DRAFT DISCUSSION PAPER:

Systemwide Financial Analysis

March 17, 2003

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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 to date of a systemwide review and planning effort begun at CPB with the assistance of McKinsey and Company last fall. This 14-member steering committee, which includes station representatives, CPB, PBS and major producers, has directed the initial analysis and crafted initial ideas for the system to consider as it seeks firmer financial ground.

We all have a stake in the future of public television, and we all have a share in solving its problems. We hope that this paper will serve as the starting point of a system-wide conversation – a conversation that will result in building consensus about both the need for action and the specific actions that are needed.

We began by posing three key questions:

- How severe and long-lasting are the financial pressures on the system?
- Which performance opportunities offer the most promise?

- How should we launch these initiatives and effect lasting change?

We reviewed financial and performance data gathered from SABS, the stations' audited financial reports, program budgets and other sources to assess the financial health of the stations and the National Program Service (NPS).

It was also important that this effort work within the context of the changes already taking place within the system. The conversion to digital offers many promises, but has also raised the level of uncertainty. Our goal was to "close some doors" – that is, to help focus attention on the real and immediate opportunities. Of the 30 different proposals we analyzed, three appear to present significant opportunities for improving our enterprise. Each of the three – station operations, major gifts and national programming – is discussed more fully below.

Public television's core service – broadcast television – is under real and unprecedented threat, and our analysis indicates that economic pressures at both the local and national levels will only increase. In these circumstances, we cannot choose the path of least resistance. Doing nothing is not a viable choice; it all but guarantees further decline. Taking action – taking charge of our future – is the only option that can ensure public television's success.

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 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

Future Outlook

Period	Flat or declining source(s)	Compensating source(s)
1992-1994	• CPB appropriation	• State and local government • Underwriting
1995-1996	• CPB appropriation • State and local government	• Net member revenue • Underwriting
1996-1998	• CPB appropriation	• State and local government
1999-2000	• Net member revenue	• CPB appropriation • State and local government • Underwriting
2000-2002	• Net member revenue • Underwriting	• CPB appropriation
2003 -	• Net member revenue • Underwriting • State and local funding • CPB appropriation	• none

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.

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.

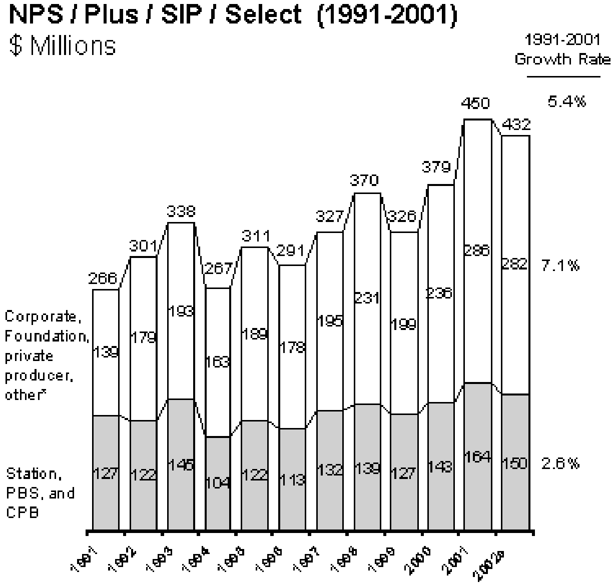
It is this television business that is under unprecedented competitive and financial pressures. Externally, it must confront sweeping changes in audience demographics and viewing environment, and increased investment in programming and promotion from cable competitors. Internally, it must deal with little 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, with increased funding from CPB and PBS to cover rising costs, and with periodic cost reductions. 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

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 program, and new station collaborations, to name just a few.

On closer examination, however, we reached two conclusions. First, there is no silver bullet, that is, no single, simple way to solve our financial problems. Second, many of the ideas originally put forth are less promising than we had hoped from a financial perspective. In our analysis, we measured ideas for their net financial impact, their risk and uncertainties, and the timeline in which we could expect returns. Of all those we examined, 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.

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 activity 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 as 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.

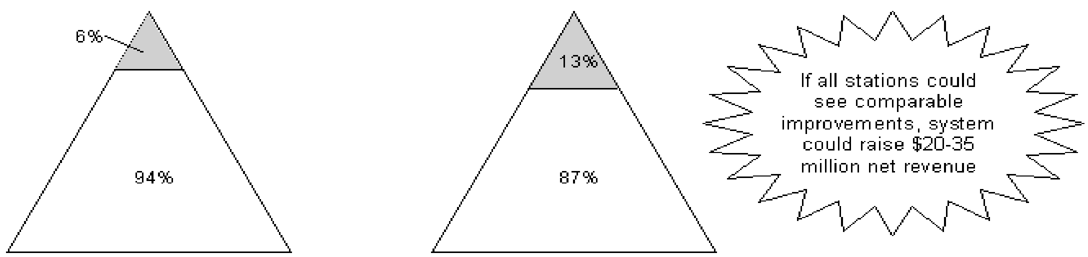
Chart 3

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

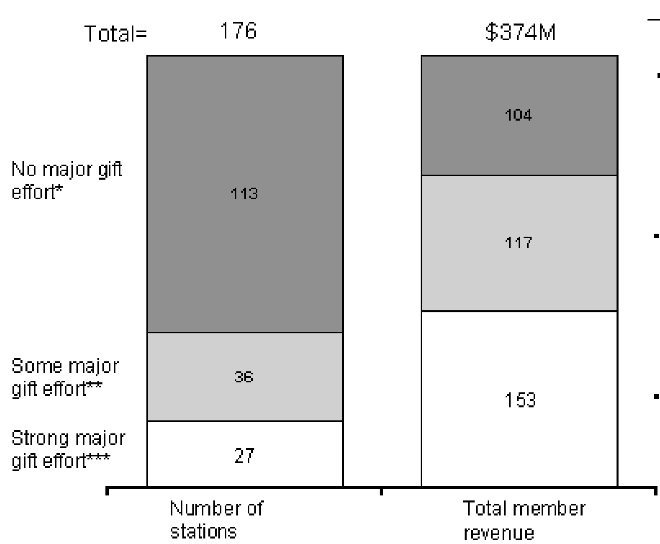


* Based on case study stations, including KUED, OPTV, KNPB, and WGBH
Source: Station interviews; McKinsey Nonprofit Practice

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

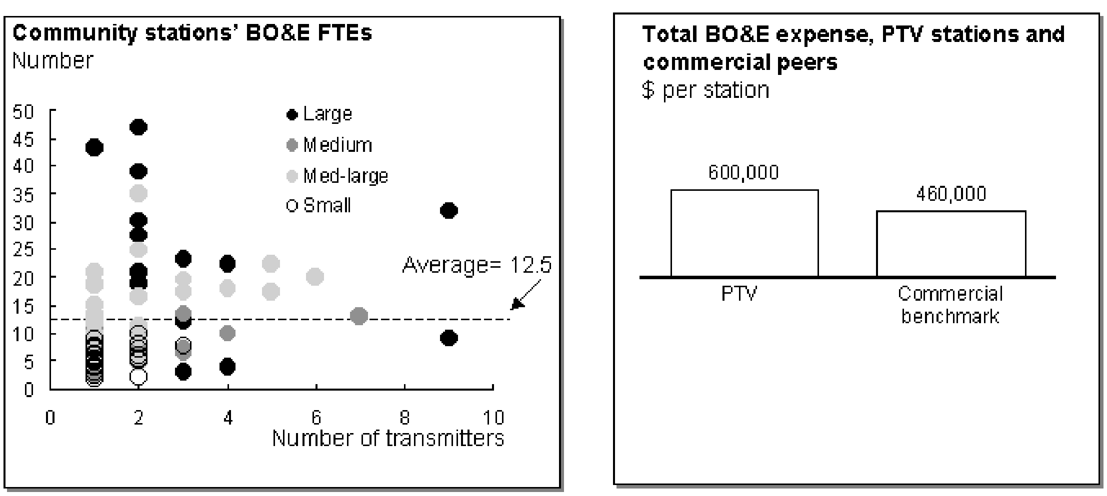
Station Operations – *Opportunity to Gain $100-200 Million*

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.

- *Broadcast operations and engineering costs – potential savings $25-30 million.* Public television developed its infrastructure and processes years ago, without today's technology and today's business efficiencies. As a result, the average public television station must bear broadcasting operations and engineering costs that are 30 percent higher than the commercial average. We have not been able to invest to support the addition of PBS feeds with traffic automation platforms in place. We have also been reluctant to share resources, even when there is compelling reason. None of the frequently advanced reasons for variation – number of transmitters, the presence of unions, leased vs. owned lines – seem to explain the large differences.

Chart 5

THERE MAY BE OPPORTUNITIES TO REDUCE BROADCAST OPERATIONS AND ENGINEERING COSTS



Source: SABS data; CPB and station interviews; 2002 NAB Television Financial Report; McKinsey analysis

- *Administrative costs – potential savings $10-25 million.* Again, our review showed a wide and unexplained variation within and between station cohorts, leading us to believe that savings are possible. By eliminating duplicative activities, relying more on outsourcing or shared activities, and recruiting and using volunteers more effectively, stations could save costs while maintaining service. The potential savings could be achieved even if no reductions were made at small stations (where administrative personnel divide their time across responsibilities) or at state licensees (which cover very large areas and have unique requirements).

- *Shared scheduling – potential savings $11-25 million.* Shared scheduling has already had proven success. To date, 17 stations have achieved savings. In Florida, scheduling costs were reduced 30-50 percent through consolidation. With scheduling-related expenses running at $44 million, system-wide savings at this level could be substantial.

- *Hub consolidation with existing technology – potential savings $30-40 million.* In this scenario, nearby stations or those with similar schedules would share broadcast facilities and transmission towers.

- *Centralized/streamlined operations leveraging new technologies - potential savings $80 - $120 million.* Advances in computer processing, storage and fiber optics are allowing television stations to distribute programs more efficiently, for example, with "file transfers" that can send programs to stations like email attachments, or by storing programs in central digital repositories, where stations can download them as needed. Public television's Next Generation Interconnection System can be developed to take advantage of the new capabilities offered by the transition to digital technology and to exploit the efficiencies inherent in both real-time and non-real-time program file transfers -- sharply reducing station costs for master control operations; for libraries and storage; for traffic log creation; for production/editing, etc. Rather than threatening local station autonomy, such a system will free up resources now being invested by each station in duplicative infrastructure and operations so that more money can be devoted to enhancing services delivered to the local community. The potential savings are high, but to be realized they will require a substantial up-front capital investment for NGIS, and a commitment to "change management" and new approaches for station operations.

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As public broadcasters, we measure our success in terms of mission and public service, not in terms of cost savings or increases to the bottom line. Yet fulfilling our mission relies in some part on sustaining our financial viability. Achieving savings in station operations – through new technology, new collaborative models, and outsourcing, for example – can free dollars and staff to be redirected to different uses that further our mission.

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 in range of $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.

Next Steps

From local stations to national programming, our systemwide evaluation and planning effort points to the need for fundamental change in public television's business and operational practices. Clearly, this will be a lengthy process as we struggle to reach consensus and to agree on appropriate actions.

But we should start now. We are providing this paper as background for a series of round robin meetings over the next month so that we can spend a full day discussing this analysis and getting your input. We will have these meetings in Chicago on March 26, in Philadelphia on April 1, in Las Vegas on April 6 (alongside the PBS Technology Conference preceding NAB), San Francisco on April 16, and in Cincinnati to coincide with the OSBE meeting on April 29 and 30. We are asking general managers to schedule time to spend a day at one of these meeting so that we can work through these critical issues in small groups.

We face a daunting financial future that will demand very difficult choices. We believe that our current approach promises little beyond further reductions in program output, missed development opportunities, criticism of "creeping commercialism," and escalating pressure to reduce costs further. In other words, we face the probability of fighting today's battles again and again.

Clearly, we must act – and to succeed, we must all act together. Individual initiatives, no matter how well-intended or well-executed, are unlikely to produce sufficient momentum to reverse the overall trends. Learning new ways of working together will involve disruptions and concessions, pain and risk. But the stakes are nothing less than our continued service to the American people.

We have significant resources and enormous support both from the public and from our institutional partners. Working with these essential assets, we can and will build a path to long-term success and vitality for public television together. It will take cooperation, imagination, and even some risk-taking. But we have a mission to fulfill -- to provide programming that informs, educates and inspires; to offer service to children, minorities and others who are underserved; to offer education and community outreach; and to create a public space in the multi-channel universe. Our opportunities are too great to miss.