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Abstract

This paper aims to explain the recent defensive strategy of downsizing at the BBC. The paper rejects the analysis of both industry practitioner and neo-classical economic academic critics who represent the corporation as an all-powerful, abusive player in a market and instead develops an alternative concept of the business model, which focuses the pressures of financial viability and stakeholder credibility to explain the restructuring. We argue that the BBC's business model is stressed because it struggles to deliver what key stakeholders want and expect from the corporation, from a pot of revenue that is limited by regulation. The BBC's problem is compounded by demands for more programming hours following its move into digital and by the increasingly formalised demands of regulators on behalf of an absent consumer. The paper concludes that without reflexive, business model-centred regulation, it is likely that the BBC's business model will become unsustainable.

Stressed by choice: a business model analysis of the BBC

I don't understand why it's necessary, particularly at a time when you can spend hundreds of millions building new buildings, moving staff to Manchester and all the rest of it… I think it would be very helpful to be told precisely why these cuts are necessary and what sort of things the boss class would like to see removed from the output.

(Jeremy Paxman quoted in Guardian, 31 January 2005)

(Within the BBC) the big question that is being asked time and time again is, 'Why?' How come the director-general is promising more programmes and higher-quality programmes, while at the same time planning to get rid of more than 2,000 production staff members, the very people who make the programmes?… 'The cuts have come before the vision,' a hard-pressed television executive admits. 'Shouldn't it be the other way round?'

(Independent, 25 April 2005)

Introduction

Job losses are a key part of the restructuring initiatives proposed by the BBC's Director General, Mark Thompson with most recent estimates suggesting that 5,000 BBC employees are to be sacked (*Guardian* 16 Sept 2005) and others are to be re-located to save £355 million in costs and reduce the corporation's total expenditure by 15% (*Guardian,* 20 April 2005). As the two quotations above suggest, the cost-cutting proposals resulted in general confusion and hostility on the part of BBC staffers who responded with strike action. This confusion also extended to the national press, who noted that Thompson's cost-cutting proposals contrasted with the expansionist regime of his predecessor, Greg Dyke (see, for example: *Guardian,* 8 December 2004; *Financial Times* 9 December 2004; *Independent* 25 April 2005). However, they did not connect the changes to external pressures nor did they reconcile the moves with Thompson's own comments in his previous position as chief executive of Channel 4, when he accused the BBC of wallowing, 'in a Jacuzzi of spare cash' (*Guardian*, 7 December 2004).

Beyond the anger and puzzlement there has been very little analysis of *why* the corporation needs to engage in the kind of defensive moves normally associated with retreating private sector organisations. This paper aims to address this '*why*' question by rejecting the industry practitioner and economists' concern with the actual or potential broadcasting market, where the BBC generally figures as an always powerful and sometimes abusive player. This paper argues that if we want to understand why a powerful player is undertaking major restructuring, we need to employ an alternative business model approach which relates sources of revenue and controllable costs to socio-cultural constraints established by stakeholders. The business model approach is valuable because it opens up a different perspective on the BBC in two ways: first, it helps us to better understand the reasons why a public sector corporation needs to restructure in the present political and economic climate; and second it raises policy questions about the possibilities of meeting key stakeholder expectations from income that is not, or at least not only, generated through management's strategic moves in the product market. This new perspective is of broader significance. The BBC is *sui generis* in ways which make it different to other public sector activities, but other public sector organisations are, like the BBC, increasingly burdened with new requirements for delivering value for money, accountability and transparency in an era of increasingly formalized and exacting consumer expectations.

The argument of the paper is developed in four sections. The first section reviews criticism of the BBC, starting with the arguments around the Charter Review in 2004-05 and then referring to the academic literature from Coase onwards, which constructs the BBC as a major player in the broadcasting market. The second section proposes an alternative business model concept, which focuses the key issues of financial viability and stakeholder credibility, and explains how these two variables play out differently in the private and public sector. Section three then begins to apply the public sector business model concept to the BBC by addressing the specific context within which the BBC operates, specifically outlining its sources of income and key stakeholders. The fourth section then develops our public sector business model analysis by explaining how the BBC's move into digital has stressed the organisation's financial viability and external credibility. The concluding section builds on our analysis and findings about the BBC and explains how our alternative business model approach has policy implications for regulation

1. The BBC and its critics

The proposed restructuring at the BBC takes place against a backdrop of ongoing criticism of the organisation's position and behaviour. This section considers first, the recent criticism of the BBC by politicians and industry figures before turning to consider the more measured academic criticism which draws on neo-classical economics. After challenging the opportunist and contradictory industry arguments, the section argues that the analytical categories of the economics frame the BBC as an abuser of market power so that it is then difficult to explain the 2005 restructuring.

In the early part of the Charter Review period, there was an explosion of publications and speeches critical of the BBC, which urged the government to curb its market power, control its income and spending and free up resources for private sector TV producers. Many of these critics were broadcasting industry practitioners and right-leaning politicians who, for different reasons, had interests or *parti pris* in a weaker or dismantled BBC. Their attacks were usually polemical, at times contradictory and remarkably parsimonious about evidence or empirical support. The end result was a kind of collective 'monstering' of the BBC by its enemies who presented all the BBC's characteristics and behaviours as entirely negative.

This form of 'monstering' is most clearly seen in the report produced by Elstein *et al*. (2004) for the Conservative party by a team where four of the five co-authors had either some ownership stake or managerial role in independent TV production companies or channels and the fifth was a board member of the Independent Television Commission (ITC). Their report opens with an introduction that accuses the BBC of abusing its market power, stifling creativity, reducing diversity and democratic pluralism (Elstein *et al*., 2005, p5), damaging the creative economy by expanding its commercial services, adopting expedient expansion strategies to defend its licence fee income (p.6) and ignoring its public service remit to educate and inform by chasing ratings (pp.6-7). The report continues by arguing that the BBC is also unable to exploit its commercial value fully because of its public sector status, while also criticising the licence fee as unnecessarily regressive (p.7). The opportunism is manifest in the contradictory identification of the BBC as both a bullying monopolist and a weak underachiever, or the hypocrisy of condemning the BBC's licence fee as a regressive tax on the poor in a report written for the Conservative Party that introduced the Poll Tax and presided over a seismic shift from progressive direct to regressive indirect taxation in the 1980s.

Similar anti BBC proposals and arguments recur in the earlier speeches of other industry leaders and right-wing politicians seeking to influence the Charter review in favour of BSkyB, a key private sector competitor to the BBC. Most notably, in the 2003 MacTaggart Memorial Lecture, Tony Ball then CEO of BSkyB, proposed an 'RPI minus X' formula for BBC funding (*The Guardian,* 23 August 2003). Similar themes are evident in Tory MP Tim Yeo's comparison between the BBC, which, 'restricts choice and insults the viewers intelligence' (Yeo 2002: section 4) and Sky, which has, 'revolutionized viewer choice, winning a large market share on the back of a bold and well judged strategic gamble' (Yeo, 2002, section 4). In such interventions, the bad BBC is always monstered but no criticism is made of good Sky, even though that major player has a very mixed record on new and original productions (Oliver & Ohlbaum, cited in BBC, 2004, pp.5-6), independent commissions (DCMS, 2000a, p.61) and UK film commissions (Select Committee on Culture, Media & Sport, 2003, paras 111-113).

Other critics of the BBC, like Cox (2004), are more intellectually measured and balanced, because they are even handed in their criticism of Sky and the BBC as the two 800 pound gorillas distorting the development of broadcasting in the UK. That shift meets the requirements of intellectual balance at the expense of political naïveté because it is unlikely that any averagely unpopular government would risk taking on both the notionally independent BBC and Rupert Murdoch's Sky simultaneously. Whether the criticism consists of intellectually one-sided monstering or politically naïve, even-handed condemnation of both gorillas, it does leave the reader puzzled. If the BBC is so abusively powerful it should be able to fund profligacy, so how and why does the new director, Mark Thompson, need restructuring and downsizing of a kind that we would usually associate with distressed private corporations in weak positions. With this point made, we can now turn to academic perspectives on the BBC.

The original and definitive academic critique of the BBC was made by economics Nobel prizewinner Ronald Coase. Coase was the first academic to use the categories of economics to frame analysis of a broadcasting market which had previously only been discussed in cultural and socio-political terms (Peacock, 2004, p. 33). Coase wrote first on UK radio broadcasting in the 1940s and early 50s (Coase, 1947; 1950) before turning his attention towards television in the mid-1950s and 1960s (Coase, 1954; 1966), always using a neo-classical economics approach (Campbell and Klaes, 2005, p. 263). His approach was later taken up by key government advisors and legislators during the Thatcher years and can be seen most clearly in the 1986 Peacock Committee Report on financing the BBC (Home Office, 1986) and the work of Samuel Brittan (1987). More recently, his ideas were developed (and critiqued) by authors in a pamphlet produced by the IEA (Peacock, 2004) in the run up to 2006 Charter Review, though his influence manifest through Peacock (see Towse, 2005), has waned and is now less obvious in recent New Labour policy documents (Barwise, 2004, p. 32).

Coase operates in a consumer centred classical problematic of scarcity where the task is to develop market mechanisms which distribute finite resources to meet consumer demands. The market as institution plus the price mechanism as a carrier of signals are the means of securing allocative efficiency and responsiveness to consumers. For Coase, broadcasting markets are desirable not simply because they secure fairness, 'level the playing field' and remove the market power of the BBC, but also because they encourage producers to provide what consumers want. From this point of view, Coase makes various criticisms of the BBC: for example, that it does not recoup its costs from the market and hence distorts the allocation process (Coase, 1966, p.441); and that the flat rate licence fee contains no price signal and thus prevents the institution from adjusting its output to meet consumer preferences (Coase, 1961).

More recent, economics-based analysis has taken a competition policy approach and focuses on the practicalities of delivering effective competition through markets, combined with appropriate regulatory regimes to prevent anti-competitive behaviour. Such work derives from the economic analyses of Mason (1949) through Bain (1951) and later Scherer (1970). These authors focus on the way industry concentration and barriers to entry affect firm profits, and emphasise abuses of market power rather than the allocative inefficiencies that concerned

Coase. Thus, for example, Collins (2003) and Cave *et al*. (2004) present the BBC as an oligopolist acting unfairly in the market place. Echoing the macro arguments of Bacon and Eltis (1976) thirty years previously, they argue that the BBC has both the size and market power to crowd out private sector competitors in broadcasting and move forcefully into ancillary markets (Collins, 2003, pp.169-170; Cave *et al*., 2004, p.252). In the absence of shareholder discipline, the BBC mobilizes resources aggressively to weaken competitors and maximize output (Cave *et al*., 2004, p.252; Collins, 2003, p.170), while at the same time avoiding public scrutiny and criticism with limited and opaque public disclosure (Cave *et al*., 2004, *passim*).

If this represents the current economics based orthodoxy, one of the puzzles is the *a priori* of these papers when Caves *et al.* do not present sustained or systematic argument or evidence but instead lean heavily on assertion about how the BBC 'might' or 'could' abuse its market power. Thus, Cave *et al.* (2004, pp.268-9) base their proposal for more *ex ante* regulation of the BBC on six examples of objectionable behaviour that the institution 'could' or 'might' engage in: monopsony, excessive pricing, refusal to supply, undue preference, cross-subsidy and predation. The authors conclude that, 'many of these potential abuses are motivated by the desire to leverage dominance from one market into another' (Cave et al., 2004, p.268), but neither the abuse nor the motivation to leverage dominance is systematically demonstrated in ways that prove that such behaviour is typical of public sector corporations, or that it generally creates problems for private sector competitors. Collins (2003) and Caves *et al*. (2004) instead develop their argument using a small number of illustrative examples that are puzzling because in many cases their interpretation can be easily contested. For example, both papers argue that the introduction of BBC4 crowded out private sector arts and highbrow culture channels, like Artsworld (Caves et al., 2004, p. 250) and Digital Classics (Collins, 2003, p. 169). The argument contains little discussion of other factors that may have undermined these companies, such as whether there could ever be enough subscribers to Artsworld at £6 a month to recover the costs of high quality arts programmes. Nor do the authors consider the evidence on audience viewing patterns which suggest that BBC4, the direct competitor channel, was unlikely ever to capture more than 1-2% of Artsworld's total viewing time because most viewers have highly fragmented watching habits (Barwise, 2004, pp. 29-30).

Thus, we would argue that such academic authors rely mainly on the authority of the discourse of economics to create the impression of misbehaviour, using it as a rhetorical framing device to construct a charge sheet that lists the putative crimes of the corporation. Hence whilst economics may be useful in understanding how markets work in some circumstances, in this instance it leaves us with exactly the same puzzle posed by the more opportunist industry critics of the BBC: if the BBC's uncompetitive and abusive practices are not being effectively regulated, why would such a powerful organisation need to restructure and shed labour under Thompson's initiative? The rest of our article represents an attempt to answer that question why.

2. Private and public sector business models

Our analysis of the BBC uses an alternative business model approach and the task of this section is to first develop a general concept that focuses on the need for companies to achieve financial viability and secure credibility that comes from satisfying key stakeholder expectations. Our basic idea of a business model is relatively straightforward because it combines financial constraints and social construction. We then use this general concept to think through the different tasks of both private and public sector management, since financial viability and stakeholder credibility play out differently in each domain. Lastly, we then apply the concept of public sector business model to the specific case of the BBC to think through the 'why' question posed above.

The business model concept outlined in this section has two aspects. First, it focuses attention on an organisation's current financial characteristics (sources of revenues, cost structure, balance sheet), which must be related to the opportunities and constraints on management action to raise more revenues, reduce costs, restructure the balance sheet and so on. However, a business model is not simply about making a set return on capital, achieving break-even or some other financial target that defines financial viability. Therefore, secondly, a business model is also about the role of key stakeholders in defining opportunity, framing options and evaluating success and, on that basis, satisfying politically and socially constructed stakeholder expectations. This kind of concept is intended primarily as an analytical device that adds understanding, rather than explicitly a prescriptive strategic tool that offers managers solutions or templates, although such understanding should allow managers to negotiate the business environment and, in particular to understand the significance of external constraints and conditions.

If business model can be a useful concept, we would begin by observing that it is at present an indistinct term which passed into general usage in the new economy era to understand private sector strategy at the end of the 1990s and early 2000s. As Michael Lewis (1999, p. 274) observes, the term was:

> one of those terms of art that were central to the Internet boom: it glorified all manner of half-baked plans. All it really meant was how you planned to make money. The 'business model' for Microsoft was to sell software for 120 bucks a pop that cost 50c to manufacture. The 'business model' for Healtheon was to add a few pennies to every bill or order or request that emanated from a doctor's office. The 'business model' for Netscape was a work in progress; no one ever did figure out how to make money from Netscape

Since the early 2000s academics have been trying to make sense of the term within a private sector frame in a post-New Economy era, though the literature is still fragmentary and inconclusive. In an attempt to move towards taxonomy, Lambert (2003) argues that a business model should both, 'depict the features of the business that distinguish it from others and it should also provide the means by which the complexities of the business can be modelled' (p.4), noting that, for some authors, business model implies, ''methods' by which firms do business' (e.g. Afua and Tucci 2001; Rappa 2003), while for others it signifies 'architectures' (e.g. Timmers) (p.5). At the same time there is debate as to whether a business model is something that firms choose to have, or whether all firms have them and the element of choice is only about whether they are articulated (Lambert 2003, p. 5).

Business school academics have differed about whether and how *business model* adds a new and interesting dimension to established strategy discourse. When Porter (2001) produced a five forces analysis of the internet and the new economy, he criticized the 'loose' business model approach as, 'an invitation to faulty thinking and self-delusion' (Porter 2001: 73). Others, however, have tried to bring business model into established strategy discourse as an add-on element. Zott and Amit (2001) argue that the strategy-structure-performance paradigm can be extended by, 'examining the interaction between a firm's product-market positioning choices and its business model design' (p. 3), where the business model 'is the template of how a focal firm interacts and transacts with customers, partners and vendors' (p. 6); while Christensen *et al.* (2002) use the concept in their analysis of the outsourcing decision. For others, classical strategy already anticipates the idea of a business model. Chesbrough and Rosenbloom (2002) argue that the current (often non-academic) usages of business model are, 'modern variations on Andrews' 1971 classic definition of the strategy of a business unit' (p. 533). In response they offer their own distinctive specification of a business model as, 'a focusing device that mediates between technology development and economic value creation' (p. 532).

Our approach differs from existing usage in that it explicitly focuses on two dimensions which allow us to explore public as well as private sector firms. First, we would note that all firms, whether public or private have a ‘cost recovery’ requirement (Williams *et al* 1995); that is, a responsibility to cover costs by relating expenditure and income over the medium to long term, when the private sector must also deliver a profit or surplus from income. Of course, the measurement of income and expenditure is done on a conventional basis which gives management a degree of leeway in terms of how the numbers are reported. But this flexibility is constrained by Generally Accepted Accounting Practice (GAAP) which formalize and institutionalize the physical act of reporting financial flows at a corporate level and, following Sarbanes Oxley, contravention of these rules could result in a jail sentence for guilty parties. Similarly, aggressive or creative accounting practices which typically recognize profit and bring income forward simply postpone the day of judgement; while payment of the workforce and suppliers requires cash which is difficult to fiddle.

Second, the financial requirement of cost recovery is accompanied by a need to respond to the demands and expectations of key external stakeholders. All firms, whether public or private, are embedded within social networks of obligation where key stakeholders make influential judgements about firm performance and those judgements then have important feedback repercussions on key variables such as share price in the private sector or the assessment of value for money in the public sector. Securing credibility in the eyes of such stakeholders then becomes an integral part of the business model because the private question of *how much* profit or *what kind* of product or service is expected (as well as the variables used to judge firm performance) vary in different contexts, activities and patterns of ownership. As such, we would argue that credibility is framed by both the national and sectoral political economy, because different macro-economic systems, institutional and regulatory structures and corporate governance norms create different sets of key stakeholders with various demands.

For example, the key stakeholders and their demands are different in the German and UK private sector. In Germany a social market (Lane 1992), co-ordinated market (Albert 1991; Hall and Soskice 2001) or neo-corporatist (Crouch 1993) system is characterized by a strong co-ordinating and financing role for banks and, in terms of corporate governance, the representation of organized labour interests via work councils at plant and company level. German business models address the expectations of these key stakeholders which explains the historic importance of performance indicators such as *technik*, market share and employment growth for management. By way of contrast, the ‘market-based’ (Amable *et al* 1997) system of the UK rests on neo-liberal precepts that assert the primacy of shareholders as owners and the capital market as a disciplinary check on management slacking (Allen & Gale 2000; Hall & Soskice 2001). The result is a governance system that aims to align management and shareholder interests around corporate strategies of increasing shareholder returns.

While this ‘models of capitalism’ approach may suffer from a tendency to read all business activity through the lens of complementary national institutions, it does emphasize the importance of understanding the socio-economic context within which corporate strategy is constructed. And the implication is that a business model analysis must identify key stakeholders whose identity and demands will vary in time, space and sector. In this context, the recent and growing Anglo American emphasis on corporate governance structures and regulation in private and public sectors is important because it gives new or existing actors (like pension funds or industry regulators) the power of sanction thereby redefining the constellation of key stakeholders whose demands and expectations in turn influence the structure and goals of the business model. This casts corporate governance in a different light because since Cadbury private sector governance has been officially represented through quasi economic arguments as an institutional device that can improve firm performance for shareholders by correcting management agency problems and preventing malpractice (Cadbury 1992; Greenbury 1995; Hampel 1998. Instead we would argue that, in these terms, corporate governance will often disappoint economically and there is no evidence that it is associated with better performance (see Erturk *et al* 2003) but governance does politically empower new stakeholders whose different demands complicate the business model.

We will now explore this point more fully with reference to the differences between private and public sector business models and how the requirement for financial viability and stakeholder credibility play out differently in each sector.

Beginning with private sector business models, a private sector business model invariably requires financial sustainability so that, in the medium to long term, the firm can recover its costs and show a profit in its accounts (or at least avoid sustained losses which the balance sheet cannot absorb). In the short term in cyclical activities like auto assembly it is entirely possible for firms to move into loss temporarily in downturns without making any major adjustment. But private companies cannot fail to recover their costs of production over a sustained period without some restructuring in the form of the sacking of senior managers and workforce, merger or takeover or even bankruptcy when the limits of borrowing to cover cash flow problems have been reached.

Second, a private sector business model should also enable a firm to meet stakeholder expectations and demands that may set the financial bar higher or add other demands. As noted above, the identity of the key stakeholders and their demands are politically defined and conditioned by the macro-economic system and the regulatory, institutional and corporate governance structures that surround the firm. Yet even under Anglo-American forms of governance, the pressure for 'shareholder value' does not generate uniform expectations and demands because shareholders want different things in various times and places. Thus, in the 1990s, a logical new requirement for rates of return higher than cost of capital (and higher than existing returns) was much emphasized by consultants and academics, but only fitfully required by the capital market (Froud *et al*., 2000) which in the late 1990s rewarded new economy stocks like Netscape which had no earnings (Feng *et al.*, 2001). Similarly shareholder expectations and trading strategies vary by sector so that pharmaceuticals have traditionally been a 'buy and hold' sector whereas the cyclicality of auto assembly encourages short term trading around whatever is not in the price. UK businesses must also heed other key stakeholders because industries operate within institutional frameworks that include regulators whose powers include permission for merger and acquisition, imposing minimum standards for environmental protection as well as more detailed intervention in heavily regulated sectors like healthcare or utilities like transport.

These complications makes the task of management more demanding because, not only must the firm recover its costs of production in accordance with GAAP principles, it must also satisfy key stakeholders who might be stock market analysts with expectations about how high a firm's return on capital should be or pension fund managers who make critical judgments about the firm's narrative of purpose and achievement, or regulatory agencies concerned about, for example, potential abuse of market power or product safety. Thus the business model does not rest solely on financial viability or profit. Business models must also connect with the mutable perceptions and responses of those key groups that influence the engagement of the organisation with its business environment, which includes product and capital markets as well as regulatory agencies. In other words the business model must be stakeholder credible.

Viability and credibility interact and are mediated by narrative, which circulates between firm and stakeholders and can take several forms including company narrative of purpose and achievement, industry narrative and grand narrative of economic transformation as in the case of the new economy. These points are developed in a recent book on giant firm strategy (Froud *et al.*, 2006), which presents extended 20-year analysis of narrative and numbers for pharmaceuticals and the conglomerate GE. In pharmaceuticals it is not enough to deliver starry financial returns if a company has few drugs in the development pipeline and the industry has a tarnished reputation. Thus, the pharmaceutical company Merck, reported in 2004 an operating margin of 29.2%, a ROCE of 16% and a dividend yield of 5.2% in 2004 which bested the S&P500 average yield of 1.7% by some way; yet analysts at Bear Stearns (2005, p.8) pressured the company to further reorganize its research activities to focus on key therapeutic areas and to increase in-licensing deals as a means of supplementing gaps in its drug portfolio. By way of contrast, the US conglomerate GE has avoided analyst and shareholder demands for break up by delivering sustained growth in sales and earnings over the past 25 years as well as presenting a convincing narrative of purposive and achievement so that the market is prepared to forgive the increasingly low return on capital of around 5% that results from a growing dependence on financial services. In each of these company cases shareholder demands and expectations differ, so that the high ROCE pharma company loses credibility and is pressured to adjust its business model, while the low ROCE conglomerate maintains credibility and the management prerogative is retained; and thus demonstrates the private sector business model requires both the development of a convincing forward looking narrative for external stakeholders and a technological, organisational and strategic plan to recover the costs of production.

Moving from the private to the public sector, the key issue within management studies has been the difference and distinctiveness of public sector management in relation to their private sector counterparts. Some like Ring and Perry (1985) emphasized the role of context and constraint in explaining the difference between two distinct modes of management behaviour, whilst others question the distinction by arguing that all organisations are public (Bozeman 1987) or that much of the public sector does not conform to a measure of 'publicness' (Boyne 2002). By way of contrast our business model approach starts from the assumption that public ownership does make a fundamental difference (see also Rainey *et al* 1976) insofar as the absence of shareholders in the public sector ensures different viability and credibility demands which in turn differentiate the organisational business model. We do however see no necessary correlation between the distinctive demands imposed on management in the public sector and different behaviours, since it is entirely possible for public and private sector managers to use identical strategies to secure different goals for various stakeholders. Sale and leaseback, for example, could be used to raise ROCE for shareholders or to reduce public borrowing requirements for the Treasury.

Financial viability (in the absence of shareholders) means the principal requirement for public sector business models is to manage expenditure from (relatively predictable) lumps of income provided by tax receipts or some other state-mediated income. Active product market moves to increase revenues and generate a surplus are generally less important although it is important to recognize that some public sector organisations do have significant sources of income from product markets or property rights, as we shall see later.

Public bodies are normally required to ensure that their expenditure is within the limits set by their income. Equally, it is in the interest of public sector bodies to spend all of their available income, because it is difficult for any public sector organisation to hoard a cash mountain of taxpayers' money. However in some cases the financial requirement is more onerous, as with hospital trusts in the UK where organisations are expected to make a surplus on their income, after meeting operating costs such as labour and materials, in a way that is intended to mimic the private sector requirement for a surplus which *inter alia* covers replacement of the capital employed in the business (Froud *et al*., 1998). Likewise public sector organisations are increasingly fitted up with balance sheets although most have very limited freedom to borrow. The financial performance of public sector bodies is now monitored more intensively and subject to public disclosure and debate; for instance the Audit Commission in the UK publishes an annual survey of the financial performance of NHS hospitals, including the extent to which they have met financial viability requirements.

The generic requirement to breakeven also has different implications for public sector business models depending on the expenditure policies and welfare priorities of the prevailing political regime which can encourage or block whole classes of expenditure, especially on investment. Thus changes in public expenditure regime, such as under the Thatcher governments of the 1980s in the UK, meant that many kinds of capital expenditure were effectively blocked for more than a decade. Under New Labour, buoyant tax receipts and the widespread use of public private partnerships, including the private finance initiative (PFI) in the late 1990s and early 2000s, led to higher levels of spending in areas like education and health where large scale capital projects were now possible.

If financial viability is increasingly important and complex in public sector organisations, securing credibility is increasingly difficult because of the distrust of public administration and management engendered by the politics of the past twenty years. In consequence, the range of stakeholders involved has increased and their expectations have become more explicit and demanding following New Public Management (NPM) initiatives. The recent history of the public sector has been about the adoption of private sector models of management and a move away from the ethos of public administration or professionalism (Box 1999; Newman and Clarke 1994; Keen and Murphy 1996). In particular this change has brought a new rhetoric of audit, inspection and review (Hood *et al* 1999) combined with new performance metrics like value for money which purport to operate in the interests of an absent consumer (Ferlie *et al* 1996). Case studies would seem to demonstrate these developments across a range of different public sector activities and organisations (eg see Currie 1999; Hoque *et al* 2004; Butterfield *et al* 2005), though it is clear that private sector models of management have not been applied evenly across all parts of the public sector in all countries (Pollitt and Bouckaert 2000). The issue of credibility in the public sector then needs to be understood in a post-NPM era where public sector management must operate business models that respond to the political sponsorship of new groups of stakeholders whose expectations have become increasingly challenging since the mid 1990s (just as financial constraints have eased in many cases).

Traditionally the major stakeholders in public sector services included trade unions and organized labour, which, by the late 1970s, were seen increasingly as a problem or the problem. The subsequent political attempts by Conservative and Labour governments to inflect a consumer rather than a producer focus into public service delivery has implications for many public sector organisations which must now re-orientate their activities and narratives around new but more dispersed groups of stakeholders. Under these new arrangements, the workers within public sector organisations have (officially) ceased to be the key stakeholders they once were, and so the business model concept has a temporal dimension that recognizes change over time. There are also specific problems arising from the fact that the public sector generally provides services whose quality is inherently much more difficult to define and judge than would be the case in the private sector where financial returns from sales in the market place provide some kind of yardstick which a small community of instrumentally oriented investors can generally agree on.

This has contradictory and complex results because much public service provision has distinctive social aims which cannot be easily or wholly reduced to simple measures of efficiency or value for money and these social aims (plus efficiency) are increasingly specified and operationalized by regulators and inspectors acting as proxies for an absent consumer who has no direct representation through political process or market action (Miller, 2005). Thus, the outcome of more than two decades of public sector initiatives in the UK and other countries aimed at making the public sector more accountable has been a quite spectacular formalisation of stakeholder expectations and demands which have been made explicit through the drawing up of detailed goals and defined targets.

The consequence has been a vastly expanded apparatus of control and regulation bearing on the public and private sectors. Power (1997) constructs this as part of an 'audit society' and Moran (2003) reads it as part of an expansion and mutation in the form of the 'regulatory state'. In the presence of private sector market power and in the absence of real 'markets' across much of the public sector, the institutional framework around public sector organisations has become more complex and difficult to navigate. As Moran (2003) cogently argues, the paradoxical result of privatisation and marketisation is not neo-liberalism and the rule of markets but a huge expansion of regulation inside and outside the public sector which all represents a process of 'hyper-innovation' by a British state whose regulatory practices had previously changed very slowly. The results include organisations like the Financial Services Authority and OFCOM whose powers and activities are enhanced by the development of new performance requirements.

In this world, we can no longer assume that management in the public sector is inherently and always easier because the state provides revenue without constraints. The business model for a public sector organisation may make the task of management no less challenging than in a private sector corporation under the glare of stock market analysts and commentators from the financial press. Yet, as Pollitt and Bouckaert (2000) observe it is important to be sensitive to the different way in which these pressures have affected different parts of the public sector and as such to understand the specific context within which any public sector organisation operates. Hence, the next section considers the context of viability and credibility for the BBC before the fourth section explains the BBC's current business model problems arising from the shift into digital.

3. The context of viability and credibility for the BBC

Any application of the business model concept to a specific case has two phases; this section provides the first phase by outlining the context of financial viability and stakeholder credibility for the BBC; while the next section of our article in a second phase analyses the logic of management moves within this context. In this case study of the BBC we have combined evidence and argument from different public sources on the two distinct contextual elements and then on management moves. Thus, analysis of financial viability used mainly long run data drawn from the BBC's company accounts. These company accounts were then reworked into time series form and the figures deflated to ensure that like-for-like year on year comparisons were possible. Meanwhile, the analysis of stakeholder credibility aimed first to identify how recent changes in the form of regulation and corporate governance within and around the BBC had politically constructed new actors to whom the BBC must now accede. Second, the analysis of credibility focuses on examining the increasing formalisation of stakeholder demands on the BBC in the form of quotas and other new performance measures.

Our method starts from public evidence and argument, which we use first in outlining context before turning to analyse the logic of management moves. The sources include company report and accounts as primary sources because they were produced *at the time* and do not involve authorial synthesis and interpretation of other (primary) documents after the event; our position here is in line with historiographic orthodoxy as outlined in Gray (1964) or Howell and Prevenier (2001). We could have gone one step further and generated material through semi-structured interviews which, in principle, could provide valuable direct evidence especially about stakeholder motivations and management calculation about restructuring. Our decision not to interview at this stage reflected the conviction that our sources allowed an adequate analysis of financial and socio-cultural context from which we could understand the logic of management action within a business model approach. While interviews might provide useful material for future research, as Armstrong (2004) cogently argues, case studies largely based on interview can be problematic where they (often uncritically) reproduce dominant management narratives and representations of change.

We now begin our analysis of context by considering the BBC's sources of revenue, especially the licence fee, before turning to governance issues and the formalisation of performance requirements by regulators. In terms of formal requirements for financial viability, the BBC must achieve breakeven over the long term; and it must also manage its cash resources without significant borrowing because the Royal Charter limits the size of its debt to £200m (Project Finance 2004, p.1). The BBC's primary source of income is the licence fee, currently £126.50, which is effectively a flat rate tax set by government and levied on television-using households (with exemptions for the over-75s and the blind). In 2004 this produced an income of £2,798 million, which the BBC does not have to share with other organisations. Unlike many other public sector organisations, however, the BBC does have access to commercial income from the market to supplement its core licence fee funding. Following publication of *The Future of the BBC: A Consultation Document* (Department of National Heritage, 1992) the corporation was encouraged to expand its commercial activities as a source of income and cash.

The BBC thus operates a commercial arm, whose major subsidiary is BBC Worldwide which brings in income from the sale of magazines, toys and other merchandise, as well as through the exploitation of property rights over programming domestically and on the global market. By 2004 BBC Worldwide was Europe's largest exporter of audio-visual material, and in the last five years sold in excess of 140,000 hours of BBC programmes to 80 different broadcasters in 100 different countries around the world. In 2004/2005 BBC Worldwide increased profit before interest and taxation to £55million, up from £37million in 2003/2004, whilst revenue increased from £657million to £706million, so that Worldwide returned £145 million in cash back to the institution (BBC Annual Report And Accounts 2004/5, p. 67). The BBC also runs a magazines business which is the third biggest in the UK with one in five UK adults regularly reading a BBC magazine (DCMS 2004, p. 3) This is built on the established success of the Radio Times as a listings magazine and now includes lifestyle and enthusiast spin offs from many BBC programmes.

Nevertheless, the licence fee is far and away the largest source of income for the BBC and its level is set annually by the Secretary of State for Culture, Media and Sport. Despite the move into commercial services, by 2004 the BBC still received 74.3 per cent of its revenue in the form of the flat rate licence fee (BBC Annual Report and Accounts, 2004) collected and enforced by TV Licencing (an autonomous arm of the BBC) or outsourced to companies like Capita. A further 8.6% comes from the Foreign and Commonwealth Office and other income, so that Commercial Services account for just 17.1% of the BBC's total income after subtracting intra-company transactions. The key conclusion must be that the growth in commercial activities has not released the BBC from its dependence upon central government as paymaster by proxy which both maintains the licence fee system and determines whether the licence fee will be increased above or below the rate of inflation. Thus whilst the BBC on the surface would appear to differ from other public sector organisations, which are funded mainly by taxation (Walmsley and Zald 1973) and controlled by the state (Dahl and Lindblom 1953), the outcome is still remarkably similar.

The BBC's traditional governance structures were designed to maintain a notional separation between government and the official national broadcaster, and until recently these structures allowed greater autonomy than in other parts of the public sector. The BBC was established in 1927 with a constitution based on a Royal Charter and a Board of Governors with supervisory powers over the Executive Board who ran the day-to-day business of the corporation. By the 1980s it was widely believed that the outcome was a BBC run by and for the producers themselves, and the Peacock Report in 1986 enforced a new consumer-led focus on the corporation (Borne 2004, p.50). However it was still to take a further 11 years before regulatory pressure for greater transparency and accountability finally enshrined the precise functions and duties of the BBC Board of Governors in the Charter for the first time (BBC 2004, p.123).

Formally, the Board of Governors were charged with acting as guardians of the listeners' and viewers' interest (BBC Annual Report 2003/4, p. 6), including making recommendations to the BBC's executive board and notionally reporting to the public via the annual report. The Governors and senior BBC management were expected to take actions to promote and deliver public service broadcasting (PSB) which implied something different from what would have happened if the BBC had been a profit-making organisation owned by a media magnate or conglomerate. But this requirement was never onerous, as long as official reports eschewed formal definition of PSB, as in the 1999 Davis report which concluded that, 'we may not be able to offer a tight new definition of public service broadcasting, but we nevertheless each felt we knew it when we saw it' (DCMS, 1999).

By the early 2000s, all this was increasingly anachronistic. The role of the governors was quite unlike that of PLC directors in the private sector system of proceduralized governance created after Cadbury (1992) while the rest of the public sector was subject to explicit performance targets. The immediate catalyst for changes in governance structures was a break down of relations with the Labour government over the Iraq war occasioned by an interview on the Today programme. The BBC's scepticism about the prospectus for the Iraq war and its refusal to endorse triumphalism led to a crisis and official inquiry followed by the departure of its director (or chief executive) and the abolition of the Board of Governors.

The Hutton Report explicitly questioned the Board of Governors' ability to act impartially[1] and unsurprisingly the 2005 Green Paper Review of the BBC's Charter then recommended that a 'Trust' or supervisory board replace the Board of Governors with a clearer demarcation between it and the Executive Board (DCMS 2005, p. 64). The 2006 BBC Annual Report and Accounts (p.7) explain that this Trust will now be, 'the body responsible for the strategic direction of the BBC (and) will scrutinize the strategies put forward by the Executive Board', enforcing this with 'Purpose Remits' which set out objectives for the Executive Board and issue 'Service Licences' detailing the budget and remit of each BBC service (p.9). In addition to this, a 'Performance Measurement Framework' has been established which aim to assess the BBC's performance over four variables: reach, quality, impact and value for money. OFCOM has also been granted new powers to conduct a public value/market impact assessment of any new commercial venture by the BBC under the principle that the BBC would only be allowed to progress the project if the public value added by the service outweighed any negative market impact.

The BBC is also governed by Office of Fair Trading competition regulations over non-broadcasting activities like rights issues and by the European Union over fair trade. The BBC's performance is also monitored in select committees in both houses, to whom the Trust will now report regularly. Thus the BBC now has modernized, multi-layered regulation and governance arrangements and a set of independent and external stakeholders charged with representing the consumer. In terms of outcomes for the BBC, it is undoubtedly the case that this attempt to reform governance, accountability and regulation will add new stakeholders, increase demands for (often contradictory) financial and cultural goals and give regulatory agencies greater power of censure (see OFCOM 2005)

What then of public service broadcasting? If the concept remains elusive, the new received wisdom is that it can be practically measured through a variety of ratios and performance indicators. A key document here is OFCOM's *Measuring Public Service Broadcasting Report* which contains a section titled 'Defining PSB' that does nothing of the sort but instead proposes a procedure or set of steps through which consumer wants can be ascertained and market developments predicted (Foster *et al*., undated, pp. 4-8). This approach goes hand-in-hand with an increasing formalisation via targets and ratios, as well as a more interventionist approach to the BBC's relations with other producers and distributors of broadcasting content, especially via the 2003 Communications Act. The resulting framework of quotas is outlined in table 1, which explains that the BBC now has a variety of formal obligations to originate content (including regional content), as well as make room for independent productions to be shown on the BBC's channels.

Table 1. Production quotas for BBC1 and BBC2 broadcasts in 2004

Quotas (% of hours)	*BBC1*	*BBC2*
Independent production[i]	25%[ii]	25%
Original production[iii]	70%	70%
Original production broadcast in peak	90%	80%
Regional production % of hours[iv]	25% across all BBC channels	
Regional production as % of spend	30% across all BBC channels	
Regional programmes made in and for the region	95% BBC1 and 2 together	
European original production[v]	50%	50%
European independent production[vi]	10%	10%

Source: OFCOM, (2005, p.7)

Notes:

i) DTT channels are also required to fulfil an independent production quota of 10%. The definition of 'independent production' excludes repeats, news and acquired programmes

ii) BB1, BBC2 and BBC3 each have to achieve 25% independent production separately, and all BBC channels need to achieve the 25% quota collectively

iii) Original production, by this definition, includes repeats

iv) Regional production consists of network programmes made outside the M25, including repeats

v) The Television Without Frontiers Directive excludes news, sport and game shows from the quota for European Programmes

vi) The same quota applies to all digital channels where practicable

While the changes in governance and regulation and the specification of explicit targets and quotas are coherent with public sector reform agendas more generally, they do not so much solve the problem of the BBC as complicate the whole process of judging whether or not the BBC is delivering on its PSB obligations. The complications have several causes. First, insofar as the BBC has several different quota targets, it is likely to meet some and miss others. In 2003, for example, the BBC missed the 25 per cent quota for independent productions (*Financial Times* 31 October 2003); but there is then no clear principle for weighing success by one criterion against failure in another, so the addition of extra ratios in the end will arguably undermine the approach more than discipline the BBC. Second, under the current regime the BBC is set no clear objective for audience market share and popularity of programming. This significant omission reflects the contradictory and incoherent nature of expectations, which led an earlier generation to avoid defining PSB. Thus the BBC needs high ratings and mass audiences to legitimate the flat rate tax licence fee, but at the same time audience-chasing popular programmes are criticized particularly by its industry enemies who would wish to confine the BBC activities to areas of market failure such as arts or regional programming.

This ratings dilemma over PSB intersects with the perennial political problem about independence and bias highlighted by the crisis over the Iraq war because the BBC must demonstrate its independence by producing news and current affairs content which is responsibly critical of the government in power and also expect that same government to give it a continued mandate for licence fee funding and strategic development. Thus, the BBC will usually be under attack from aggrieved critics who seek to redefine and restrict its activities and can do no more than please some of the stakeholders some of the time.

Such regulatory pressures and reorganisations of corporate governance structures are not new in the public sector, however the BBC is something of a special case because it is not so much a public sector organisation as the last of the giant public corporations with a level of employment, income and expenditure under one management which is far greater than in other public sector operating units such as hospitals or schools. In 2004 the BBC employed some 27,000 staff, received income of £3,767.9m and spent £4,001.6m. The distinctiveness of the BBC means this case has limited direct, transferable lessons for other parts of the public sector. On the other hand, the business model framework allows similarities and differences between organisations to be identified and analysed allowing a more nuanced understanding of the texture of the 'public sector' in terms of organisational and financial structure, as well as the different expectations of disparate key stakeholders. Hence the centralisation and vertical integration of public broadcasting within one corporation has historically made it easier for the BBC to control expenditure and balance its books than for the NHS which operates through a multiplicity of trusts which collectively overspent by £752.6m in 2005 (*Guardian* 11 February 2006). It now remains to be seen whether developments in the broadcasting market, most notably the growth of the digital sector, mean that this trend is likely to continue.

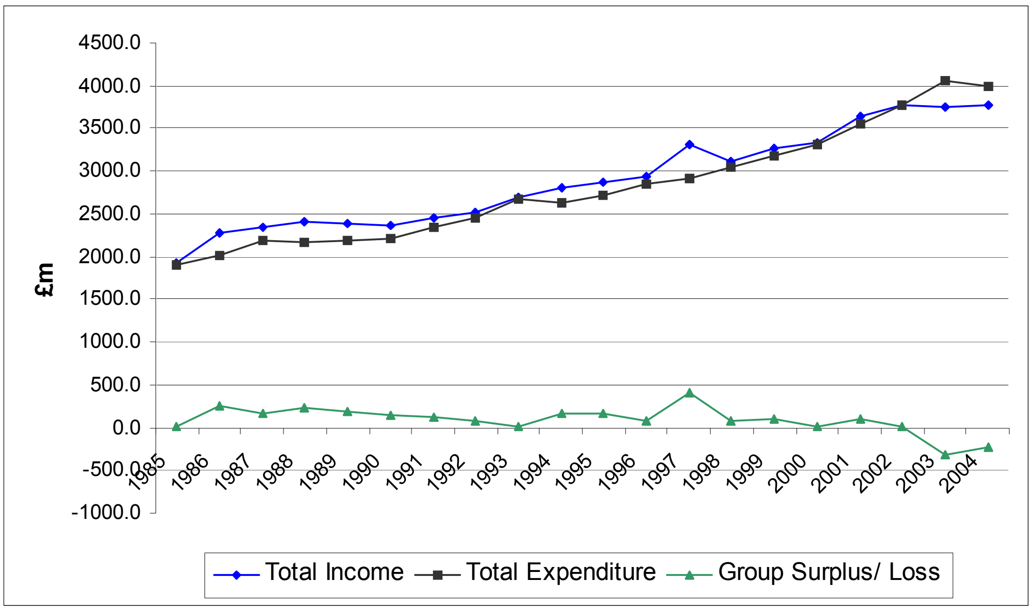
4. Stressed by choice: the BBC's business model in the digital age.

With context established, this section presents a business model analysis that highlights the current interaction between viability and credibility and explains the nature and implications of the financial problems which require restructuring to shed labour so as to improve credibility. There is no huge BBC deficit arising from gross imbalance between the BBC's income and expenditure but we would argue there is an underlying post-1998 problem about the expansion in broadcast hours resulting from the creation of new digital TV channels; and this overlays another longer standing problem about the rising purchase to sales ratio which is a consequence of the regime of enforced outsourcing. These problems stress the business model's financial viability and motivate the Thompson programme of restructuring and job cuts which (within a new political context) is an attempt to control costs in a way that creates the financial headroom for the programming necessary to sustain credibility.

If we begin by considering the trend of the BBC's real income and expenditure, the organisation appears to be in a comfortable position at the end of a trajectory of sustained income growth. As figure 1 shows, the (real) income of the BBC more or less doubled from £2 to £4 billion and the BBC then acted in a public sector way by spending more or less all of its income. Thus, figure 1 indicates that any surplus is usually less than 5 per cent of income and in some years (1992-3 and 2002-4) there is a deficit. Overall, from an income perspective the BBC has been on a fairly comfortable growth trajectory since the mid-1980s and although the BBC has sometimes incurred small deficits, income and expenditure are generally in balance around the breakeven point so that, in these terms, the business model does not appear to be stressed. But, whereas imbalance between income and expenditure is one nearly infallible indicator of stressed business model, it is not the only indicator; and, in this case, we would argue that the BBC has subtler problems.

The trend of BBC income does not reflect a generous income settlement under successive Conservative governments up to 1997: in constant 2004 prices, the licence fee was £110.93 in 1986 and just £108.64 in 1997. But the Conservatives encouraged the expansion of the BBC's commercial services after 1992 and the BBC benefited considerably from demographic changes which increased the number of households and from improved collection systems which reduced evasion (DCMS 1999, p. 47); the number of licences issued increased from 19.7 million in 1993 to 21.5 million by 1997. New Labour was more generous about the licence fee, albeit in a conditional way. In 2000, the Secretary of State for Culture Media and Sport, Chris Smith, introduced an RPI plus 1.5 per cent formula for year by year licence fee increases to allow the BBC to invest in preparations for switching off the analogue signal and facilitate the move to digital (DCMS 2000b, p. 8). The Treasury of course hoped to make money by auctioning off the analogue spectrum after digital switch off in 2010 (*Financial Times* 30 October 2002).

Figure 1. The BBC's income and expenditure 1985-2004 £m (in 2004 real values)



Source: BBC Annual Report and Accounts, various years.

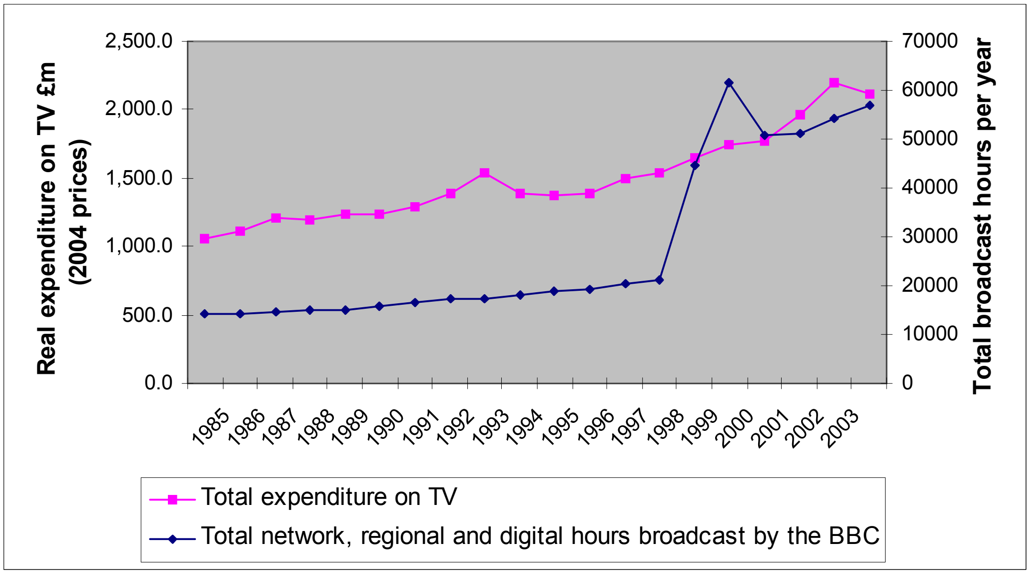
Note: Income = all income from PSB/Home Services, World Service, Commercial Operations plus all other income gained or lost from: share of operating surplus of associates and joint ventures, sale and termination of operations, profit/loss on disposal of fixed assets, net interest payable/receivable, other finance income and minority interest. Expenditure = all expenditure on PSB/Home Services, World Service, OU production centre plus Commercial Operations.

The BBC's options were closed in 2002 with the collapse of the terrestrial ITV venture OnDigital (see *Financial Times* 30 April 2002) whereby the BBC became the champion of digital. This was a huge strategic opportunity because the BBC could now defend its position as the premier national broadcaster in a multi channel world where its two-channel share of mass audiences would inevitably be eroded. The price was that this immediately increased the number of programming hours required because the BBC as two channel and regional output producer quickly acquired an extra two new niche channels (BBC 3 and 4) two childrens' channels and a rolling news service. As figure 2 shows, the number of programming hours almost trebles, from around 20,000 in 1998 to over 50,000 from 2001 onwards. As figure 2 also shows, the increase in expenditure on television is much less marked, with a real decline in 2004. The implication of figure 2 is that the average expenditure per programming hour must have declined. This is demonstrated in figure 3 which shows that the BBC's real average spend per broadcast hour declines from £73,009 in 1998 to just £36,966 in 1999.

This decline in spend per hour reflects the fact that some of the extra digital hours, like rolling news, were inherently very cheap. The BBC's costs per hour for its own originated, digitally distributed news and weather programmes are extremely low at just £4,500 per hour, compared with £70,100 per hour for music and arts programming, £171,900 per hour for entertainment programmes and £316,300 for drama programmes distributed via their digital platform, i.e. not on BBC1 or BBC2, where the costs are even higher (BBC Annual Reports and Accounts, 2004). The rest of the adjustment was met by repeats from the BBC's back catalogue or with filler such as cheap format reality TV shows. In 2004, of the 8,664 hours of programming broadcast on BBC2, 4,771 hours were *not* original productions, which represents the equivalent of 199 days of consecutive TV which has all been shown somewhere else beforehand (*The Times* 20 July 2005). While BBC2 produced 699 unique programme titles in 1993, this had fallen to just 439 in 2002 (Bergg, 2004, p. 11). According to *The Guardian,* repeats are also creeping into prime time slots: almost 1 in 10 programmes shown on BBC1 during peak hours is now a repeat, with the volume rising sharply during the summer of 2005 (*The Guardian* 19 July 2005). As well as repeats, the BBC has changed the composition of some of its popular programming. This is partly the result of Sky pricing the BBC out of the market for rights to blockbuster films and sporting events, but it also reflects the BBC's increased use of reality TV, makeover shows and the use of independents to produce cheaper programmes: independent productions account for only 11.1% of the value of the BBC's originated programmes despite their 25% volume quota share of programme hours (PACT, 2004, p. 23).

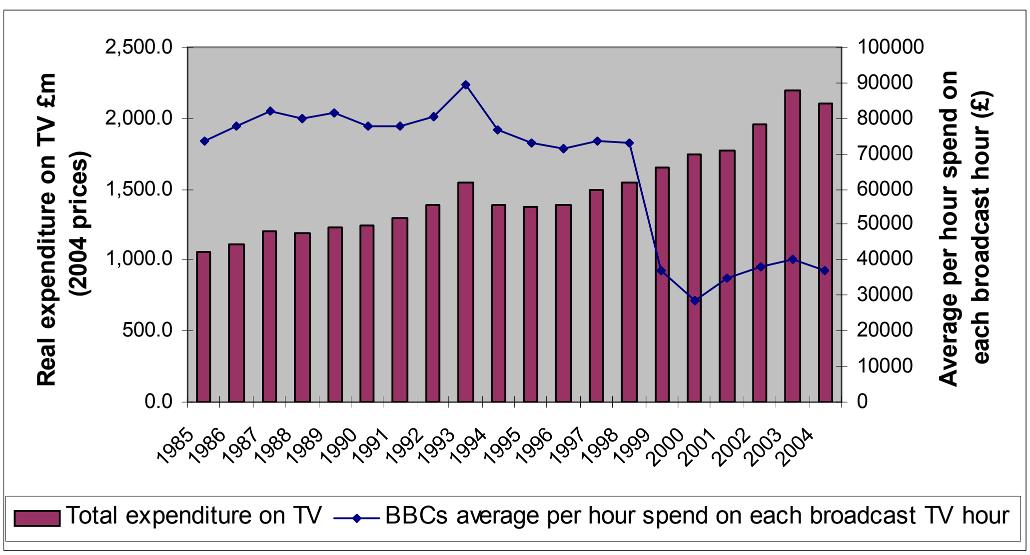
Thus the BBC adjusted to the challenge of digital as any private sector operator would do: the BBC met the requirement for more hours by changing and cheapening the programming mix so that it maintained a balance between income and expenditure and thereby safeguarded financial viability. But its consequent and distinctive public sector problem is credibility because its stakeholders expected a prestige PSB broadcast service and there was no mechanism for adjusting stakeholder expectations about output to the available programming spend. A report for the DCMS during the Charter Review period found that the viewing public wanted more and better sport, comedy and costume dramas (Cragg Ross Dawson, 2005, p. 25). The inexplicitness of the business model then compounded the confusion because the Governors endorsed such demands and insisted the BBC could and should do better. In 2004 the BBC's Board of Governors pressed the Executive Board to reduce the number of makeover programmes and increase arts and current affairs coverage during primetime (BBC Annual Report and Accounts, 2004, p. 27). In 2005, the Board of Governors' annual report singled out the number of repeats on the BBC as a key indicator of low quality (BBC Annual Report, 2005, p. 17) and demanded a reduction in peak time repeats below a 10 per cent ceiling (p. 19; p. 24). The BBC's chairman, Michael Grade, then promised to make BBC1 and BBC2 'repeat-free zones' (*The Times* 19 July 2005) which strictly would require 7,000 more hours of new, original programming each year (*The Times* 20 July 2005).

Figure 2. The BBC's total programming hours (network, regional and digital) and its real expenditure on television (£ million in 2004 prices)



Source: BBC Annual Report and Accounts, various years.

Figure 3. The BBC's total expenditure on TV broadcasting, compared with the average expenditure per TV broadcast hour (all in real 2004 prices)



Source: BBC Annual Report and Accounts, various years

The story of the BBC from 1999 to 2005 is about how a crisis of viability was avoided at some cost in terms of credibility in a climate of increasing fantasy about what the BBC could provide by way of hours of quality programming from its limited resources. The business model pressures were more intense because the crisis about digital hours overlaid another long standing series of tensions arising from the BBC's involvement in a regime of compulsory outsourcing where the vertically integrated corporation was forced to buy in programmes from independent producers and then increasingly prevented by regulation from using its power to exploit its subcontractors.

It is important at this point to distinguish between private and public sector outsourcing. Outsourcing for the giant private sector firm is a voluntary and pragmatic decision whose financial motivation is profit through cost savings obtained from some combination of lower wages, avoidance of corporate overhead and market power exercised by the large corporate customer. Back in the 1980s, when the Conservatives pressed compulsory outsourcing of local government services like refuse collection under a competitive tendering system, the mimetic public sector decision principle was whether the private contractor could deliver more cheaply. But that single decision principle was explicitly dropped after 1997 by New Labour for the whole of local government under its 'best value' scheme and the BBC operates under a different regime of sector specific system of compulsory outsourcing whose increasing safeguards for the contractor must either increase the BBC's costs or diminish its revenues. As we have already noted, the BBC is obliged to outsource 25% of the hours on its two mass audience channels (BBC 1 and BBC2). And, in response to lobbying by independent producers, the terms of the standard contract which originally favoured the BBC has been amended, with new Codes of Practice mandated by the Communications Act 2003. These changes prevented the BBC, as well as other broadcasters, from treating independent producers as labour only subcontractors and subsequently pocketing most of the profits from secondary rights when programmes are sold onto other networks.

The implications for the task of BBC management are straightforward in ratio terms. Under a regime of compulsory outsourcing, what BBC management must do is adjust to an increasing claim of external purchases on income by making appropriate adjustments in the internal labour costs of a previously vertically integrated corporation. Income and expenditure can be balanced if the rising share of external purchases in income can be offset by internal labour cost reduction, with the extent of the squeeze depending of course on the trend of absolute income. These shifts can be tracked in the BBC's accounts which show the purchase to income ratio does rise: as table 2 shows, it increases from 51.5 per cent in 1990 to 59.4 per cent in 1997 and upwards again to 65.6 per cent by 2004 so that cumulatively there is a large rise in external purchases. This was the result of outsourcing of some 'non-core' business functions plus buying in a variety of programmes.

In the period up to 2000, the BBC management did what it had to do on labour costs and the task was relatively easy. But, after 2000, the task got much harder because, at the same time as the BBC moved into digital, numbers employed increased to the point where the corporation's wage bill could not be covered by the money left after external purchases had been paid for. Between 2000 and 2004, numbers employed increased from 24,639 to 28,873 and the real average labour cost increased from £43,958 to £46,618. On publicly available information, it is not possible to make any judgement about whether these increases in head count and wages were necessary or good value for money given the extension into digital and the expansion into commercial activities. We cannot endorse press claims that Greg Dyke, the director prior to Thompson, caused the BBC's deficit by irresponsible expansion (e.g. *The Times* 2 Dec 2004) because the numbers employed under his management and labour costs as a percentage of total operating expenses were in fact much higher in the mid 1980s. What is certain is that labour costs did not create an immediate crisis about large deficits that threatened the BBC's viability in the short term, but the average labour share of internal costs for years 2000 to 2004 was 100% and that was simply not sustainable going forward.

In this context, the internal headcount reductions proposed as part of Thompson's restructuring plan are an attempt to pull the only available cost reduction lever in the hope that redundancy will within a year or two free up cash for programming budgets, which may also help deal with external credibility issues. Workforce reductions, however, are rarely straightforward cost-savings: they may have implications for either the range or quality of outputs produced, or lead to self defeating increases in purchases of sub-contractor services to substitute for lost in-house expertise.

Table 2: The BBC's cost structure and employment, 1985 to 2004

	External purchases as a % of incomes	Labour cost as a % of internal cost	Operating margin % (negative figures indicate a deficit)	Employee numbers	Real average labour cost per employee (2004 prices, UK£)	Labour costs as a % of total operating expenses
1985	48.5	88.3	0.0	30,036	28,950	50
1986	46.0	75.1	10.8	30,393	30,299	55
1987	50.8	83.9	5.5	29,800	32,077	52
1988	50.7	82.7	6.0	28,892	32,939	52
1989	50.3	81.6	5.4	27,974	33,676	49
1990	51.5	83.3	3.7	28,690	32,441	49
1991	54.6	83.0	3.3	28,524	31,622	45
1992	53.6	82.3	3.1	28,321	33,705	43
1993	56.5	84.8	0.8	26,375	37,249	35
1994	53.2	73.6	6.8	25,254	38,304	36
1995	53.9	73.4	6.0	24,962	38,933	34
1996	57.7	76.8	3.2	25,415	37,887	33
1997	59.4	74.3	3.0	24,401	37,010	30
1998	65.3	83.4	0.1	23,556	37,452	29
1999	63.1	78.5	1.4	24,427	38,181	29
2000	61.6	85.5	-0.7	24,639	43,958	33
2001	63.7	94.8	-4.1	25,616	45,826	33
2002	63.7	96.2	-5.1	26,993	46,460	33
2003	69.2	116.2	-11.5	28,650	45,548	32
2004	65.6	105.5	-8.0	28,873	46,618	34

Source: *BBC Annual Report and Accounts, various years*

Notes:

i) Income = all income from PSB/Home Services, World Service, OU production centre plus Commercial Operations plus all other income gained or lost from: share of operating surplus of associates and joint ventures, sale and termination of operations, profit/loss on disposal of fixed assets, net interest payable/receivable, other finance income and minority interest.

ii) Expenditure = all expenditure on PSB/Home Services, World Service, OU production centre plus Commercial Operations

iii) Employee figures include employees for BBC Home, BBC Worldwide, OU Production Centre, BBC Orchestra and singers on programme contracts and BBC Commercial activities on full time, part time and casual basis.

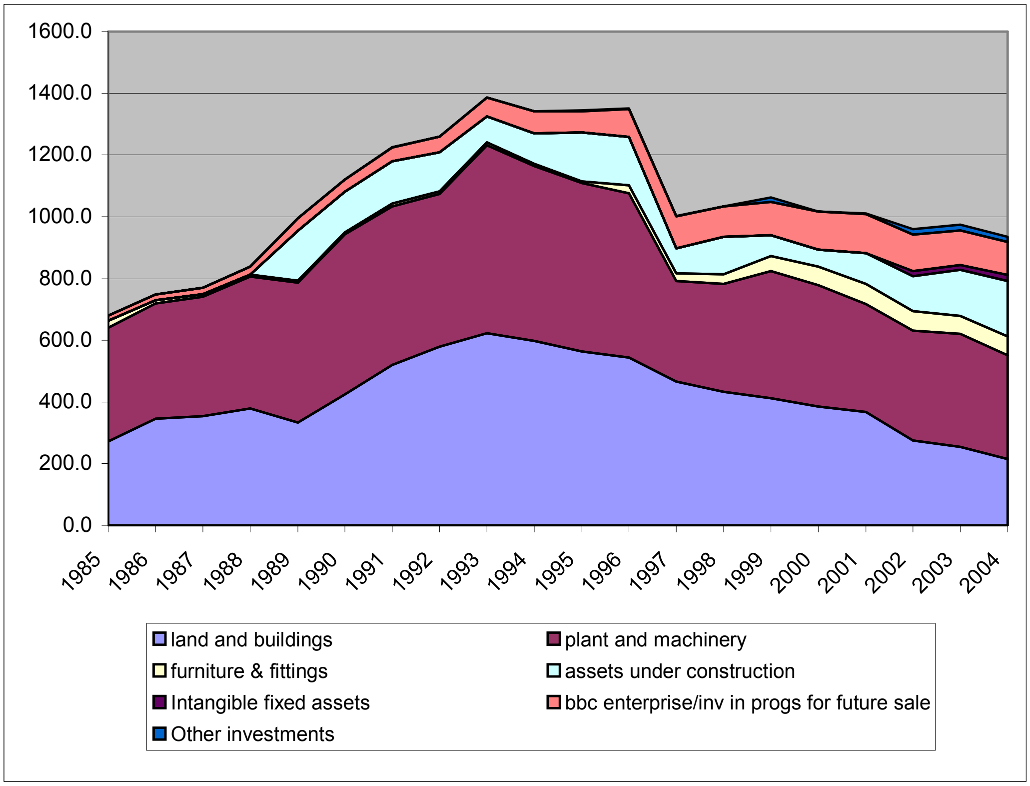
iv) BBC Orchestra and singers, BBC casuals and BBC part time employees measured as full time equivalents

v) Employment figures used are, 'average for the year'.

There is no alternative because the BBC has already pulled other levers and after 1995 made very limited, one-off gains from reducing the asset base to release cash through disposals, outsourcing non-core activities and financial engineering. The BBC has sold off businesses including BBC Technology, its IT arm, which went to Siemens for £150m in October 2004 (*Financial Times* 2 October 2004); while BBC Broadcast, its digital transmission business, was sold to Australian bank and infrastructure group Macquarie for £166m in August 2005 (*Financial Times* 28 June 2005). The BBC has also outsourced much of its property maintenance, which include setting up a joint venture with Land Securities Trillium for the upkeep and renovation of the White City building and 65 other buildings in a deal that was expected to net the BBC an extra £35m in cash to invest in programming (*Financial Times* 18 September 2001). This case also highlights how a pressured BBC is now increasingly willing to use financial engineering to boost cash and circumvent regulatory restrictions, much as private sector companies routinely do. The 30-year arrangement with Land Securities Trillium for the upkeep of White City was recently scrapped because the BBC found that its AA credit rating meant that it could refinance the deal with a low-interest bond *(The Times* 13 May 2005). This not only worked out cheaper but also did not breach the terms of the BBC's Royal Charter which caps borrowing at £200m because a bond issue is classified as an operating lease rather than as financing (*Project Finance*, July 2004, p.1).

The net result, as figure 4 shows, is a changing composition of fixed assets with a reduction in the real value of land & buildings and plant & machinery by 2004 to less than that of 1985. Overall, after the restructuring of the 1990s, the BBC's asset base shows only a fairly small increase over the mid-1980s, despite the investment in new digital technologies. One-off financial engineering moves generate cash to help solve this year's problem (though they may also lead to leasing charges in future years) but only labour share reductions will change the ongoing financial characteristics of the business model. Financial engineering adjustments are, on balance, more an indicator of business model stress rather than the solution to that problem.

Figure 4 The composition of the BBC's fixed assets, 1985-2004
(all in real 2004 prices, £ million)



Source: BBC Annual Reports and Accounts, various years

It is now easy to see why the Thompson restructuring is an attractive move for BBC managers aiming to keep the organisation out of crisis. Whether this works partly depends on the arithmetic of how many go and on what terms, and partly on how hard OFCOM from the outside and the new trust on the inside push the BBC to deliver increased proportions of quality cultural outputs at the same time as it meets all its other obligations and targets. If they push really hard, the BBC's business model is not so much stressed as unsustainable or, more exactly, unsustainable without major conflict with the internal workforce over pay and conditions as well as head count. Thompson's restructuring initiative represents a gamble that this can be avoided in an organisation which has survived Charter Review but has business model problems so that it would be wrong to suppose that everything will now go on much as before for another decade.

5. Conclusion

This paper has presented a public sector business model analysis, which makes explicit the connection between financial viability and political credibility. We have argued that this approach provides a useful way of understanding public sector business choices and management strategies. As such, the approach, method and conclusions complement a book length study of giant firm strategy which explains how private sector management strategy involves narrative and numbers (Froud *et al* 2006). The usefulness of the business model is also apparent in considering the implications for regulation and, in particular, it highlights the social need for a new kind of regulation. Regulatory structures and mechanisms are themselves increasingly stressed as regulators struggle with the problems and limits of mainstream economics-based approaches. In too many cases, the result is more of the same because such economics provides a set of default principles. Thus, the ‘public value test’, proposed in the Green Paper on Charter Review is effectively just a market impact test; while OFCOM’s document on measuring PSB focuses on the need to strike a ‘Third Way’ between ascertaining consumer wants through audience research and interviews with experts on behalf of consumers and plugging market failure (Foster *et al*., undated, p. 5).

Mainstream economics no doubt has many uses, but its preoccupations with markets, consumer choice and corporate power do not help us to understand public sector business choice and management strategy because it entirely misses the point about political credibility and the interaction between composition of costs and the politically sponsored expectations of key stakeholders at the business level. The inevitable consequence of economics-based regulation is that policy makers try to regulate aspects of corporate behaviour without realising that these are often symptoms of business model pressures, and not necessarily market characteristics that can be modified. The implication of our argument is that regulation should be reflexive and flexible rather than a dogmatic and rigid attempt to make the world more like economic textbooks; and, in our view, this reflexive element can be added by making the business model (not the industry or the market) the object of regulation. It also provides a new heuristic for future management research into public sector organisations, where the balance of financial viability and stakeholder credibility is often problematic. Thus, the public sector business model concept directly allows academics and regulators to think through and understand business choice and management strategy and indirectly helps to create a new space for citizens to think about what we want socially and how we might organize and regulate corporations to make sure those goals are met.

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[1] The Hutton Report’s conclusion was that, ‘the Governors should have recognised more fully than they did that their duty to protect the independence of the BBC was not incompatible with giving proper consideration to whether there was validity in the Government's complaints… (T)he Governors themselves should have made more detailed investigations into the extent to which Mr Gilligan's notes supported his report… (T)he BBC should publicly acknowledge that this very grave allegation should not have been broadcast’, The Hutton Report (2004), Chapter 8, section 291, paragraph 5.

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