Forward Thinking – New Solutions to Old Problems

Investing in the Creative Industries

Undertaken for the National Endowment for Science, Technology & The Arts (NESTA) by Tom Fleming, 2003

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Chief Executive's foreword

The Creative Industries are at the forefront of Britain's modernisation, bringing innovation, hope and economic resurgence to many regions. As one of the fastest growing areas of the UK economy, they contributed £11.5 billion to the Balance of Trade in 2001 and are a major employer of creative graduates who originate new products and services for global markets. Despite these positive signs, creative entrepreneurs experience barriers to finance, which limit opportunities for their further growth and the expansion of the sector. At the heart of the problem is a lack of investor awareness of Creative Industries business models, limited access to useful market research, and the perception that creative businesses are lifestyle-directed, rather than goal-focused. This document is a call to action for organisations and individuals who are in a position to help the Creative Industries become a profitable powerhouse, to do their part to effect change.

As an initial contribution to this process, NESTA (the National Endowment for Science, Technology and the Arts) has commissioned research into the area of investment in the Creative Industries to inform the launch of its Graduate Pioneer Programme in 2003. Our aim is to understand how graduates from Creative Industries disciplines can realise the commercial and social potential of their enterprises through dedicated business planning and financial training.

The emphasis of the Graduate Pioneer Programme is not just on how individual creative businesses might grow. Our intention is to influence positively the image and profile of the sector as a progressive and sustainable driver of the UK economy. At the end of the programme our graduates will be better equipped to attract investment and support from other sources, such as equity. But their impact is expected to be much wider, as they lead the way as new innovators and show other creatives how a change in approach can lead to new opportunities.

The Graduate Pioneer Programme works to complement and advance the impact of NESTA's established Fellowship, Learning and Invention and Innovation programmes. In these programmes, we consciously tailor our services to each and every individual, to maximise their hard work and open doors to new ideas and opportunities.

NESTA's purpose is "to pioneer ways of supporting and promoting talent, innovation and creativity in science, technology and the arts". We hope to be a catalyst for change, by fostering new thinking that has a domino effect in driving through genuine improvements. As such, we hope this research will spark a debate on the issues affecting the Creative Industries and lead to greater collaboration by financiers, Government and expert NGOs to kickstart successful initiatives in the sector.

This report and the Graduate Pioneer Programme are just the first steps in an important but much bigger action plan.

J. Newton

Jeremy Newton
Chief Executive, NESTA

Executive summary

A meeting of minds – building bridges between the investment and creative communities

> **"The real assets of the modern economy come out of our heads, not out of the ground: imagination, knowledge, skills, talent and credibility"**
>
> **(Leadbeater and Oakley 1999).**

1. Overview

This report examines the role of investment in the Creative Industries. For the sector to achieve its full potential this report recommends greater collaboration between investors, the public sector and creative entrepreneurs. The challenge is to achieve a new middle ground for investment for creative businesses that delivers sustainable growth and longer-term financial performance.

The findings have been developed using a qualitative methodology, which has enabled a more detailed overview of the issues affecting finance and business development in the Creative Industries sector. Fifty senior level consultees, representing private and public sector financiers, Government departments, Creative Industries development initiatives and expert NGOs, were interviewed. The research also involved website and document analysis and was informed by a review of the existing literature of the sector.

The Creative Industries sector was defined by DCMS as constituting[1]:

> "Those activities which have their origin in individual creativity, skill, talent, and which have their potential for wealth and job creation through the generation and exploitation of intellectual property. These have been taken to include the following sectors: advertising, architecture, the art and antiques market, crafts, design, designer fashion, film, interactive leisure software, music, the performing arts, publishing, software and television and radio".

2. The Creative Industries sector: leading the way

The Creative Industries is a key growth sector for the UK economy:

- It is a large sector, amounting to 7.9 per cent of GDP in 2000. This compares with 0.8 per cent for agriculture and 3.4 per cent for the automotive industry[2]. It is of a similar size to the UK construction industry[3], and is over a third of the size of the overall UK manufacturing sector[4]. The sector contributed £11.5 billion to the Balance of Trade in 2001 (twice that of the pharmaceuticals sector)[5] with an average increase of 13 per cent per annum[6].
- It is a fast-growing sector. In Scotland, it is expected to grow by a third over the next five years[7]. The average UK creative business grew by nine per cent from 1997-2001. Creative sector exports grew 13 per cent per annum. from 1997-2000. By contrast, the UK manufacturing sector contributes 50 per cent less to the economy than it did in the 1950s[8].

[1] Definition sourced from DCMS 2001 Creative Industries Mapping document

[2] See www.tradepartners.gov.uk

[3] See www.tradepartners.gov.uk

[4] See www.foresight.gov.uk

[5] Pharmaceuticals contributed £5.5 billion to the Balance of Trade in 1997. See www.tradepartners.gov.uk

[6] Sources: DCMS Creative Industries Economic Estimates – Statistical Bulletin, July 2003; and DEFRA Economics and Statistics – Agriculture in the UK, 2002.

[7] See www.scottish-enterprise.com

[8] Sources: DCMS 2002 and http://news.bbc.co.uk

- It is an innovative and transforming sector, based on the development of new ideas and products with commercial potential. For example, wireless gaming is poised for explosive growth over the next few years. It is estimated that there will be 107 million active wireless gamers worldwide by 2006[9].

The Creative Industries sector also leads the way for other sectors by positioning creativity, innovation and flexible business practices at the heart of economic change. Successful businesses are increasingly adopting Creative Industries practices and products as a strategic imperative.

2.1 A distinctive sector

There are distinctive Creative Industries sector characteristics:

- It is driven by businesses for which the creation of new content and intellectual property is a central activity.
- Creative businesses are ideas-based, in terms of both product/service development and business practice.
- Creative businesses seek to develop new markets as much as to serve those that already exist.
- The sector is predominantly made up of small to medium sized companies (SMEs)[10], such as advertising and entertainment. These work within complex supply chains to provide products and services on which other sectors depend.
- The sector thrives when located within 'creative clusters'; it is dependent upon informal networks through which creative ideas flow.

The sector is also distinctive in terms of how it is positioned and understood as a major contributor to the UK economy, and this creates problems for the sector:

- The sector is understood as 'new', lacking a historic legacy. This means that it is not valued in the same way as sectors that were once key drivers in national economic significance, such as Agriculture, or a range of Manufacturing sub-sectors.
- The sector lacks intelligence data that is sufficiently detailed and accurate to show its importance to the economy and the breakdown of current public sector investment.
- The sector lacks a strong, historically formed voice, represented by trade bodies. Its fragmented identity means that it lacks the emotive power of other sectors.
- The sector is relatively under-supported through Government creating misperceptions about its economic importance.[11] There is no co-ordinated and direct 'business subsidy' for the Creative Industries sector. Public intervention is piecemeal and reliant upon localised support services, training programmes, or small-scale and often short-term investment initiatives. These are mostly European Union subsidy dependent, rather than UK Central Government driven.
- Investment in the sector through private finance is also relatively low, with most investment occurring in mainstream sectors that are recognised, understood and thus valued by investors. Many of these sectors are not growing as fast or as sustainably as the Creative Industries sector.

[9] See Strategy Analytics, 2001

[10] The European Union definition of an SME is: ← 250 employees, with an annual turnover not exceeding 40 million Euros or a balance below 20 million Euros (See SBS 2002).

[11] For example, Agriculture received £2.6 billion in direct subsidies in 2002 to support a sector almost nine times smaller than the Creative Industries. Source: DEFRA Economics and Statistics – Agriculture in the UK, 2002.

Therefore, it might be supposed that if the Creative Industries sector received similar levels of attention and support as other sectors, its significant growth and vital contribution to the economy could reach a level where the sector operates as the key driver for the UK economy.

2.2 Creative businesses: investment ready?

Despite the significant growth of the Creative Industries sector in recent years, and regardless of the sector's 'value-adding' role for other sectors, commercial investment in individual creative businesses has been low. In part, this is due to a real and perceived lack of investment readiness.

There are key structural and cultural barriers to 'investment readiness' linked to the business models and practices of the Creative Industries sector. These include:

- Creative businesses, especially during start-up and early stages of development, too often lack essential 'investment readiness' features. These include: robust business plans, an acute awareness of markets, solid management structures/expertise, existing capital, and a track record of high growth.
- Creative businesses are innovators, developing products and services for which there is not always a proven market. Despite the success of the sector in developing new markets and thus growing year by year, investment is not forthcoming.
- Creative businesses are often 'information poor', lacking basic routes to market knowledge, details of available specialist support, and business planning guidelines.
- Creative businesses often lack the specialist knowledge and expertise necessary to fulfil investment criteria: the sector does not present itself as the 'investment proposition' that as a high growth sector, it appears to be.
- Many creative businesses lack an appreciation that there may be finance opportunities for them, which might create higher and faster levels of business development.
- Too many creative entrepreneurs consider investors, from both the private and public sectors, to be 'honour-bound' to invest in their idea or concept. This is both due to a marked lack of information about investor requirements and to an understandable sense that something as personal and 'special' as a creative idea deserves respect and thus investment.
- The creative individual must be driven by a sense that his or her work offers something distinctive, convincing and investable. Packaging these ideas into a tangible form is often not a focus or even desirable. Therefore, it is important for both the Creative Industries and investors to work collaboratively to understand one another's mindsets and achieve mutual objectives.

2.3 Creative Businesses: a reliable investment?

Creative businesses are frequently perceived by investors as having some of the following characteristics:

- They are emotionally rather than business-driven, with a weak connection between ideas and market, and an unwillingness to relinquish control.
- They are non-conformist – in dress, business practice and etiquette.
- They can be demanding of funds without attending to structural impediments to them obtaining these funds, such as high quality business plans and a more assured connection to markets.
- They move quickly, rarely settling on long-term plans.

Some of these attributes are also assets, such as the drive for innovative products and practices. With better market intelligence and support, this entrepreneurial energy could be transformed into a more 'investor-focused' approach.

2.4 Investors: Creative Industries ready?

Investors' perceptions of the Creative Industries and their areas of expertise need to change if they wish to take advantage of this important economic growth area. The following represent barriers to investment:

- Established 'investor communities' are reluctant to invest in small and early stage creative businesses due to a lack of knowledge of creative business growth potential and the inflexibility of current investment criteria.
- Investors perceive creative businesses as 'lifestyle-oriented' businesses and are wary of them because they are not seeking to become big enterprises that make large profits. This is a popular complaint among the equity investment community, which in recent times has tended to adopt a more 'macho' approach to the assessment of investment opportunities. Creative businesses do, however, contribute greatly to the national economy. However, they do not offer investment fund managers the potential for large bonuses.
- A lack of investor expertise reduces investor confidence, and creative businesses will often be dismissed as falling short of investment-readiness regardless of the viability of the business.

2.5 Towards Creative Industries investment: a two-way process

It has been established that:

- Many creative businesses are not developing investment-ready approaches and lack the support and information to do so.
- While some 'investor-types' are aware of barriers to investment for creative businesses and are dedicated to finding ways to reach the sector, the Creative Industries sector is far too misunderstood and/or negatively stereotyped.

This report will show that that investment in the Creative Industries is both necessary and achievable in order for it to achieve its potential. For this to be achieved, it is vital that:

Creative businesses work to meet the criteria of investors while investors work to capitalise on the growth potential of the Creative Industries sector. It is crucial to find and develop a new middle ground, where newly investment ready creative businesses build a relationship with better-informed, fast-moving, creative investors.

3. Proposals

To achieve this territory between investors and creative businesses, three key intervention areas are proposed.

i. The Creative Industries gateway:

- The Creative Industries need greatly improved market intelligence that advances understanding of the sector and helps investors to make informed decisions.

- DCMS and its partners should disseminate this intelligence and showcase the potential of the Creative Industries sector to potential investors.

- Dedicated business support, network and intermediary structures should be instituted as a 'Gateway' between the Creative Industries sector and potential investors. It is vital that investors are introduced to creative businesses that are investment ready.

ii. Bespoke creative finance:

- Initiatives should be developed to encourage investors to adopt flexible investment criteria for creative businesses.

- More research is required to develop bespoke Creative Industries investment opportunities. This includes a focus on specialist Business Angel syndicates and dedicated Creative Industries venture capital funds.

iii. Creative spin-outs and clusters:

- Initiatives should be developed to target investment in the Creative Industries through existing and new creative clusters, with an emphasis on reaching talented businesses that are surrounded by other talented businesses and support services.

- The Higher Education sector must be more active in developing commercially focused Creative Industries businesses and engaging itself with growing Creative Industries clusters. This will improve investment readiness and build investor confidence. However, it would be more productive for the sector to focus on business development and spin-outs for graduates rather than undergraduates. This is because the 'reality' of business is unlikely to emerge for creative undergraduates until they step outside an academic environment.

4. Areas for further research

Although beyond the scope of this report, additional studies would be helpful in the following areas:

- Company law: to investigate the applicability of existing legislation, much of which was conceived in the 19th Century.
- Financial tools: to examine the effectiveness of existing financial packages that are tailored to the needs of the Creative Industries and to examine how successfully these have been adopted by creative start-ups.
- Success factors: to identify what drives exceptional business growth in the Creative Industries.
- Community: to examine the particular challenges faced by women and minority ethnic groups in developing creative ventures.

5. Conclusions

Creative Industries entrepreneurs will struggle to access finance without a concerted effort to provide a loud, coherent and appropriately targeted voice. Based on the findings in this report, and the learning from the Graduate Pioneer Programme, NESTA intends to work with Government departments and other stakeholders ranging from think tanks to regional development agencies to debate the best way of delivering regulatory, operational and financial improvements to the Creative Industries sector.

It is important to express the importance of the commercial potential of this sector. As this report has shown, access to finance is dependent upon better understanding by the following audiences:

- Graduates and businesses: knowing what is possible and what is expected of them.
- Investors: understanding the real commercial potential of early stage creative businesses.
- Policy and decision-makers: recognising the significance of partnerships, sectoral intelligence and leadership for a growing Creative Industries sector.

This research has identified a new 'middle ground', that would enable creative businesses to demonstrate their investment readiness and for financiers to gain access to robust market intelligence that accurately reflects the true risks and potential of the Creative Industries sector. The sector is not a risky proposition: it is a safe bet for a vibrant and highly productive UK economy.

1. Introduction and methodology

Though fast growing and increasingly strong, this report shows that the Creative Industries sector requires targeted support and a stronger voice. This is vital to attract investment that provides high levels of return to investors and allows creative businesses to grow faster and earlier. It is potentially vital to the future of the UK economy, because it is creative businesses that provide the ideas, products and services upon which an innovative and expanding economy is built.

There were two key aims for the research:

- To strengthen NESTA's Graduate Pioneer Programme by improving understanding of Creative Industries businesses. Its aim was to focus on the ability of creative businesses to attract investment as part of a viable and convincing sector that plays an important and growing role in the UK economy.
- To identify opportunities for advancing the investment readiness of creative businesses. This relates to notions of investor readiness and ensuring that this is recognised by investors, intermediaries and policymakers. It also outlined possible interventions and models that can help to increase investment in young Creative Industries businesses, to enable the sector to reach its potential.

The research had five key areas of enquiry:

- To clarify the key characteristics of business start-ups or developments in the Creative Industries sector, as distinct from businesses emerging from other sectors.
- To find out and compare the key criteria that different forms of investors use in deciding whether or not to invest in businesses and projects within the Creative Industries sector.
- To ascertain the willingness of different types of investors to invest in the Creative Industries sector. For instance, how prepared they might be to adopt different assessment methodologies to invest in Creative Industries start-ups and developments.
- To identify what those seeking investment in their start-ups might need to do in order to enhance the likelihood of attracting funding.
- To propose assessment criteria or methodologies which investors might use in order to better assess the potential of a creative business. This encompasses forms of support and approaches to monitoring that could enable investors to increase the likelihood of a return on their investment.

This research was driven through a qualitative methodology with three key interfaces:

- A review of existing literature available in hard copy or online. This provided information on the business profiles of the Creative Industries sector and the investment criteria of each targeted investor community. It also included commentaries, policy documents and studies that engage with issues relating to finance and investment readiness for the Creative Industries sector. This necessitated a diverse reading list that contains technically focused financial reports alongside qualitative profiles of Creative Industries businesses.
- Online searches for investor and investment programme websites that complemented hard copy findings and provided a context for the qualitative interviews. Websites were subject to the same textual analysis as other literature. Key websites consulted are referenced in the text.
- In-depth qualitative interviews with 50 consultees. These were targeted to complement available literature and existing research, and many signposted the research team to further literature. Consultees were recruited from four key investor communities: public sector debt finance, commercial debt finance, Business Angel equity and venture capital equity. Consultees were also recruited from strategically related areas such as the Higher Education sector, Central and Regional Government and expert Creative Industries intermediary agencies.

2. An exceptional case? A Creative Industries business profile

The last decade has seen the rise and rise of the Creative Industries in the UK. As a high growth sector with economic power and a progressive, inclusive agenda, it offers Government an effective tool for regeneration and renewal.

The DCMS, working in tandem with local and regional Government, has advocated the regenerative potential of the Creative Industries. It is a sector that offers major growth areas for the UK economy, such as in software and product design, and is viewed longer-term as a key-driver in the economic, social and definitional transformation of the UK. Creative businesses are innovation rich, particularly in new technology, are research and experimentation-led, and deliver their best performance in specific environments. What's more, they employ 1.3 million people and generate revenues of £112.5 billion to the UK.[12] Most significantly they sell ideas: ideas of lifestyle, ideas of identity and ideas of 'distinction'[13] that touch people's lives.

This section of the report will outline the distinctive business profiles that have driven the burgeoning creative economy. It also outlines the challenges presented by the Creative Industries unconventional approaches to business or 'business models'. These are articulated as signifiers of risk and poor business practice to many public and private sector decision makers and investors.

The Creative Industries sector is likely to remain at the margins of public sector intervention and private sector investment unless key issues are addressed. Of particular concern is the weak or untargeted support infrastructure and underdeveloped intelligence on the sector's business profiles and productivity. After preparing the groundwork for an approach to creative business profile building, this section of the report calls for an intensive approach to the development of creative sector intelligence and for associated advocacy (this is pursued further in section four).

A brief policy context

The Creative Industries sector is recognised as a potential driver for regional economic and social policy[14]. For some English Regional Development Agencies (RDAs) and for the major vehicles of Scottish, Welsh and Northern Irish economic policy, it is located as a priority intervention area. Similar specialist interventions are emerging. Many of these were introduced in the 2002 Regional Creative Industries Strategies, such as the South East England Development Agency (SEEDA) and the North West Development Agency (NWDA).

At a local and regional level, the public sector has led a myriad of initiatives designed to support Creative Industries activity. These range from dedicated intermediary support services such as the Cultural Industries Development Service in Manchester (www.cids.co.uk) or the Cultural Enterprise Service in Wales (www.cultural-enterprise.com) to Creative Industries managed workspace and cluster initiatives. At a national level, the DCMS has acted as an initiator of activity[15], providing an economic argument for a Creative Industries focus through the 1998 and 2001 Creative Industries Mapping Documents. These interventions were developed by DCMS through the former Creative Industries Task Force, represented by leading industry figures and charged with an advocacy and advocacy remit.

Such interventions include the establishment of NESTA. Dedicated initiatives for the sector have grown, but not significantly, and recognition of the economic, social and cultural significance of the Creative Industries sector is widespread, though underdeveloped.

[12] See DCMS 2001

[13] See O'Connor and Wynne 1996; Florida 2002; Hesmondhalgh 2002.

[14] See DCMS 2000 and DTI 2001

[15] This dates back to New Labour's pre-1997 election manifesto, which was strongly influenced by Australia's 1994 'Creative Nation' policy.

On the margins of policy and investment

The DCMS is a relatively small Government Department that competes for resources and influence with departments such as the DTI. In addition, local/regional Creative Industries initiatives are often short-term and certainly under-resourced. The Creative Industries community perceives that it is not a high priority for local, regional or national Government, regardless of the fast-growing support infrastructure that has been introduced in recent years[16]. For if it was, the resource allocation would be greater. Indeed, more research is required here to quantify current levels of support.

That public investment levels in the Creative Industries sector are unknown is perhaps symbolic of the sector's low strategic profile and the lack of investment to understand the sector more. No other key sector is so sparingly researched.

What is impeding further public sector intervention in the Creative Industries is a lack of detailed knowledge in key areas. Notably, a complete overview of the economic impact of the sector, and flexible, nuanced information systems detailing growth, market gaps, skills shortages and so on. Without this data, it is almost impossible to build confidence in the Creative Industries, which demonstrates that it has the potential to translate public support into marked positive economic outcomes.

Given the paucity of high quality baseline data, and without a unified voice, such as that offered by a trade body or even the DCMS, the sector will provide a high risk, albeit intriguing, proposition for private sector investors. The forthcoming introduction by the DCMS of the Regional Cultural Data Framework[17] will help to provide comparable regional statistics across the UK, but it will fall short of providing real change. This is because it may be some years before appropriate changes are made to standard occupational and industrial classification codes[18]. In addition, greater sectoral intelligence is required that includes detailed business models for different Creative Industries' sub-sectors. For instance forecasting tools, as well as structural and legal data are needed to reduce the costs for due diligence. Without this data, it will be difficult for the Creative Industries sector to be considered as an orderly and meaningful proposition by investors.

The value of statistics? The need for intelligence

Despite the absence of sophisticated data intelligence for the Creative Industries sector, for the purposes of advocacy, the DCMS in 2001 estimated that the total annual revenue of the sector is £112.5 billion, employs 1.3 million people and provides £10.3 billion in exports. It also is said to contribute 7.9 per cent of the total GDP and is growing faster than the rest of the economy.

At a regional level, for example, the sector employs 99,000 people in the North West[19], with a £21 billion output in London[20], and employs more than 100,000 people in Scotland, with a turnover of more than £5 billion[21]

However, the problem here is that statistical basis here is inconsistent, the counting methods questionable and the level of detail negligible. This makes the presentation of a compelling case to investors difficult. Without detailed comparable intelligence, focused towards sub-sectoral and geographical areas, sector statistics will not convince investor communities as they should.

[16] Findings from the Barriers into the Realisation of Creative Ideas, NESTA, 2002

[17] Offering a transferable tool-kit for creative business and employment 'counting'.

[18] See London Development Agency (LDA) 2002

[19] Arts Council North West 2002

[20] Greater London Authority 2002

[21] See www.Scottish-Enterprise.com

DCMS' definition of the Creative Industries Sector

In 1998, the DCMS provided the first Government-backed definition of the Creative Industries Sector within the first Mapping Document. This was adhered to in the second edition in 2001. It states:

'Those activities which have their origin in individual creativity, skill, talent, and which have their potential for wealth and job creation through the generation and exploitation of intellectual property. These have been taken to include the following sectors: advertising, architecture, the art and antiques market, crafts, design, designer fashion, film, interactive leisure software, music, the performing arts, publishing, software and television and radio.'

Defining the Creative Industries sector: introducing its 'alternative' qualities

Questions remain about the definition of the sector, its growth forecast, and its potential return from both public and private sector investments. There is also the degree to which it differs from other sectors and is deserving of special attention. The latter point is of importance, because issues that are often cited as specific to the Creative Industries sector – such as low level business skills, a lack of capital and barriers to accessing finance – are common to the small business sector as a whole[22]. Greater insight is needed of the Creative Industries' complex and unique business profiles if it is to achieve the support of investors and public sector sponsors.

The DCMS' definition of the Creative Industries sector enabled for the first time a discursive unity to be established whereby content driven industries, such as film or publishing, could exclaim their growing importance and communicate the benefits they bring as part of the 'fastest growing national sector'.

Although the sectoral definition has at times been contested, it has enabled the role of the Creative Industries sector and its value for national, regional and local economies, to be widely recognised. While there are some anomalies, such as the omission of the visual arts sector, it offers a means to promote the sector, to advocate intervention and to begin the process of attracting attention to sub-sectors that by themselves lack the power and mass for more weighty public and private sector intervention.

This research examines the Creative Industries' economic value, because its focus is on improving investment readiness and attracting new investment. However, before this is discussed in more detail, some of the softer attributes of the sector deserve recognition[23].

The Creative Industries sector is represented by businesses that[24]:

- Characterise a place as attractive, energetic and forward thinking.
- Whose cultural and business values can help support individuals and build communities.
- Focus on flexible and innovative business models that can help other sectors develop new ways of communication, accessing markets, and organising production.
- Maintain a professional interest in and a commitment to high quality design and environments.
- Offer presentation and animation skills and other public and outward facing skills which are integral to the successful realisation of business goals.

[22] See for example the Small Business Service 'Competitive Strategy for Start-ups', 2003a.

[23] For in-depth qualitative appraisals of these attributes, see for example Leadbeater and Oakley 1999; O'Connor and Wynne 1996; Landry 2000; Evans 2001; Pratt 2002; Fleming 2003; Fleming forthcoming.

[24] Adapted from DPA 2003.

- Have links to a variety of institutions, particularly higher education, for research, recruitment and professional development purposes.
- Offer interesting, inclusive and amenable locations, where networking between companies and individuals can be facilitated. This enables businesses to help grow, attract and retain a talented creative community based on their reputation, quality of life, and the local cultural offer.

These ingredients define the 'exclusivity' of the Creative Industries, which is a sector represented by mainly small companies for which creative content production is central. Other sectors will be able to claim some of the above, but not that they are developing such synergies through creative exploration.

2.1 Creative Industries business profiles: the significant seven[25]

Creative Industries businesses are in the business of cultivating meaning-laden products. While the Creative Industries sector itself and the space(s) it inhabits lead to particular understanding of ways of living, ways of seeing and ways of 'doing business':

- Creative Industries businesses are not like traditional businesses: they inhabit multiple business positions. They traverse between and across 'the formal' and 'the informal'; 'the sub-sector-specific' and 'the generic', 'the lifestyle orientated' and 'the utterly profit-motivated'[26].
- Creative businesses and the amalgam or 'sector' that they form, are defined through the creative processes that are at their core. They each contribute to new and evolving products that in many cases have an under-explored commercial value[27].

There is a danger of over-casualising the sector and of glamorising its lifestyle attributes. Of course creative processes do not always follow linear business development models, but they work within the Creative Industries sector, with commercial reward as a key aim, and very often a market 'in mind'.

Of course many Creative Industries businesses have their roots in the enjoyment of creative practice, and although this can be a distracting factor that undermines full commercialisation, the focus of any creative business is to make a profit. With the caveat of making as much of a profit as possible, without compromising the quality and uniqueness of the creative content, that made profit achievable in the first place. Though 'messier' and more fraught than some business models, such as retail, a creative business is profit motivated. It seeks to reach markets and inspire new markets, and the key objective is growth[28].

It is essential for accurate, flexible and consistent (sub)sectoral intelligence is gathered if public sector policymakers and private sector investors are to make sense of this 'messier sector' and develop confidence in the Creative Industries sector. This intelligence should have a sharp statistical focus, but it is also important to understand the uniqueness and ordinariness of the sector. If the sector's anomalies can be interpreted as a strength, and its mainstream attributes as a reassuring presence, then confidence in the sector as an 'investable proposition' will grow. This is especially likely given the potentially large commercial return that this might bring.

The following 'significant seven' provide an entry-point to the particular business profiles of the Creative Industries sector.

[25] This research has uncovered seven key atttributes as a helpful way of engaging with the distinctive business profiles of the sector.

[26] See Wynne 1992; Verwijnen and Lehtovuori 1999; Evans and Foord 2000

[27] See NESTA 2002 and Fleming (forthcoming)

[28] Pratt 2002; Hesmondhalgh 2003

Element one: higher-educated businesses

The Creative Industries is more graduate-rich than any other key sector in the UK economy. For example, in the South West Region, 43 per cent of employees in the Creative Industries sector have a first degree or higher. This compares for example with 29 per cent for advanced engineering[29]. Morey et al (2002) finds that graduates from a creative media background are valued by employers for:

- The contemporary nature of their knowledge.
- Breadth of outlook.
- Flexibility.
- Self-organisational skills.

They may have higher confidence levels, be more resourceful, have the capacity to multi-task, and have more ambition:

'The hands-on, problem-solving approach of creative subjects equips graduates well, as it produces flexible, adaptable entrepreneurs'[30]

But it takes time for this to develop and for graduates to appreciate the value of these skills. Indeed, creative graduates often take several years in a range of employment areas, operating across different 'employment portfolios' before making the decision to establish their own creative businesses. This is in part due to perceived lack of the market value of their work[31], a sense of trepidation of the skills sets required to manage a business[32], and ineffectual quality careers guidance and business training for creative undergraduates[33].

A predominantly graduate background for creative entrepreneurs is no guarantee of commercial robustness, though it is likely graduate entrepreneurs will have a high level of reflexivity and thus a capacity to 'build-in' skills and approaches as required. Indeed, creative graduates display a willingness to learn throughout their careers. For example, a study of 390 creative professionals in the South East region revealed that 60 per cent undertook training in an average year[34]. Yet 53 per cent did not feel that their training needs were being met. In addition, it is likely that many of those that do undertake training are working in public sector arts organisations; and it is even more likely that they will be employees rather than management.

Business start-up for Creative Industries graduates is in many cases unconventional, with businesses often the unintended 'product' of the process of creative practice, a "narrowly focused single professional activity"[35]. Issues of content production, originality and the development of new work are motivating factors. Commercial practices emerge later such as market research, professional image, networking and profit[36]. Indeed, a defining feature of a successful creative business is its ability to change direction, mutate and transform. It is by moving fast in creative ways that the business succeeds. They are as commercially-driven as enterprises in many other sectors, but seek joint rewards that are financial and creatively liberating. Yet the pathways to ongoing commercial success do not always run in the same direction. This can present problems to an investor seeking a clear business path; but for the creative business a different approach is a necessary challenge and a commercial imperative.

[29] Higher Education Regional Development Association Research, 2003.

[30] Ball, 2003, p.33

[31] Daniel 2002

[32] Ball 2003

[33] Ball and Price 1999

[34] Blythe 2000

[35] Summerton 1999

[36] Ball and Price 1999

Element two: fleet-of-foot businesses

Creative businesses are often flexible, fleet-of-foot, constantly seeking new ideas, collaborations and markets. A successful creative entrepreneur is a good anticipator and a market-focused innovator. To develop market opportunities, creative entrepreneurs must have a built-in mobility: to follow the affordable workspace, build an interesting partnership, or access an untapped market. This is why creative graduates so often establish businesses far from home or their place of Higher Education[37]. They often select places that are creatively stimulating or buzzing with opportunities for collaboration[38].

This is also why the creative sector is so dependent on a supply chain relationship with freelancers – individuals capable of keeping up to speed with the changing development needs of businesses as they develop new projects and seek to access different markets. Finally, this is also why cash-flows in early stage creative businesses are often unpredictable and capital under-developed. Intellectual property is a mobile force that requires flexible approaches to production and its consumption, which belies a rootedness favoured by many more traditional business models. This mobility is a factor of independence, a business necessity and a cherished matter of corporate distinction[39].

Element three: small businesses

Early stage creative businesses are predominantly SMEs, with a high proportion led by owner-managers and an even higher proportion legally constituted as sole traders. A common misconception is that this is an intentional structural characteristic, an embodiment of lifestyle values, where a creative practitioner requires control over the creative process and is protective of intellectual property. This is a version of the harboured autonomy so important to Leadbeater and Oakley's 'independents', and in many cases has great resonance.

Yet a high proportion of creative businesses gain their size through collaboration with other creatives, which as aggregate supply chains, have similar profiles to sectors with larger companies. Processes of temporary agglomeration are necessary for a sustainable and commercial Creative Industries sector. Indeed, the dynamics of creative collaborations often have a vigour and acute complimentarity, because they are so bespoke, in ways that enhance creativity and certainly lead to improved commercial opportunities. In this sense, small is not always a limiting factor for sectoral growth, and investment in collaboration, especially if formalised through official mergers, can be of lower risk than in individual larger companies.

Yet for many creative businesses, small is an unintentional and highly limiting business model. It presents limitations on investment readiness and creative development. Many creative entrepreneurs do have the ambition to grow their business, to increase management capacity rather than rely on multi-tasking between the creative, administrative and strategic. However, as will be explained in sections two and three, a complex mix of investment readiness and investor readiness factors are preventing growth and keeping them small.

Element four: networked businesses

The Creative Industries sector is creatively and commercially dependent on networks[40]. Networks and their spatial expression – be they virtual, building-based, sub-sector-specific, formalised, raggedly informal, social or business orientated – provide the Creative Industries sector with its infrastructure and knowledge; its sense of sectoral identity and source of inspiration. Networks also provide a channel for expression, exploration and the translation of ideas into economic reward. Without highly developed networks of the multiple forms

[37] Fleming 2003

[38] Evans and Foord 2000

[39] Leadbeater and Oakley 1999

[40] See for example Crewe 1996; Crewe and Forster 1993; Purvis 1996

described, creative businesses are left knowledge-poor, unaware of opportunities and are unlikely to develop creatively and commercially. This has direct relationship with investment readiness issues, for an isolated, under-networked business is less likely to have the best ideas and the strongest partners. Indeed, such a business is unlikely to ever become aware of investment opportunities and certainly not how to reach them.

Element five: shy businesses

Despite its propensity for networking and dependence on networks, the Creative Industries sector is not made up of boisterous, dauntless networkers, confident in themselves and promiscuous in the routes they will take to develop ideas and secure business. The sector is distinctive in terms of its relative youth, with a large proportion of very young practitioners, fresh out of college, lacking business skills, weak of voice and often unaware of how to articulate their creativity as commodity[41]. There are significant cultural and social barriers to talented individuals endeavouring to develop businesses in the Creative Industries sector. The occasional exclusivity of the Creative Industries sector, the debarring qualities of its networks, and the absence of a dedicated approach to career path development, all introduce challenges if a sector is to achieve a level of investor confidence.

Indeed, many attempts to support the sector do not attend to these distinctive features. For example, training schemes designed for small businesses in other sectors are rarely transferable to the creative sector. There is a growing appreciation of the need for bespoke approaches to creative business support and skills development, with a client-focused approach. There is also recognition of the important role of sector intermediaries, such as Inspiral in Sheffield and The Creative Lewisham Agency[42] in London. These may work for a specialist business support agency or sector skills body. Their task is to be the interface and buffer zone between the shy creatives and investors, decision-makers, or even markets. They often work at a local level, immersing themselves in the specific cultures and approaches of the local Creative Industries sector, and then step out of the sector, to communicate the needs of the sector to a wider audience.

However, creative intermediary support services are not widespread: their resources are limited and their voice muted. Creative businesses are therefore also shy because they do not have a coherent, articulate, confident voice. Taken as a whole, there are great disparities between the content, function and direction of the Creative Industries' sub-sectors.

There is a lack of awareness from creative businesses, investor communities, decision makers and commentators, of what the sector means, its current productivity, its growth potential, who it represents, and how it can feasibly work with divergent sub-sectors. Many of these organisations don't consider themselves to be a part of a unified Creative Industries sector.

Without strong sectoral leadership, provided with a confident and respected voice, creative businesses will remain undervalued by policymakers and investors alike. Underpinning this is the requirement for robust sectoral intelligence that proclaims the growth potential of the sector to key audiences such as potential investors. In addition, a coherent sectoral voice spares creative businesses of misplaced approaches to investors, where it is assumed that finance is expected as a right in return for fantastic ideas or products. A strong lead will enhance investor relations because fewer creative businesses will feel impelled to go it alone.

[41] Ball and Price 1999

[42] See www.creativelewishamagency.org.uk

Element six: knowledge rich businesses

Creative Industries businesses are key knowledge producers, with a major influence over patterns of economic production and consumption. Plus they play an energetic role in recreating senses of place and identity, from Scottishness to Mancunian[43]. They are also intrepid knowledge consumers. They are unbridled and exuberant in their search for new information, ideas and technologies, unbounded in their capacity to experiment to develop new concepts, forms and thus knowledge. However, this creative knowledge exploration often distracts from the search for practical knowledge. These include opportunities, assistance and tricks that will help them to translate their creativity into commodities that sell.

Many Creative Industries businesses are not fulfilling their potential to become profitable businesses. There are fashion designers with great ideas but little concept of the market for these ideas; there are furniture designers showcasing prototypes at inappropriate trade shows; there are musicians peddling demos to every record company listed, as if this will work. For a knowledge rich sector, Creative Industries businesses in any locality are remarkably under-informed and thus under-prepared for investment.

This is due to the absence of dynamic, inclusive networks, which as discussed above are excellent ways to stumble across vital knowledge or to channel targeted and specialist information. For instance, how to develop export markets if you are a designer-maker. It is indicative of the shy and isolated nature of much of the sector, in particular sole traders. It can be linked to the low business aspirations of some creatives, even a lack of awareness that their skills and products are potential commodities. And it is due to the absence or failure of dedicated information, business support, advisory and specialist investment readiness services for the Creative Industries sector. These would permit businesses to be more aware of the market systems, competitor environment, skills/training and finance[44].

Element seven: ambitious and entrepreneurial businesses

Creative businesses, often led by young and relatively inexperienced graduates, develop their business practice in unconventional ways. This requires high levels of ambition and the adoption of entrepreneurial values where risk and trust are prevalent. A sector that thrives through its innovativeness and is deliberate in its efforts to experiment is a sector familiar with the notion of risk[45]. Yet exercised risks are too often extended into business strategies, partnership arrangements, and non-contractual relationships. The informal, often social-driven networks that are so important for the knowledge systems of the Creative Industries sector, are carried into transactions and business plans often based on little other than trust and intuition, rather than evidence and market intelligence.

This of course impedes the sustainability of creative businesses and, unless a rich slice of luck is involved, can be linked to the false economy whereby many businesses remain unnecessarily small, operating on a portfolio rather than corporate basis. Creative businesses need to concentrate on commercial skills involving meticulous market research, a strong focus on sales, and a hunger for information and assistance that will help the venture to grow. Without this groundwork, excellent qualities such as ambition and entrepreneurialism hang rather shabbily from struggling creatives.

[43] See Haslam 1999.

[44] DPA (2003) highlights the lack of business skills and the general isolation of creative businesses struggling to develop markets on the fringes of Kings Cross in London. The report recommends network initiatives that connect these businesses to local information and market opportunities.

[45] Raffo et al 1999

Very few creative businesses lack ambition and entrepreneurialism – a common perception. What they often lack are the skills or human resources to focus their creativity through robust processes of business planning. Of course, specific sectoral characteristics often make this difficult. For example, the relationship between market and product is unclear when a product is yet to be developed, and a market for that product may only develop as a response to the product's existence. Overly complex supply and demand relationships do not ease the business planning process nor provide investor confidence. However, in many instances, growth and the factors that may facilitate growth, such as finance, will be more likely to occur with the introduction of:

- Bespoke business training would enable creative businesses to develop their market research and professional skills in a commercial context. Nuanced understanding of what is achievable, such as finance, and how to reach it is needed for a sector that is currently under-informed.
- Strong professional networks that provide opportunities for issues related to business development as much as for creative exploration.
- Targeted and highly specialised sub-sectoral support, focusing on issues such as intellectual property or export.[46]
- Continuous professional development.

These are key processes that facilitate degrees of investment readiness. Many early stage creative businesses have the business skills and market awareness, plus of course the creative talent to develop successful high-growth businesses. Many do not.

[46] Different varieties of sub-sector support may be required.

3. The ladder of finance: investor attitudes and current provision

"Despite being one of the UK's fastest growing sectors, the Creative Industries are under-invested"

(The Mayor's Commission on the Creative Industries, London 2003).

'Banking on Culture', the important and influential report published by North West Arts Board in 2000, states that the creative "...sector has difficulty getting finance and services...that access to financial services is harder for this sector than for others" and that "The form of investment they do get actually damages the sector's medium and long-term prospects" (p.13). The business cultures and structures of small, early stage creative businesses[47], are in many cases not compatible with the desired business profiles of investor communities. Furthermore, the predisposition of investment towards traditional sectors tends to exclude creative businesses. This stems from a lack of familiarity with the sector as a proposition.

Although the Creative Industries are situated at the margins of mainstream investment opportunities, most small early stage companies experience difficulties in raising capital, regardless of sector. This represents a market failure:

> "Start-up businesses and those lacking a track record sometimes face difficulties in accessing debt finance, and SMEs with high growth potential are often unable to raise the modest amounts of equity finance required to meet their growth ambitions. The Government believes that some SMEs that fail to raise this investment may be victims of structural market failures that give rise to finance gaps"[48].

Such gaps vary from start-ups struggling to raise debt finance from the retail banking sector for amounts up to £100,000, to an equity gap for amounts from upwards of £50,000 to £1 million[49]. However, in general the capital market is understood to be reaching most areas of need, with market failure uncommon and often linked to issues of investment readiness. The UK has well developed capital markets that, by comparison to other European countries, are efficient and flexible in developing instruments that support the majority of early stage investment needs[50]. Attempts to bridge the finance gap, such as through adjustments to the Small Firms Loan Guarantee Scheme or through the Enterprise Investment Scheme, might be viewed as a mere tinkering with a system that is working rather well.

Yet this is not the consensus for early stage creative businesses and the intermediaries that seek to support them. Discrepant business profiles that do not meet mainstream expectations of investment readiness, combined with a lack of sectoral intelligence, which heightens investor risk are exacerbated by structural barriers to investment, such as lack of capital. These are combining to marginalise talented and pioneering creative businesses, denying them the opportunity to fully explore their market potential.

This section of the report explores further the creative business profiles introduced in the previous section of the report. It involves a direct assessment of the practical investment criteria for start-ups and early stage Creative Industries businesses of four key investor communities. Here, notions of investment readiness are further interrogated to isolate those business characteristics and investor attitudes that

[47] Across most creative sub-sectors.

[48] Small Business Service, 2003, p.9.

[49] This varies by circumstance and sector (see for example Bank of England 2002; Carpenter and Petersen 2002).

[50] Bank of England, 2002

can be changed to enable flexible, bespoke approaches to investment that help to bridge the finance gap for early stage Creative Industries businesses. Such potential ways forward are presented in sections three and four.

3.1 Small scale public debt finance: a help or hindrance?

For many creative businesses, small amounts of finance offered through loans or micro-credit schemes[51] provide the necessary cash injection to get the business up and running, with investment often targeted towards capital items, materials and marketing. Sources of such finance include local regeneration companies, Regional Development Agencies, small organisational credit programmes and national programmes such as The Princes Trust.

They are attractive to early stage creative businesses because:

- Small loan funds offered through regeneration companies are often unsecured or risk loans. They require less capital to secure the loan, reduced due diligence on the part of the lender and thus less evidence of investment readiness by the borrower.
- Administration and delivery can be more flexible than loan capital from banks, often working as soft loans that support the urgent need for cash flow. For example, a fashion designer may need an injection of cash to finance a fashion show, which it is hoped will attract orders enabling the repayment of the loan.
- Business support and mentoring is often a precondition of the investment. In some cases, this can be of a specialist nature, greatly improving the business and sectoral acumen of the borrower[52].
- Finance is normally targeted to areas with high levels of deprivation and often tied to European Structural Fund areas[53]. Many such areas are in the inner city and city fringe. Creative Industries businesses often cluster in such areas, attracted by relatively low rents and a general creative dynamism[54].

Correspondingly, Creative Industries businesses (in particular start-ups) are attractive to such investors because:

- Creative Industries businesses are often understood as social enterprises, perhaps due to the cultural element, the initial cash flow problems, and a capacity for some creative forms to be attuned for social purposes[55].
- Creative businesses are disproportionately clustered in areas of deprivation. Indeed, they are often seen as drivers of the regeneration process in such areas, transforming the built environment and cultural ambiance in ways that lead the way for wider processes of change[56].
- At a start-up stage, a relatively high proportion of creatives are from Black and ethnic minority backgrounds and/or are women. The challenges such groups face in building creative careers and/or gaining employment in larger creative companies requires more research.

[51] Plus some grant schemes – such as that offered by the Cultural Industries Development Agency 2000-2002 (see www.cida.co.uk) or through specialist awards such as 'Small Film Funds' (ie as offered by the old London Film and Video Development Agency). This report does not focus on grants as their value as investments is less clear. See NWAB, 2000.

[52] The Cultural Business Venture in Essex, Bedfordshire and Cambridgeshire offers beneficiaries bespoke mentoring services. It is part of a start-up investment service of Princes' Trust loans (up to £5,000) delivered in partnership with Arts Council East see Cultural Business Venture 2003.

[53] This refers to Objective One and Two areas for the European Regional Development Fund

[54] See Evans, 2001; City Fringe Partnership, 2002

[55] NWAB, 2000

[56] There are multiple examples of creative businesses leading urban generation processes. These include St Katherine's Dock in London and the Northern Quarter in Manchester.

Micro-credit

Within the UK as a whole, community finance initiatives aimed at social enterprises serve around 100,000 people and control around £170 million of capital (GLE 2000). Micro-credit provides loan and sometimes savings services to entrepreneurs at either start-up or growth stages. Most projects focus on group-lending techniques as a way of achieving the high repayment rates. Projects include Street-Cred, targeting ethnic minority women in East London through loans of up to £1,500, managed through the women's business development agency, Account Three[57] and Street UK, providing loans of up to £5,000 (a national project)[58]. These are based on funding delivery mechanisms where donations or investments are made by organisations and institutions (mainly banks). A typical model is the Deutsche Bank Micro-Credit Development Fund, a registered charity seeded by Deutsche Bank with £500,000: Deutsche Bank staff and contacts give charitable donations to the fund, which is then distributed to a local micro finance institution (such as Street UK), which is then transferred to businesses as micro-credit or banks as collateral.

A micro-credit initiative that targets the Creative Industries sector has been launched by Culture Finance North West[59]. Here, micro-credit loans are delivered through Bolton Business Venture (a recognised micro-credit fund manager), providing small business development opportunities for creative SMEs. The fund helps to bridge a gap in seed and development finance for the sector, providing a useful stepping stone towards larger finance opportunities that Culture Finance North-West is seeking to lever.

Start-up and seed capital

More research is required to assess the take-up and benefits of start-up and seed capital offered through such socially focused business investment and development schemes. The impact on new regional seed-capital loan funds also requires attention, with their capacity to lever commercial debt finance in need of analysis. In addition, the opportunities provided by new financial instruments such as Local Enterprise Trading Systems (LETS) require analysis[60]. Though of obvious importance for struggling creative start-ups where any source of finance is welcomed, there are some key limitations to small loans and micro-credit schemes of debt finance:

- There are scores of local and regional loan and micro-credit initiatives across the UK, delivered by multiple organisations, delivered to discrete geographical areas. This causes problems of accessibility and intelligence, where creatives have difficulty knowing what is available in their area and whether they are eligible for an initiative. It also raises issues of the quality of advice and support systems than can be attached to such a high number of initiatives.
- There is a lack of targeted marketing to creative businesses and specialist Creative Industries support is uncommon.
- Initiatives often have very short lives, limiting their reach and sustainability.
- If offered in areas where grants are also available, especially bursaries for creative practice. Creative businesses may be disinclined to pursue debt finance and instead continue to operate on a hand-to-mouth project basis. Again, good quality business advice might dissuade creatives from this grant mentality.

[57] See www.account3.org.uk

[58] See www.cdfa.org.uk

[59] Established by the North West Regional Development Agency and Arts Council England. Its role is to develop opportunities for the Creative Industries sector by delivering a loan and micro-credit programme. See www.culturefinance.co.uk

[60] NWAB 2000

- Many loan facilities have investment criteria that require similar investment readiness profiles to the retail banking sector. Creative businesses without a financial track record or lacking capital will therefore be excluded.
- Investment is often provided to loan schemes through the social investment departments of major banking institutions[61]. If many beneficiaries of such investment are Creative Industries businesses with high growth potential, then it follows that major banks position small creative businesses (both strategically and conceptually) as a 'social concern'. By pursuing community finance, creative businesses are in danger of inviting opinions that question their commercial potential.

Creative Industries businesses in search of start-up and seed capital therefore encounter barriers or imperfect solutions at the very bottom of the finance ladder. Of course good quality advice and information, leading to robust business planning, would be of value. But there is a broader danger where attracting some forms of finance at the outset can lead to a typecasting for the rest of the business lifetime. Notable exceptions include the general recognition of the Princes Trust as a good starting point for many pioneering businesses and the Deutsche Bank Pyramid Awards, offering £7,000 to Design or Art graduates as a crucial start-up investment[62]. Yet other finance sources are not viewed so favourably.

For a creative business wishing to grow – and to grow quickly – debt finance through a community banking initiative is not ideal if the next stage is to impress upon a retail bank their commercial potential. In an economy where 80 per cent of the loan market is provided by the banking sector[63], it is often wise to attempt to step over debt finance opportunities from other sources.

3.2 Commercial debt finance: the retail banking system

Put simply, the retail banking system adheres to exactly the same investment criteria for any small business, whether it is a bakery or a fashion designer. Unless the business has a turnover of more than £10 million per annum, bespoke financial instruments are not available to creative, or indeed any other small business, in search of capital or seed funding. The opportunities for debt finance provided by a typical high street bank are, therefore, the same for every small business. However, as this research will show, this is not the case. Creative businesses face barriers to investment from the retail banking sector through a combination of:

- Structural issues relating to the strict investment criteria of banks.
- Cultural issues relating to the business profiles of creative businesses.
- Knowledge issues relating to levels of mutual (mis)understanding between banks and potential customers.

However, there are recognised barriers to finance for small and especially start-up businesses regardless of the sector:

- Information needed by banks to undertake due diligence on loan applications may be expensive or impossible to obtain. This may result in an application being denied, or lenders may attempt to reduce risk by rationing lending by quantity[64].
- Many assessments of risk are based on information gained through past relationships with borrowers and/or on business track record. Fledgling businesses therefore face the highest barriers and if successful in acquiring investment, are likely to receive less favourable terms.

[61] The UBS Enterprise Fund Ltd is managed through HBV Enterprise (a local regeneration firm in Hackney, E. London). It provides loan finance of £3-25,000, with some guarantee required through commercial sources. See www.hbv.org.uk

[62] see www.rca.ac.uk for case studies. Over 60 pyramid awards have been given to London creatives. The awards enable bank staff to engage with and learn from creative entrepreneurs.

[63] Mayo et al 1998. Banks provided 61 per cent of all external finance to SMEs during 1997-99. See Cash and Hughes 2000.

[64] Stiglitz and Weiss, 1981

- Problems of 'informational asymmetry' such as those outlined can be softened if the borrower can demonstrate a significant personal or other stake in business success. This might involve personal equity, collateral, or finance from other sources. Many small businesses cannot do this.

The HSBC Model: PARSERS[65]

Each bank has developed a complex system for making judgments on borrowing. This is often broken-down as an accessible system for business managers to use when judging applications. At HSBC, an acronymic model called 'PARSERS' is used. This reveals much about investment criteria and helps to identify possible barriers for creative businesses:

PERSON: the attitude, presentation skills, level of market research, quality of CV.

AMOUNT: the level of stake proposed (bank prefers to have a minority stake), liquidity and anticipated profitability over the first year.

REPAYMENT: the expected cash flow relative to the quality of the market research.

SECURITY: this is dependent upon amount requested; if a limited company, the limited assets will be tied to the company.

EXPEDIENCY: any underlying factors that may favour or prejudice investment.

REMUNERATION: level of interest and potential bank profit.

SERVICES: any other bank services that can be offered to the applicant.

Providing Security? The Small Firms Loan Guarantee Scheme (SFLG)

The SFLG is a Small Business Service (SBS) initiative that provides guarantees on loans to small firms of up to 75 per cent of the loan. This mechanism is designed to provide debt finance opportunities to businesses that lack security (such as property or personal equity), yet have a commercially sound business proposition. In simple terms, a retail bank unable to invest in a proposition due to the lack of security, though favourable otherwise, can administer the SFLG as security[66]. The SFLG should therefore increase access to debt finance for creative businesses seeking commercial debt finance. It does not, however, overcome every barrier to accessing debt finance. For example:

- There are exclusions to the scheme, including 'own account' businesses such as artists, musicians, composers and authors[67].

- The SFLG will only be considered by a bank if the loan application passes every commercial consideration. Where there are information asymmetries, such as with creative businesses, the bank may be unable to undertake appropriate due diligence and will therefore reject the application.

- The loans are guaranteed over a medium period of 2-10 years. This is not sufficiently flexible for some creative products.

Key assets for a business when making an application for debt finance from a bank are thus informational security, where a bank feels it knows enough about the business to invest; and capital, where risks can be under-written through other sources.

[65] Provided by Chris Cherryman, Business Manager, HSBC, Deptford, London.

[66] See DTI 2003. Guarantees are provided for loans of a minimum of £5,000; and a maximum of £100,000 (unless the firm has been established for more than two years, when up to £250,000 can be accessed). For amounts of £30,000 or less, the bank processes applications in-house. The SBS administers approximately 4,000 loans per year which is less than one per cent of total bank lending.

[67] These are excluded on a legal basis through Section 8 of the Industrial Development Act, 1982.

While accessing such assets is a struggle for many start-up companies, for early stage Creative Industries companies it is additionally challenging. Early stage Creative Industries businesses face significant barriers in securing debt finance from the retail banking sector because:

- They have few tangible assets such as property. The major asset of the creative business is the intellectual property and the potential for further content production held by creative practitioners. Such assets are not valued or understood by banks, and the costs of making a valuation would be prohibitive[68].
- They are unlikely to have strong commercial track records, either because they will be fresh from graduation or will have undertaken unpredictable portfolio work. Banking records are likely therefore to be patchy, with unfavourable track records and a regular dependence on overdrafts.
- Many early stage creative businesses require investment to build market(s) for their product(s). The relationship between product and commercial value is thus unclear. Without secured orders or a recognised market, banks are reluctant to invest.
- The retail banking system lacks creative sector specialists in most locations. Indeed, there is a low level of understanding of what the sector means and the types of businesses it contains. Without in-depth knowledge of the markets (real and potential) of creative businesses, or of the distinctive business profiles of such businesses, for instance whether they are project directed or dependent on intellectual property, a creative business is unlikely to secure a favourable response. The lack of mainstream sectoral intelligence and widespread sectoral advocacy outlined in section one of this report, present additional impediments to investor confidence.
- Creative businesses often have longer lag times between the idea and its realisation as a commercial asset. This can be problematic for a lender seeking a return within a narrow time frame (usually one year).
- Creative businesses are too often perceived as lifestyle businesses, without serious commercial intent or potential.
- A long-term business skills deficit amongst early stage creative business, where businesses have approached banks short of investment readiness on any terms, has reduced the likelihood of high quality propositions gaining investment.

Barriers to investment for creative businesses are therefore caused by the technical investment criteria of banks. These can be problematic for any small business but are often prohibiting for creatives. There are also issues of informational asymmetries related to technical criteria and a lack of mutual understanding. This in part stems from the banks' lack of sectoral expertise and because the creative sector is not forthcoming with high quality sectoral intelligence and robust business plans. The onus on reform is thus relevant to both the banks and the Creative Industries sector.

Where specialist banking systems have been introduced, their reach has not extended to significantly fit start-up and early stage creative businesses, although more research is required here. A creative business which requires a loan of £50,000 to invest in key capital items, a basic marketing campaign and some product development research, cannot expect to meet sympathetic bank personnel who are familiar with the markets and business models of the sector. Without significant collateral and a very solid banking record, such a business will in most cases be asked to seek finance elsewhere.

[68] See Euclid 1999 for an analysis of the financial and business support services available to the creative sector on Merseyside.

A specialist banking service? Barclays Media Division: MORFA

Barclays and the Royal Bank of Scotland have established a dedicated Creative Industries service that seeks to provide targeted business support services to creative businesses. More research is required to assess the impact of these services[69].

Barclays Media Division, based in Soho Square amidst the largest cluster of Creative Industries activity in the UK, offers specialist services to companies that focus on post-production, marketing services, publishing, television[70], film and music. The main focus is on providing advisors who speak the language of the creatives, who understand the challenges and markets, and who can provide helpful sector contacts. This, in theory, should help to mitigate issues of information asymmetry and enable due diligence to be conducted in-house in an efficient and affordable manner. Evidence is not available to support this, but it is likely that fewer good quality propositions get turned away than at a regular high street branch.

Other specialist services include the potential for television producers to borrow the full value of their production (including all costs and legal fees); and filmmakers can borrow up to 66 per cent of the costs of an independent evaluation of intellectual property. Yet such services are available to already established, high value companies.

Small early stage creative companies are faced with the same investment criteria as any other branch of Barclays. They are tested against MORFA:

MARKETS

OBJECTIVES

RESOURCES

FINANCE

ABILITY

3.3 Business angels: a creative opportunity?

Business Angels are private individuals, often operating within syndicates, who seek investment opportunities in private companies in return for a minority equity stake[71]:

- They often commit amounts of between £10,000 and £100,000 in a single investment (few commit more than £50,000 to a single investment). Larger investments are achieved through syndicates of Business Angels or through the leverage of additional finances such as through the Small Firms Loan Guarantee Scheme (SFLG).
- There are estimated to be approximately 18,000 Business Angels in the UK actively looking for investments.
- They invest around £500 million a year in 3,500 companies.
- They like to invest in sectors they are familiar with to reduce risk.
- They are likely to spend less time on due diligence processes than venture capital firms, due to resource availability.
- They don't like to invest in companies that are too far away[72].

[69] Particularly with The Royal Bank of Scotland, where contact was not achieved through this research.

[70] 40 per cent of UK television production companies bank with Barclays. This is suggestive of an attractive service (see Barclays 2003).

[71] See www.one-london.com for a concise definition.

[72] Usually no more than 100 miles from where they live or work (BVCA 2000c).

Tax Relief for Business Angels

The existence of tax relief upon subscribing for ordinary shares in a 'qualifying company' provides an incentive for Business Angel investment, with possibilities for model-transference on a sub-sectoral basis (for example, there are models that provide tax relief for investment in environmentally sustainable activities). There are four key areas of tax relief in this context, each a part of the Enterprise Investment Scheme (EIS)[76]:

- Income Tax relief: Angels can obtain income tax relief on the amount subscribed for shares in one or more qualifying company, provided the company is not connected to the investor. Relief at the rate of 20 per cent is calculated on the amount subscribed.
- Exemption from Capital Gains Tax: Any capital gains realised on the disposal after five years of the shares, on which EIS income tax relief has been given and not withdrawn, are tax free.
- Loss relief against income or gains.
- Capital Gains Tax: investors can claim to defer paying tax on all or part of a chargeable gain arising on the disposal of any asset.

A key issue for Business Angels seeking syndicate partners or intermediaries working to expand the Business Angel market is the transparency and navigability of tax regimes. Private investors are deterred from investment if tax issues are cloudy or costly to translate. The removal of red tape upon entry and disposal is a major aspiration[77].

- Due to the size of the transaction a preference is for an equity stake that carries management influence, so investment is usually in start-up and early stage companies. They usually choose to be minority shareholders.
- Many Business Angels utilise networks to gain access to propositions[73], and form syndicates to make investments.
- They are likely to want to keep their investments for at least three to five years. This is usually established at the outset.
- More than 90 per cent of potential investments are rejected at the initial screening stage[74].

Business Angels provide a vital source of finance for start-up and early growth businesses from a range of sectors. They help to fill finance gaps because they will consider propositions turned down by a bank and they make relatively high risk investments. They are, however, more likely to invest if finance is available from other sources, as a kind of match, or where detailed sectoral intelligence is available. Investment is not solely motivated through financial gain and capital appreciation. The Business Angel often invests with a by-product being the hands-on experience such as through a mentoring or management role[75]. Indeed, a Business Angel can add real value to the growing investee business, often as a non-executive director, aiding its development and preparing it for future rounds of investment. Business Angels can:

- Introduce business contacts and enhance supply chains.
- Provide strategic and operational advice.

[73] The National Business Angel's Network is the largest example. The Best Match service connects clients to each other and provides information on trends and the relative movement of risk. See www.nationalbusinessangels.co.uk .There are many other networks, either offering start-up or seed capital through public sector initiatives, or those that make a profit brokering the deal. See www.one-london.com and www.advantagebusinessangels.com.

[74] Much of the above information is provided through the National Business Angels Network: www.nationalbusangels.co.uk and the British Venture Capital Association (BVCA 2000c).

[75] See NBAN 2003.

[76] See Inland Revenue 2003 for more detail.

[77] See Investor Pulse 2003 Business Angel Survey.

- Take short-term active roles to resolve management issues.
- Mentor key staff[78].

Business Angel investment is thus more than merely financial.

Yet it is of course the quality of the business proposition that drives the market. Tax relief is helpful, as is the availability of additional finance that is co-invested, such as by other Angels in a syndicate or through a partner investor programme such as an Early Growth Fund[79].

Guided by national organisations, such as the British Venture Capital Association (BVCA) and the National Business Angels Network (NBAN), syndicate partners and private equity networks[80] seek a range of essential technical investment criteria before moving towards establishing a finance role. These include:

- The basics: robust business plans with in-depth details of management team and structure; products/services; market research with a customer and competitor focus; operational details (premises, suppliers, facilities, equipment needed etc); strategic planning (sales and marketing methods); legal status; financial information (investment required, finance sources to date, previous investment); appendices (providing CVs, brochures, technical information etc)[81]. Of course, high growth potential is key.
- Qualitative factors: a familiar market for which there is investor intelligence (at least from someone in the syndicate); location (proximity is favoured); the personal qualities of the management (good organisers and/or good presenters).
- The level of venture capital competition: a larger investment made up of a syndicate of Business Angels may be under threat from a venture capital firm, which will always have more investment clout.
- The level and cost of due diligence required: less is preferred (hence the value of syndicates). A level of sector intelligence and gatekeeping processes offered through Business Angel Networks or other intermediary companies, such as those that specialise in growth acceleration, is vital.
- Opportunities for syndication are also valued because they enable risk to be spread across a portfolio of companies.

Key to the development of Business Angel networks and co-investment programmes is the reduction of risk introduced through a mix of gatekeeping, intelligence by numbers (a network is likely to carry a wide range of expertise), and the additional due diligence and finance provided through the partner fund. The scope for developing sector specific networks is introduced in section four of this report.

This research has uncovered structural (or technical) and cultural (attitudinal, social, perceptual) barriers to Business Angel investment in early stage Creative Industries businesses[82]:

[78] See NBAN 2003.

[79] See Small Business Service 2003b.

[80] See www.hotbed.uk.com or www.beerprt.com for examples. Such companies often also operate as incubators and business accelerators for client companies, investing in companies and providing them with the infrastructure and expertise to accelerate their growth through the critical stages of initial development.

[81] Taken from guidelines provided by the One London Business Angels Network: www.one-london.com

[82] Also see Mason and Harrison 2001.

A Business Angel Network and an Early Growth Fund: One London Business Angels Network (OLBAN) and London Seed Capital

Business Angels invest in smaller investment sizes than other forms of equity, such as venture capital. This makes investment in processes of due diligence inefficient and disproportionately costly (due diligence costs similar amounts regardless of the transaction size). The greater the available intelligence, the stronger the consensus that surrounds a deal, and any additional finance, invoke confidence in a Business Angel by reducing a sense of risk.

Organised Business Angel networks play such a role. OLBAN is a long-standing not-for-profit Business Angel Network that operates within Greater London Enterprise[83]. It has access to over 500 Business Angel investors across London and the South East. OLBAN works to:

- Provide members with investment propositions.
- To deliver seminars that provide investors with key guidelines on issues such as syndication, company valuation and tax breaks.
- To make connection with potential complimentary finance sources.

OLBAN invites businesses to submit business plans to the network. In-depth assessment is made of such plans, often followed-up by further questioning. Once accepted as a potential high growth company, OLBAN seeks to connect propositions to investors through initiatives such as 'presentation days', where Business Angels are invited to meet proposition businesses in both a formal and informal capacity.

In late 2002, OLBAN secured an investment partner for deals developed through network members: London Seed Capital (LSC)[84]. This £2.8 million fund is the first of the SBS's Early Growth Funds, designed as co-investor for Business Angel deals. It is presented as a vital 'plug' in the 'equity gap' for early stage businesses in the UK[85]. Once a business has secured a commitment to investment from a Business Angel (or a syndicate of Angels), it can approach LSC, which in turn can call its Investment Committee at 72 hours notice to ensure rapid deal flow. Investments range between £100-600,000.

The structural:

- Small(er) creative businesses often require relatively small amounts of money (less than £100,000). This is too small for most Business Angel Syndicates relative to the amount of due diligence required on the investment[86].
- Small(er) investments require that the Business Angel invest in the people rather than the business, which requires a higher degree of risk.
- There are few examples of good quality collaborations and mergers between small creative companies that can help to aggregate the risk, reduce the costs of the transaction, and in many cases inject a stronger business model[87].

[83] See www.gle.co.uk

[84] See www.londonseedcapital.co.uk

[85] SBS 2003b

[86] See NBAN 2003.

[87] See www.pembridge.net for an example of how 'investment readiness' can be enhanced through the aggregation of small creative companies.

- Business Angel networks have to carefully monitor the sectors and business profiles of propositions as part of their gatekeeper role. It does not make strategic sense, for a not-for-profit network manager, or in a commercial sense, a private network, to present businesses to investors that have little chance of attracting interest[88].
- There is a general lack of confidence at present, with investors looking as much as possible for low risk propositions.
- Many creative businesses lack the strong management teams with the skills to grow businesses in line with projections. Business Angels can provide support here but are reluctant to invest due to the current flatness of the market.
- The lack of exit options is increased in a sector that a potential investor knows little about. The often shorter cycles of trade for creative businesses increases investor uncertainty.
- Business Angel networks vary in the quality and sectoral focus of members. For example, in rural or declining industrial areas, finding Angels with expertise and sufficient finance can be difficult.

The cultural:

- There is a lack of expertise amongst Business Angels regarding the business models and growth potential of early stage Creative Industries businesses. Many investors have inherited their money or come from a financial management or communications background. Intelligence on the Creative Industries sector is therefore low.
- Such low confidence in the sector is deepened by a low understanding of 'what' the sector contains.
- A perception remains that creative businesses are lifestyle-focused and lack commercial skills and potential.
- There is a perception that many creative businesses are unwilling to surrender shares in their company for fear of losing creative autonomy and legal ownership of intellectual property. It is assumed that this jarring of agendas is more acute where syndicates of investors are involved.
- Many creative businesses are not aware of the potential for Angel investment and are thus disinclined to prepare themselves as 'investment ready' for this particular market. A lack of available information on finance opportunities and specialist business support is relevant here[89].

As with debt finance, 'informational asymmetries' and structural constraints prevent fluid investment in early stage Creative Industries businesses. Indeed, even Business Angels who have 'made their fortune' through Creative Industries activity are likely to display investment practices that are as conservative as other investors. Yet for many creative business propositions, high growth is achievable. With improved business planning and management, better sectoral intelligence and perhaps the development of progressive sector-focused Business Angels, confidence in the sector can be improved. Coupled with increased confidence from other finance providers, such as the banks, Angel investment might provide opportunities for early stage creative businesses that far outstrip current provision. The potential for this is explored in section four.

[88] See www.onelondon.co.uk

[89] Unless stated, the 'structural' and 'cultural' Business Angel criteria are based on opinions stated by consultees. These include Business Angel investors and creative business intermediaries.

3.4 Venture capital: a gap too far?

While there are considerable barriers to small firm investment through commercial debt finance and Business Angel equity, there is a recognised equity gap 'beyond the £250,000 upper threshold of most UK Business Angel investment...the effect of the equity gap only begins to ameliorate for deals over £1 million'[90]. It is at this stage – £250,000 and above – that venture capital finance is the only feasible source of investment. Yet for small early stage creative businesses, access to such finance is extremely rare.

Venture capital investors avoid smaller deals because:

- Transaction costs are disproportionately high: informational asymmetries can only be overcome after due diligence. The costs for due diligence are largely fixed, so a smaller investment is as expensive to process as a larger investment.
- Smaller investments are likely to be unfamiliar types of deal, perhaps in sectors for which there is a relative absence of investor intelligence. This raises the cost of the transaction yet further.
- Ongoing costs for deals are largely fixed, thus acting as an additional disincentive to 'invest small'. Indeed, with younger, less experienced management teams, investors might anticipate higher ongoing costs than for mainstream deals.
- Risk is perceived to be higher because the management team, product and market may be unproven.
- The lack of exit options is troubling for investors used to clear development plans.

In addition, factors that have been highlighted previously in this report, such as a perceived lack of 'investment readiness' within early stage companies (relating to issues such as the poor quality and presentation of business plans), present another barrier to venture capital investment.

Creative businesses are extremely unlikely to attract venture capital in the open market. The barriers to such investment are even higher for the Creative Industries sector, incorporating all of the above plus additional investment constraints. Many of these stem from widely held negative perceptions or under-developed profiles of the sector. This research has uncovered a discursive unity between a range of venture capital firms, where the sector is understood as a non-proposition. In addition to the structural factors highlighted above, investor attitudes to early stage Creative Industries propositions include:

- Creative businesses are understood in a similar way to technology propositions, except without the growth potential. The high costs necessary to assess the potential of creative businesses are prohibitive.
- Venture capital investment has relatively low returns on investment for early stage and technology investments, so investors are unlikely to be persuaded that Creative Industries propositions will provide sufficiently high returns.
- Creative businesses don't require the larger sums of money invested through venture capital: the focus should be on accessing finance for amounts less than £100,000.
- Creative industries propositions are only likely to succeed if there is a very strong track record or if their focus is on distribution and localisation rather than content development. For example, a retail chain or a firm that localises games so that they have a relevance to different markets (such as by changing the language), deal with creative products, but are not subject to variations in trends.
- Few creative businesses have well developed distribution arrangements; they have 'flimsy' marketing channels; and weak supply chain relationships.

[90] SBS 2003b, p11. The equity gap is estimated to be at its widest in the range between £375,000 and £900,000.

- Creative businesses are reluctant to cede control of intellectual property.
- The Creative Industries sector is very diverse, which presents difficulties for an investor attempting to identify opportunities. An investor likes to identify a favoured sector, then target a niche, and then sharpen the focus to specific companies. The Creative Industries sector presents a disparate landscape with few obvious opportunities.
- The Creative Industries sector is very 'service-based' and thus people-centred and reliant. This presents new risks.
- There are few specialist investors in the sector, which does not breed confidence for other potential investors.

There is widespread cautiousness from venture capital firms (operating across a wide portfolio of sectors) of the likely return on investment from creative propositions. Indeed, one fund manager from a major venture capital firm said:

"Everyone likes being creative, but it's only worth being creative if the market demands it".

Venture capital trusts and regional venture capital funds

With investments normally well in excess of £1 million, few early stage creative businesses require venture capital support. However, Venture Capital Trusts (VCTs) and Regional Venture Capital Funds (RVCFs) do have relevance, because they provide opportunities for smaller investments through venture capital.

VCTs can be established by investment firms to enable them to target smaller investments. In these cases, tax incentives are offered by the Treasury for indirect portfolio investments and are administered by professional fund management companies[91]. This provides opportunities for investors with an interest in developing a Creative Industries market to build companies through VCT investments. This might stimulate growth by enabling the companies to access mainstream venture capital finance through future investment rounds.

The venture capital firm Ingenious Media is working on this principle, with a VCT to be launched in late 2003 that targets investment at or below the £1 million level. It aims to 'stiffen' business opportunities towards future investment through their larger development capital fund. Ingenious Media is a specialist investor, focusing on creative-led and media companies[92]. Such an operator is rare, largely because investor expertise and thus investor confidence in the Creative Industries sector is rare. The company's main Development Capital Fund[93] is essentially a 'high end creative fund'. Propositions are assessed on exactly the same commercial basis as in other funds, but in this fund the sectoral and technical expertise exists to properly assess potential. The relief offered through VCTs has enabled this specialist fund manager to build-in a kind of nursery of creative investments.

However, most VCT investments avoid Creative Industries investment on the same principles as described above. In addition, VCTs are being established in partnership with Business Angel syndicates in ways that collectively raise investments beyond the £1 million upper limit, thus undermining the 'early growth investment principle' of the VCT instrument. The Small Business Service is currently reviewing options for VCT reform to enhance the focus of the instrument so it meets initial policy objectives.

Regional Venture Capital Funds (RVCFs) were introduced through the DTI in England and Wales to improve the supply of risk capital beyond the reach of

[91] SBS (2003b) p.23 offers a breakdown of the tax relief offered through VCTs.

[92] Current creative investments include the club brand Cream; 19 Management (led by ex-Spice Girls Manger Simon Fuller), and Stage 3 Music Publishing. See www.ingeniousmedia.co.uk

[93] Established in partnership with Genius Media and UBS Warburg.

mainstream venture capital investors, with initial investments of up to £250,000 in the first round and an option of a further £250,000 after six months[94]. The RVCFs are sponsored by the Regional Development Agencies and DTI and managed by recognised fund managers (at great expense)[95]. Examples include the North-West Equity Fund[96], Catapult in the East Midlands[97], The Capital Fund in London[98], and Finance Wales[99].

Though some investments have reached creative businesses[100], creative investment is rare. This is due, once again, to perceptions of investment readiness and actual investment readiness. These evaluations are based on the quality of creative propositions or the lack of such propositions by the creative entrepreneur, and the lack of Creative Industries knowledge amongst fund managers. The RVCFs are starting to make some progress in narrowing the equity gap for SMEs in different parts of England and Wales, but their impact on early stage creative businesses is only slight. More research is required here to adequately track the process.

Targeted creative industries equity

There is a Creative Industries equity gap in the UK. Early stage creative companies denied access to debt finance face significant barriers accessing mainstream equity through Business Angels, 'small-amount' venture capital funds (such as VCTs and RVCFs), and larger amounts through the venture capital 'mainstream'. However, attempts are being made through public sector support, mostly driven by the RDAs, to introduce equity instruments as targeted investments for the Creative Industries sector. For example, the Welsh Development Agency will soon launch a 'Film and Television Fund', offering a Mezzanine (equity and loans) programme that utilises available European Union Objective One regeneration funds to invest directly into indigenous companies. Its overall goal is to attract activity and creative investment in the principality as part of a broader inward investment programme.

An alternative approach is being developed by Scottish Enterprise, which has established a £3.5 million 'Scottish Digital Media and Creative Industries Co-Investment Fund'[101]. Significantly, this offers project finance to early stage creative companies, enabling them to follow a content-focused development plan rather than feel constricted by the corporate business development pressures that mainstream equity enforces. Co-investment is sought from private investors with an expertise in the sector, utilising the tax relief offered through the Enterprise Investment Scheme.

However, this is not through a classic equity arrangement: shareholdings will not be available in investee companies. The aim is to highlight the potential of Creative Industries businesses as investment propositions while remaining loyal to the distinctive, project-focused, business models that many such businesses employ. The Fund compliments the cross-sectoral Scottish Co-Investment fund and raises the profile of the Creative Industries sector. This is within the context of creative businesses operating as a high growth sector, which require more nuanced and bespoke investment packages to facilitate growth, in order to leverage mainstream finance in the longer term. Any intensive

[94] See DTI 2002a and 2002b for more information. Also see www.invest.uk.com

[95] Funds are around £30 million per region, depending on the sponsorship available through the RDA.These are relatively small investments for venture capital.

[96] See www.nwef.co.uk

[97] See www.catapult-vm.co.uk

[98] See www.thecapitalfund.co.uk

[99] See www.financewales.co.uk

[100] Such as Skaramoosh, a television animation, design and production company based in London's Covent Garden. See www.thecapitalfund.co.uk

[101] See www.scottish-enterprise.com

investment readiness programme is wrapped around the Fund to ensure that the Fund acts as a development stage that can lead to further investment opportunities.

In the West Midlands, The Advantage Creative Fund has moved beyond its 2000-2001 pilot stage, by relaunching as a £5 million venture capital fund that targets Creative Industries businesses. The target is to invest in over 50 businesses over a five-year period, with investments ranging from £25,000 to £100,000. The Fund is managed by a not-for-profit company, supported through Advantage West Midlands (the RDA), Arts Council England, and European Structural Funds. Apart from developing links with other investment sources such as banks and Business Angel networks, the fund's prime purpose is to build familiarity and confidence within the traditional financial community towards Creative Industries businesses.

The Fund is managed through a virtual office, with creative businesses encouraged to submit business plans to the website[102], which are then assessed through a staged process culminating in – if successful – an investment agreement 'in principle' followed by the undertaking of due diligence.

The costs of due diligence are kept down, though there are small investments for risk capital, because a large initial investment was made into a standardised procedure. As with any venture capital programme, the aim of the Fund is to realise a commercial return.

Such specialised creative investment initiatives show that equity investment in the Creative Industries sector is achievable and that the public sector can play a leading role in levering investment and achieving the confidence of the private sector. Such programmes allow for smaller deals than normally considered by private sector investment, although a range of potential 'problems' have been identified.

These include:

- There is a danger of ghettoising the Creative Industries sector by establishing it as a special case. This detracts from its potential as a real commercial proposition.
- The costs of due diligence are too high, so a false market is created.
- The lack of commercial success of some deals has been noted.
- The initiatives provide tiny amounts of money relative to sectoral need and the broader equity market.

These are all important points, with the reference to commercial success crucial. However, these initiatives are relatively new and it will inevitably take time to attract better commercial propositions and for fund managers to identify winners with more clarity. Moreover, a specialist approach to financing the Creative Industries provides additional benefits that include:

- Building partnerships with business support agencies, such as Business Link, so that a more co-ordinated approach to investment readiness is adopted.
- Raising the profile of creative businesses as potential investment opportunities. For example, the management team behind the Creative Advantage Fund has worked very hard to establish links with Business Angel networks, to attract co-investment and to lever investment into growing businesses, after the lifetime of the Fund.
- In this sense, a £5 million Venture Capital Fund for the Creative Industries sector finds its real strength as an advocacy tool. It facilitates a process where potential investors such as Business Angels, the RVCF and private venture capital firms, start to build a relationship with the sector.

[102] See www.creative-advantage-fund.co.uk

It is this focus on investor confidence that is crucial. Investor confidence is primed through three main factors:

- Improved investment readiness of creative business propositions.
- High quality intelligence on the Creative Industries sector 'as a proposition'.
- Technical levers such as tax relief and co-investment opportunities.

The first of these factors is presented in the next section of this report and the others in section four. It must be restated that structural and cultural barriers often present barriers to venture capital investors considering creative propositions.

4. Overcoming barriers: prepared to grow, ready to sell

There are two key barriers to investment that can be reduced with relative ease and with a more calculable impact. These are:

- The lack of sectoral intelligence, and advocacy systems to spread this information, continues to perpetuate investor nervousness, scepticism and indifference when confronted with Creative Industries propositions. Creative businesses must be presented to investor communities as high growth, investment ready propositions, with differently nuanced versions of 'investment readiness' according to investor-type.
- The lack of investment readiness of many early stage creative businesses. This includes poor business skills, under-developed markets, and a lack of awareness of the technical criteria that a proposition must meet.

Creative businesses have a responsibility to focus on both of these issues. But they can only do this with targeted investment readiness support, and overriding campaigns that promote the investability of creative businesses to investors at a national, regional and local level. What is required is high quality and convincing sector intelligence. There is a role for public policy here:

- To develop bespoke investment readiness programmes that provide creative businesses with the information, skills and – most importantly – the self-drive to source investment opportunities.
- To develop research that enhances sector intelligence. The outputs of this exercise must:
  - Be targeted at the investor communities.
  - Seek technical changes to some investment criteria on the basis that opportunities are being missed.
  - And to develop new financial instruments that bridge remaining finance gaps and counter market failure.

This section of the report focuses on the first of these challenges. The second point is explored in the final chapter of the report, section five.

Investment readiness?

This is an over-used and under-considered term, which should always refer to basic structural components such as a robust business plan (and all that this signifies), but should also be constantly re-assessed according to changing market opportunities, legal contexts and investor priorities. In this sense, a business can be 'investment ready' one day, but not the next. Here, the importance of understanding the need for a constant re-evaluation of the business profile (and thus the fallibility of 'investment readiness') is the key attribute of a creative firm that has a chance of re-presenting itself as investment ready.

For investors, it should be incumbent upon them to initiate and maintain a dialogue with potential investees, so that 'investment ready criteria' (and thus finance opportunities) are clear and accessible. Yet perhaps of greater importance is the potential for investors to consider adjusting their assessments of 'investment readiness' to be inclusive of growing Creative Industries businesses. Such businesses can change their approach to business planning and development (the 'cultural dimension'), but they are not in a position to influence investor criteria.

4.1 An 'investment readiness model' – a vain pursuit?

As this report has shown, there is no such thing as a universally applicable 'investment readiness model'. That is because the business profiles of the Creative Industries sector are diverse. Each finance instrument has a different emphasis, and the perceptions and prejudices of investors are multiple and in transition. However, what is clear is the need to improve the basic business skills of early stage creatives. Key actions include sharpening creatives' focus towards investors or markets, and developing a more resourceful culture where creatives start to demand access to information, such as on finance sources. At present many creatives are unaware of the existence of such data. It is also clear that this can only be achieved by appealing to the basic 'Creative Business Profiles' introduced in section one.

This requires investment readiness programmes to be tailored more accurately to the Creative Industries to ensure sustainable growth and profitability. This requires the following actions:

A focus on the Creative Industries sector:

- **Building a dialogue with graduates:** most creatives are graduates, so opportunities to reach graduates should be developed as soon as possible after graduation, or perhaps prior to graduation (although this is a contested issue).
- **Understanding the importance of mobility:** investment readiness support programmes should move to where the businesses are located. Different locations have different finance opportunities that demand a different set of readiness indicators. These should move with the businesses as they change and grow.
- **Small business awareness:** which translates as a focus on small business issues. For example, such businesses are time-poor and can waste valuable time seeking support and investment. Clarity and quality are thus vital characteristics of any investment readiness programme.
- **Appreciating the role of networks:** for information to reach creatives most efficiently, and for this information to be accessible, it must adapt to the networks of the sector. This means that it is promoted through virtual networks (such as online communities), local clusters and existing network initiatives. It is important that the issues of 'investment readiness' have a currency, that they are talked about and respected within the sector.
- **Building market intelligence:** the sector is information-poor. Many creatives do not have the confidence to seek support. Many are unaware that they are developing content with commercial potential, or feel uncomfortable about approaching investors. Some do not know investment opportunities exist. Investment readiness is as much about building confidence as it is developing sharp business plans.
- **Managing over-confidence:** a sector that is information-poor is also likely to make mistakes when assessing what is achievable. This may be articulated by inaction (as above), or by inappropriate action. For instance, some creative businesses approach investors, are rejected, and then look to the investor as the party at fault. In many cases, it is the creative business that is at fault. This might be because it has chased inappropriate finance or has lacked an understanding of what is required to access finance. Better information and advice are required, plus intermediary gatekeeping systems. This should help to minimise the number of inappropriate and under-prepared propositions that creatives present, perhaps overconfidently, to startled investors.

- **Knowledge management:** creative businesses are knowledge producers and work as small, highly networked businesses where knowledge (or the absence of it) is even more critical than it is for other sectors. They are thus rampant knowledge consumers, alertly seeking knowledge that may bring opportunity. However, many creatives are not skilled in separating the useful knowledge from the useless. Investment readiness initiatives – and the importance of 'investment readiness' – must be presented and locked into creative networks as highly useful knowledge.
- **Harnessing ambition and entrepreneurialism:** investment readiness initiatives must ride on the back of the ambition and entrepreneurialism of the sector, for these are essential attributes in commercial growth. However, the initiatives must challenge ambitions and ensure they are realistic, facing towards real investment opportunities rather than those that can never be reached.

A focus on the investment sector:

- **Negotiation on the technical investment criteria:** if these can't be reached, then the dialogue should focus on other areas.
- **Intensive and bespoke business planning:** following the procedures as laid-down by potential investors.
- **Identification of goals, objectives and key performance indicators:** which vary according to investor requirements. A business that is aware of 'investment readiness issues' though, will continue to identify and problematise the factors.
- **Crisper presentations:** the task is to impress upon the investor the value of the proposition in terms of the product, services and people.
- **Establishing reliable market intelligence:** providing the facts and figures that make the case. Crucial here is a commitment to generating ongoing Creative Industries intelligence that is developed in partnership with investors. This will ensure that they are more Creative Industries ready because they will be familiar with sector intelligence and have a sense of ownership.
- **Knowledge of management and markets:** showing that sustainable growth is possible and that down-times can be managed as effectively as up-times.*
- **Financial and fiscal awareness:** how much is needed, how much can be sourced from elsewhere, and how much will be made. Also an understanding of tools such as tax relief, preference shares or benefits of working with a creative company.
- **Understanding the difference:** the special characteristics of a creative business that the investor may be nervous about. These issues range from intellectual property ownership, the relationship between supply and demand, to how to invest in an intangible product. A thoroughly convincing case for investment must be developed.
- **Better monitoring:** linked to the above point, it is important that creative businesses devise convincing systems to monitor performance that satisfy investors.
- **Engaging with sustainability:** if a track record is absent, the business plan must be shown to be executable, and – if equity is sought – clear opportunities for investor exit must be revealed.
- **Policy awareness:** new legislation on finance, taxation and small business growth, plus on sector-focused issues, such as the Communications Bill, can impact upon the potential for attracting finance. Businesses and those that support them need to be knowledge-rich on policy.

- **Managing the skills base:** evidence should be presented at every opportunity of the technical, creative and corporate skills of key staff, with a track record of continual professional development plus a willingness to continue that development, vital.
- **Evidence of ongoing innovation:** If project focused, a stockpile of projects and products with commercial potential may be as close as a creative business can get to a tangible asset.

The above provide a basic 'investment readiness' focus list that must be re-packaged and provided with bespoke depth according to the location, sub-sectoral focus, investor target and so on, of the 'investment readiness' initiative. It is likely though that most such initiatives will be either fund-specific, such as the support offered in partnership with the Scottish Digital Media and Creative Industries Project Fund; or sector-specific, with the daunting task of developing a flexible model that provides the necessary balance of targeted intelligence and generic business planning information.

Agencies such as Business Link have started to develop this, using their mix of sector experts and finance experts to build an 'Access to Finance Programme' for the creative and other sectors.[103] Finally, it is also likely that a mix of support will be needed. This will require business support agencies, intermediaries and investment readiness facilitators to alert creative businesses of support that is provided elsewhere.

For investment readiness initiatives to achieve their objective, and leverage appropriate finance for Creative Industries businesses, they must be clearly positioned within the overall portfolio of support available at a national, regional and local level to Creative Industries businesses. The areas to be addressed include training, workspace, advice and showcase initiatives. This requires a lot of strategic partnership, such as between agencies and programmes, so that initiatives gather widespread support and, more importantly, have a high profile. They must make a noise.

There are, for example, existing 'investment readiness' programmes such as 'ready4growth', a workshop programme that culminates in a pitch to equity investors (as a rehearsal) for early stage digital companies across the UK[104]. However, if such initiatives aren't attracting the most appropriate businesses or are not complimented by support initiatives, at a very local or sub-sectoral level, then they will not reach their potential. In this sense, as much attention should be paid to the broader business support and informational context than to specific investment readiness interventions.

Indeed, it is this broader intervention, strategic and policy context that will give or deprive investment readiness initiatives of their impact and influence. A much more coherent approach to business support and training for the Creative Industries sector is required[105], coupled with a strong advocacy voice that emanates from central Government and reverberates across the UK.

[103] See www.bl4london.co.uk for more information. European Regional Development Fund (ERDF) Objective Two monies are delivering a tiered 'investment readiness' programme that provides essential training and support to businesses for a range of available finance instruments.

[104] 150 early stage digital companies participate in an intensive workshop programme which aims to: a) improve the quality of business plans; b) improve entrepreneurs' capability to build successful digital businesses and increase investor confidence in the digital sector. It is supported with three million Euros from the European Commission Directorate General on Information Society. See www.ready4growth.com

[105] The London Development Agency recently commissioned research to assess the quality and appropriateness of Creative Industries business support in inner-London. This is the first stage towards adopting a 'quality assurance kite mark'.

5. Proposals

This section offers ideas and recommendations for developing financial tools, sector intelligence and collaborative initiatives, which can enhance the commercial profile and investment prospects of SMEs operating in the Creative Industries sector.

5.1 Confident investment: strategic intervention and leadership for Creative Industries growth

> **"If private and public investors want a piece of the action, they need to devise new, more flexible financial products that deliver the right amount of money and demand for lower levels of control in return. They must then publicise them effectively… for greater effort needs to be put into raising awareness of the full range of financial vehicles, with a role for finance advisors to explore myths and assuage fear".**
>
> (New Economics Foundation 2002).

The New Economics Foundation, in the same document as the above quote, has identified a series of themes or intervention areas that require attention if enterprise in the UK is to grow. Not just generically, but to grow across different sectors and in the middle of our cities. Each of the themes identified is applicable to issues of improving investment readiness for Creative Industries businesses and changing investor attitudes towards the sector. The Foundation argues for:

- A National voice.
- Local leadership.
- An increase in the uptake of business support.
- City-level strategies.
- Reduced leakage of graduates.
- Better research.
- More flexible finance.
- The overcoming of equity aversion.
- More roadshows, networks and mentors

If early stage Creative Industries businesses are to gain access to finance which for the majority is currently out of reach, then a simple focus on local, regional or national investment initiatives (such as through workshops, bespoke business support and training) will not be effective. The 'investment readiness' focus lists (presented in the previous section of this report) and the actions that they might inform, only make sense if embedded within a high profile, strongly-led, UK-wide strategic approach to improving access to finance and thus sectoral growth. The above list by the New Economics Foundation includes many of the features necessary for this to occur.

Three key intervention areas have been identified for a strategic approach to creative finance. Each is for consideration at national and regional policy level and in need of further partnership-focused action research.

5.2 The creative investment gateway

This report has shown that both investors and creatives must change if the sector is to grow to its potential and provide the rewards it can to the businesses, investors and the wider economy. Business skills must be improved, high quality information made available, technical awareness upgraded, perceptions changed, and so on. Attention to these factors and more is crucial. But the most significant and effective means of reducing the barriers to finance for early stage creative businesses – for those Graduate Pioneers and colleagues – is to focus not only on the technicalities but on the profile, image and reputation of the Creative Industries sector.

There is a need for:

- High quality and convincing sectoral intelligence.
- Strong leadership and advocacy from national Government to local authority level (imparting this intelligence; developing intervention).
- Targeted network and showcase initiatives that can make a noise and prove a point.

Creative Industries intelligence

The DCMS, in partnership with the Office for National Statistics (ONS), DTI and information sources through the RDAs and equivalents, can lead a programme that seeks to build a high quality resource of sectoral intelligence that is meaningful to investor communities and can help to inform public sector intervention. Consultation with different investor communities is required to identify what kind of intelligence influences their decision to invest. This research has started the process and has pointed to the need for intelligence on:

- **Sector size:** on a sub-sectoral level, with information for employment, company size, turnover, and growth rates. Present intelligence is outdated. The Regional Culture Data Framework will help to focus research towards establishing accurate and meaningful information.
- **Business profiles:** including business failure rates (again by sub-sector), legal structures, previous occupations (such as students, sole-traders etc), levels of export and markets, patterns of research and development, workspace needs, typical locations, asset accumulation etc. At present this information is available in piecemeal and uncoordinated data sets based on different methods of counting, often with geographical limitations. Vital is the accessibility, clarity and uniformity of source and presentation.
- **Current finance sources:** where creative businesses currently access finance, data is required on the stage of business development when this is taken on; how this is used; the quality of the finance; evidence of investor return; awareness of available finance and how to reach it.
- **Access to and quality of support systems:** including business advice and management support.
- **High quality and convincing success stories:** a portfolio of fast-growing creative businesses that have benefited from and provided high returns to investors would help to increase confidence and showcase the 'spectacle' of successful creative investment. Examples might include Warp records, the night-club brand Cream, or games publisher Eidos[106]. Typologies or formula for successful growth would be a useful addition here, enhancing the 'Creative Industries readiness' of investors by providing familiar business development models. More research is required here to uncover the key drivers towards exceptional creative business growth.

If intelligence can be developed and disseminated on such issues, businesses and investors will be able to make better-informed decisions, confidence will improve and the potential for investment will increase. It is vital that such intelligence is presented quickly, sharply and often, to investor communities and to creative businesses. This will increase the efficiency of assessments and, over the longer-term, be internalised as more accurate perceptions of the sector. There is a need then to showcase this intelligence, to blow away the misconceptions, by providing the answers to the questions that investors often ask.

Such intelligence also has a role to inform the development of policy and support; and as a way of raising the profile of 'investment readiness' and a commercial approach to Creative businesses, with a commensurate emphasis on potential sources of finance for different types of business.

[106] See www.gamesinvestor.com for details on Eidos and other fast-growing games companies.

The DCMS research and subsequent presentation of 'Banking on a Hit' (2001) is perhaps a starting point. Here, barriers to finance for music businesses were identified (including investor perceptions of music businesses), based on some detailed intelligence of the types of finance proportionately (un)available to the sector. However, the research falls short of identifying ways of overcoming barriers and did not have an investor focus. For instance, the music sector could be presented more positively as an investor proposition.

Advocacy and leadership

The focus on intelligence is part of a process of professionalising the image of the Creative Industries sector, of countering the lifestyle business stereotype so that those with the potential to grow are allowed to grow. In many cases, creative businesses remain 'lifestyle businesses' due to a lack of finance to enable the business to grow. Advocacy and leadership is required to establish a profile of the Creative Industries sector as a growth sector with considerable untapped potential. DCMS should lead an 'advocacy assault' that has three main audiences:

- **Creative Industries businesses and undergraduates:** sectoral identity is weak in the Creative Industries. This inhibits the growth potential of individual businesses and the sector generally, because support targeted through the 'Creative Industries brand' is under-used. Rather, investors seeking a unified and understandable sector are confronted with a weak and disparate sprawl of sub-sectors. If investors are to feel comfortable with the sector, then it is essential that businesses do too.

- **Investor communities:** high quality sectoral intelligence will not be heard without advocacy and targeted promotion by the DCMS and RDAs of the coherence and power of the sector. Dedicated marketing initiatives are required, targeting those that make the investment decisions.

Policy and decision makers: DCMS must work closely with Central and Regional Government partners to raise the profile of the Creative Industries sector as a key economic driver. RDAs need to take responsibility for establishing the Creative Industries as a key driver of regional economies (with the support and investment commensurate with a key sector). In addition, DTI support is crucial if 'economic arguments' are to be convincing. A DTI stamp of approval to promotional strategies that target investors would be helpful. A policy focus, where the DTI and RDAs could introduce technical and financial support through specific initiatives would add value.

There will also be opportunities to present a 'Creative Industries Focus' alongside or in response to high profile initiatives from Government departments other then DCMS. In its advocacy, leadership and intelligence role, the DCMS should seize every available opportunity to raise the profile of the sector and situate it as innovative and commercially driven. A recent example of such an opportunity is the Small Business Service (SBS) publication 'A Comprehensive Strategy for Start-ups'. Here, DCMS could work with the SBS to ensure some reference to early stage Creative Industries businesses, or preferably, publish a complimentary 'Strategy for Creative Business Start-ups'. With the latter, the core of the text would be similar to the SBS document – the generic start-up issues – with specific Creative Industries factors, including a focus on finance, interlaced throughout. Such a publication is an intelligence provider and a focus for advocacy.

Creative networks and gateways

It is also important to 'make some noise', to strongly impress upon investor communities, creative businesses and decision-makers that a targeted approach to Creative Industries finance is underway. There is of course a need for launch events at a national and regional level. But there needs to be an action-orientated programme where pilot initiatives are introduced as reference points for the advocacy drive.

These might take the form of:

- **Intensive sub-sector focused 'investment readiness' training programmes:** these might be held as a pilot with one in each English region and one in Wales, Scotland, and Northern Ireland. Where possible they should focus on a specific type of funding and in some cases a particular fund, such as the Proof of Concept Fund in Northern Ireland, as a step towards equity[107]. The programmes might culminate in 'staged' meetings with investors, where business plans are presented to, for example, banks or Business Angels. Elsewhere this has been a productive process, with some business plans subsequently attracting equity from attending investors, even though this was not their purpose in attending[108]. The Investment Readiness Programme devised by Etc. Consulting or Baker Tilly could be adjusted as bespoke Creative Industries initiatives[109]. This would help to gain DTI approval because in 2002 the DTI invested in a series of investment readiness pilot initiatives based on these models.
- **Creative investment banking initiative:** a clear and agreed relationship with the retail banking sector is necessary, where awareness of creative business issues and business development profiles are understood all the way to branch level. At a national office level, there is an openness to the potential of the creative sector. If it can be proved that there are profits to be made with creative clients, then banks will welcome them as customers. Yet at a branch level, the Creative Industries sector is little understood, with under-investment a problem for the sector. Therefore, DCMS and partners should build a relationship with the retail banking sector that seeks partnership at a national and local level. Creative sector intelligence might be produced in 'Packs' and disseminated at High Street level, backed by leadership of national offices. Some resources should be made available to provide training for Bank staff, such as creative business profiles. Specialist services (even finance instruments) should be advocated, so that a creative business doesn't have to go to Soho to meet a lender that understands their business. The key aim here is increasing understanding.
- **Creative Business Angel mentoring and network initiatives:** this research has shown that relatively few Business Angels invest in Creative Industries propositions. There is a lack of understanding and – relatedly – the perception of risk is too great. Also, perhaps surprisingly, Business Angels who themselves have developed wealth through Creative Industries generally do not re-invest in the sector. The most progressive way of reducing this perception of risk is to broker contact between potential Angels and potential creative business propositions. To achieve success, national leadership is required, driven through DCMS and perhaps NESTA, the RDAs and the creative delivery teams they support. These organisations should be encouraged and resourced to establish dedicated Creative Industries, Business Angel Mentoring and Network initiatives. These would involve:
  - The identification and recruitment of appropriate Angels, using newly produced sectoral intelligence to attract them into a free network. Business Angels with a Creative Industries background should be a priority recruitment.

[107] This provides small amounts of seed capital from £1,000-£20,000. The investment is made through the European Objective One Information Age Initiative. Intended as an early stage investment, it is linked to investment readiness support with connections to the venture capital New Enterprise Fund for Northern Ireland. See www.creativeni.com and www.investni.com

[108] Etc. Consulting ran a series of half-day investment readiness seminars in 2002 as a pilot for the DTI. Specialist industry advisers then work with entrepreneurs to prepare their business proposals to a stage where they can attract funding for a new stage of funded growth. See www.etcconsultancy.co.uk

[109] www.investmentreadiness.co.uk The Investment Readiness Quiz could be adapted for the needs of creative businesses at each stage of development

- Presentation days and networking events, where creative businesses are introduced to Angels on a non-investment-based showcasing and social basis.
- Mentoring programmes, where Angels are paid to work closely with selected creative businesses to problem-solve, plan and develop strategic approaches to the commercialisation of ideas. This process might, in turn increase investor confidence and sense of ownership, leading directly to investment.
- Investment-focused presentation days targeted at potential investors. Here, creative propositions that have undertaken investment readiness training will present directly to investors with the objective of attracting investment. To ensure that only those propositions with the best chance are seen by Angels, a team of Creative Industries experts, lawyers and accountants would undertake a sieving and gatekeeping role.
- Ongoing deal brokerage and matchmaking: creative intermediaries working at the RDAs (or equivalents) provide an ongoing business-focused advice and development role, and a match-making role introducing business propositions to investors This will require a well-resourced 'fleet-of-foot' approach, sometimes building ad hoc investment partnerships between Angels.
- Advocacy initiatives that seek co-investment opportunities. These would include banks or available public funds, such as Early Growth Schemes or other regionally delivered debt finance initiatives.
- Regional networks be connected through a national website portal, which drives cross-regional partnership. This would allow, for example, Angels in Cambridge to connect to investment opportunities in London.

5.3 Bespoke creative finance

This research has shown that some barriers to finance for creative businesses are based on technical investment criteria that no amount of improved investment readiness, sector intelligence or advocacy will bring down. If early stage creative businesses are to access adequate finance and thus grow to their potential, then it is clear that a range of new finance instruments is required.

Yet there is a danger here of 'ghettoising' the sector by attempting to channel the market in a direction that it might not otherwise go. It is important therefore to show that there are genuine market failures, based upon a lack of investor expertise. Also, bespoke finance for the Creative Industries sector is only justifiable if creative businesses are improving their levels of 'investment readiness'. In this sense, such forms of finance address creatives from their current position of under-developed creative businesses, which are ignored by investors lacking sector expertise.

It is not an aim of this research to present detailed models of new finance instruments for the Creative Industries sector. The approach has been more focused towards the barriers that exist in the present finance offer. However, the following paragraphs summarise the possible ways forward for bespoke creative finance, as articulated by consultees. The key issue remains though that without high profile leadership and advocacy – without improved understanding – new finance instruments will not work or they will lack credibility.

Dedicated Creative Industries Business Angel syndicates with a co-finance lever:

This would be a formalised version of the Regional Creative Business Angel Mentoring and Networking Initiatives introduced previously. Business Angels are willing to invest additional funds in small businesses, so long as they are high growth. However, they are constrained by the time required to identify new deals and the investment required to eradicate informational asymmetries, once a potential proposition has been located[110]. A series of Creative Business Angel syndicates established through the RDAs and equivalents, and managed by Creative Industries experts (who could bring in skills as required on a case-by-case basis), would:

- Allow individual investors to reduce risk by spreading investments across a portfolio of creative businesses.
- Enable syndicate members to share expertise and thus reduce informational asymmetries.
- Provide an entry-route for new or inexperienced Angels, with a syndicate offering a kind of creative training ground.

Research is required into the Structured Angel Groups in the USA, where Limited Liability Companies (LLCs) manage the syndicates[111]. In the UK, the LLC might be an arms-length not-for-profit company, such as that which manages the Creative Advantage Fund in the West Midlands. Efficiency and flexibility are key.

For such an initiative to work in the UK for what is seen as a minority sector, it may be necessary at least in the medium-term, to introduce co-investment programmes to really 'suck in' the investors. The Early Growth Funds introduced by the DTI, such as London Seed Capital, might provide an applicable model here. However, they would need to be introduced with smaller investment levels and would therefore require some subsidy of due diligence. If the public sector can supply small amounts of risk capital as a co-investor, once Business Angel syndicates have brokered a deal, the investment process would attract more Angel interest. Forms of debt finance or project funding would also add value as a co-investment tool, but they would not instill the same level of confidence as another fund executing a 'risk'.

However, the true test of such an initiative is the level of growth displayed by investee companies. Low growth for a high profile initiative undermines the case for further investment in creative businesses. As such, the gatekeeping role of creative intermediaries, the use of high quality sector intelligence, and a careful nurturing of Business Angels, are all vital.

Dedicated Creative Industries seed and project funding

Creative businesses are innovators and trendsetters. They create markets as much as respond to them. This means that the development process from idea to product to commercialisation is complex, subject to all kinds of impediments, and in some cases never completed. This is a key reason why some investors are cautious of the growth potential of a creative business: without a track record showing a high percentage of 'ideas success', the risk of investment is assessed as too great. Here is therefore a need to develop 'investment platforms' that allow creatives to develop ideas and test them commercially whilst undertaking business development support that includes an awareness of potential future investment opportunities.

This requires more and better targeted seed funding for start-up and early stage creative businesses. Such project development funds enable older companies to develop new products and investor-focused business development initiatives. Driven by strong and clear leadership from DCMS, with the support of NESTA, it is likely that such 'funds' and initiatives will be established through public sector sources. They should though be targeted to other investor communities with co-investment an aim or as a way of advocating next stage investment.

[110] See Mason and Harrison 2000; SBS 2003.

[111] See Venture Capital, Vol.4. 2002.

A strategic partnership with the arts funding system is necessary to avoid mixed messages and a descent into a project funding 'mentality'. Creative businesses that acquire project funds from, for example, Arts Council England, must do so based on an agreement that the project is instrumental to broader creative business development. It must be central and not a distraction. It is important that this is made clear to potential commercial investors: the re-emergence of a 'Culture' Vs 'Economy' dichotomy will be unhelpful for creative businesses seeking long-term commercial growth.

Dedicated Creative Industries venture capital funds

More research is required to assess the potential such initiatives have in bridging the equity gap for growing creative businesses. While there are just a number of these funds in the UK, the money available from them is likely to be small, based on smaller venture capital investments, and as a result, their impact on sectoral growth may be limited. The role of high quality sector intelligence and careful gatekeeping has emerged as key issues when assessing the potential returns to investors.

A dedicated fund might be better positioned at a national scale. This would increase the size of the fund and a reputable lead body, for example, NESTA, could provide a gatekeeping and proposition development role alongside regional partners. The potential though of dedicated venture capital funds to lever finance from other investor communities, such as banks and Business Angels, is high. In the West Midlands, it is anticipated that the Advantage Creative Fund will broker a new relationship with the sector for investors, so that they will be more confident in making Creative Industries investments even after the lifetime of the fund.

Tax relief and technical amendments

To attract nervous investors, tax relief might be introduced on Creative Industries investments. For example, 20 per cent Income Tax relief presently available on investments through the Enterprise Investment Scheme (EIS) might be extended to 25 per cent on Creative Industries investments. This would assist in the development of the above Creative Industries Business Angel Syndicates. The removal of Capital Gains Tax referral in EIS and Venture Capital Trusts might also attract more creative investment, since different investors have varying amounts of Capital Gains to declare. A dedicated focus on tax relief and incentives for Creative Industries investment is required. This applies in particular to the film sector.

A minor though significant technical amendment required is the removal of the 1982 law that prevents investment in 'own account' businesses through the Small Firms Loan Guarantee Scheme. This is an impediment to the business development of young sole traders, who lack security, but have the potential to develop high growth creative businesses. Further research is required to uncover other technical anomalies.

Small Business Investment Companies

The SBS is considering the introduction of Small Business Investment Companies (SBICs) as a way of reducing finance gaps for small businesses. SBICs are important tools in stimulating private sector venture capital activity in the USA. SBICs are allowed to borrow money at low rates on capital markets, which they use to co-invest with privately raised capital in small(er) companies. Benefits include enhanced returns (offered due to the leverage of the debt finance), an increased supply of risk capital managers specialising in smaller deals, and stronger local investment networks. A detailed introduction of the SBICs is provided by the SBS in the 2003 document, 'Bridging the Finance Gap'. Research is required assessing the potential impact of SBICs on Creative Industries investment. Advocacy and leadership is necessary to ensure that, if established, SBICs provide the best possible deal for creative businesses. This is the kind of sector lead role the DCMS should undertake, ensuring that the sector is 'represented' to the DTI.

5.4 Creative spin-outs and clusters

A distinctive feature of small early stage creative businesses is their tendency to cluster in specific locations. Hoxton, East London; Soho, Central London; North Cambridge; The Northern Quarter, Manchester; The Lace Market, Nottingham; The Jewellery Quarter, Birmingham; The Italian Quarter, Glasgow. These are all recognised creative districts, chosen by clusters of Creative Industries businesses due to the mix of business opportunities and flexible specialisation brought by proximate complimentary businesses. They offer innovation opportunities introduced through business to business interrelations; social opportunities driven by this dynamic milieu and enhanced by the range of bars, galleries and retail spaces; and branding opportunities linked to having an address in these 'sexy', progressive locations.

Creative Clusters are therefore the spatial expression of Creative Industries business development preferences, 'habits' and needs. They are sector-driven, the physical 'product' of multiple complex decision-making processes. But they are often stronger, more sustainable and have more commercial potential when supported through public sector initiatives. These include targeted creative intermediary services (offering business advice, supply-chain initiatives, training), managed workspace 'cluster initiatives' (from artists studios to high-technology incubator spaces), or technical support (such as Broadband installation or intranet projects).

It therefore follows that 'investment readiness' initiatives should target the clusters, new finance instruments should be piloted in these creative milieu, and the dynamism of such locations should drive 'the brand' of the Creative Industries as an investment proposition.

A focus on creative clusters and on particular buildings within these clusters, presents the opportunity for targeted finance initiatives. These might include:

- **Creative Business Angel syndication:** where 'the risk' is spread across designated creative businesses operating within the same cluster or building. Creative clusters therefore make presentable investment portfolios for Business Angel syndicates.
- **Direct cluster investment:** equity could be attracted to invest in a 'building of early stage creatives', spreading the risk and using the property (often in 'downtown' areas with rising prices) to provide some security[112]. This might be focused through a type of 'Centre of Excellence' approach, such as that modelled through the Centre for Fashion Enterprise in London[113]. Here, a flexible and changing approach to 'investment readiness' support is provided, and The Centre sources seed funding for fashion start-ups through individual investors and public sector funds. In this sense, investor risk is reduced because they are directing investment to the high 'value-adding' and 'talent-rich' environment of The Centre. Such models could be developed for other creative sub-sectors and targeted through existing clusters to provide emerging start-ups with a dynamic commercial and social milieu once they leave The Centre. Vital here is the expertise of support staff and intermediaries and an extremely high quality of creative practitioners[114].

[112] The role of the building as part of the investment requires further analysis. Other potential investment models should be considered such as debt finance or equity.

[113] The London Institute has enabled early-stage UK fashion start-ups to obtain capital to build viable fashion businesses with strong management teams. Support ranges from market intelligence to case studies. See www.fashion-enterprise.com

[114] See www.ukfilmcouncil.org.uk to read about 'A Bigger Picture' which is a good example of kitemarking in the Creative Industries sector.

A further example is the Creative Enterprise Club developed through The Lighthouse Centre for Architecture and Design in Glasgow[115]. The club provides a network 'hub' for Creative Industries businesses across Scotland, allowing them to build networks share knowledge through expert presentations, informal dialogue and directed business-to-business fora. The club, which will soon be opening 'sister hubs' in Northern Ireland and Northern England, also provides a filter service to potential investors.

Creative businesses are informed of the necessary changes they will need to make to reach a level of 'investment readiness', and potential investors (including NESTA) are supplied with potential investees. The physical cluster of the The Lighthouse thus provides a hub for Creative Industries networking across a wider geographical area, offering an excellent forum for dialogue and development and a high quality interface with potential investors.

- **Higher Education spin-out initiatives:**

  As discussed previously, Creative Industries businesses are likely to be managed and staffed by graduates. However, as has also been discussed, business and management skills are low, and commercial awareness not as developed as necessary for a widespread change of approach from investors. This is because:

  - Universities offering creative courses have been slow to offer complimentary business and commercial development courses.
  - When such training is offered, it is difficult for students to grasp the relevance because they are not yet 'in business'.
  - Undergraduates are often more concerned with their future vocation rather than specific types of business management. In many cases this is wise, because they are likely to move between jobs in a sector before starting their own business[116].
  - Entrepreneurialism has not been widely encouraged for creative undergraduates, with business development opportunities not explained or explored.
  - Universities have been slow to develop spin-out and incubator programmes in the Creative Industries, focusing instead on new technology[117].
  - Links with industry have been weak – be it with small creative companies or corporates. Higher Education establishments are not playing an active role in 'the local cluster'.
  - Work based learning, which enables students to develop skills in a commercial context, is underdeveloped.

The Higher Education sector has an important role to play in Creative Industries development and thus in assisting graduates to attract finance. Initiatives such as The Centre for Fashion Enterprise that focus on commercialising creativity or providing entry points to industry are rare. Universities contain the talented creative businesses of the future: they have enormous in-house staff skillsets; offer the potential for affordable workspace, and they have a voice that investor communities may listen to.

[115] See www.thelighthouse.co.uk

[116] Ball 2003

[117] The Nottingham University Business School shows that Universities are focusing activities on technology transfer, with a narrow sectoral focus (NUBS 2003).

But they cannot work in isolation. The potential is huge for universities working from the heart of creative clusters. They are in a position to initiate work-based learning programmes, develop relationships between creative businesses and undergraduates and build managed workspaces as early stage creative 'hot-beds'. They provide opportunities to leverage public and private sector investment, and develop the competencies of students and graduates to provide a return on those investments.

Once again, DCMS, working in partnership with the DTI and Department for Education and Skills, should play a lead role in establishing a true 'Higher Education Agenda for the Creative Industries'. Better prepared graduates and earlier engagement in the business life-cycle by investors will reduce future barriers to investment. The DCMS should be a lead partner in the SBS-led 'Council for Graduate Entrepreneurship', which will identify ways of encouraging graduates to run their own business. Its own Universities Working Group, which focuses on Creative Industries cluster development, should establish an 'access to finance component', and ensure that its ideas are heard by the Council for Graduate Entrepreneurship.

5.5 Areas for further research

Although it is beyond the scope of this report, further research would be useful in the area of company law. This has created issues for SMEs in the Creative Industries, given that many laws were conceived in the 19th Century, and have limited applicability to the current structure, networks and operations of creative businesses. While some aspects of the legal framework have been updated, technical anomalies abound, such as the 1982 amendment to the Small Loans Guarantee Scheme, which prevents investment in own account businesses. This appears to be an impediment for young sole traders, though it would be helpful to understand the extent to which creative businesses generally are accessing this service.

Further research would also be helpful on the effectiveness of specialist financial tools such as the role of Barclays Media Division's MORFA scheme and its impact on early stage creative businesses. Particularly of interest would be the take-up and benefits of start-up and seed capital generally by young entrepreneurs in the Creative Industries.

In relation to the Creative Industries' impact on the community, further analysis might be helpful to learn from the experiences of Black, ethnic-minority backgrounds and women developing creative ventures. Of use generally, would be new findings into what drives exceptional business growth within the Creative Industries.

5.6 Next steps

Young creative pioneers will struggle to access appropriate finance unless the sector that they work in is provided with a loud, coherent and appropriately targeted voice. Based on the findings outlined in this report, and the learning from its Graduate Pioneer Programme, NESTA intends to work with Government departments and stakeholders ranging from think tanks to regional development agencies, to debate the best way of delivering regulatory, financial and operational improvements for the Creative Industries sector

It is important to express the commercial potential of the sector. As this report has shown, access to finance is dependent upon better understanding by the following audiences:

- **Graduates and businesses:** what is possible and what is expected of them;
- **Investors:** the real commercial potential of early stage creative businesses;
- **Policy and decision-makers:** the significance of partnership, sector intelligence and sector leadership for a growing Creative Industries sector.

It is incumbent on policymakers and investors, working hard and in partnership, to increase access to finance for the Creative Industries sector. But of equal significance, it is dependent on creative businesses, with public sector support, to transform their approaches to ensure that they present the best possible 'sectoral proposition' to investors.

This research has identified a new 'middle ground' that allows the space for finance to reach creative businesses in ever greater amounts. This ground will be inhabited by Creative Industries businesses that have worked hard and been well supported to develop their businesses as 'investment ready', and investors enlightened by intelligence that shows the potential of the sector and lightens them of a perception of 'risk'. The Creative Industries sector is not a risky proposition: it is a safe bet for a vibrant, distinctive and highly productive UK economy.

Appendix 1: Key references

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Appendix 2: List of consultees

Investor Type	Organisation/Institution	Name
Standard business Support Agency/initiative		
	Prevista, North London	Tricia Jenkins - Business Manager
	HBV Enterprise, East London	Gerald Matthews, Grant Funds Manager
	Centa, Kings Cross and Lewisham	James Walsh - Business Manager
	Ethnic Minority Enterprise Project (EMEP)	Em Ekong, Business Manager
Targeted Creative Industries development funds/ initiatives		
	Creative Advantage Fund, West Midlands	Fred Brookes - Director
	Culture Finance North-West	Sue Peters - Director
	London Development Agency Creative Industries Team	Graham Hitchen - Head of Creative Industries
	Scottish Enterprise - Scottish Digital Media and Creative Industries Project Fund	David Reilly, Director - Pacific Quay and Creative Industries
	Dream Ireland Proof of Concept Fund (NI)	Gary McCauseland, Director
	North-West Regional Development Agency: TechNet Equity Programme	Vivienne Ubcott-Gill, Director
	North West Regional Development Agency Creative Industries Team	Andy Lovatt, Head of Creative Industries
	Manchester Cultural Industries Development Service (CIDS)	Dale Hicks, Business Support Manager
	The Cultural Industries Development Agency, East London (CIDA)	Terence Dimmick, Business Advisor
	The Creative Lewisham Agency	Andrew Carmichael, Director
	Welsh Development Agency	David Swallow, Partnership Director
	East England Development Agency	Katie Huane, Creative Industries Sector Manager
	Ipswich Ip-City Programme	Simon Meacham, Ipswich Borough Council
Banks		
	Barclays Bank Media Division	Julie Nash, Business Manager
	HSBC Bank, Deptford High Street	Chris Cherryman, Business Manager
	Deutschebank	Steve Lovegrove, Manager Media Corporate Finance
	UBS Warburg	Nick Wright, Social Investment Manager

Investor Type	Organisation/Institution	Name
VC Funds / initiatives / individuals / holding companies		
	Bridges Ventures	Tom Matthews, Associate
	First Stage Capital	Amer Vohora, Executive
	London Seed Capital	Andrew Cavaghan, Fund Manager
	Classic Fund Managers	Bill Cunningham, Fund Manager
	Lynx Capital Ventures	Rene Miller, Fund Manager
	GLE Development Capital	Eric Tung, Manager
	British Venture Capital Association	John Mackie, Director
	Ingenius Media	Patrick Bradley, Director
	Axiomlab	Vicky Praiso, Fund Manager
Business Angels and Business Accelerators		
	Pembridge Partners	David Prais and Hugh Mason - Directors
	One London Business Angels Network	Aisha Ejaz, Network Manager
	National Business Angels Network	Nick Cox, Director
	UNICO	David Catton, previous Chair of UNICO, Sheffield University
Investment readiness programmes		
	Business Link for Norfolk	Alice Lowe, Business Manager
	Etc. Consulting	Alison Harper, Director
	Ready 4 Growth	Aisha Ejaz, Network manager, OLBAN
	New Economics Foundation	Sam Collin, Access to Finance Associate
	New Economics Foundation	Liz Antcliffe, Inner City 100 Fund
Government programmes		
	DTI	Roy Evans, Head of SBS Finance Directorate – manages Grants for Research and Development
	SBS	Owen Fernandez, Head of RVC Programme
	SFLG	Mike Yates, Head of SFLG
	SBS	Bill Hallahan - Business start-up Manager
	DCMS	Michael Seeney - Head of Creative Industries
	DCMS	David Humphries, Creative Industries
Misc. Schemes, experts and intermediaries		
	Princes Trust	Peter Hipsey - Culture Business Venture, Eastern Region
	Noema Research and Planning	Lia Ghilardi, Director
	David Powell Associates	David Powell, Director