

## **DISCUSSION PAPER: Systemwide Financial Analysis**

June 4, 2003

### **Introduction**

What makes public television distinctive? We all have our own answers. Some might point to the extraordinary non-commercial programming that offers Americans entrée into the worlds of arts, science and public affairs. Some would say our programming and services for children, or teachers, or learners of any age. Others would note the broad outreach and educational efforts that accompany our programming, or the depth of additional information and resources that are available to viewers. And still others might focus on local stations and their service to the communities in which we live and work – the partnerships we've forged, the local programming we provide, our involvement in community affairs, the service we render every day.

Every one of these efforts is important. Whatever our particular area of interest and commitment, we - and the vast majority of the Americans whom we serve - agree that public television is a unique and valuable resource, one worth preserving and strengthening over the long run. In other words, we understand and support the vital mission of public television.

But critical as it is, mission is not the issue this paper is intended to discuss. Neither are the demographic and technological changes that will likely transform our role in the years and decades to come. In fact, our best ideas about rethinking and transforming public television's role in today's changing environment may never see the light of day - unless we deal first with the fracture that runs through our entire financial structure and threatens both our national and local operations. So this paper is not about what public television does, or what it should do. **This paper is solely about how public television can and will pay for what it does.** Our task is to improve our financial prospects and the outlook for our enterprise, to ensure that we will continue to provide our vital service to the public.

### **The Process to Date**

This paper summarizes the results of a system-wide review and planning effort begun at CPB with the assistance of McKinsey and Company last fall. A 14-member steering committee, which includes station representatives, CPB, PBS and major producers, directed the initial analysis and crafted the discussion paper containing preliminary findings for system consideration.

In March and April, representatives of 110 stations joined with CPB, PBS, APTS, NETA and other national organizations to participate in five regional round robin meetings held to discuss the preliminary findings. Additionally, nearly 50 stations shared additional feedback through calls, emails and comments. Throughout this paper, themes from these round robins and communications will be included to complement and augment the original study.

We all have a stake in the future of public television, and we all have a share in solving its problems. The original version of this paper served as the starting point for a system-wide conversation. Now as the conversation continues, we must work toward consensus about both the need for action and the specific actions that are needed.

## Station Finances

Between 1990 and 2001, public television system revenue grew from \$1.25 billion to \$1.88 billion. We analyzed the major sources of station revenue, and found that, historically, growth occurred at about the rate of inflation across most revenue sources. In the future, without action, all major revenue sources are likely to be flat, declining or insufficient to drive overall growth.

Although individual stations may have different experiences, the systemwide picture is troubling:

- Since 1990, real net member revenue has declined, with a cumulative loss of \$17 million in *real* income, after adjusting for inflation. This decline is part of a long-term, slow, downward trend, not a cyclical event. It has many causes, including audience erosion (which reduces the pool of prospects); the rising costs and falling productivity of pledge; and an increasingly competitive philanthropic environment. It is worth noting, too, that increases in renewal rates are not likely to offset declining acquisition since PTV's renewal rates are already among the highest in the nonprofit sector.
- Institutional support, far from offsetting these decreases, may actually fall. Both federal and state budgets are showing large deficits, and many states are cutting support for this fiscal year. Many universities face similar issues and foundation giving, hurt by the falling stock market, is unlikely to rebound until endowments recover their losses.

Chart 1

### HISTORICALLY, THE SYSTEM HAS MAINTAINED GROWTH THROUGH DIVERSIFICATION - FOR THE FIRST TIME ALL REVENUE SOURCES ARE SIMULTANEOUSLY THREATENED

Period	Flat or declining source(s)	Compensating source(s)
1992-1994	<ul style="list-style-type: none"> <li>▪ CPB appropriation</li> </ul>	<ul style="list-style-type: none"> <li>▪ State and local government</li> <li>▪ Underwriting</li> </ul>
1995-1996	<ul style="list-style-type: none"> <li>▪ CPB appropriation</li> <li>▪ State and local government</li> </ul>	<ul style="list-style-type: none"> <li>▪ Net member revenue</li> <li>▪ Underwriting</li> </ul>
1996-1998	<ul style="list-style-type: none"> <li>▪ CPB appropriation</li> </ul>	<ul style="list-style-type: none"> <li>▪ State and local government</li> </ul>
1999-2000	<ul style="list-style-type: none"> <li>▪ Net member revenue</li> </ul>	<ul style="list-style-type: none"> <li>▪ CPB appropriation</li> <li>▪ State and local government</li> <li>▪ Underwriting</li> </ul>
2000-2002	<ul style="list-style-type: none"> <li>▪ Net member revenue</li> <li>▪ Underwriting</li> </ul>	<ul style="list-style-type: none"> <li>▪ CPB appropriation</li> </ul>
2003-	<ul style="list-style-type: none"> <li>▪ Net member revenue</li> <li>▪ Underwriting</li> <li>▪ State and local funding</li> <li>▪ CPB appropriation</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>

As Chart 1 illustrates, public television has historically benefited from its diverse revenue streams, with one source's gains often offsetting declines in another area. The situation today is unique in that no revenue source is offsetting simultaneous declines in membership, underwriting, and state funding.

Additionally, nothing indicates that these flat or downward trends will reverse themselves soon. Local stations will be hard-pressed to deal with these revenue shortfalls other than by making repeated - and painful - cost reductions. A typical station scenario based on interviews and data from SABS showed that a 15 percent revenue loss translated into a 26 percent reduction in staffing, a 40 percent cut in the local production budget, and elimination of some member services, including the program guide.

As we look to the future, we must also recognize that our financial needs are not static, and that, as a system, we must be able to make strategic investments to help position us for the future. In addition, public television has not yet fully funded the costs of its transition to digital technology, and may also have to contribute substantially to the costs of the next generation interconnection system. These big-ticket items will further reduce funds available for strategic investments in digital media and new services.

*Round robin results:* We found strong agreement with the discussion document's analysis of station finances. General managers widely agreed with these financial findings and were eager to examine options to address the challenges. At each session, several general managers suggested that the report may in fact understate the severity of the situation, as they already had faced the predicted 25 percent cuts in headcount and 50 percent cuts in local programming as a result of budget cuts.

## **National Programming**

The problems that stations face do not exist in a vacuum, but are inextricably linked to national programming. Measured strictly in financial terms, the national organizations and producing stations are losing the financial support of the local stations, and the local stations are losing support from viewers and members. Measured in audience and service terms, public television's continued struggle to present the public with a coherent, convincing vision of who we are is eroding the impact of the extraordinary individual programs which continue to gain awards and recognition but fewer viewers and fewer underwriters.

We recognize that many stations have significant activities in other areas, and may even define themselves in ways other than as providers of noncommercial television programming to home audiences. For the purposes of this analysis, however, we have focused only on our television business. It is the main – and commonly shared - activity among all stations, and it gets the lion's share of resources from a systemwide perspective.

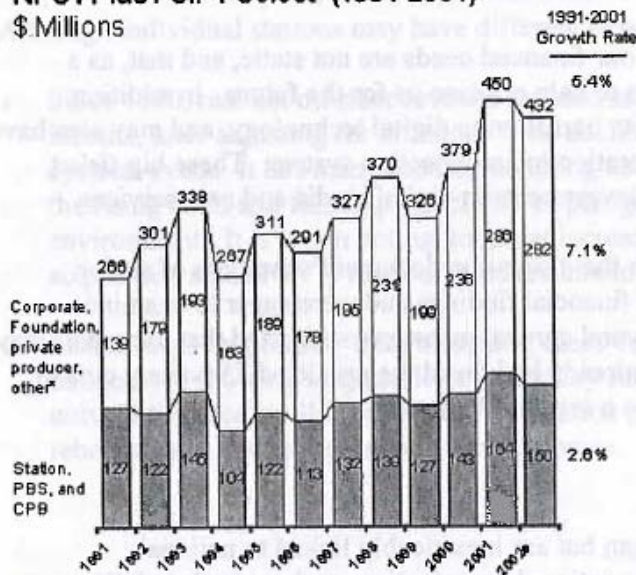
It is this television business that is under unprecedented competitive and financial pressures. Externally, it must confront sweeping changes in audience demographics and viewing environment, and increased investment in programming and promotion from cable competitors. Internally, it must deal with little or no growth in traditional revenue sources, as well as rising production and technology-related costs.

Public television has made efforts to slow the ratings decline with new programming, and has tried to address rising costs through periodic cost reductions and increased funding from CPB and PBS. But these stopgap approaches raise more issues than they solve about our system's sustainability. For example, we have relied more on specials and limited run series to improve ratings, but their typically higher costs suggest that this strategy may not be sustainable over time. And as Chart 2 below shows, prospects for future funding growth from traditional revenue sources are not strong.

Chart 2

## HISTORICAL TRENDS SUGGEST THAT TRADITIONAL SOURCES OF REVENUE WILL NOT PROVIDE RELIEF FOR THE NPS

Growth in total programming investment - NPS / Plus / SIP / Select (1991-2001)  
\$ Millions



Prospects for future funding growth

Source	1991-2001 Growth Rate Percent	Future outlook
PBS / stations	4	Station- financial challenges make it impossible to increase assessments absent very compelling case
Corporate underwriters	5	Ability to join in recovery of TV ad market threatened by turnover of key underwriters and commercial competition
CPB	3	Federal deficits, fiscal environment threaten requested increases
Foundations	9	Slower growth likely as foundations stabilize giving levels after rapid increases in the late 1990s and shrinking endowments since 2000
Private producers	8	Continued growth uncertain
Government agencies	9	Threatened by government deficits
Other	10	Too small to make a difference

\* Includes government agencies such as NSF and NEH, but not CPB appropriation

Source: PBS SG's *Environmental Scan of the PBS Sponsorship Sales Model August 2002*; 2002 figures are estimates as of 12/12/02

*Round robin results:* With regard to national programming, we heard general managers recognize that PBS and producing stations are facing cost pressures as they create the National Program Service. Eager to learn from approaches outside our industry, general managers asked questions about public radio, commercial broadcasters and cable channel business models and economies.

### Potential Solutions

Public television's difficulties are interrelated. Both local stations and national programming face problems, and both stations and producers must help with solutions.

As we turned from analysis of the financial situation to the more hopeful task of identifying the most promising areas for improving performance, there was no shortage of suggestions. Ultimately, we looked at 30, drawn from the many discussed in national conversations, including the range of traditional revenue sources, ancillary income from other platforms, new services, new approaches for programming, and new station collaborations, to name just a few.

Three criteria were used to assess the options:

- Likely, large and near-term: the opportunity to achieve at least \$10 million net per year within 5 years, based a on clear business case, either from compelling internal examples or relevant external benchmarks
- Under PTV control: the opportunity's success did not rely solely on a "happy accident" outside of the system's control

- No major strategic issues: pursuing the opportunity would not require major consultation within the system to reassess or reaffirm the strategy, mission or positioning of public television

As we examined the options, we reached two conclusions. First, we realized that there is no silver bullet, that is, no single, simple way to solve our financial problems. Second, many of the ideas advanced proved less promising than we had hoped from a financial perspective. In fact, testing ideas against the benchmarks described above, we found that, of all we examined, only three emerged as holding the kind of promise we need. They are:

- Developing strong major and planned gifts programs at local stations, an area where public television could significantly strengthen efforts;
- Improving station efficiency, especially by consolidating technology and standardizing operations; and
- Reexamining our approach to national programming, seeking solutions from research and planning all the way through to back-end rights exploitation.

*Round robin results:* Most general managers agreed with the analysis that identified major giving, station efficiency, and program strategy. In addition, general managers have identified other opportunities that could help a number of stations, but may not have a system-wide impact for all stations. Among the most frequently mentioned were: educational and other state services; additional earmarked federal funds (like those from the Department of Agriculture); consolidating/sharing graphics and promotional staff; and increasing membership numbers through best practices and programming changes.

There was also some interest in moving more aggressively on system strategy questions and long-term public television positioning. These questions are well worth considering and will be central to our collective future. But they will require substantially more analysis over a longer time-frame, and we believe efforts to shore up our financial footing must not be delayed any further. These questions thus remain out of the scope of this effort, but will be addressed in the future.

### **Major Gifts - Opportunity to Gain \$20-35 Million**

Public television has long taken pride in its strong donor base. We are almost unique among nonprofits in relying on smaller gifts - those of less than \$100 - drawn from across our entire community. As a result of this strategy, most stations focus their development units on activities like pledge and direct mail, which encourage small, mass giving.

In our communities, however, there may be opportunities to take our relationships with some individuals to a new level of support. In fact, in recent years, some stations have expanded their activities to include other, more typical, nonprofit fundraising strategies, focused on major and planned giving. Their success has been impressive; average major giving revenues more than doubled, with margins higher than traditional membership.

Across the system, a well-orchestrated major and planned giving effort could increase net revenues by \$20-35 million - a 10 percent increase in the total net member revenue base, as shown on Chart 3. This is a conservative estimate. As shown in Chart 4, 113 stations have a minimal major gift effort and only 27 have a strong effort.

Achieving these results would require a significant overhaul of local development - in the role of the

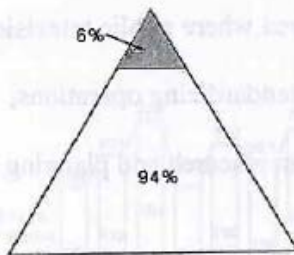
Chief Development Officer, and especially in the roles of general managers and station boards. It will also mean that dozens of stations improve their efforts - and many others begin this activity. And it would mean providing stations with standardized tools, financial incentives, and information on best practices to encourage wide adoption.

**Chart 3**

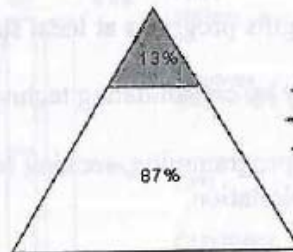
**IMPACT OF IMPROVED MAJOR AND PLANNED GIVING EFFORTS COULD BE AS MUCH AS \$20-35M INCREMENTAL NET REVENUE**

Major giving revenue

**Giving pyramid for typical station before launching major gift effort\***



**Giving pyramid for typical station after launching major giving effort**



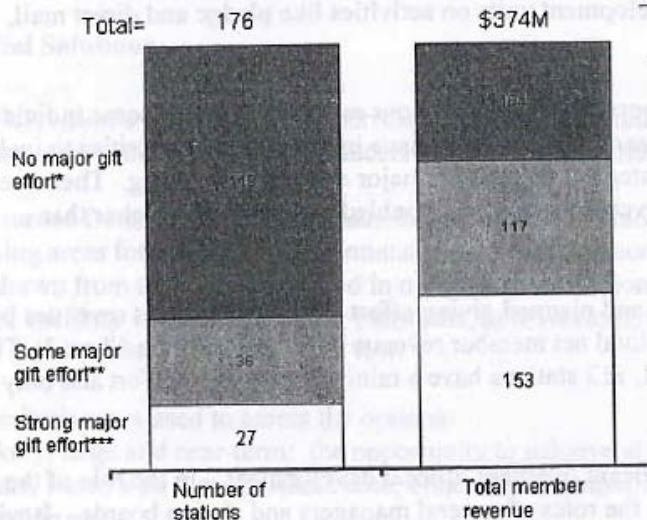
If all stations could see comparable improvements, system could raise \$20-35 million net revenue

\* Based on case study stations, including KUED, OPTV, KNPB, and WGBH  
Source: Station interviews; McKinsey Nonprofit Practice

**Chart 4**

**A MAJORITY OF STATIONS HAVE ALMOST NO MAJOR GIVING EFFORT**

**Stations segmented by major gift efforts**



**Opportunity**

**Potential**

- Establish full range of high touch development efforts (i.e., major giving, planned giving, endowment development)

**\$10-20M net revenue**

- Raise current efforts up to best practice (e.g., improve existing major giving, expand menu of high touch development offerings)

**\$8-15M net revenue**

- Continue efforts to maximize potential

**Total unknown**

**\$20-35M+**

\* Defined as stations with no or limited major giving efforts (e.g., less than 5% of total member revenues from major gifts)

\*\* Defined as stations where major giving revenues account for 6-13% of total member revenue

\*\*\* Defined as stations where major giving revenues account for +14% of total member revenue

Source: SABS

## **Station Operations - *Opportunity to Gain \$100-200 Million***

Stations vary greatly in their broadcast operations and overhead expenses - even when controlling for number of transmitters, licensee type, and market size. As a result, we believe that there are substantial opportunities for reducing costs through the adoption of best practices and/or operational consolidation. We have identified five key areas which, taken together, could free up resources worth between \$100-200 million annually.

## **National Programming**

The processes of developing, funding and producing national programming are profoundly interdependent and interwoven. For this reason, no single action can produce a major financial impact. Instead, this issue may be best addressed through a series of smaller steps. Taken together, these modest opportunities to improve funding should also improve relationships, reduce redundant activities across entities and improve the quality of the service.

- *Rights management -potential impact \$1-10 million.* In most cases for which a market exists, off-air rights are already being exploited. For example, nearly every program is already available for home video, and there are product licensing deals for most marketable programming. The international situation is similar, with all producers marketing their programs overseas. However, there may be some opportunities for gaining scale through consolidation and improving margins that could create additional revenue and cost savings.
- *Underwriting -potential impact \$0-30 million.* Public television's current performance in underwriting - measured by low sell-out and inconsistent realized pricing - may be attributable to our scheduling and selling practices. For example, we set our schedule late; we do not provide the comprehensive information on audience that underwriters see from others; we rely on multiple selling groups; and we do not realize the value of our inventory. In fairness, however, we also face an extraordinarily difficult marketplace. Corporate underwriting dollars are now driven by marketing, and commercial networks are adopting look-alike sponsorship models, making them very competitive with public television. On balance, there is certainly room for improvement in our practices, but there is no guarantee that the market will respond. Improvements in this area may be most important in maintaining current levels, rather than growing additional revenue.
- *Multi-project fundraising -potential impact under \$20 million.* Donors may be interested in significantly investing in national programming in addition to local station activities, in ways that benefit both local and presenting stations. However, we do not know the level of this interest, or whether it would be primarily in specific programming, in thematic investments (e.g. health, world politics) or in a more general fund. We are also concerned that efforts to raise this money would compete directly with those of local stations, especially in the area of major gifts. Clearly, any effort in this area would have to be carefully designed and fully collaborative among stations, producers and national organizations.
- *Domestic windowing -potential impact \$1-10 million.* Offering material developed with public broadcasting funds for use on commercial channels offers relatively small opportunities for potential revenues. Capturing it should be relatively easy, however, requiring only the drafting of a policy and creation of a small sales unit. It does raise important questions of long-term impact on brand if it results in PTV-developed shows appearing on commercial networks.

- *Digital TV service -potential impact \$0.* We spent some time looking at the potential revenue from new DTV channels. Although they may have significant strategic and public service value, in strictly near-term financial terms, they are more likely to generate costs for the system than to provide a source of revenue.

In the short term, we should move forward with the initiatives that the major stakeholders can agree on. These might include consolidating our efforts to sell remnant sponsorship inventory; exploring better coordination and revenue sharing in rights management; and piloting a joint effort to raise program funds against specified targets.

In the longer run, we should launch a task force charged with refining the national programming strategic planning process. Ideally, this would allow local stations and PBS to develop a shared view of the national program strategy, based on combined insights into audience needs and behaviors. It should reduce redundancies in development and co-production activities, and establish better processes and guidelines for scheduling, commissioning and production. The task force should also evaluate alternative distribution relationships and determine key requirements for future success, such as levels of common carriage and a branding approach.