach the next settlement on that aspect of the BBC's income. For these reasons I think that a settlement for less than 2 years is impracticable, and we will need to discuss the political and other advantages and disadvantages of 2 years and 3 years respectively.

I am sending a copy of this minute to the Chancellor of the Exchequer and to Sir Robert Armstrong.

L. B.

11 March 1985

PMM REPORT: WEAKNESSES IN THE BBC'S FINANCIAL MANAGEMENT
AND ATTITUDE TO RESOURCES

1. The Incremental Approach

- a. "A persistent belief that there is a directly proportional relationship between quality and money in broadcasting".
- b. A general expectation "that the status quo represents a base on which new activities and expansion can be built".

2. Resource Management

- a. Not sufficient pressure for adequate mechanisms everywhere in the system to ensure that the best value is obtained for the BBC as a whole.
- b. Not always adequate justification or consideration of costs and benefits when new projects or ventures are under consideration.
- c. Insufficient development of the management skills of middle managers, who often have a "creative" background.
- d. Accountability for resources sometimes poorly matched with the authority to use them.
- e. Inadequate follow-up to the 1982 systems review of the BBC.

- f. In some areas managers do not have a clear view of their objectives.
- g. More attention needed in the BBC's activity review programme to implementation, the preparation of action plans, priorities, and timetables.

3. Productivity

- a. "Any sizeable organisation can achieve some improvements in efficiency and economy without affecting its output and the Corporation is no exception."
- b. "New techniques and methods of production are regarded primarily as adding to quality and complexity rather than productivity."

THE BBC'S INFLATION ASSUMPTIONS:

1. People. 56% of the BBC's expenditure goes on staff, and a further 19% on artists and sporting contracts. Their assumptions in this area are as follows:

- a. Staff. 7% per annum for pay, allowing for basic pay awards of 5%, with the balance to meet enhancements in pay, London Weighting and increments. A recent agreement on conditions of service will add a further 1% per annum.

Total 8%

PMM comment: Had they been asked to make a forecast they would have suggested 7.1% to 8.4% in individual years over the period. If the BBC fail to provide earnings increases broadly in line with that projection, they thought it a reasonable expectation that labour turnover will increase and the quality of recruits decline.

- b. Artists and Sporting Contracts.

10-11%

The BBC is in direct competition with ITV. BBC artists fees (writers, musicians, performers) are about 35% below

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current ITV rates. The cost of films and sporting rights continues to rise.

PMM comment: Nil.

2. Things.

a. Programme cash costs:

10% per annum

(Design, materials, costumes, graphics etc)

b. Other operating costs:

5½% per annum

(But exceeded in some areas, such as rental increases for BT lines).

c. Capital expenditure

7% per annum

The BBC accept that 5½%-6% should generally reflect changing price levels, but the rising costs of hi-tech "state of the art" equipment leads them to increase the allowance.

PMM comment: 5½-6% would be an appropriate figure.

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ENHANCEMENTS AND NEW SERVICES

APRIL 85 PRICES

Enhancements(a) Capital

1. The BBC explain that £395.1 million capital expenditure they plan over 3 years includes an unavoidable element of enhancement, which they estimate amounts to

	£47.1m	£47.1m
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(b) Operating

2. Visible improvements to television drama, and the quality of other television programmes	£69.9m	
3. Similar improvements to radio	£11.4m	
4. Improvements in television news and current affairs	£35.5m	
5. Strengthen news gathering capacity of local radio; wider coverage of overseas matters, closer ties with local communities	£9.9m	
	£126.7m	£126.7m

New Services(a) Capital

6. New Services for Television (largely Parliamentary broadcasting)	£7.3m	
7. Construction of 10 new local radio stations	£14.2m	

8. Increase in local radio output	£10.3m	
9. Gaelic broadcasting and development of community stations in Scotland and Wales	£3.9m	
	<u>£35.7m</u>	<u>£35.7m</u>
 (b) <u>Operating</u>		
10. 2 hours additional television, weekday afternoons	£10.6m	
11. Televising Parliament	£2.3m	
12. Improved television regional programming	£4.5m	
13. Operating costs of 10 further local radio stations and to increase local and network programming to sustain local radio	£19.5m	
14. Minor developments in radio programming in national regions including increase in Gaelic broadcasting	£3.5m	
	<u>£40.4m</u>	<u>£40.4m</u>
Total improvements and New Services		<u>£249.9m</u>

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