Project W Summary Findings

October 2008

Project objectives

The Boston Consulting Group (BCG) was engaged by ABC to provide an objective perspective on estimated quantitative benefits relating to potential integration scenarios for ABC and SBS. The key project activities were to:

- Define integration scenarios for ABC and SBS
- Estimate quantitative benefits that could be realised in each scenario
- Set out governance models compatible with these scenarios
- Assess potential issues and develop high level responses to them
- Lay out a high-level implementation timeline for benefits realisation.

Purpose of this document

This document summarises the project findings and is set out in five parts:

- Methodology
- Overview of recommended scenario
- Summary of benefits
- High-level implementation plan.

Executive summary

This work explores and quantifies the hypothesis that there is value to be gained for the government from some level of operational integration of ABC and SBS. Four integration scenarios were developed, with varying degrees of integration. Each scenario is incremental to the previous one, and incorporates and then builds on the benefits of the previous scenario.

- The **Low** integration scenario focuses on the integration of facilities such as studios, transmission and distribution services and delivers an estimated annual benefit of $11m.
- The **Medium** integration scenario also integrates the HR, Finance and IT support services and delivers an estimated annual benefit of $21m.
- The **High** integration scenario envisages a combined organisation with integrated strategic direction, TV Production, Marketing and Sales. In effect, this means forming a single organisation with two programming groups focusing on the ABC and SBS brands. It delivers an estimated annual benefit of $41m.
- The **Very High** integration scenario manages the separate brands through an integrated functional organisation and brings an estimated annual benefit of $45m.

The High scenario is recommended as it provides the most attractive trade-off between cost savings and the value perceived in maintaining the different programming cultures of ABC and SBS. In addition, political sensitivities notwithstanding, it is relatively straightforward to implement. The Low and Medium integration scenarios lack a clear single point of accountability, and risk a lack of clarity over the relative strategies of the two organisations. The Very High scenario offers only small incremental benefits for considerably greater cultural change and is therefore not recommended in the short term.

The benefits of the High scenario represent 17% of SBS's $248m cost base and are within the 10-35% range from BCG experience with similar types of mergers and published figures for integrations with medium to high cost base overlap.

In addition to the annual operating cost benefits, asset disposals are estimated to deliver a further $52m, primarily due to the disposal of excess studio and office space.

Qualitative benefits of integration have also been identified, and range from clarifying the strategies for relative brand positioning and programming, through to sharing knowledge and expertise on multiculturalism and commissioning models.

A governance model has been described which will enable the appropriate balance between operational efficiency and the independence of the existing entities. This model outlines the role of legal and Editorial Committees and the roles of senior managers, and provides illustrative key reporting lines within the integrated organisation.

Potential concerns and risks have been identified, and ways to deal with these have been described at a high level.

The duration of the specific tasks associated with implementation is expected to be between 6-12 months, following the appropriate consideration and legislative changes. However, legal, political and cultural issues are far more likely to be on the critical path.

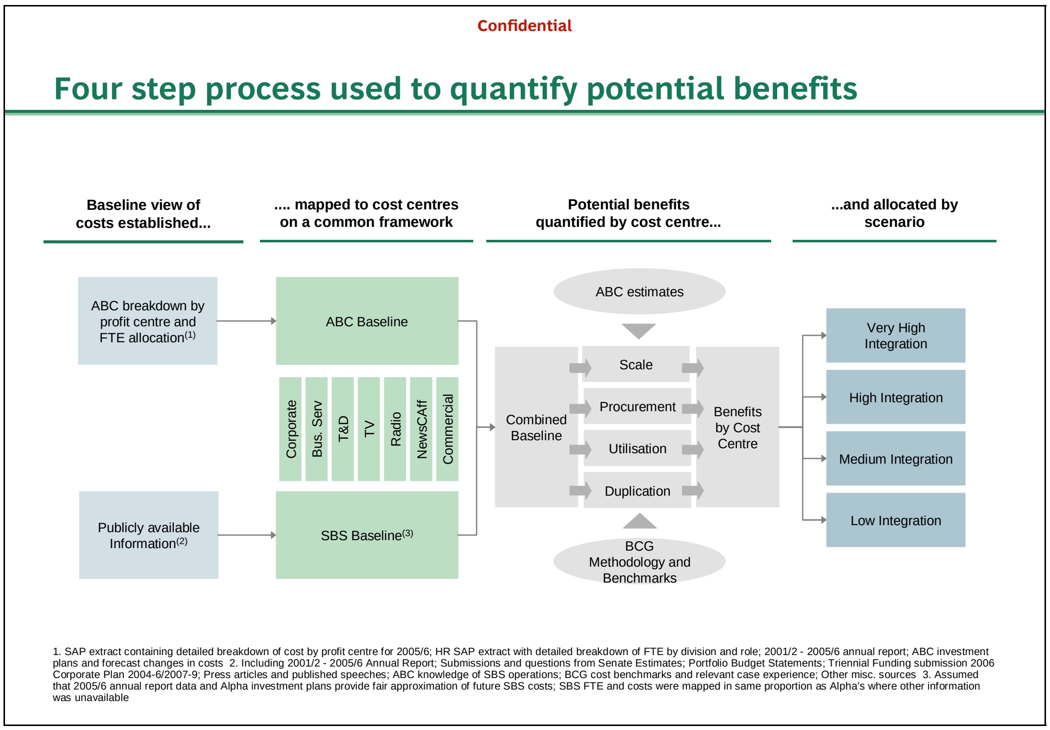
All estimates of SBS costs and detailed activities have relied on publicly available data and should therefore be treated as approximations of actuals. Thus, some of the detailed analysis may over or under-estimate the actual potential savings. However, we believe the total benefits calculated for each scenario are likely to be close to the actual benefits that could be achieved.

Methodology

A four step process was applied to estimate the potential benefits (Exhibit 1)

1. A baseline view of costs for both organisations was established
2. These costs were mapped to cost centres organised on a common divisional framework
3. Potential benefits were then assessed for each cost centre
4. Benefits were then allocated to scenarios.

Exhibit 1



Step 1: Baseline view of cost structure

The first step was to establish a baseline view of the cost structure for both organisations.

ABC's operating expenditure was derived from an SAP extract by profit centre for 2005/6. Distribution of FTE was supplied by a further SAP extract of Human Resources, and capital expenditure was drawn from the cash flow statement in ABC's 2005/6 Annual Report.

As an internal view of SBS's cost structure was not available, an approximation of SBS's cost structure was generated based on publicly available data including:

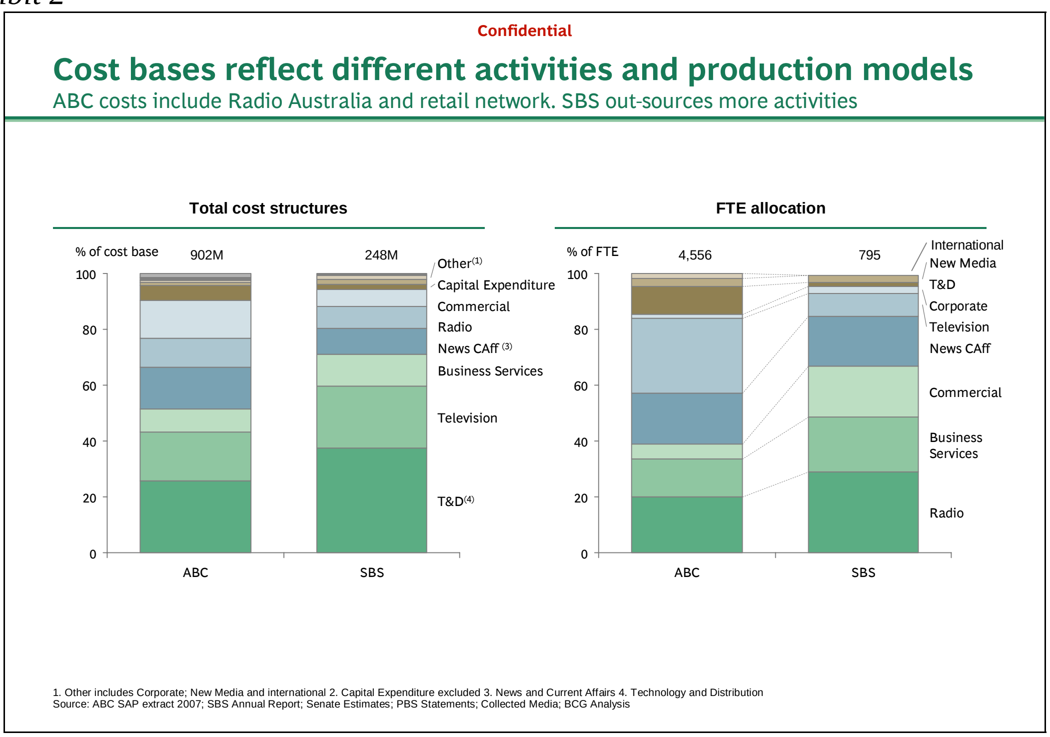
- SBS's annual reports from 2002-2006
- Responses to Senate Estimates questions
- Portfolio Budget Statement Submissions
- SBS's Corporate Plan 2004-9
- Published speeches by SBS personnel
- A detailed press search from 2001 to 2007.

Where necessary this data was augmented by BCG Corporate Centre benchmarks, the experience of relevant BCG experts and interviews with ABC personnel.

Step 2: A common divisional framework

The expenditure and FTE of both organisations was then mapped to a common framework of 126 cost centres split into 11 divisions (Exhibit 2).

Exhibit 2



Mapping to common costs centres allowed direct comparison between ABC and SBS.

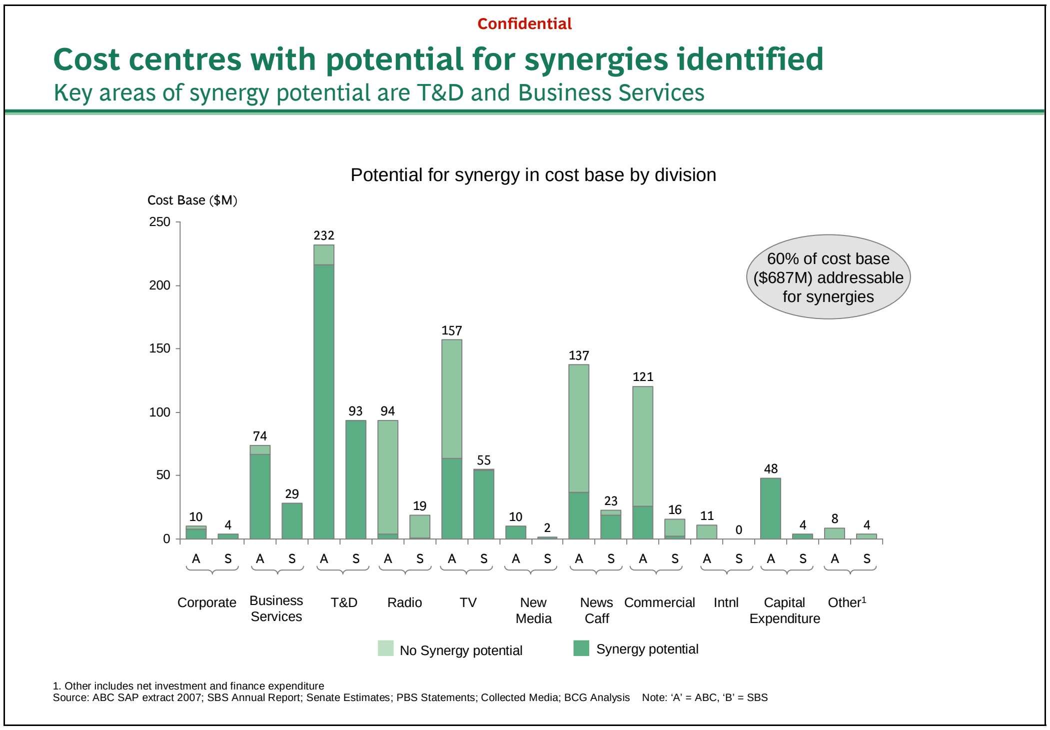
It was also necessary to adjust our assumptions for likely medium term changes to the cost base. Four key changes were identified and incorporated into the analysis:

- *Investment in digital production technologies:* Duplicated element of SBS's up-front capital investment counted as an avoided cost
- *Investment in play-out systems*: Scale benefit of shared play-out systems taken as an annual reduction in operating expenses
- *Rationalisation of ABC's production assets and processes*: No impact on benefits due to the limited savings from integration of ABC production resources
- *Move to digital broadcasting*: Benefits included in procurement savings from negotiations with broadcast providers.

Step 3: Potential benefits

Potential for synergy between ABC and SBS was then examined in each of the 126 cost centres (Exhibit 3). 57 cost centres (40% of the combined cost base of $1.15bn) were found to have no overlap in operations and therefore no synergy potential.

Exhibit 3



The remaining 69 cost centres (60% of the cost base) were then examined to quantify the potential synergies.

To determine benefits at the cost centre level, five types of synergy were identified and investigated:

- *Duplication*: The removal of replicated activities (eg HR policy formulation)
- *Scale*: Leverage economies of scale (eg increased productivity from larger finance teams)
- *Utilisation*: Increase usage of assets (eg higher use of studio time)
- *Procurement*: Leverage increased scale in supplier negotiations (eg program acquisition contracts)
- *One-Off Benefits*: Sale of assets (eg property).

This process was conducted through interviews with ABC staff, internal BCG experts and benchmarks from BCG experience in similar projects. $41m in potential annual synergy benefits was identified across the 69 cost centres in the recommended scenario. $52m one-off benefits were also identified through the avoidance of digitisation cost and sales of property, plant and equipment.

Step 4: Allocation to Scenario

In the final step, synergy benefits relating to specific cost centres were allocated to the relevant integration scenario.

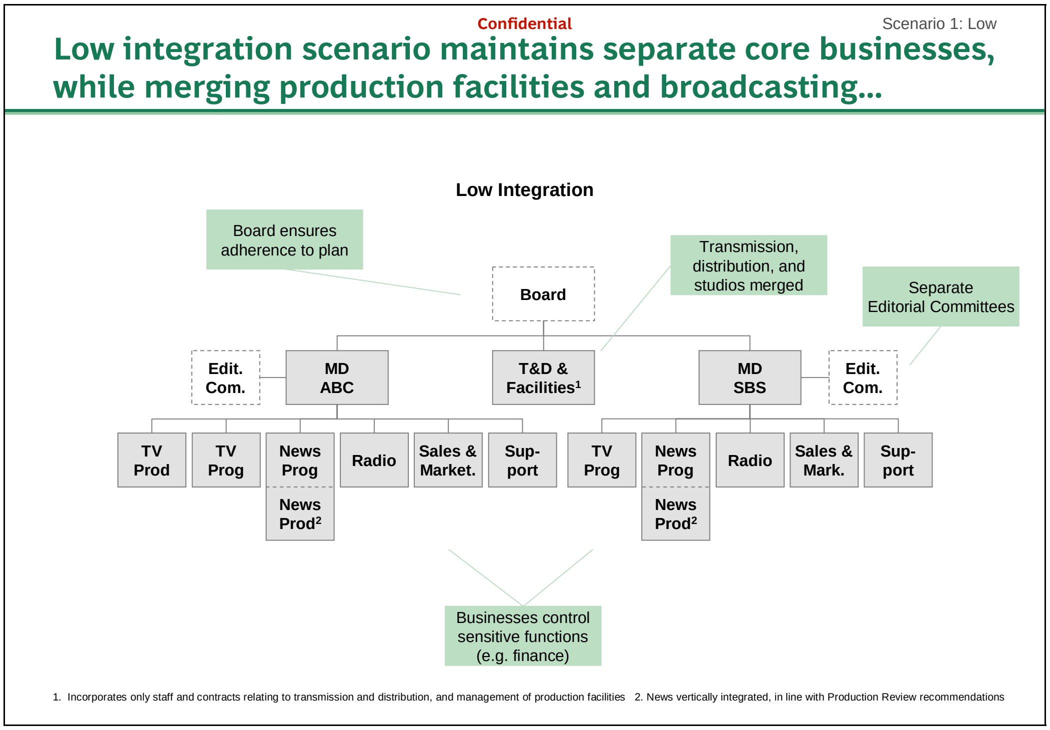
High integration scenario overview

The High integration scenario merges all functions other than TV Programming, News and Radio (Exhibit 4). The two broadcasters would effectively integrate into a single organisation, managed by a single CEO with full strategic responsibility for both brands. The separate ABC and SBS Boards of Directors (Board) would be integrated into a single Board for Australian public broadcasting. The Board would be the primary forum to address issues affecting both organisations and would have ultimate responsibility for the delivery of both broadcasters' Charters. Separate Editorial Committees for ABC and SBS would be established. These committees would be given specific responsibility for ensuring that program output and programming decisions were made in line with the respective distinctive charters of the two organisations.

Two TV programming teams would continue to produce separate content for two brands, while separate, vertically integrated News organisations, incorporating both Programming and Production, would be maintained, in line with the recommendations of the Production Review.

The integration of Finance, HR, IT, TV Production, Sales & Marketing and central management functions (eg communications) would allow scale benefits to be achieved, remove duplication, and empower the CEO to ensure the programming strategies of both public broadcasters were fully coordinated. The location of the teams from both organisations would be combined and the number of office buildings would be rationalised to take advantage of existing excess capacity.

Exhibit 4



The role of MD of SBS and ABC would be replaced by heads of SBS and ABC programming charged with delivering on the content strategy of the organisation, under the CEO's direction. The CEO would also be responsible for the operational side of the business, from TV Production, to marketing, to support functions. The CEO would have a seat on the Board of the integrated organisation and would take ultimate responsibility for all aspects of strategy and operations.

Roles and responsibilities by group

Board of Directors
A single Board would be created for the integrated public broadcasting organisation. The Board would have ultimate responsibility for the activities of both ABC and SBS, and would have specific responsibility for ensuring that commitments within each broadcaster's charter were carried out. The CEO would sit on the Board and be accountable for the operational performance of ABC and SBS. The Board would continue to include representatives of key interest groups and stakeholders.

CEO
A single CEO would replace the MDs of ABC and SBS. The CEO would have responsibility for setting the strategic direction of both ABC and SBS, and for maintaining the appropriate relative position of the brands and their content. The heads of ABC and SBS programming would play a key role in defining the strategies of their respective brands, and would be fully responsible for implementing those strategies.

Editorial Committees
The Editorial Committees would be responsible for representing key interest groups and ensuring that the broadcasters deliver effectively on their charters. There would be separate Editorial Committees for ABC and SBS including members from outside of the organisations. The Committee members' backgrounds and expertise would need to support their ability to interpret the differing charter obligations of the two broadcasters. A joint sub-committee could be established to develop and approve policies and principles that should apply to both broadcasters (eg approaches to ensuring journalistic integrity and political independence).

ABC/SBS Managing Directors
The roles of the MDs of ABC and SBS would be replaced by Heads of ABC and SBS programming. The CEO would take responsibility for the strategic direction of both broadcasters and for all functions of the organisation other than programming. The roles of Head of ABC and SBS would focus on programming rather than general management.

Responses to potential issues associated with integration

The project team considered a range of potential issues associated with the integration of ABC and SBS, and proposed ways to address them. The objective was to highlight the major issues and to assist in structuring the debate around them:

1. *A unified organisation might de-prioritise multiculturalism and reduce viewer choice*
   In previous discussions of the potential integration of ABC and SBS, significant concerns were raised about the impact on SBS's role in promoting multiculturalism. The primary method of defining the output of ABC and SBS is government legislation and the charters of the respective broadcasters. With well defined charters, strong differentiation and focus of programming output should continue to be achieved. In addition, in each of the four integration scenarios, Editorial Committees would be established for both ABC and SBS to ensure that charter obligations were met and minority interests represented

2. *Integration might lead to the increased commercialisation of ABC*
   Concerns about the degree to which ABC is commercialised, and specifically the prospect of ABC carrying advertising, are at the core of debates about ABC's role and future. In any scenario, the degree to which ABC is commercialised is defined in ABC's charter and one of the key functions of ABC's Editorial Committee would be to ensure adherence to charter guidelines on commercialisation. Therefore an integration would not lead to unwanted increased commercialisation

3. *Integration might disadvantage independent producers*
   Concerns could be raised about the impact on independent producers in the event of consolidation amongst Australian public broadcasters. However, any increase in ABC and SBS's negotiating power with independent producers is likely to be offset by the increased spending on content that the integration might facilitate. If a significant amount of the benefits from integration were re-invested in programming, the integration could enable a significant increase in spend on Australian independent productions

4. *ABC's TV production model might add cost to SBS's*
   Concerns could be raised that integration would inevitably lead to the amalgamation of ABC and SBS's distinct production models, to the detriment of SBS's cost position. However, the structural changes put forward in the integration scenarios do not include any specific changes to ABC or SBS's production models. It is proposed that production models be chosen based on their efficiency, effectiveness and quality of output, and that a variety of production models would be maintained within the integrated production department.

Responses to potential implementation risks

The project team considered a range of potential implementation risks arising from the integration of ABC and SBS, and proposed ways to mitigate them. The objective was to highlight the key risks and to determine the extent to which they could be managed. Three potential implementation risks and responses are set out below:

1. *Competition between broadcasters could lead to inefficiency within the organisation*
   There is a risk that competition, driven by cultural differences, between two broadcasting groups within the same organisation could lead to poor decision-making and increased inefficiency. There is a risk that management decision-making would take more time as each broadcaster needed to present arguments to make the case for resources. A number of measures would decrease this risk:

   - The strategic purpose and objectives of each broadcaster need to be clearly defined by legislation, and emphasised by the CEO of the integrated group. The clearer the strategy, the less there will be conflict over programming acquisitions, funding and resources
   - Interactions between shared functions and programming teams need to be carefully structured with effective transfer pricing mechanisms and clear processes, roles and responsibilities
   - Clear decision rights need to be defined for senior management roles, and effective decision-making processes established and adhered to

2. *Integration of support functions could lead to 'worst of both worlds' productivity*
   As in any integration, there is a risk that the combined entity follows the path of least resistance and adopts the working style of the organisation with worse capabilities and lower levels of productivity. To avoid this, a clear integration plan incorporating rigorous internal and external benchmarking and clear financial targets should be used to ensure that efficiency is improved through the integration.

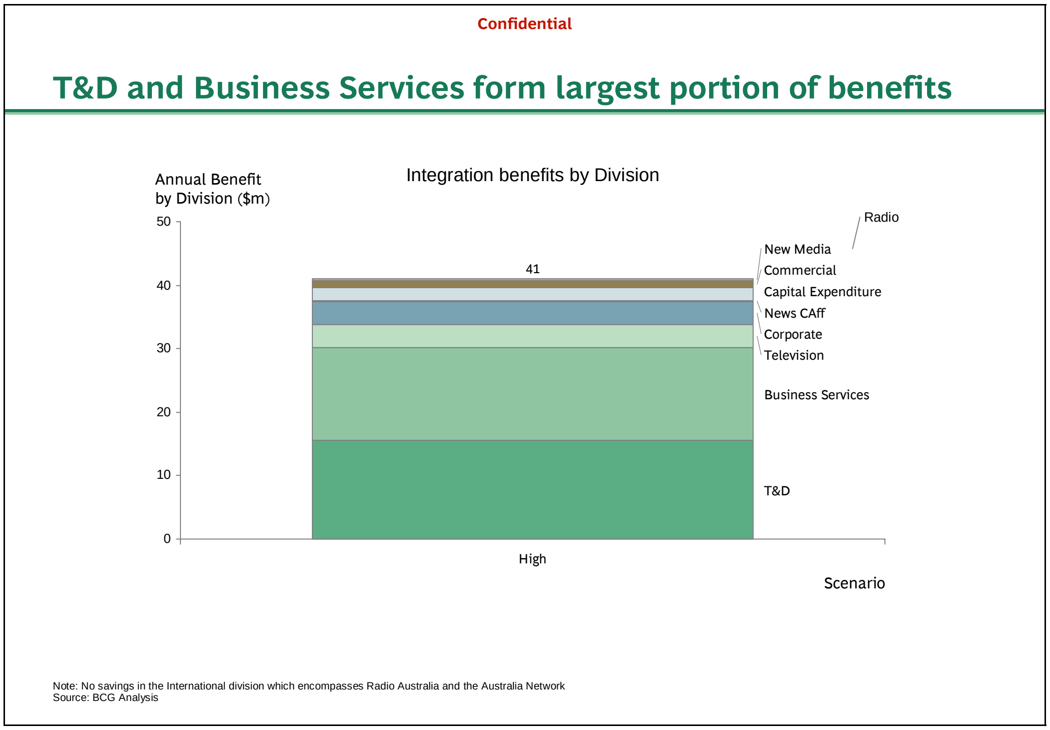
3. *Opposition from staff and unions could delay or negate integration benefits*
   In an integration of this scale, there will be significant uncertainty, with issues around job security and dislocation impacting on staff morale. This can be addressed by a thorough communication and change management plan. The case for change should be clearly made, outlining the advantages for staff and customers; consultation should be clear, honest and open, and staff and unions should be given ample opportunity to participate in the process.

Summary of Benefits

Benefits by division

When segmented by division the main sources of benefits are Business Services and Technology and Distribution (Exhibit 5).

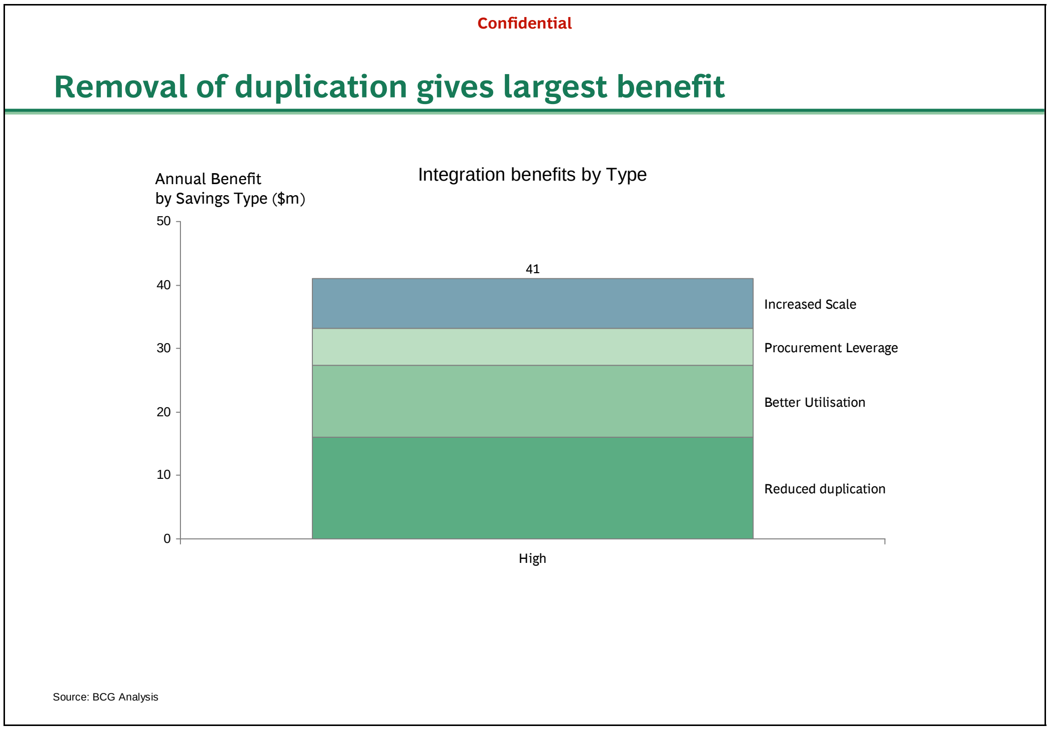
Exhibit 5



Benefits by Synergy Type

When segmented by synergy type, the main source of benefits is from reducing duplication between the integrated organisations (Exhibit 6).

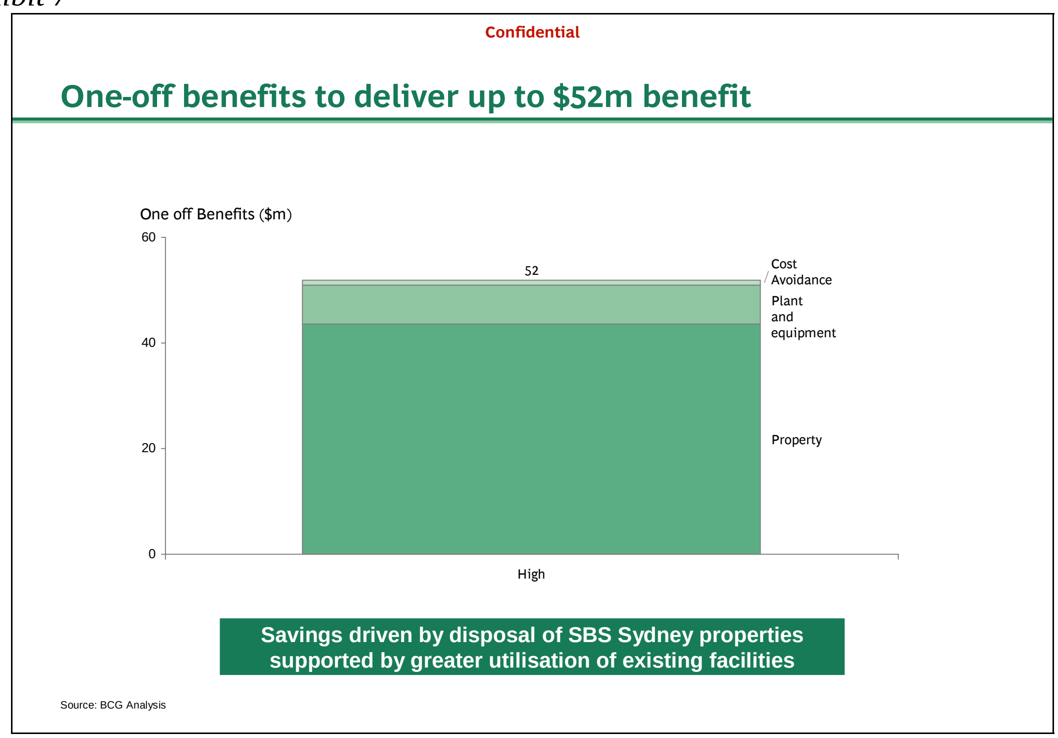
Exhibit 6



One-off Benefits

The bulk of one-off benefits are derived from the sale of assets (Exhibit 7).

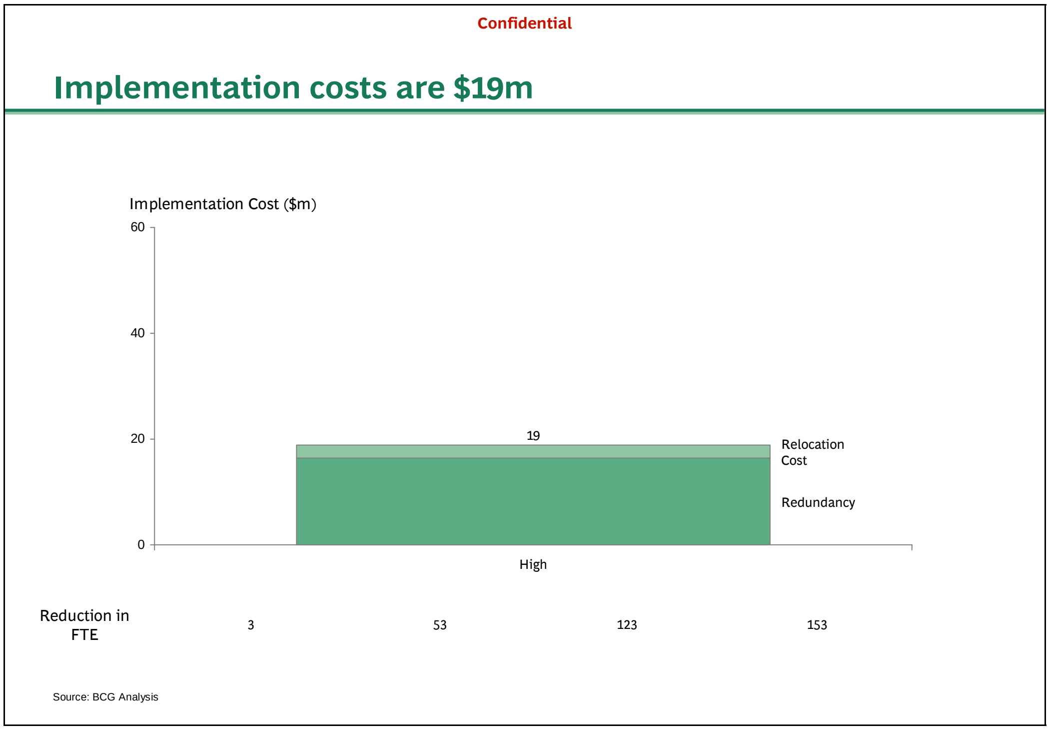
Exhibit 7



Implementation costs

Redundancy costs from a reduction of approximately 125 FTE (full time equivalents) make up the majority of implementation costs

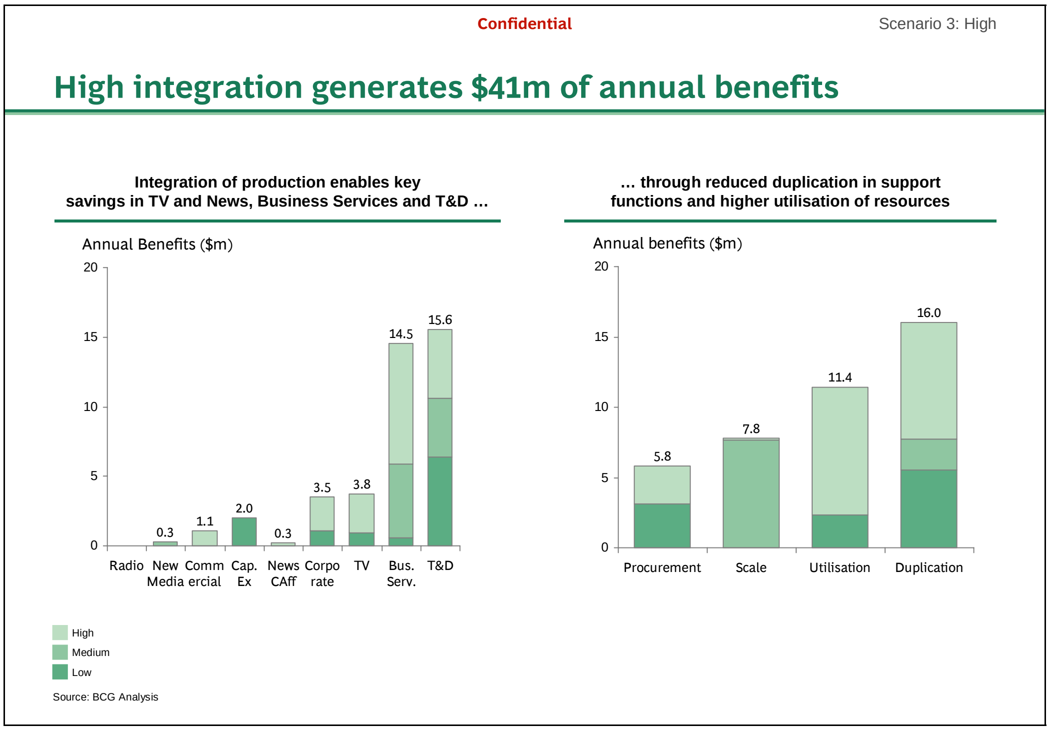
Exhibit 8



Summary of potential benefits

In the recommended scenario all back office functions (Finance, HR, IT) are integrated, together with TV Production, Sales & Marketing and central management functions (eg communications)

Exhibit 9



Key benefits include:

- *Corporate*: $1.1m from elimination of duplicated non-exec directors (46% from $2.4m combined cost base); $1.9m from elimination of duplicated strategy and communications senior executives (eg government liaison, corporate planning) and administrative support (25% from $7.5m combined cost base)
- *Technology and Distribution*: $2.2m through leveraging increased scale in renegotiation of broadcast contracts (estimated at 1% from $220m combined cost base); $1.9m from reduction in duplication of technical services requirements such as audiovisual technicians and studio maintenance crews (20% of $9.9m combined cost base); $4.3m from elimination of duplication in technology management and scale benefit in IT systems development and maintenance, internal support, consultant spend and licenses for software (18% from $22m combined cost base);
- *Business Services*: $3.3m from elimination of duplicated finance senior management and teams engaged in scalable activities such as accounts receivable/payable (18% from $18.4m combined cost base); $1.6m scale benefit in HR policy, services and operations (11% from $14.1m combined cost base); $3.5m from reduction in property maintenance and expenses (such as cleaning

and utilities) due to property consolidation (13% from $26m combined cost base); $3.8m from reduction in marketing and research spend due to increased cross-promotion and reduced duplication (15% from $25m combined cost base)

- *Television*: $0.9m from increased leverage when acquiring content (estimated at 1% from $90m combined cost base); $3.6m from greater leverage, coordination and better usage of blanket agreements in procurement (4% saving on combined program acquisition budget of $90m)
- *News and Current Affairs*: $0.25m from rationalisation of duplicated international desks
- *One-off benefits*: $2.2m property saving from disposal of excess studio capacity due to increased utilisation of assets; $43.5m from closure of SBS Sydney premises (or equivalent ABC facility); $7.5m from sale of plant and equipment; $0.9m digitisation cost avoided.

The total operating expense benefit of the high integration scenario is $41m with total one-off benefits of $52m.

Implementation costs are an estimated $21m in redundancy costs due to FTE reductions, and systems integration spend due to the integration of the TV and Radio control rooms.

Other benefits

In addition to the primary synergy benefits, the project identified a number of secondary benefits that are likely to result from integration of ABC and SBS. The key benefits are set out below:

1. *Clarification of brand positions*
   Whilst no change in charters is necessarily envisaged, the integration of ABC and SBS would facilitate a clarification of the broadcasters' respective brand positions. A single organisation could increase the coherence of a public broadcasting strategy with each broadcaster performing a clearly distinct role

2. *Co-ordination and cross-promotion of schedules*
   With similar logic to the clarification of brand positions, the integration of the two organisations could facilitate greater co-ordination and cross-promotion of programming schedules. The CEO would have oversight and authority over both organisations' output, and have the ability to optimise the programming output to meet charter objectives

3. *Leverage of commercial best-practice across both organisations*
   Greater scale in the integrated commercial department would facilitate best-practice sharing, for example in merchandising, publications and other commercial spin-offs.

High-level implementation plan

Assuming there is limited disruption from external factors, the integration implementation could be completed within 6-12 months following the enactment of legislation (Exhibit 10). Given the high-profile sensitivities around such an integration, the legal, political and cultural issues are likely to be on the critical path; the business and operational issues are relatively straight-forward.

Exhibit 10