

“The lazy assumption that the creative industries are inherently risky is harming Britain’s path to growth...”

RISKY BUSINESS

Helen Burrows
Kitty Ussher

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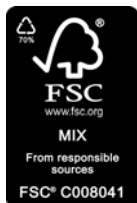
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Any errors and omissions remain our own.

Helen Burrows
Kitty Ussher
October 2011

Foreword

The UK's creative industries present an extraordinary opportunity for growth. We are in the top five countries worldwide for independent television production, exports of music and publishing, and advertising. I want to see business build on those strengths to maintain our leading position in the global creative economy.

That is why I welcome this report as a timely and informative contribution to the debate about how we can best enable our creative industries to fulfil their potential. I certainly endorse the need to increase levels of understanding between the creative industries and the investment community, and to challenge the perception that the creative sector is somehow more risky than other areas of business. The Government's agenda is to enable innovation and growth and the creative industries, from start-ups to established players, have much to contribute.

This pamphlet makes considerable progress in these areas, and whilst independent of Government, usefully expands the evidence base on which good policy making depends. I look forward to reflecting on the new data, analysis and recommendations presented here.

Ed Vaizey MP
Minister for Culture, Communications and Creative
Industries

Introduction and summary

There is confusion in the minds of policy makers about the role that the so-called creative industries have to play in Britain's economic future. On the one hand the sector is perceived to be strong, cutting edge and competitive, one where Britain leads the world, in music from the Beatles to Adele, in fashion from Carnaby Street to the continued pre-eminence of London Fashion Week, not to mention TV and film exports from *Undercover Boss* to *The King's Speech*, video game hits from Lara Croft to Little Big Planet, its strong design culture, and a vibrant theatre scene.

In October 2010 Prime Minister David Cameron clearly supported this view when he announced the Government's intention to put its resources 'behind those industries where Britain enjoys competitive advantages... We have great industrial strengths across our country, underpinned by world-beating companies... [including] creative industries in London, Manchester and Glasgow.'¹ Indeed, the sector makes up around 6 per cent of GDP according to government and sector experts.²

But there is another view: that business risks for creative industries are greater, or are perceived to be greater, than those for other sectors. The popular image is that creative geniuses – whether computer programmers, writers, designers or musicians – are preoccupied by their art rather than the mechanics of their business, which implies that they are a high-risk option for creditors and investors. In addition, it is argued that businesses based on design and intellectual property by their nature produce hits, but past performance has little correlation to future success, so it is therefore harder for start-ups in the creative industries to succeed.

This view is expressed by leading figures within the sector: Jane Sheppardson, CEO of Whistles, said to Evan Davis in an

edition of Radio 4's *The Bottom Line*, discussing the clothing and fashion businesses: 'There are financial rewards to be had, but it's a very, very risky business: it's not something that you can go into unless you can hold your nerve', to which Evan Davis responded: 'That is something that is special about it, isn't it, and is shared with something like the music businesses or the film business.'³

Indeed some would argue that this perception of risk is so pervasive that it leads to good propositions being turned down because of prejudicial presumptions by lenders or investors, rather than the reality of the risks involved. Those in the sector believe that loan applications they consider viable are rejected or offered unfavourable terms. A Nesta survey from 2004 shows,

*One third of investors agree that the business models for the creative industries sectors are too risky to be worth investing in – here again, previous experience makes a difference with just 14 per cent of those who have invested previously agreeing with the statement compared to 40 per cent of those who haven't.*⁴

These two views are in some ways contradictory: can the creative industries simultaneously be globally competitive, with huge potential for UK plc, and also be unpredictable and risky? Or is it possible that the risk is overstated and that perceptions of excessive riskiness put off creditors and investors, leaving unrealised potential in the sector frustrated by lack of finance?

If the latter view is correct, there is an immediate urgency in understanding better how risk really operates in the sector, and for taking steps to inform, enable and incentivise lenders, investors and creative businesses to work together to ensure its full potential is realised; otherwise the economy will lose out. Contributing around 6 per cent to the UK GDP, twice the European average,⁵ the creative industries play a significant role within the country, and in 2009 Nesta suggested that in the medium term they were capable of growing at double the rate of the economy as a whole.⁶

We define the creative industries as businesses that ultimately seek to make a profit through the sale of something

that is based on an original creative idea, and the surrounding businesses that enable this. The sector has tended to make its case to government on the basis of being: ‘important, unique and risky’. But without empirical evidence of what ‘unique’ and ‘risky’ really mean, it is difficult for policy makers to decide what policies would support the sector effectively, should they seek to do so.

As the definition of what makes up the sector is incomplete, and there has been little comparative analysis of how this sector compares to others in structure and business outcomes, it is clear that it is time for a fresh look at the subject. Given the potential that the sector is often presumed to have, it is particularly urgent to examine these matters at a time when the focus of economic policy is on how to return to growth. This pamphlet examines the concept of risk from different perspectives and aims to establish whether being in business in the creative industries sector carries inherent additional risk. We publish new data that map the sector as a whole, describe the different types of businesses that work within it, and examine the way in which the sector is treated by government. We also publish new data and analysis on the propensity of companies in the sector to survive, compared with similar firms from other sectors. We have carried out new qualitative research on factors behind the lending decisions of banks and others, and conducted interviews with representatives from successful companies in order to understand the key to their success. We look at the way that government classifies and collects data about the sector. Throughout we aim to draw these strands together in order to make specific recommendations on how government can best deploy the resources at its disposal to maximise the potential of the sector as a whole.

The authors bring complementary experience to the table. Helen Burrows, who led the research and is the main author of this pamphlet, worked from 2008 to 2011 as a parliamentary researcher and adviser for the Conservative MP Ed Vaizey, currently a minister in the Department for Culture, Media and Sport. Her background is in the creative sector, having trained and worked as a photographer and freelance writer for six years,

after working for a record label and a fashion label. She devised the project jointly with Kitty Ussher, who has led it from the Demos side and contributed to the writing. She is a former Labour Treasury minister, and before that was a special adviser at the then Department of Trade and Industry. Between them they have a good handle on the policy place where industrial hits cultural, and they draw on this experience in putting forward the recommendations that flow from this research. The authors are grateful for the research support of Mark Littler, Andy Stuckey and Jonas Altman, all of whom have contributed their enthusiasm and expertise to the project, particularly in the primary research for chapters 1, 2 and 3, respectively.

The methodology that this project has employed is cutting edge. Throughout, the aim has been to get back to primary data in order to shed light on a confused subject in an orderly manner. In doing so, new data have been extracted from existing large datasets held in the Office for National Statistics (ONS) Business Structure Database (BSD). We have worked with them in two different ways: first, by establishing the relative size and structure of the creative sector; second, by conducting a new and detailed analysis of business demography data from the BSD on enterprise births, deaths and survivals to compare the aggregate performance of creative industries businesses with those in other sectors of the economy. This new information has been supplemented by that provided by previous research, such as by the Department for Business, Innovation and Skills (BIS) on access to finance for creative industry businesses, which in turn draws on other existing research and expertise. We also use the data held by our partner organisations, including some of the leading trade bodies for the sector for video games (the Association for UK Interactive Entertainment, UKIE), music (UK Music) television and film (Producers Alliance for Cinema and Television, PACT) and fashion (British Fashion Council, BFC; and the UK Fashion & Textile Association, UKFT). In order to provide context, this quantitative section has been supplemented by qualitative surveys and interviews with the aim of identifying the factors that lead to success, where the raw data can only describe the success itself.

The document is structured as follows. Chapter 1 (‘Defining and mapping the creative industries’) begins by setting out our definitions of ‘business’ and ‘creative’ before exploring how the sector is defined by the government and in official economic data. We compare this with how parts of the sector would define themselves, pointing out a clear anomaly of the absence of the economic contribution that manufacturing, services and retail sales make to the size of the creative industries in the government’s approach.

We then present an overview of the structure of the sector by business size and contribution to the economy. We show that while the sector is dominated by sole traders and micro businesses (those with one to ten employees), this is no different from the rest of the economy. The chapter closes with a brief discussion of the resource the government puts behind policy making for the creative industries in comparison to its size and arrangement.

We highlight that BIS, the government department that originates almost all the policy initiatives that might support small and medium enterprises (SMEs) in the sector, has little or no civil servant resource focused on the sector. We recommend that the Government reviews its definition of the creative industries, and boosts its capacity to advise relevant ministers appropriately.

Chapter 2 (‘The creative industries and the risk myth’) discusses the concept of risk. Drawing on new qualitative research, it explores the attitudes of banks and equity investors, discussing how creditors seek predictability of revenue, while investors seek opportunities for high growth. Therefore we show that different creative businesses are more suited to different types of financial investment and support and that there are likely to be straightforward – and fixable – explanations for why any individual firm might find it hard to obtain finance.

The chapter presents new data on indicators of business risk, including survival trends of new business start-ups over the first five years and business failure rates as a percentage of all businesses operating. We find that, contrary to expectation, the creative industries sector does not show notably higher failure

rates by either indicator. We suggest that the reason for this might be the greater resilience of small creative companies; unlike other start-ups, which have higher fixed costs, creative industries businesses can minimise their outgoings when times are tough. Indeed it can be argued that these businesses are outperforming other sectors of the economy in ability to cope with overall business risk, if it is the case that they are launching more products, of unpredictable potential, into the marketplace than most other businesses.

In contrast, another sector perceived as ‘high risk’ – hotels and restaurants – shows notably higher failure rates than the average. This suggests that, in business terms, rumours of the riskiness of the creative industries have been exaggerated, a point corroborated by commercial credit ratings.

In the light of these findings we then provide a brief assessment of the policy implications and recommend that the Government routinely publishes economic data on the creative sector in a satellite account as part of the ONS Blue Book cycle. We also recommend that the Government and the sector work together to champion the business success of the sector and to facilitate the bringing together of different types of funders with businesses seeking support and to improve understanding on both sides.

In the third chapter (‘How to succeed’) we draw on detailed interviews with some of the most successful companies in fashion, television, video games and music to understand the story of their success. We find there are the following ‘ingredients of success’ in common among the most successful businesses:

- a clear intention to make a profit
- a strong performance in businesses planning
- a clear understanding of the risks that face their businesses, how to assess, manage and mitigate against them
- in-depth experience in the business of the sector
- financial and numerical experts working in mutually respectful partnership with creatives
- an understanding of the importance of good relationships to spot and manage creative talent, and to do deals

- an ability to innovate and adapt to changing business environments
- an ownership stake in the intellectual property the business is creating.

We examine the suitability of the Enterprise Finance Guarantee Scheme and the Enterprise Investment Scheme, recommending that the Government, sector trade bodies, and those who administer the schemes should work together to enable and improve their utilisation by the sector. Taking into account the success of the codes of practice and window of creative competition in stimulating growth in television production, we recommend that the Government should consider how best to increase competition and intellectual property ownership among companies elsewhere in the creative industries that contract with public sector broadcasters and other public bodies.

We discuss whether creative businesses are uniquely different from other businesses in different sectors, and show that while one group of businesses in this sector is engaged in bringing a constant stream of new and unpredictable creative products to market (which we term SNUCP businesses), there are also many others that have predictable revenues and trajectories. We provide an overview of these different business models, sector by sector, and discuss in each case to what type of financing options they are best suited.

We highlight that there may be a funding gap for this stream of new and unpredictable creative product businesses, especially when they are small or new, as their revenues are too unpredictable for creditors while their growth trajectory is not sufficiently exponential to attract investors. We suggest the Government should review its plans for a patent box and extend it (perhaps to a broader copyright box) to cover these highly innovative businesses, as well as offering a possible solution based on the Prince's Trust Enterprise Scheme.

In chapter 4 ('The map') we turn to the thorny issue of the Government's Standard Industrial Classification codes system, the mechanism for collecting and presenting official economic

data, on which all other macroeconomic analysis is based. We show how little the current Standard Industrial Classification (SIC) code structure has changed since it was first introduced in the 1940s and how this increasingly outdated system operates as a map that frames our understanding of the economy. We show how the invisibility of the creative industries in the top line sector distinctions creates the perception that it is marginal. Moreover, this top line invisibility, combined with a lack of clarity and detail offered by four and five-digit codes, contributes to the paucity of data driven analysis of the sector.

Finally, we highlight problems with the Government's SIC definition of the creative industries, for example being unable to separate music from other performing arts like theatre and dance, and under-reporting the economic contribution of companies as large and diverse as ASOS, Festival Republic, Lulu Guinness, Netaporter, Spotify and Topshop. We recommend that in addition to publishing creative industries' satellite accounts in the Blue Book, the Government should automatically group the creative industries in all its data sets, public and confidential, to enable its own and external researchers to better understand the sector. In line with the discussion in chapter 1, we recommend that the Government re-examines its definition of the sector with a view to widening it considerably, and makes it easier for ONS and external researchers to aggregate data on the sector to improve the knowledge base, as well as lobbying in the EU and UN for international reform that supports the reality of the UK economy.

The UK has a deep competitive advantage in the creative industries. With better reporting and analysis of the sector by the Government, combined with a coordinated effort to build business skills, fund businesses appropriately and champion the sector with investors, the sector itself can deliver on its promise to create significant economic growth.

Policy recommendations

Recommendation 1: The Government should explore whether it is economically coherent that the manufacture and sales of new

design and copyrighted material should not be covered in any definition of the creative industries. (Chapters 1 and 4)

Recommendation 2: The Government should ensure that the civil service resource devoted to analysing the creative industries corresponds to its size and potential, and that departments that originate relevant policies have an appropriate number of civil servants with sectoral expertise. (Chapter 1)

Recommendation 3: The Government should routinely publish aggregated creative industries data sets in Department for Business, Innovation and Skills business surveys and start a creative industries satellite account in the Blue Book and quarterly national accounts, and clarify whether or not it considers there to be something about creative businesses to make them inherently more risky than other companies in the UK economy. (Chapter 2)

Recommendation 4: The Government should work with the sector to improve the visibility and appreciation of the sector's business success with investors, creditors, analysts and business journalists. This might include regular high-profile 'speed dating' events such as one recently run by Nesta, designed to put banks, investors and businesses together in a way that rapidly spreads ideas and talent. (Chapter 2)

Recommendation 5: The Government should work closely with creative industries sector representatives, and research young companies directly, to ensure that as Business Link is moved online, those providing business skills support, mentoring and guidance that are relevant and accessible to creative industries that want to grow.

Recommendation 6: The Government should raise awareness in the creative industries sector of the support UKTI offers to businesses abroad, and task UKTI to work with sector trade bodies of the creative industries to ensure they provide rolling programmes of support that enable long-term strategic planning. (Chapter 3)

Recommendation 7: The Government should seek to extend the principle behind the codes of practice in TV – intellectual property ownership – to other sectors to enable creative companies working in TV, radio, games, photography and websites to retain and exploit a share of the intellectual property they create for public sector broadcasters. As intellectual property ownership is a key driver of growth this should also apply to work commissioned by other public bodies. (Chapter 3)

Recommendation 8: The Government should consider ways that the BBC can encourage creative competition, building on the success of and extending the window of creative competition, not just in TV production, but across all other creative content production (radio, online, gaming) in the next BBC charter renewal. In the meantime, the Government should ask the BBC to do this voluntarily, to stimulate growth in the creative industries.

Recommendation 9: All public support for the sector should be structured to enable creators to retain an intellectual property or equity stake in their work.

Recommendation 10: The Government should take seriously the recommendations of the BIS Select Committee report on government assistance to industry and review the accessibility of the Enterprise Finance Guarantee scheme to creative industries. As part of this undertaking the Government should facilitate shared understanding between industry, government and finance on which type of businesses are suitable for credit funding. (Chapters 2 and 3)

Recommendation 11: The Government should work with HMRC's Small Companies Enterprise Centre and sector representatives to explore how the Enterprise Investment Scheme can enable small enterprises ambitious for growth in the creative industries sector to attract investment. In particular Government and HMRC should clarify the rule around earnings

from royalties to enable creative industry content companies to access the scheme.

Recommendation 12: The Government should re-visit plans set out in its consultation⁷ on the patent box and extend the scope of this box to include new creative intellectual property and trade-marked designs allowing a reduced rate of corporation tax to apply to profits derived from copyright and trade-marks registered in the UK. Such a system could be linked to the R&D tax credit, creating a virtuous circle of investment, innovation and growth. The Government should also simplify the R&D tax credit, make it more straightforward for companies to claim under, and consider expanding it to cover more of the creative sector.

Recommendation 13: the sector trade bodies should accelerate their efforts to learn from and model peer success stories in mentoring promising businesses, nurturing business skills, and enabling and mediating in discussions between these businesses and creditors and investors.

Recommendation 14: The Government and the sector should discuss with relevant third sector bodies such as Nesta and UnLtd whether recommendations (5) and (13) can be best achieved by creating a programme of business skills workshops and business mentoring support that also offer entry level loans following the model of the Prince's Trust Enterprise Scheme. This could be funded by sponsorship, from third sector bodies, from government or a combination of these options.

Recommendation 15: The Government should consult the sector to establish where the current SIC system is lacking and how it can be improved. The Government should press for international reform through the EU and the UN to enable the system to better reflect the reality of the UK economy. (Chapter 4)

Recommendation 16: Government should task its statistics agencies to make it easier for the ONS and external researchers

using government data to track and study new and important sectors of the UK economy, including the creative industries, which are not well served by the current SIC system. (Chapter 4)

1 Defining and mapping the creative industries

In this paper we are interested in creative businesses and we draw a distinction at the outset between ‘businesses’ that are aiming to turn a profit for their owners or shareholders, and creative charities and not-for-profit organisations whose prime motives and obligations are different. As Deborah Flemming, the owner and designer of fashion business Pistol Panties, says: ‘You build a company because you have a vision but you also want to make money out of it... If you don’t – there is no point in doing it.’

So – illustrating the point with an example – we draw a firm distinction between an organisation like the Royal National Theatre, currently riding high with its international (and profitable) hit *War Horse* and, for example, Studio Lambert, producer of *Undercover Boss*, which has been a hit in the UK and internationally.

We define the National Theatre as a creative organisation, but not a creative business, and so outside the scope of this report. This is because the National Theatre’s primary objective is to make good theatre – and any income or profits it earns will be put back into making good theatre. It is a not-for-profit organisation. This is in contrast to Studio Lambert, where the organisation’s prime objective is to make good television shows to sell at a profit. To grow, a creative business may well re-invest some of its profits in creative new projects; nevertheless, one day these companies, unlike non-business creative organisations, will pay a profit dividend to their shareholders.

There is also a distinction here in the original sources of funding of these not-for-profit organisations. The National Theatre and other arts organisations usually receive at least a third of their funding from the public – tax payers – or from philanthropy, where private individuals and companies are

investing their money, but are not looking for a direct financial return.

In contrast, the creative businesses that we are interested in are those that are mostly or wholly funded from private or commercial finance. This might be investment of personal savings, credit in the shape of a loan from a bank, investment from individuals or investment houses. It is private money, and those investing it are aiming to make a profit, to generate a return on their investment.

The Government's own figures put the contribution of the creative industries sector to the UK economy at £59.1 billion or 5.6 per cent of gross value added (GVA) in 2008.⁸ This figure is more than double the European average size of the sector.⁹ The Government estimates there is sector employment at 2.3 million jobs, 1.3 million in the sector and a further 1 million outside the sector. In 2010 there were an estimated 182,100 businesses making up 8.7 per cent of all UK enterprises.¹⁰ Moreover, the sector has been growing at twice the rate of the rest of the UK economy.¹¹ In total it employed nearly 2.3 million people in 2010, some 7.8 per cent of the workforce, 633,900 of whom are self-employed. Sector exports totalled £17.3 billion in 2008, 4.1 per cent of the total.¹²

While charity and not-for-profit creative organisations are included in these official figures, it is creative businesses, under our definition, that are generating nearly all of this economic activity.¹³ This pamphlet seeks to explore the nature of the risk in this sector of the economy, and whether there are things that can be done to enable the sector to grow. It is therefore the creative businesses, not other parts of the creative sector, in which we are interested. Not because the rest of the sector is less important, but because the potential for growth is higher in those parts of the economy that are firmly part of the private sector.

If this explanation addresses the 'business' half of the descriptor, what is 'creative' about a creative business? Intuitively this seems an easy question to answer. From the supply side, it is businesses that derive their profit from selling creativity: music, fashion, film, TV, games, writing; as well as the activity around this, like advertising. From the demand side, it is

the money we spend for enjoyment or to express our tastes and interests: the clothes we buy, the films and TV shows we watch, the books and papers we read, the games we play, the music we listen to, and the gigs and concerts we go to.

An alternative way of thinking of it is that the route of all value in this sector is the creation of new design and copyright material: from the design of a dress, through new songs, games, TV shows and films, to *Harry Potter*, the sector begins with original creative ideas. It is this concept that differentiates a creative business from the creative insights that occur, for example, during the innovation process. We are not discussing patenting inventions, but recognised designs, trademarks and copyrighted creativity. And the financial and economic rewards, if the creative idea is a good one, and produces a hit (bag, show, song, game) can be huge. After all, as economist Dambisa Moyo points out, ‘The marginal cost of an idea is zero.’¹⁴

Our definition of the creative industries sector is similar, but not identical, to that used by the UK Government, although how this translates into the statistical data collected by the Office for National Statistics is a different matter, as discussed in chapter 4.

The UK Government’s definition of the creative industries sector is derived from the mapping document for the creative industries published by the Department for Culture, Media and Sport (DCMS) in 1998 and updated in 2001 under the then Secretary of State Chris Smith. It defined creative industries as ‘those industries which have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property’¹⁵ and then listed 13 sectors: advertising, antiques, architecture, crafts, design, fashion, film, leisure software, music, performing arts, publishing, software and television and radio.¹⁶

There have been slight amendments since then, for example, changing the descriptor of fashion to ‘designer fashion’ and ‘leisure software’ to ‘interactive leisure software’, but the Government has also made it clear that the main definition was unaltered, and has provided economic data accordingly, for example, on the economic contribution to the economy (GVA

and exports) as well as employment and number of businesses. The current list of sectors is: advertising, architecture, art and antiques, crafts, design, designer fashion, film and video, interactive leisure software, music, the performing arts, publishing, software and computer services, television and radio.¹⁷

This list is in itself controversial. For example, by restricting its definition of fashion to high-end fashion designers, mainstream fashion retailers and the retail and manufacturing activity that high end and high street fashion designers generate are excluded from the definition of a creative industry by the Government. Since 22.5 per cent of retail activity is fashion spending, this is an important point.¹⁸

It seems rather arbitrary that retail sales of fashion, music, games and books should be excluded from the definition of a creative industry whereas retail sales of art and antiques are not. Likewise, it seems anomalous that production of a TV show or film should be considered part of the creative industries when manufacturing of bags, clothes and shoes is not.

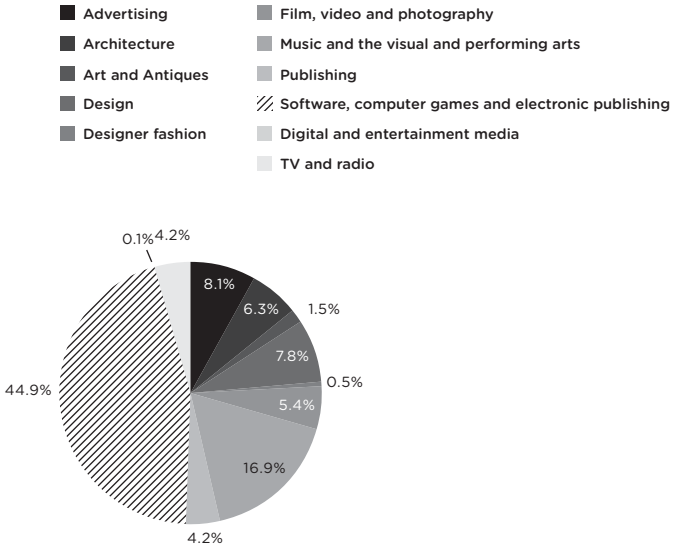
Recommendation 1: the Government should explore whether it is economically coherent that the manufacture and sales of new design and copyrighted material should not be covered in any definition of the creative industries.

However, in attempting to map the sector, this pamphlet can only use the definitions provided by the Government; we return to this issue in chapter 4. Suffice to say that these definitions are contested and the figures for the number of companies, GVA contribution and employment, for fashion and music in particular, are lower than the ones these sectors understand and report themselves.

Sector structure

Since 1998 the DCMS has provided a list of the Standard Industrial Classification (SIC) codes it uses to describe the characteristics of the creative industries sector.¹⁹ In order to set

Figure 1 **Companies in the UK by creative industries sector**



the context of what is involved, the remainder of this chapter looks at the information these data provide.

The following analysis uses figures from the most recent DCMS *Creative Industries Economic Estimates* (2010) as well as original research of the Office for National Statistics (ONS) Business Structure Database (BSD) to map the number of companies in the creative industries by sector, size and number of employees. We have combined this new analysis with publicly available data from the Department for Business, Innovation and Skills (BIS)²⁰ to see whether there is a notable difference between the demography of the creative industries and industries in the rest of the economy.

In 2010, the number of companies that met the government's definition of a creative industry business was 182,100.

Figure 2 **Gross Value Added of the creative industries in basic prices (£ million)**

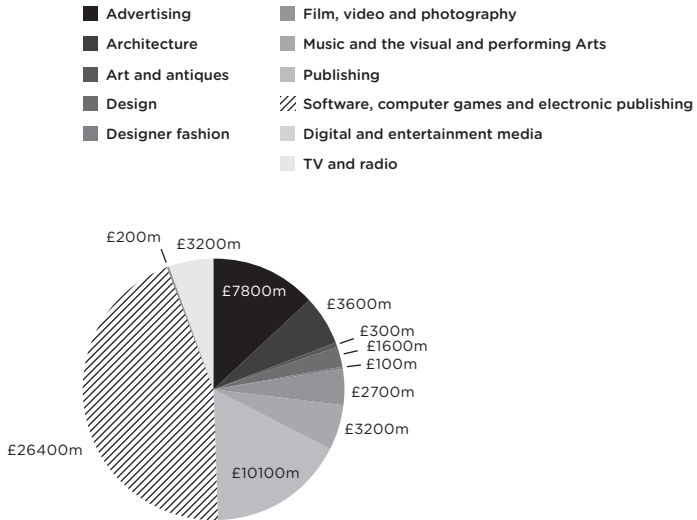


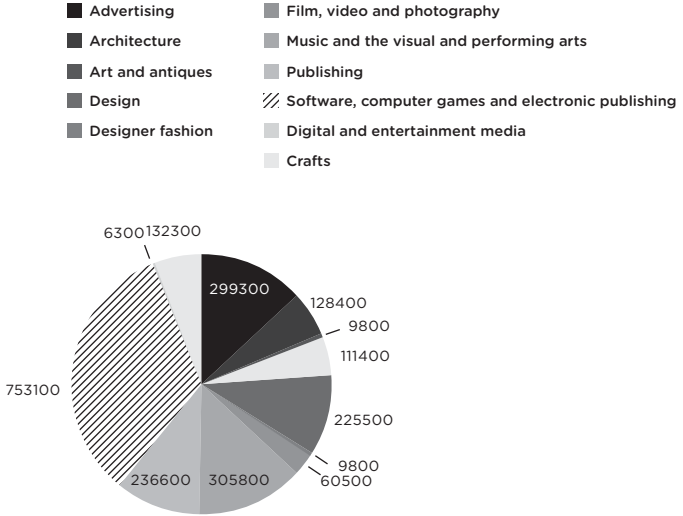
Figure 1 shows how this is divided up; the sectors with the most companies are software and video games, architecture, and then music and the visual and performing arts.

Likewise, the largest contribution to economic growth (GVA), accounting for nearly half of the total, is the software and video games sector, followed by publishing, advertising, architecture, TV and radio, and music and the performing arts (figure 2).²¹

Figure 3 shows that the sector generating the most employment is also software and computer games, followed by the music, visual and performing arts, advertising and publishing sectors.

The sector is dominated by micro companies (with fewer than ten employees). However, economy-wide data suggest that

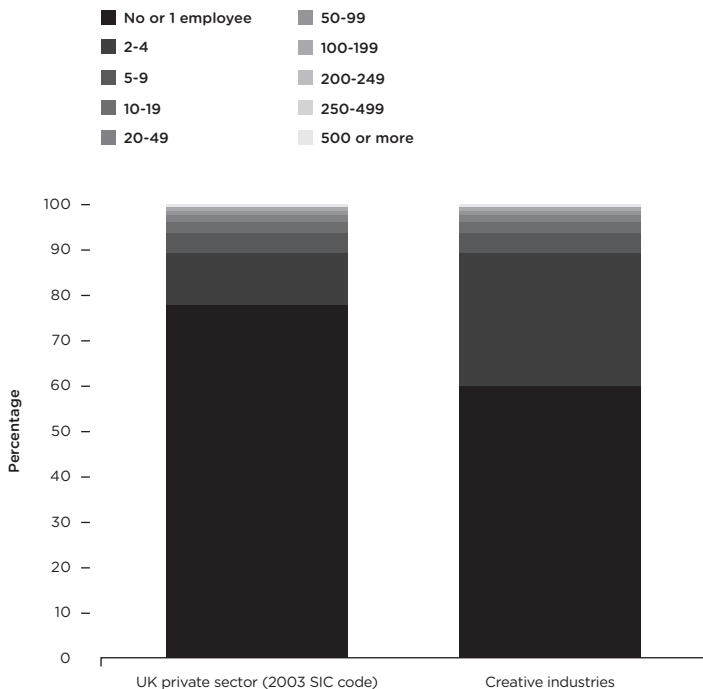
Figure 3 **Employment in the creative industries, broken down by sector**



this is not unusual,²² as figure 4 shows. Indeed, when we look at the structure of other sectors of the economy in comparison to the creative industries (figure 5) we see that all sectors are dominated by micro businesses and sole traders.

Figure 6 shows that structure within the sector has some variation, with publishing, advertising, art and antiques and architecture having slightly higher proportions of larger firms. Comparing Figure 6 with Figures 1 and 3 yields some interesting detail on the difference between sectors within the creative industries. The publishing sector has a small proportion of the total number of businesses in the creative industries, but is the second largest earner and has some decent-sized companies. The software and video games sector may have some very large companies in it, but there are also a lot of small ones.

Figure 4 **Employment in creative industries, compared with private sector as a whole**



Overall, however, the most powerful observation from figures 4, 5 and 6 is that the creative industries sector is remarkably similar to the make-up of the rest of the economy.

Mapping government resource

While we are on the subject of mapping, it is worth pausing to consider the way that the Government deals with the creative industries. Figure 7 gives an overview of the bodies and

Figure 5 **Enterprises in the UK by number of employees, by sector**

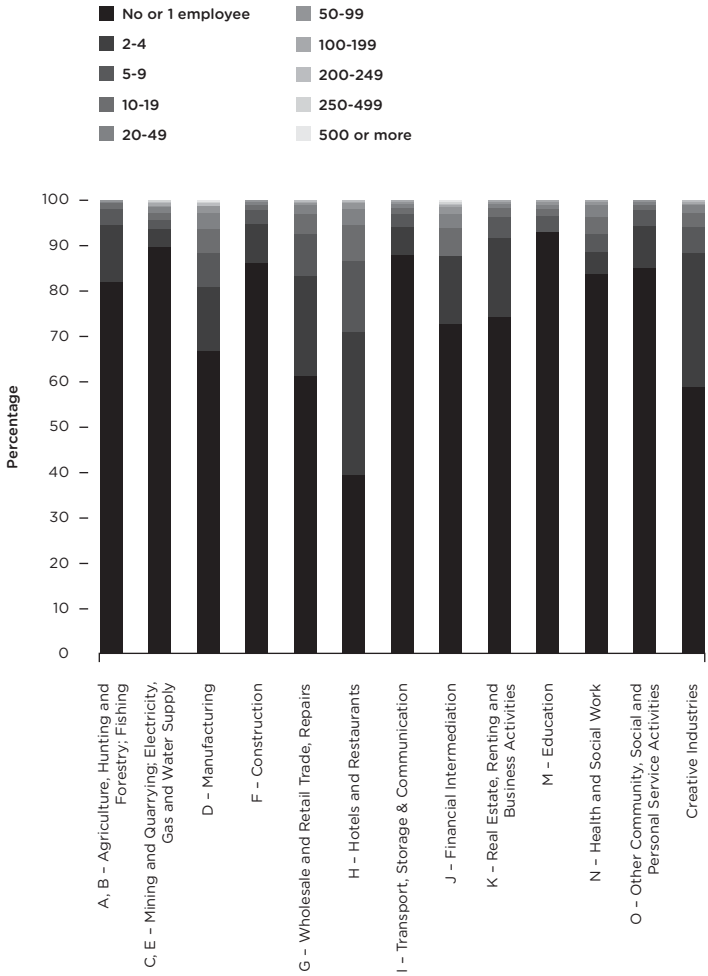


Figure 6 **Enterprises in the creative industries by number of employees**

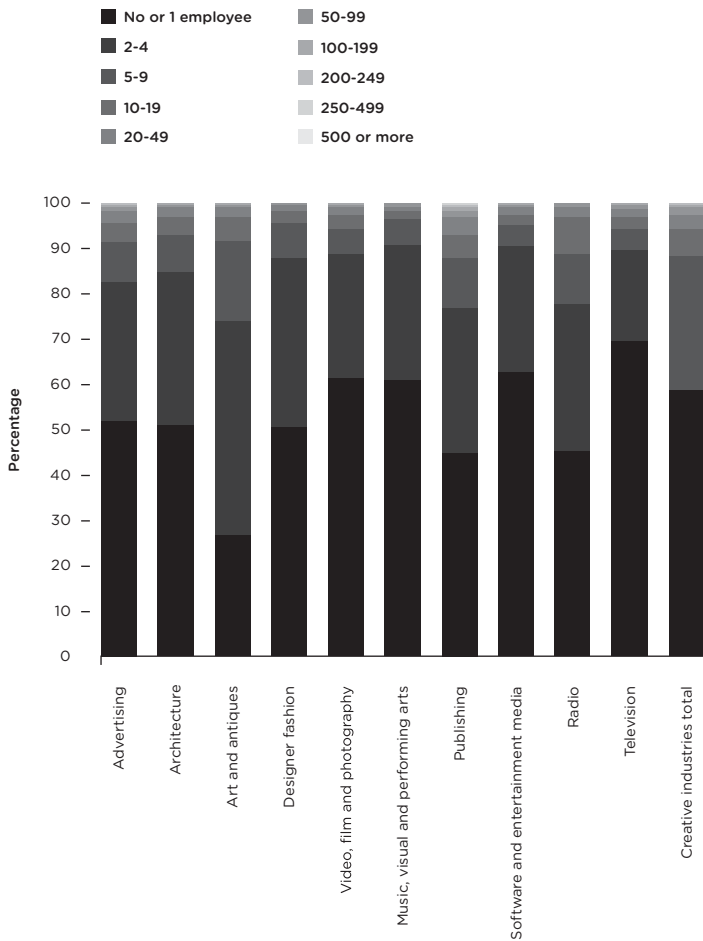
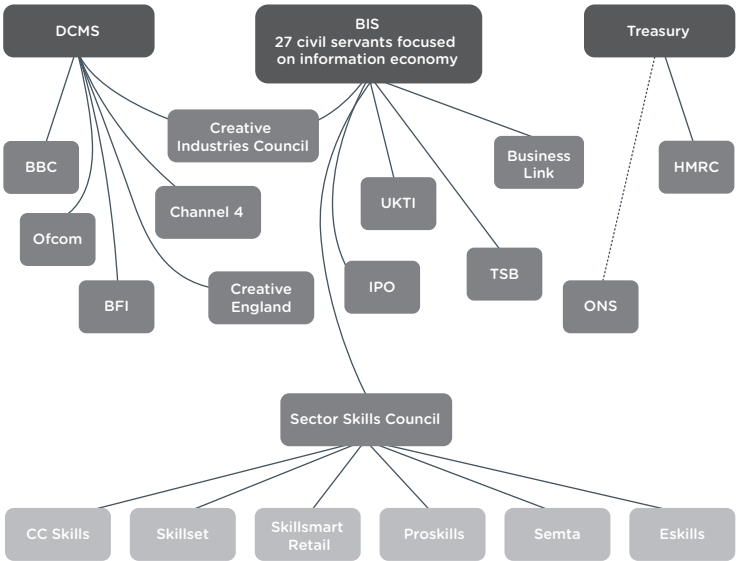


Figure 7 **Government bodies engaging with the sector on business and economic policy, and their sponsoring departments**



departments to which they answer that deliver top line business initiatives relevant to the sector.²³

It is a complex picture, leading to concerns about whether the Government has a clear direction for its policy for the creative sector. Possibly of greater concern, however, is the paucity of government resource devoted to providing any kind of engagement with and analysis of this sector. DCMS ‘seeks to provide the regulatory environment in which the creative industries can contribute to the growth of the UK economy and to its cultural wellbeing’,²⁴ but all the significant policy initiatives that might support businesses in the sector originate from BIS.

BIS has no civil servants in its enterprise team focused on the creative industries, and no civil servant at BIS has a

specialism in fashion, although there are 15 civil servants focusing on retail, services and construction. By comparison, the department has 19 civil servants specialising in aerospace, marine, defence, manufacturing advisory service, 21 civil servants specialising in automotive, advanced manufacturing showcasing and 33 civil servants specialising in electronics, materials, chemicals.²⁵ And yet the contribution to UK GDP of the car manufacturing and chemical manufacturing industries are each half the size of fashion's contribution, at £10.1 billion and £10.6 billion respectively.²⁶ When will there be a team of 20 civil servants at BIS specialising in fashion manufacturing, retail and export, as is appropriate for a sector of its size? How much more would the Government know about the sector, and how it might assist it, if Whitehall had such expertise? These questions also apply to HM Treasury: the report *The Plan for Growth*, issued by the Treasury and DCMS (March 2011), does not mention fashion.²⁷

Following the publication of *The Plan for Growth*, DCMS claims to be 'working with BIS and other Government departments to deliver the actions set out there', highlighting in particular setting up the Creative Industries Council to 'provide a mechanism for business to drive the agenda in tackling the issues of greatest concern to them'. The DCMS civil service resource is 'fluid and kept constantly under review to ensure staff are deployed where they have most impact'.²⁸

Recommendation 2: The Government should ensure that the civil service resource devoted to analysing the creative industries corresponds to its size and potential, and that departments that originate relevant policies have an appropriate number of civil servants with sectoral expertise.

Summary and conclusion

The definition of what makes up a creative business is contested, and needs reconsidering, but even using the Government's current definition, it is clear that the sector has a significant contribution to make to the economy. While different parts of

the creative industries share defining characteristics – they are selling creativity in some form or another in a way that gives pleasure to consumers and can usually be copyrighted – there are significant differences in the way that subsectors are structured.

Moreover, much has been made of the high proportion of small businesses and sole traders in the creative sector. In March 2011 a CBI paper stated: ‘The sector has a disproportionately high number of SMEs and micro businesses.’²⁹ In fact when considered in the aggregate, that is no more the case than for other sectors of the economy. There are exciting start-ups and many self-employed, sole trader and lifestyle businesses across the whole economy, not just in the creative industries. While the sector’s contribution to GVA, growth and employment is important, the early conclusion from this work is that this sector is not unique in the way it is structured. The next chapter looks at whether there are differences in risk between the creative industries and other sectors.

2 Creative industries and the risk myth

In this chapter we discuss what is meant by risk, and how it means different things to people with different perspectives on, and interests in, the sector. We present here new data on outcomes for businesses in the creative industries in comparison with businesses in other sectors of the economy, drawn from the Office for National Statistics (ONS) Business Structure Database (BSD). We show that, contrary to expectation, businesses in the creative industries show relatively good outcomes in business survival. We start by considering the perspective of creditors and investors, concluding that different types of risk are more or less suited to different types of investment. Chapter 3 draws on interviews with individual companies to see how this might translate into real-life examples.

At a meeting in Westminster two years ago attended by senior politicians, a private sector analyst of the creative sector asserted that ‘creative industries businesses are riskier than other businesses’ as fact, with no recourse to evidence or data. In one memorable discussion that partly led to the idea of writing this pamphlet, this assertion was challenged by a member of the audience and in the ensuing discussion it became clear that the expert opinion derived from a *belief* that businesses in the creative industries are riskier than other businesses, despite having no data to back this up.

Similarly, a CBI briefing paper from March of this year suggests, without reference to data, that because of their business models, ‘from an investor or lender perspective, creative industries can... be viewed as a riskier proposition, resulting in either a reduced appetite to invest or lend, and/or a higher cost of finance to compensate for the higher level of perceived risk’.³⁰

The main purpose of this chapter is to explore the nature of risk, how it operates in the businesses in the creative industries,

what data there are on business outcomes and what these data reveal. Is it possible to identify and quantify risk in the creative industries, or is it really the case that in this sector, as William Goldman famously said: ‘Nobody knows anything’?

Certainly, the perception of risk can have powerful impacts, especially among those without experience of the sector: A Nesta survey from 2004 shows that ‘one third of investors agree that the business models for the creative industries sectors are too risky to be worth investing in’ and that ‘previous experience makes a difference with just 14 per cent of those who have invested previously agreeing with the statement compared to 40 per cent of those who haven’t’. Thus those with no experience of the sector were far more likely to view it as risky, making them less likely to dip their toe in. It is no surprise, therefore, that of those investors surveyed, just one in five was considering investing in the sector.³¹

What the banks say

Recent research conducted for BIS and DCMS by the Economic and Social Research Council shows that banks assess risk according to their customer’s ability to repay. As the following quotes from banks show:

Banks don’t discriminate against the creative industries, but they do discriminate against people who they think can’t repay. It may just be in our eyes that there are more of them in the creative industries.

Banks don’t fund people to paint pictures which they will then sell at a later date.³²

To supplement the work undertaken by BIS, in the course of research for this project we interviewed a number of individuals working for high street banks, who decide whether to grant loans to creative (and other) businesses. We heard the following views:

We will lend to anyone who can pay us back. So the more we lend, the better we are at our job.

We will not lend to anyone who has not already got a revenue stream. All companies, creative or other, need some kind of revenue stream before we can lend.

In the creative sector, the value is linked to the individual to a greater extent. In other sectors, in the worst case scenario they can chuck out the boss and run the business themselves to extract the value. If a creative business owner says 'sod this, I'm off', the bank is shattered.

In practice, we would not lend to a young lad with a guitar – there are other routes that they go to in order to reach their market rather than going to a bank. But if a record label that was already selling stuff wanted to raise finances to re-equip their studio, that they would look at if they thought it would lead to more sales. It's the job of the label to find the bands, not the bank.

The quality of business plans from the 'creative' sector such as media was less good: it takes more time to work with them to get them better.

The hits-based nature of much of the creative sector was also seen as a turn-off; in particular there was thought to be no increased likelihood of it being time for a hit if there had previously been a number of failures:

The [value of] intellectual property could be very high, but it could equally be very low. It's extremely volatile and that adds a level of risk.

If a TV show is nine-tenths completed, and stops for whatever reason, it could be worth ten times the funding costs, or it could be worth a tenth of the funding costs. Very volatile and hard to tell at the beginning, so therefore riskier.

There are no end of films that have been made in the UK and never been seen.

Yes, it's a hit-based business but that does not mean we will invest in ten projects on the presumption that one will come off. Unless there is already a revenue stream, we just won't invest at all.

Banks that have taken a different approach have lived to regret it – there was an organisation called Gap Funding that was designed to [fund] the remaining 30 per cent when only 70 per cent could be raised. They went bust.

Box 1 gives an example of how a high-street bank assesses whether to give a loan to a creative industry business. There is little in this that is directly linked to the nature of the industry; it is far more about general principles that could apply to any entrepreneur in any sector.

Box 1 **Criteria a high-street bank uses when deciding whether to lend to a business**

A mainstream retail bank considers whether to lend to a creative industry according to the following criteria, summarised by the acronym CCC PARTS:

Character: Do we want to lend to this person? We assess the person as much as any deal they want to borrow against, to examine whether the individual is trustworthy and whether they have a relevant track record.

Capability (financial and professional): Is this person skilled in the detail and knowledge of their business, and financially capable? Are there sufficient skills in the whole management team to run the business?

Capital: What assets does the applicant have? How much is committed to the project? The loan amount requested should be in proportion to the customer's own stake, with banks rarely lending more than 70 per cent of the total cost of the project. Or, as a banker from another bank put it, 'They have to have skin in the game – something to lose if things go wrong, that motivates them to work hard to make things go right.'

Purpose: The bank needs to establish that the purpose of the loan is fit and proper and in the customer's best interests.

Amount: Is the applicant asking for the right amount to fund the project? Is it consistent with what they are doing in the business overall? Applicants can be optimistic and overlook potential problems; the lender can bring a degree of realism to the project.

Repayment: Can applicants provide evidence of their ability to repay? This can be done through thoroughly tested revenue projections, or if the business relies on a small number of significant orders, through a legal commitment from the buyer to pay.

Terms: The terms set the cost of the loan: the interest rate and other fees. This is determined by an assessment of the risk versus rewards. Proposals that have adequate security (see below) attract a lower interest rate than unsecured deals. The amount and complexity of work involved to assess the loan determines the level of fees.

Security: There needs to be a 'second way out' for the bank, something that it can reclaim or repossess if the loan holder defaults on their loan.

Other banks use similar rules of thumb; another acronym, for example, is CAMPARI (Character, Ability, Margin, Purpose, Amount, Repayment, Insurance). The criteria under consideration are practically identical; none are specific to the creative sector itself.³³

From these qualitative interviews, two clear themes emerge:

- Banks will lend to businesses that fall within our definition of a creative business, provided they meet the criteria that would be applied to every lending proposition.
- These criteria always involve some form of subjectivity, particularly in the 'character' part of the assessment. A representative from Lloyds says that 'existing business experience is not a prerequisite for us, we want to encourage all viable start-up growth'. The bank will lend 'to an enterprising individual, a lot of our decisions come down to local lending discretions'.

If creative businesses have a viable business plan with predictable revenues, and can demonstrate that their commitment to their art gives them a determination to succeed that may not apply to entrepreneurs in more traditional industries, it may present an opportunity. It also presents a risk;

given that a creative business depends on an asset that exists inside the entrepreneur's brain, banks are unable to secure their investment against it.

Understanding this dilemma is a major part in determining what action both sides should take when discussing a loan, and which parts of the industry would in principle meet the criteria for bank lending and others that would not.

For example, a fashion business that has, in essence, shown a series of prototypes at a fashion show and received signed orders would be in a strong position to access a loan to deliver the work on the expectation of being paid. Similarly an architect, a TV series producer or a video games developer who has already been commissioned to produce an output by a larger organisation should in principle be able to access a bank loan to cover the up-front costs of actually delivering the work. Larger companies may also be able to access loans on the basis of their track record, knowledge and assets (including intellectual property); a fashion company could use figures from the last season plus proven expertise to obtain up-front investment in stock for the next season. As one of the quotations above showed, a record label might be able in principle to obtain a loan to expand its studio, if it could show that there was clear demand for its use and that the company had a demonstrable success rate per number of bands it could sign up.

However, the market for some things is easier to predict than others. Martin Mills of record label Beggars Group, which puts out around 30 new releases per year, says: 'We're not trying to sell music that customers want; we're trying to sell new music that they don't yet know they want.' He points out that some of the (now) biggest artists at the label, like the Prodigy, were considered to be deeply edgy and experimental when they released their first album, and yet over time their popularity has grown and they have become million album sellers.

Mills also described how, starting his business 30 years ago, no bank would lend to him. In contrast, today, with a well-established company with a desirable back catalogue, including the Prodigy, Radiohead and Adele, a number of revenue streams from retail, promotions and record sales, and

over 200 employees worldwide, the company has a (rarely used) credit facility with its bank for millions of pounds.

Propositions that are unsuccessful in obtaining bank lending are likely to fall into one of the following three categories:

- There is too much general business risk that is not linked to the fact they are in the creative sector.
- The business plan is not of sufficient quality.
- No revenue stream has been proven.

Too much general business risk that is not linked to the fact they are in the creative sector

Clearly, all businesses contain elements of risk: over time customers may want more or less of what your business is offering. Customers might find a competitor's offer more appealing. Suppliers may become scarcer, or more expensive. The legal or regulatory framework might change.

Business planners aim to consider these possibilities before starting a new venture. Managers of smart and successful businesses continuously assess and reassess the relevant circumstances in the supply and demand side of their business, with the aim of anticipating and planning for relevant risk factors. When businesses do this successfully they survive and thrive; when they don't, in the end, they fail.

Some activities are considered likely to increase business risk: trading abroad makes the business vulnerable to exchange rate fluctuation; different countries' legal framework may work differently, or not at all. A new product launch may appeal to customers and do very well, or be beset with problems, or just not be popular. Again, these kinds of risks can be assessed, estimates of their likelihood made with the aim of mitigating them as far as possible. If creditors (or investors) are considering loaning or investing in a business, they will want to see research and analysis on all relevant issues along these lines, to understand the possible opportunities and risks before agreeing to loan or invest.

The business plan is not of sufficient quality

While there is no reason why creative businesses should not put together good business plans, there is anecdotal evidence that this might be a particular problem in the creative industries. The image of the sector is that it attracts many entrants from non-business backgrounds, as well as many young entrepreneurs aiming to set up businesses in their 20s.³⁴ But this hurdle can be overcome with training, mentoring and support, possibly from within the sector itself. The British Fashion Council, for example, seeks to nurture new businesses with potential, teaching them business skills and facilitating conversations with lenders. But there is also a role for government, for example through its small business service.

No revenue stream has been proven

This may well be the case for a number of hits-driven businesses in film, television, music and video games where the business model relies on bringing a stream of new and unpredictable creative products (SNUCPs) to market. It will particularly apply to start-ups and companies that are attempting to build their own value rather than operate on commissions from other firms. There is no indication of any appetite from the bank lenders for these types of propositions; the lesson for the individuals involved is that it may be more productive either to seek equity capital or try to work with a stronger brand, difficult though these options are.

What the investors say

Banks are concerned about loan risk; they want to be sure they will get their money back. Investors by contrast want to grow their stake; they are concerned about the likelihood of making a good return on their investment. For them, high risk is not necessarily off-putting; on the contrary it can be attractive, if the potential reward is correspondingly high.

Investors are there to make money. As Colin Ellis of the British Venture Capital Association says, 'Private equity and venture capital are looking for growth businesses.' Investors aim

to find and back winners in order to make a return (profit) on their investment, not only earning dividends on profits of the company, but also getting their original stake back (an exit strategy). An 'exit' is either selling their stake to another investor, selling the business to another business (for example, AOL buying The Huffington Post) or selling shares publicly either on the stock exchange or on another public market such as the alternative investment market (AIM) in the UK or the NASDAQ in the US.

Venture capital trusts (VCTs) usually manage money in the hundreds of millions, and there is a size, by revenue, below which they cannot invest as transaction costs make it uneconomic. One fund manager specialising in the creative industries told us: 'We don't really invest in companies that have less than £1 million in turnover, and our preferred size of company to invest in is around £2million to £5 million turnover.' Most VCTs only invest if there is a clear, timed exit strategy, and their exit timescale is usually around five years.

Angel investors invest earlier, perhaps with an initial stake as low as £10,000 but many are prepared to invest higher sums and many angels invest together in syndicates or groups, enabling them to make larger amounts available. While they may be prepared to wait longer for the 'exit' when they take their return on investment, they are looking for companies that offer a ten times return – so that at exit, that initial £10,000 stake would be worth £100,000.

All the investors we talked to stressed two things:

- They are looking for a business model that offers scale.
- They invest as much in the individuals involved and their ambition and ability to deliver growth as in the business idea.

So for an investor, the lack of a steady revenue stream at the outset is not necessarily off-putting, although they will be looking for evidence that there is a market for what the company is making.

Likewise, personal investment from the entrepreneur is not necessarily an issue, although most businesses seeking investors

will go through a ‘boot strapping’ start-up phase where they self-finance research and development (possibly working on the venture in the evenings or at weekends, or investing their own savings) to get themselves in a position to have a proven or evidenced concept of value to pitch to investors.

The stakes here are high: an angel investor might make 8–10 investments of £10,000–30,000. Of these, 50 per cent will fail and the investor will lose their money (although there are tax schemes that offer some tax relief on losses, such as the Enterprise Investment Scheme) and only one will achieve its ten times return target (some interviewees suggested that the hit rate overall is lower still, at more like one in 20). As an aside, we note that this anticipated hit rate is very similar to that expected by record labels working with new acts. In effect, a record label or music publisher is a specialist investment vehicle for investing in musicians and composers.

So while on the one hand all things are a possibility for an investor, on the other hand businesses seeking investment need to make a convincing case to show that their proposition has value, and they can deliver significant growth in sales and profits, and execute an exit strategy in order to provide returns.

Based on this information, it would seem that the following creative industry propositions are more suited to equity investment:

- firms without a steady revenue stream from existing customers or commitments to pay from business customers (this may be particularly true for start-up music, TV, film and video games companies)
- firms where the potential reward-to-risk ratio is high, in particular when bringing a constant stream of new and unpredictable creative products to market
- young businesses, especially those without their own capital to invest

However, we note that investment funding is unlikely to work for the many small creative businesses that are seeking relatively small sums of money (tens of thousands to hundreds of thousands of pounds) to fund sustainable rather than spectac-

ular growth. As we saw in chapter 1, the creative industries – and the wider economy – rely on a large number of small, steady growth sustainable businesses, while it is high and/or fast growth that many VCT or angel investors seek. If commercial credit is also unavailable or unaffordable, there may be a funding gap for these businesses.

The difference between creditors and investors

As other writers have shown, there is an inherent difference in the interests of creditors and investors: equity holders are inevitably attracted to high-risk, high-reward opportunities whereas creditors prefer lower risk and more certain reward.

This is because the investor is first in and last out, with a variable earnings potential: the creditor is paid back from future profits first, but once the loan is paid, all remaining earnings belong to the investor. So it is rational for the investor to prefer an approach that has the highest earnings reward, even if it carries a higher risk.

In contrast, a creditor is last in and first out, with a fixed earning potential; the creditor is paid back first, but only up to the loan amount plus an agreed interest rate. So it is rational for the creditor to prefer an approach which has the lowest risk, even if it carries a lower earnings reward.

Even in businesses where there is no actual cash investment on the table, the business owners are, in effect, the investor: they own the value in their business and thus are the equity holders. Therefore, what looks like a workable risk well worth taking to the equity holding business owner may look like an unworkable high risk to an external creditor from whom they are applying to borrow. To a creditor, what looks like a more sensible and viable approach may look like an awful lot of work for not much reward for the business owner.

More, for a business owner, it is cheaper to seek credit to grow their business than equity: If the project is successful, once the loan is repaid all future gain is theirs alone. In contrast, with external investment, future profits are shared with the external investor.³⁵

Therefore, it is rational for business owners to seek credit for growth in preference to investment. It is also rational for creditors to decline these opportunities some of the time. This does not make either the creditor or investor wrong. Rather, it means their interests and motivations are different. When a compromise between the two can be reached, credit is a viable source of funding for a business; where they cannot agree, it is not. This compromise is usually around the level of project risk taken, the terms and cost of borrowing, or both.

Understanding this conflict may shed light on why (some) parts of the creative industries are self-reporting failures in credit support schemes while the creditors themselves deny anything is wrong. However, given that creative businesses are no more likely to fail than businesses in other sectors, there should be no reason why aggregate lending to the sector is not on a par with that across all small businesses. However, as we have shown in Chapter 1 and will explore in more detail in chapter 4, there are structural issues such as the limited amount of available data on the sector, which may add to the uncertainty of lenders and could be contributing to the sector's reported lack of access to credit finance in some areas of the creative industries.

Summary

We conclude that all businesses face risks, and all (successful) businesses develop ways to anticipate, manage and balance these risks. Within the creative sector there are different types of risk, depending on the nature of the company, which might point an individual firm to seek either bank or equity financing, or to seek commissions from larger companies in order to build up an established track record. In the next chapter we use in-depth interviews to explore the specific characteristics of successful businesses in the creative industries.

In the meantime the next section approaches the question of whether creative industries are inherently riskier than other businesses from the other direction, using large quantitative datasets.

What the numbers say

It seems logical to expect that a greater degree of risk (from factors that are difficult to anticipate, manage and balance) would over time lead to a higher rate of business failure for those businesses.

Therefore, if they could be analysed by different sectors of the economy, data on business survival and failure rates will provide an indication of whether some sectors of the economy really are riskier than others.

Companies House registers every business operating in the UK annually. New businesses must register there; operating businesses must file their accounts there annually; those being wound up register there too. Companies House charts the relative number of business births³⁶ and deaths³⁷ each month, and the data are used as one indicator of economic growth: increases in aggregate totals of business deaths suggest a downturn, increases in aggregate totals of business births suggest economic recovery or growth.³⁸

Since 2002 Companies House has also charted the survival trajectories of each newly registered business. All companies filing accounts indicate which part of the economy they are operating in, by Standard Industry Classification (SIC) Code, the Government's method for sorting economic data.

The Office for National Statistics (ONS) made these data available to us in aggregate figures, sorted by five-digit SIC code. This makes it possible to chart and compare the five-year survival rates of businesses in different parts of the economy.

We have analysed these data covering the six years from 2003 to 2008, sorting them by economic sector.³⁹ We have then separated into a distinct category data on businesses in the creative industries, following the Government's definition of the sector, first set out in the creative industries mapping project in the late 1990s.⁴⁰

The SIC code system has been adjusted several times since; we have used the 2003 SIC codes and proportions specified by the Government to analyse the data, most of which were collected under this system. We collected data for 2007 and 2008 under the updated 2007 SIC code system, and converted them back to the 2003 system using government conversion methods,

to make the data for all six years directly comparable.⁴¹ This has enabled us to aggregate the survival rates of creative businesses, and to compare them with the overall survival rate of businesses in the rest of the economy, and with other specific sectors of the economy.

As discussed above, if businesses in the creative industries are inherently riskier than other businesses, we would expect these data to show a poorer survival rate for businesses in the creative sector than for businesses elsewhere in the economy.

Average survival rates over a five-year time series created from 2003 to 2008 data can be seen in table 1 and figure 8.

Table 1 **Average survival rates of UK businesses in the creative industries and elsewhere that started trading in 2003, after one to five years (%)**

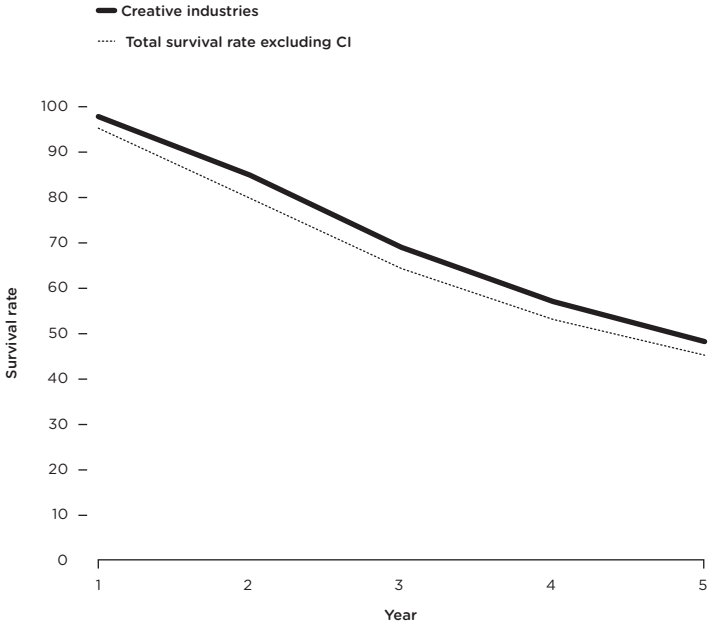
	Still trading after				
	Year 1	Year 2	Year 3	Year 4	Year 5
Businesses in the creative industries	96.3%	84.1%	69.2%	58.0%	49.7%
Businesses in the rest of the economy	93.9%	79.4%	64.8%	54.3%	46.9%

The survival rate of a businesses operating in the creative sector five years from its birth is on average 49.7 per cent. This is slightly better than the average rate of survival for businesses in the rest of the economy five years from birth, which was 46.9 per cent.

The first observation is that all start-up businesses are risky. The average survival rate of any start-up business in the UK five years from birth during this time period is just 47.1 per cent.

We have gone further, and broken down the businesses in the rest of the economy by their five-digit SIC code, to compare the survival rates of the creative industries against other sectors of the economy (figure 9 and table 2).

Figure 8 **Average survival rate of businesses in creative industries compared with other businesses**

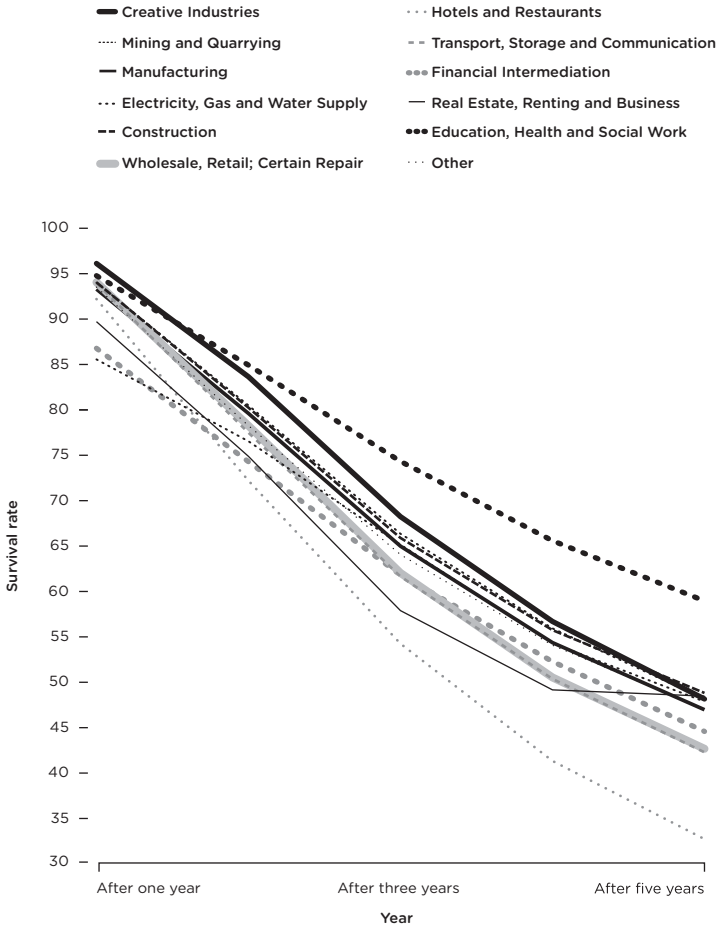


As we can see from figure 9, at 49.7 per cent, the survival rate of businesses in the creative industries after five years is one of the best; it is exactly the same as that for ‘Real estate, renting and business’, with ‘Electricity, gas and water supply’ (50.0 per cent) and ‘Construction’ (50.3 per cent) doing slightly better.

Only the ‘Education, health and social work’ sector – businesses that operate in the public sector – has a notably better five-year aggregate survival rate; at 60.2 per cent, its survival rate was 10.5 per cent above that of the creative industries. In contrast, only one sector, ‘Hotels and restaurants’, has notably poorer outcomes, with an aggregate five-year survival rate of 34.7 per cent, some 15 per cent below that of the creative industries.

Apart from these outliers, all the other sectors’ aggregate five-year survival rates fall between 50.3 per cent (‘Construction’) and 44.4 per cent (‘Wholesale, retail and certain repair’).

Figure 9 Average survival rate of businesses by sector



It is unsurprising to see ‘Education, health and social work’ with the best five-year survival rates. After all, these businesses supply parts of local and national government, and other public

Table 2 **Average survival rates of UK industries that started trading in 2003, after one to five years (%)**

Industry	Survival rate				
	After 1 year	After 2 years	After 3 years	After 4 years	After 5 years
Creative industries	96.3%	84.1%	69.2%	58.0%	49.7%
Mining & quarrying	86.0%	77.2%	66.2%	55.7%	49.4%
Manufacturing	93.5%	80.2%	66.0%	55.7%	48.5%
Electricity, gas and water supply	90.0%	75.6%	59.1%	50.7%	50.0%
Construction	94.2%	80.8%	66.9%	57.1%	50.3%
Wholesale, retail; certain repair	94.2%	78.9%	63.2%	52.0%	44.4%
Hotels and restaurants	92.5%	73.0%	55.6%	43.1%	34.7%
Transport, storage & communication	94.2%	78.2%	62.8%	51.8%	44.0%
Financial intermediation	87.2%	75.1%	63.0%	53.7%	46.2%
Real estate, renting & business	94.2%	81.1%	67.4%	57.2%	49.7%
Education, health & social work	94.9%	85.4%	75.1%	66.6%	60.2%
Other	93.7%	78.9%	65.1%	55.4%	48.6%
Total survival rate	94.1%	79.8%	65.2%	54.6%	47.1%
Total survival rate excluding creative industries	93.9%	79.4%	64.8%	54.3%	46.9%

sector organisations such as primary health care trusts. Spending decisions in these sectors are usually taken a long way in advance and are very public, enabling businesses that work in them to anticipate future changes.

Likewise, it is unsurprising to see ‘Hotels and restaurants’ with the poorest five-year survival rates; this is another sector notorious for being risky, and the data bear out this perception.

However, the data do not bear out the perception of risk attached to the creative industries. On the contrary, the five-year survival outcome for creative industries is the fourth best of the economy.

The full figures as percentages are provided in table 2.

We know these data only include new companies (not those resulting from a merger, split or restructure) and we know that they are active: they have reported either turnover or employment at any time during the reference period. Nevertheless, we should be aware that a company filing accounts with Companies House each year tells us merely that it is surviving, not that it is a great success. This mitigating factor applies to all sectors of the economy, however, so comparisons between sectors are still meaningful.

The churn of businesses, or a high failure rate, is not necessarily a bad thing. On the contrary, a high failure rate may reflect a high birth rate – more people choosing to go into business, or be strong in sector competition. This could be contributing to overall economic growth on the one hand (more business start-ups increase economic activity) and quality of businesses in the sector on the other (as competition means only the best businesses survive).⁴²

Within the creative industries sector

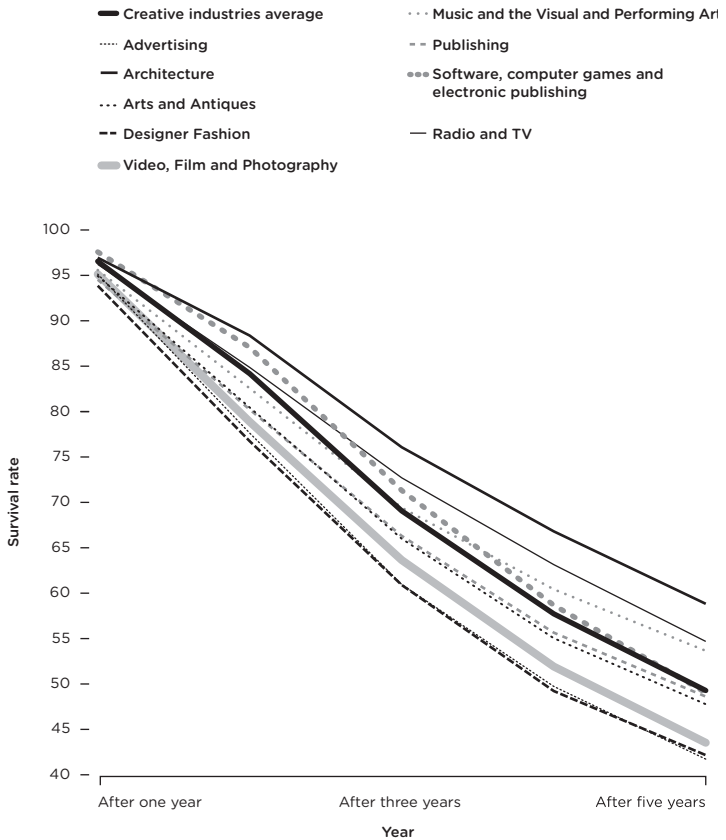
The data we sourced from ONS were sufficiently detailed (to the five-digit SIC level) to enable us to go further, and examine the survival rates of businesses in different sectors within the creative industries.

As before, we sorted the data by SIC code, following the Government's 2003 definition of the sectors that make up the creative industries, adjusting the data for years 2007 and 2008 (reported using 2007 codes) back to 2003 codes for comparability (figure 10 and table 3).

The survival rates within the sector have a narrower spread than those across the economy as a whole; from 'Architecture', the least risky sector with a five-year survival rate of 58.4 per cent, to 'Advertising', the most risky at 41.4 per cent, closely followed by 'Designer fashion' at 41.8 per cent.

As in the economy wide data, those sectors that have the best survival rates are those that have the highest chance of public sector contracts. 'Architecture' has been going through something of a boom as a result of a property boom and high

Figure 10 **Average survival rate of businesses by creative industries sector**



public spending on capital projects during the period our data cover; likewise the 'TV and radio' sector has had considerable public intervention, such as quotas and codes of practice in the 2003 Communications Act.

Table 3 **Average survival rate of the UK creative industries sector that started trading in 2003, after one to five years (%)**

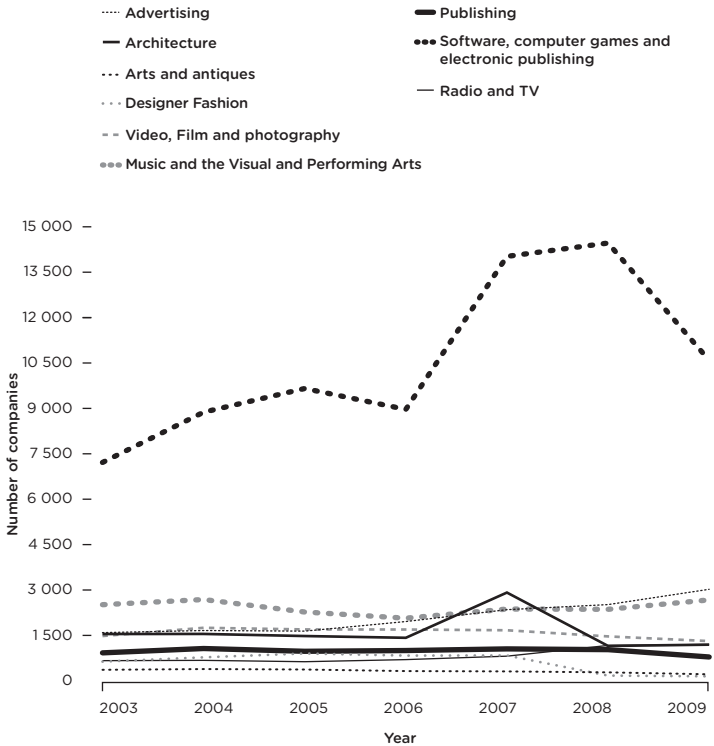
Industry	Survival rate				
	After 1 year	After 2 years	After 3 years	After 4 years	After 5 years
Total creative industries	96.2%	83.8%	68.7%	57.4%	48.9%
Advertising	94.8%	77.3%	60.6%	49.4%	41.4%
Architecture	96.6%	88.0%	75.7%	66.5%	58.5%
Arts and antiques	94.6%	80.1%	65.7%	54.7%	47.4%
Designer fashion	93.5%	76.4%	60.6%	48.9%	41.8%
Video, film and photography	94.8%	78.5%	63.3%	51.6%	43.2%
Music and the visual and performing arts	95.2%	82.2%	69.1%	60.1%	53.3%
Publishing	94.2%	79.9%	66.0%	55.3%	48.3%
Software, computer games and electronic publishing	97.2%	86.7%	71.0%	58.3%	48.7%
Radio and TV	95.9%	84.5%	72.4%	62.8%	54.3%
Total survival rate excluding software etc	95.2%	81.2%	66.8%	56.6%	49.1%

As we can see in the breakdown of company births between 2003 and 2009 (figure 11), there was a peak of business births in ‘Architecture’ in 2007. The arrival of ‘Design’ as a distinct line in 2007 results from 2007 SIC codes, which identified this sector for the first time in that year.

Finally the high birth rates in the ‘Software, computer games and electronic publishing’ sector throughout this period were at least double the birth rates of any other sector. In the survival rates data, we therefore excluded this industry when plotting survival rates of the rest of the sector, to see if it had an impact on the trend. The broken line in figure 10 is very hard to distinguish, which shows it had no impact.

Finally, we looked at survival trends following the Technology Strategy Board’s (TSB’s) approach to ‘aggregating the sector into three broad markets; Content, Services and Artefacts’ (figure 12).⁴³ The artefacts category includes art and

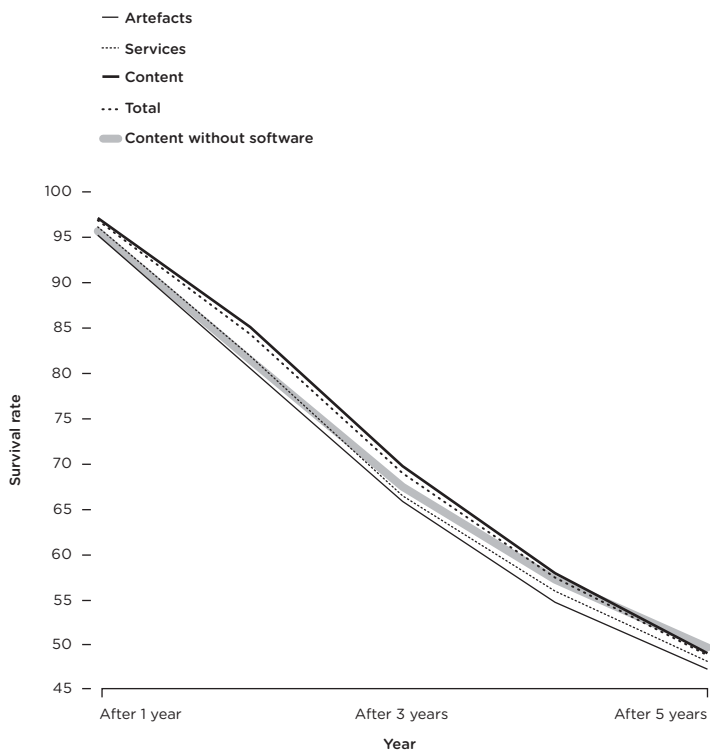
Figure 11 New businesses by creative industries sector



antiques and crafts (no data available); the services category includes design, designer fashion, advertising and architecture, so the riskiest parts of the sector are balanced out by the least risky. The content sector is computer games, music the visual and performing arts, video film and photography, radio and TV and publishing.

As we can see, the survival rates of these groups follow each other remarkably closely. In particular, the content sectors are not significantly riskier than businesses in other parts of the

Figure 12 **Average survival rate of businesses by the Technology Strategy Board's aggregates**



sector, or businesses in other parts of the economy, running counter to expectations expressed by one policy official to the author.

Year by year totals of births and deaths across the economy

Looking at the number of new companies launched and the number of business deaths in each sector in each year may shed some light on the issue of business churn.

It is important to remember that these figures are different from the survival rate figures for these businesses, as the survival rate figures were only charting the progress of businesses started in 2003 onwards, whereas the business deaths data count all businesses closing each year, many of which were started in years before 2003.

It should also be noted that a change in Inland Revenue guidance in 2008, clarifying when freelancers were considered employees, caused many sole traders to become limited companies, contributing to the overall spike in business births in that year.⁴⁴ This may also explain why the number of 'Creative industries' births climbs in 2007, exceeding the number of business births in 'Hotels and restaurants' for the first time.

This aside, the effects of the 2008 credit crunch on business births (figure 13) can be clearly seen in the reduction in the number of business births between 2008 and 2009 in 'Real estate', 'Construction', 'Transport and communications' and the 'Creative industries'. It is interesting to note that 'Creative industries' is the only sector in which this drop in business births began one year earlier, in 2007.

In contrast, there are several sectors of the economy where the credit crunch had no depressive effect on the number of business births. For example, in 'Education, health and social work', the number of business births increased slightly during the credit crunch, from 9,665 births in 2008, to 10,365 in 2009.

Turning to business deaths in this period (figure 14), the effects of the 2008 credit crunch can be seen clearly, with business deaths in several sectors starting to climb from a low in 2006 ('Real estate', 'Construction', 'Creative industries') and 2007 ('Retail', 'Transport and communication').

Most interesting to note is that the sector that as appears to be most risky for new business survival, 'Hotels and restaurants', has a fairly steady death rate during the credit crunch period, with total deaths at 22,370 in 2007, falling to 21,700 in 2008 before rising to 23,340 in 2009.

The number of active companies over time, shown in figure 15, echoes the 2008 peaks of figure 11 (births of new companies), for the same reason: a change in tax rules.

Figure 13 Number of new businesses by sector

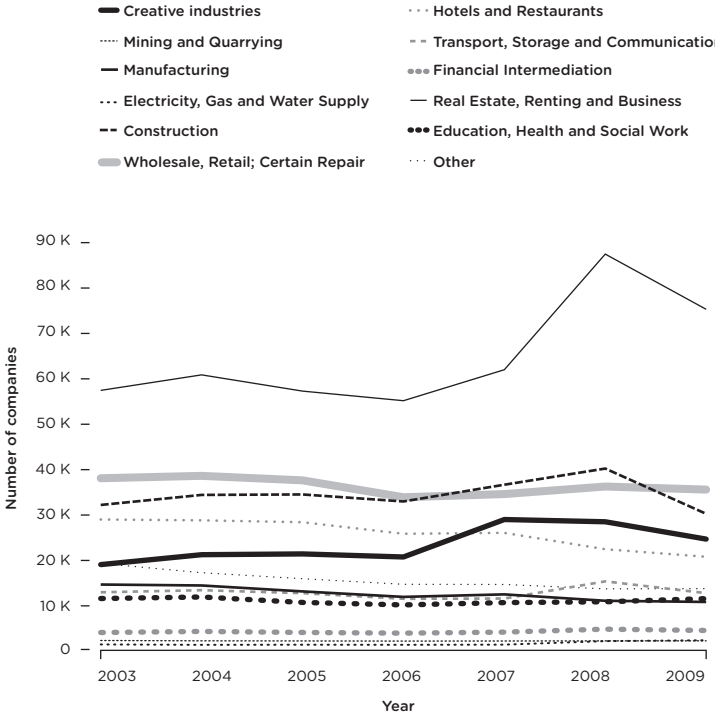
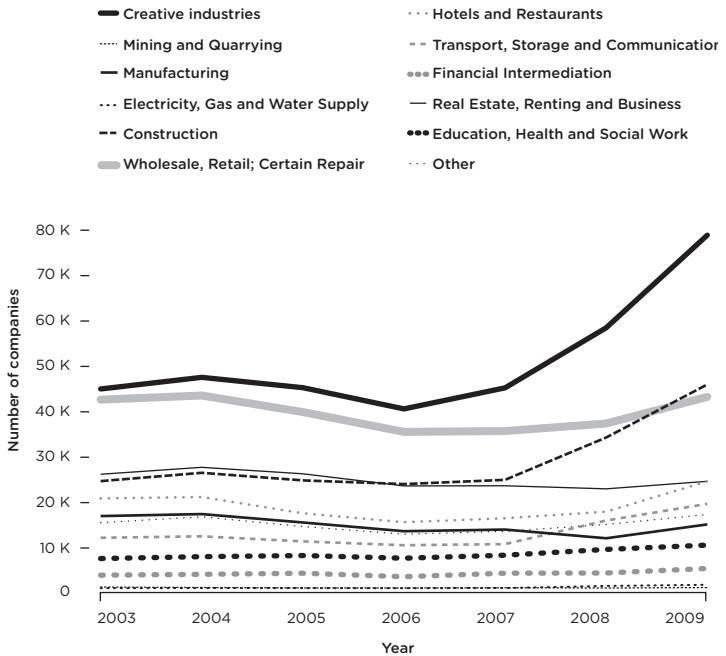


Figure 16 is effectively the graph shown in figure 14 expressed as a percentage of figure 15 – company deaths as a percentage of all active companies.

Here, too, the creative industries as a sector are squarely in the middle of the range, with the sector tracking pretty closely to the percentage death rate across the whole economy, and showing less volatility than some other sectors.

We repeated this analysis for industry break-downs within the sector: figures 17 and 18 show total company deaths and total active companies (as before, this includes all companies,

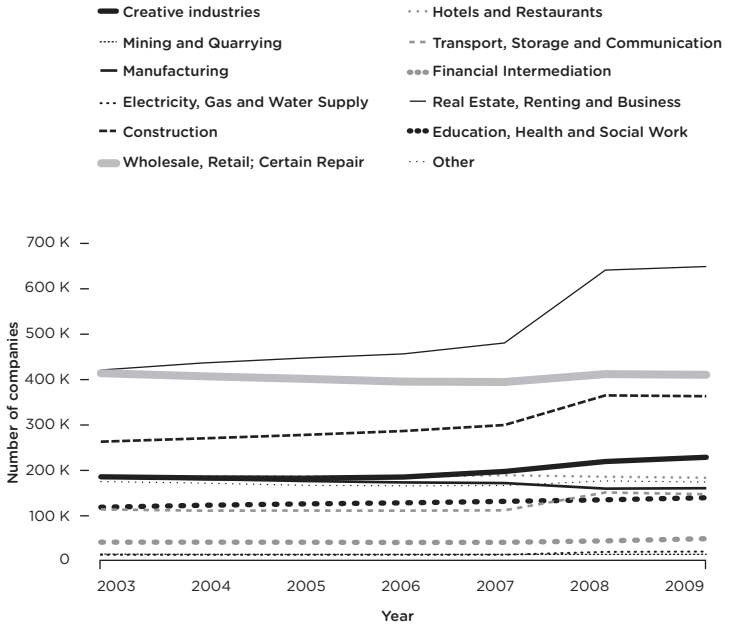
Figure 14 Number of company deaths by sector



including many that started before the 2003 cut-off point for survival trajectories).

Economy-wide sector death rates (figure 16) have a range of between 6 per cent and 18 per cent, which is echoed by the spread of company deaths in the sector of between 16 per cent and 6 per cent (figure 19). The large drop in death rates as a percentage of the total for the designer fashion sector from 2007 to 2008 seems odd and may be explained by the change in SIC codes that year. Although we have converted data back to the 2003 codes to make year by year data comparable, for some sectors the different approach may result in a change in the number of companies being counted.

Figure 15 **Number of active companies by sector**

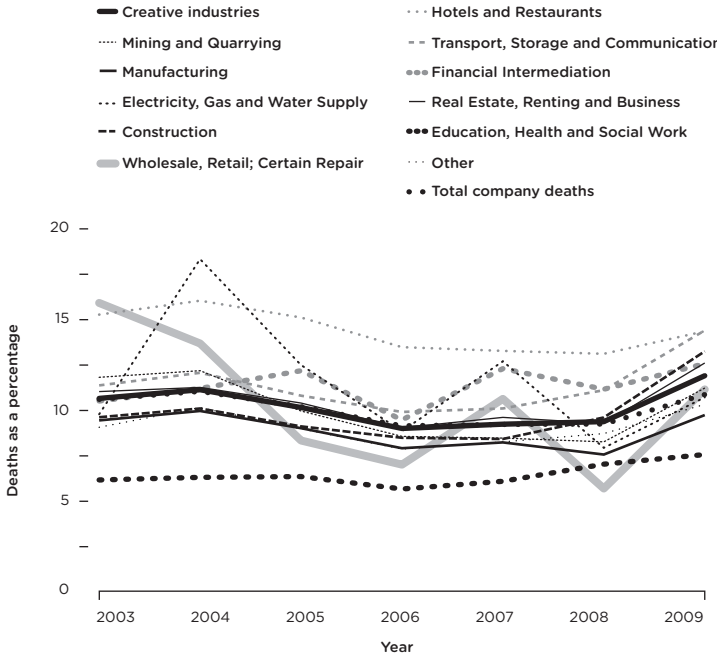


Summary

To summarise, the data show that survival and death rates of start-up and established businesses in the creative industries are not notably different from those for businesses in other sectors of the economy: perceptions that businesses in the creative industries are ‘risky’ or ‘riskier’ than other businesses have little foundation in reality.

However, as we have already noted, survival does not necessarily equate to success. As Stephen Garrett, Chairman of Kudos Film and TV, pointed out: ‘If a TV production company is struggling – you can run it out of a cupboard for a while. Whereas if a restaurant fails to get enough customers, you can no

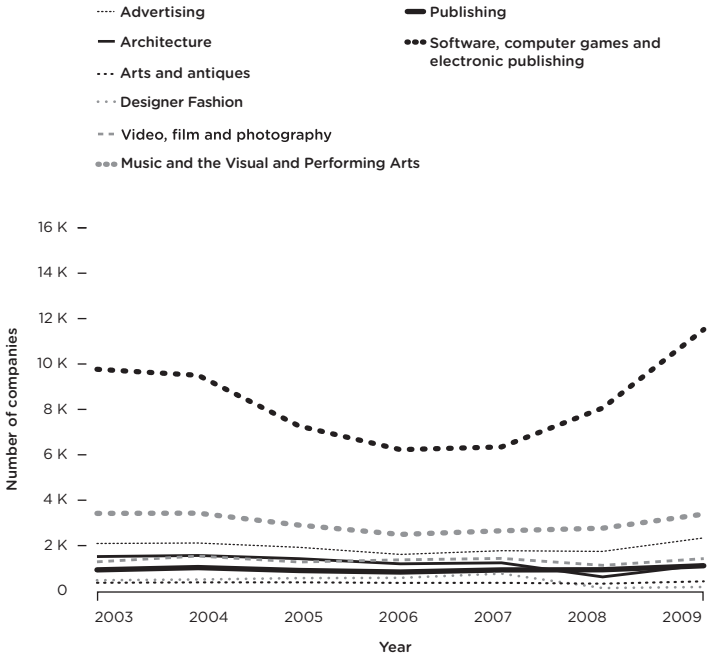
Figure 16 Company deaths as a percentage of active companies by sector



longer afford the rent, or the chef's wages, and you go bust.' And one of our bank managers commented: 'Nine out of ten start-up restaurants go bust; no bank will lend to a first-time pizza restaurant owner unless they already have a revenue stream from their first premises and want to expand.'

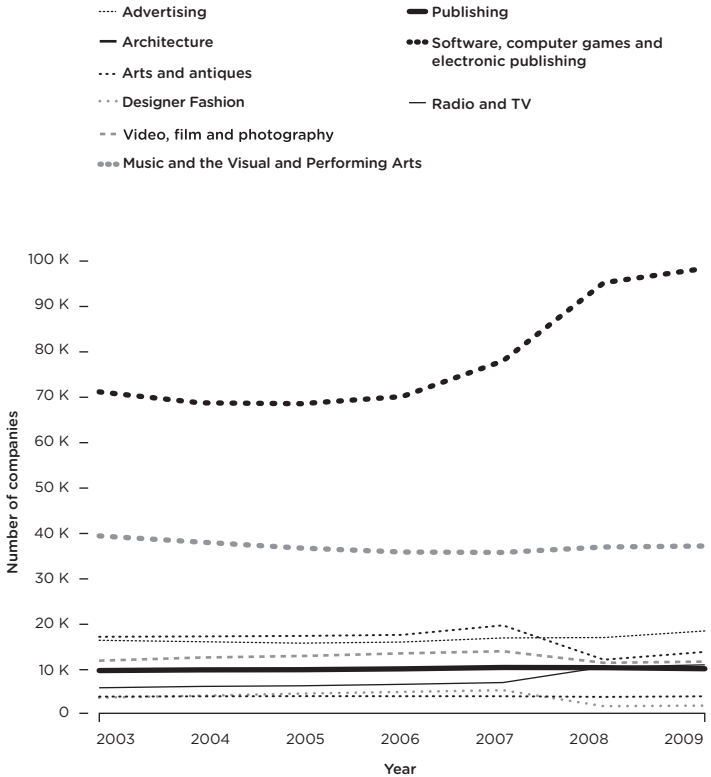
So it is possible that failure rates are lower for businesses in the creative industries because these commercial entities are able to reduce their activities significantly in tough times, but do not show up in the 'death' figures (as we have seen, to still appear in the active data, a business must be reporting either revenue or employment, so these figures are not hiding entirely dormant companies). Moreover, the practicalities of this depend on

Figure 17 Company deaths by creative industries sector



individual circumstances: is a business able to get out of its lease contract, or make staff redundant fast enough, to survive as a commercial entity? It is not clear why this should be inherently easier for a creative business than, say, a restaurant, unless the creative business owner knew that future revenue (say the commissioning of a new programme) was uncertain, and therefore was careful only to enter into flexible arrangements enabling him or her to manage costs if the programme was not commissioned.

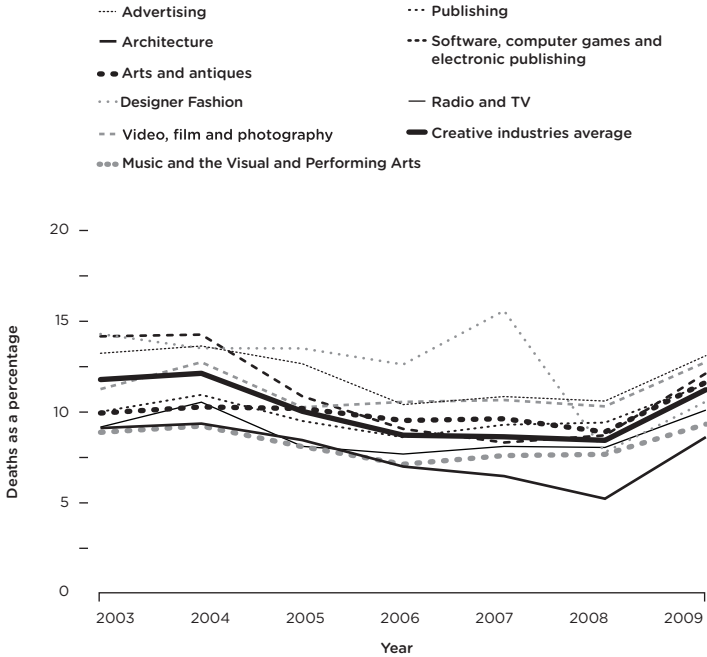
This, then, demonstrates effective and wise management of project risk and the costs that depend on it. If being able to vary costs to revenue is easier for a creative business than, say, for a restaurant (where you need to have a space to sell food, or you

Figure 18 **Active companies by creative industries sector**

cannot sell it), this flexibility is better understood as a strength of the creative sector, and a weakness of the restaurant sector.

In conclusion, if risk is a function of business survival, creative businesses are not actually riskier than other businesses. This fits the conclusions of the first section of this chapter: different parts of the sector have different characteristics, which might lead to different approaches in raising capital, but not necessarily make these businesses less viable than comparable businesses in other sectors of the economy.

Figure 19 **Company deaths as a percentage of active companies by creative industries sector**

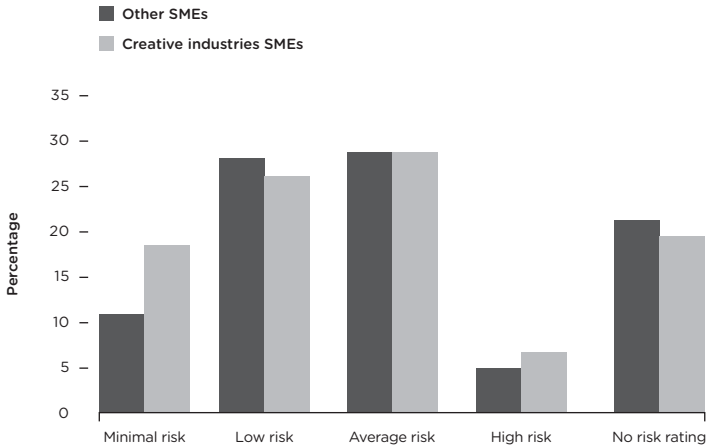


Finally, in this chapter, we test our results from a further source. Figure 20 shows the Dun & Bradstreet credit ratings for creative industry small and medium enterprises (SMEs) compared with SMEs in other parts of the economy. This shows a similar story: on aggregate, businesses in the creative industries do not display a riskier profile than businesses in other sectors of the economy.

Conclusions

We have seen that overall business outcomes for start-ups and established enterprises in the creative industries are good in

Figure 20 **Dun and Bradstreet credit ratings for creative industries SMEs compared with other SMEs**



comparison with other sectors of the economy, even though some of the revenue models of these businesses rely on a constant stream of new product launches for which it is not straightforward to test the market.

Overall the data suggest that the perception that businesses in the creative industries are riskier than other businesses is a myth. Instead, the data imply that successful creative businesses find ways to be resilient (up to and including being run out of a cupboard when times are tough). It is possible to suggest that these businesses are outperforming other sectors of the economy in their management of overall businesses risk, especially if they are launching more products, of unpredictable potential, into the marketplace than most other businesses.

What are the implications for policy makers, the sector, creditors and investors?

First, perceptions of the businesses, credit and investor community quoted at the beginning of this chapter need to be reassessed:

Recommendation 3: The Government should routinely publish aggregated creative industries data sets in Department for Business, Innovation and Skills business surveys and start a creative industries satellite account in the Blue Book and quarterly national accounts,⁴⁵ and clarify whether or not it considers there to be something inherent about creative businesses to make them inherently more risky than other companies in the UK economy.

Second, there is a misunderstanding of the type of finance that is suitable for different types of companies within the creative sectors. As business accelerator Bethnal Green Ventures told us in an interview, ‘Investor perception is that most creative ventures are not going to amount to something. The real challenge is to change perceptions.’

Recommendation 4: The Government should work with the sector to improve the visibility and appreciation of the sector’s business success with investors, creditors, analysts and business journalists. This might include regular high-profile ‘speed dating’ events such as one recently run by Nesta, designed to put banks, investors and businesses together in a way that rapidly spreads ideas and talent.

Third, as with all businesses, the importance of business skills training is paramount to reducing general business risk. A great business plan and clear understanding of the needs and priorities of capital is in itself a way of attracting investors, or improving the risk profile of a business to secure credit. Happily, these skills are teachable, and the evidence from the creditors, investors and companies we interviewed (see following chapter) suggests there is a need for this in the creative industries. A representative from Lloyds commented: ‘The focus on revenue growth for us comes from a planned and realistic cash flow, which means thoroughly researching and building your business case.’ They highlight a new portal (www.mentorsme.co.uk) offering business mentor support.

Recommendation 5: The Government should work closely with creative industries sector representatives, and research young companies directly, to ensure that as Business Link is moved online, those providing business skills support, mentoring and guidance that are relevant and accessible to creative industries that want to grow.

The creative industries sector should continue to prioritise training and mentoring, which can be done in partnership with the banks. For example the British Fashion Council (BFC) runs an extensive programme to nurture young business talents, offering a combination of business skills teaching, mentoring and funding (from the private sector, often for a competition winner), as well as mediating in negotiations with banks for loans and investors.

A representative of HSBC says of its relationship with the BFC:

We work with the British Fashion Council across a range of issues. The industry is hugely important to us with many customers involved directly and indirectly. From our point of view it sits nicely with our international presence and we see the sector making inroads to new markets time and time again... As with any growing business there will always be a crossroads where it is important to re-examine business models and to have an eye for the future to grasp the opportunities that lie there. That is just one of the reasons we've partnered with them [the BFC] for the Vogue Designer Fund. The businesses that apply want to expand. The quality was excellent and as part of our work we've been keen to provide business mentors to help them. While early days, the feedback already has been strong. The mentors will provide their time over the course of the 12 months and are some of our most experienced managers. It is something we have always encouraged and believe there can be real value in it both ways. The mentors find it incredibly rewarding and the businesses have access to someone who sees a huge range of sectors, business models and finances.

Carol Bagnald, HSBC regional commercial director, sits on the BFC's board.

The need to acquire business skills and learn from experience is not confined to start-ups in the creative sectors, but the sector has strong trade bodies that have considerable experience they are well placed to pass on.

We have established that the creative businesses are not necessarily riskier than other sectors of the economy. In the next chapter we explore in more depth the characteristics that successful creative businesses share in order to see if there are ways that policy makers can support more companies to succeed.

3 How to succeed

Success in business is doing everything right.

Richard Craig, managing director of Margaret Howell.

In this chapter, we present an overview of what we have learned from interviews with successful businesses across the creative industries sector. Our focus on success is deliberate to see whether there were similarities and, if so, to identify key traits that successful businesses in the creative industries display.

We interviewed entrepreneurs and business leaders in four industries within the creative sector: fashion, video games, music, and film and TV. For the purposes of this study we focused on sole traders and self-employed people, micro businesses (with up to ten employees) and small (up to 50 employees) and medium enterprises (up to 250 employees). Between them they turn over more than £250 million a year and employ more than 1,000 people. The appendix to this report gives a full list of the companies that we interviewed as part of this research.

We found that those running commercially successful businesses have underlying similarities:

- a clear intention to make a profit, and grow the venture
- an ability to prioritise business planning and research in a way that is convincing for investors and lenders, and enables creativity to drive value
- a strong awareness of the risks that face their business, and how to manage that risk, or know what steps to take to reduce it, always considering and assessing whether their business can survive both failure and success
- a clear track record of business experience (of success), often in other companies and businesses
- financial and numerical expertise, by either employing a multi-

- talented chief executive officer (CEO), or working in a mutually respectful partnership with the creative director and their team
- an understanding of the importance of building and nurturing personal relationships: to spot and manage creative talent, to make sales, to win the financing their businesses need to grow, and to know and understand their customer
- an ability to innovate and adapt to changing business environments
- an ownership stake in the intellectual property the business is creating to attract investment and incentivise growth

There are clear differences and similarities between the sectors we are studying. From the highly innovative world of video games to the TV sector, where the codes of practice are set out in the Communications Act; from the more speculative world of film to the challenges of manufacturing in fashion; from the ecology of sole traders, agents and promotion companies to indies and majors in music. We start by focusing on the key traits successful businesses throughout the creative industries display, discussing how sector differences play out later in the chapter.

The key characteristics of successful businesses

Intention to make a profit

A key characteristic of a successful business is the intention to make a profit. Thomas Benski, founder of Pulse Films, told us: ‘We had an idea, we had a strategic vision for a business, and we always wanted to build a business.’

This may seem obvious, except that many inside and outside the sector see one clear problem with the creative industries: the question of motivation. Those outside the sector worry that an entrepreneur whose foremost motivation is to find a creative outlet may be unaware of, or uninterested in, the commercial risks of running a successful business. Stephen Lambert of Studio Lambert sees the indie TV sector as split into two parts: those running businesses as a ‘lifestyle option’ – not aiming to grow a business of value – and those running businesses as commercial entities, on a principle of growth,

whose revenue is based on rights ownership. Milliner J Smith is at a crossroads. He is currently a sole trader, who is enjoying notable success having won awards, featured in *i-D* magazine, and a commission with a large hotel group. He could choose to develop his business into a larger company to rival, say, Philip Treacy, or continue as he is as an artisan business.

While both types of business are generating primary economic activity, to attract credit or investment, creative business entrepreneurs must build a convincing case that they are serious about building revenue growth. Or as Andrew Manning from Lloyds TSB said, ‘A business is a business: the key way to understand it is to follow the cash, which means working closely with your bank and your advisers to put in successful financial planning right from the start-up of your business.’

The question we are interested in is whether business owners are in their business for creative *and* financial capital. As we shall see, our business owners drive profit by finding the right balance between the two: being overly focused on short-term profits can damage the creative assets and long-term growth prospects of a business. It is possible that the problems of understanding between the financial and creative worlds result from financiers not understanding how creative businesses manage their risks and assets and thus poorly assessing their potential,⁴⁶ rather than creative businesses being unaware or unconcerned by business risks.

Thomas Benski, the young founder of Pulse Films, says of business entrepreneurs: ‘Know who you are. This industry is so broad, you must understand what your role is. And I always understood my role as making the crossover between business and art.’ With a fine balancing act between creativity and commerce we also see that there is an underlying emphasis on having a strong sense of purpose. Benski again: ‘Be the best at whatever you do. Mediocrity is the killer. Don’t do it for lifestyle, be truthful to what you want to do. Come from the right place.’

Business planning for finance and creativity

While ideas and creativity are the key driver for all wealth creation in the creative industries sector our interviewees clearly took business planning seriously, and described an atmosphere of cooperation and mutual respect between the business and creative people in their organisations. This is undoubtedly a key part of their success.

Richard Craig, managing director of fashion company Margaret Howell, told us, ‘If she [Margaret] doesn’t come up with the idea for the dress, I wouldn’t be doing the figures’, but he added, ‘every creative genius needs a business partner’, and gave examples of other well-run fashion businesses including Paul Smith, Ted Baker and Rupert Sanderson. These businesses have in common people in the senior team with strong backgrounds in finance – the back stage players who make the business tick and not only understand but also love the industry. Several interviewees engaged with the creative process told us they lacked business skills when they started as their interest lay elsewhere (their initial motivation was to design a great hat or release great music; starting a business was a means to achieve this, rather than an end in itself) and they underestimated how integral business skills are to success (actually selling the hat or the music). All talked about their rapid learning curve to acquire business skills, as they are essential for success. Some learned as their business grew; some learned the hard way (when things went wrong); and some actively sought out a business mentor or business partner.

Some of our most successful interviewees had or prioritised business skills from the outset: Thomas Benski, founder of Pulse Films, told us: ‘Actually appreciating the value of capital, and what it can do to creativity – it is one of the most important things, and this is my job: being able to tell [investors] a vision for business and translate that to creativity.’

Stefan Kosciuszko, chairman of entertainment and tech start-up TwoFoldTwenty, had a similar view:

What is important is vision, imagination, persistence... creativity – but there is also a need to start putting in some basic structures... and in particular to find people who have all the creative knowledge but can also read a balance sheet and read a model.

After all, the very definition of a ‘producer’ in TV and film projects is someone that stands at the nexus of commerce and art and negotiates between the two worlds.

When Martin Mason joined Lulu Guinness as CEO, he spent considerable time carrying out detailed research to enable him to develop a five-year business plan. The plan is export led, and focused on emerging markets, but it is difficult to operate in those markets successfully, so he took the time to research carefully which markets to enter, in which order, and how to enter them (for example, whether to make a joint venture deal, or go it alone). Martin Mason emphasised the importance of ‘data driven design’, of analysing sales figures and demand trends, and using them as a guide when designing the next season’s collection. He told us that ‘there is space for creativity in every collection – perhaps 15 per cent of the collection will be designers doing whatever they want, rather than building on merchandising guidelines’, and contrasted this business-minded approach with the mind set of young fashion graduates who ‘think it is all about their genius’. Mason believes they have the balance between creativity and business imperatives wrong.

Managing risk

This ‘15 per cent’ rule is one way to approach (creative) risk. Assessing and managing all aspects of risk is clearly a key part of business planning. This is how two of our interviewees approached it: Anya Hindmarch told us, ‘We ask ourselves: “Is it going to kill us if it goes wrong?”’; similarly Richard Craig, of Margaret Howell, said: ‘We look at the worst possible outcome, and see if we can afford it (from a money point of view).’

The record label Beggars signs ten to 15 artists a year, and all but one or two (artists in the league of Radiohead and Sigur Rós) will be a risk. However, for Beggars chairman Martin Mills these risks are the point: ‘We’re not trying to sell people what they want; we’re trying to sell people what they don’t know they want yet.’ Long-term success for businesses that repeatedly bring new artists, games, TV show or films to market is predicated on building up a track record of managing creative risk well:

spotting talent or an idea, knowing it will sell, and owning and managing the rights wisely. There are two elements to this: spotting the idea or talent, and executing it successfully – structuring the deal right, working with the right musicians, designers or director, and marketing the project well.

Tim Morgan from gaming company Picklive acknowledges that he has the personality to take risks:

We're not like a 'me too' product; there isn't a game like ours out there. That's really why I get out of bed in the morning. I'm doing it because it's new... [in the gaming world]. We are a European company trying to innovate in a US dominated scene. We are pursuing innovation and disruption; we don't want to be safe and steady.

He focuses on customers to counteract risk: 'Once you have customers it doesn't feel risky.'

Mark Hawkins, group managing director at TwoFour, aims to mitigate risks by assembling the best possible creative and tech teams, and then to control their intellectual property and exploit it. The senior manager at TwoFoldTwenty talked about how a business plan could – or in some sectors should – include space for creative failure. Giving the example of the game Angry Birds, he pointed out that there can be 'a lot of duds before you hit the home run'. He emphasised how important it is to be persistent and to learn from failure. For this, you need to plan for energy and resources (time and money), and to just keep going.

Anya Hindmarch believes education is crucial to help minimise risk: '[Business] education is key to help the new generation of fashion designers and entrepreneurs. Mentoring is crucial for start-ups and growing businesses that hit the "grindy bit"' (reach a challenging point of growth). Lingerie designer Deborah Flemming worked through the 'grindy bit' on her own. She talked about how taking a poor risk had been a real opportunity to learn, and how surviving it had changed the way she approached her business: She had a major obstacle when all the merchandising for her biggest sales season so far was stolen en route for delivery. She was not insured, but called every retailer, promised to deliver for them anyway, and from then on

really treated her business like a business by going to scale with multiple retail chains. She had previous experience in five other large retailers and so she knew specifically her target market and how best to reach it. She told us, ‘I wouldn’t be in this business if I thought it was risky.’ Indeed Flemming went on to explain how the fashion industry can be very profitable if you know what you are doing.

There are also the risks associated with success. Doubling or trebling your sales in a short space of time can be as challenging for your business as not making enough sales. Martin Mason of Lulu Guinness advised entrepreneurs to plan for success:

Have you planned for success? Buyers want to see you at the next trade show to see if you are still around. They might watch you for several seasons before they get confident enough to buy. Success is about putting the time in, letting something grow organically. Overnight success tends to disappear just as quickly.

The company managers we visited found that merely having a product or service with value was no longer enough to thrive. Making decisions such as purposefully under-marketing or choosing to set up a joint venture in a foreign region are also key for business success. In one case, the CEO of a record company turned down a large licensing deal to allow a track to be used on a TV commercial, knowing the likely outcome would be adverse consequences through over exposure in the longer term. In another instance the manager of a gaming company turned down new business when he knew that it did not fit with the company’s wider sense of purpose and impeccable reputation in the industry, in this case the niche of serious and social games.

Experience

All our interviewees had extensive business experience. Some gained this before their current venture: Martin Mason joined Lulu Guinness having worked at John Smedly, Mulberry and

Pringle. He had more than 15 years' experience of the fashion business when he joined the company as CEO.

Before setting up Studio Lambert in 2007 Stephen Lambert had considerable sector experience, having worked for the BBC as a producer and executive producer for many years, before leaving to join RDF at a point of fast growth: the company's turnover grew from £3.5 million to £45 million from 1998 to 2005. RDF floated on the alternative investment market (AIM) in 2005, having done a deal with venture capital to raise additional working capital beforehand. Following the AIM float RDF started acquiring other companies to consolidate the group.

TwoFoldTwenty has creative partnerships and investment in China, so it helps that founder and CEO Neill Watson has lived in Asia and knows its culture and commercial approach well, and that chairman Stefan Kosciuszko has spent most of his extensive business career in Asia. Others gained experience in their current venture: Anya Hindmarch started at age 18 importing bags from Italy and wholesaling in UK; over time the company moved into retail, then a first-floor shop, then a second-floor shop, then a franchise. Richard Craig advises learning in steps, suggesting that new fashion businesses should 'do one shop first, get that right, before taking what you have learned to grow'.

In contrast, in the gaming and tech world Tim Morgan from Picklive suggests that you only learn by doing: 'What is it they say? Launch early, fail fast? Get out there. Don't talk to me about it. Go now, because ultimately the customers will decide. The beauty of the internet.'

Some have learned the hard way. Stephen Garret, CEO of Kudos TV, talked about how he 'went strategically into Channel 4 to learn more about the TV drama business'. On leaving, he set up Kudos and worked with a then little-known comic, Rory Bremner, making his first series, *Who Else*. It was a big hit, and won a Bafta, but Bremner set up his own production company after the first series, and the whole creative team left with him. After that he 'swore he'd never be dependent on one talent for anything'.

Numbers and business models

As a representative from Lloyds told us, ‘Financial planning is key’, and Thomas Benski, the founder of Pulse Films, emphasised the value of capital:

I realised the value of capital, going through due diligence.... you effectively decide how you deploy capital. The value of having the right kind of capital, and being able to deploy capital correctly, can change the face of a business. I learned that capital was extremely important; I think it is a completely underestimated thing in our industry.

Tim Morgan from Picklive puts it another way:

Investors don't want to take a punt on whether something is cool. They are not interested in the art or the idea, but the revenue stream. So to attract investors, you need to show that you have a game developed; users signed up; and that those users are willing to pay. Once you have a working product, and customer enthusiasm, investors will see the demand and be attracted.

Picklive did not seriously consider seeking credit finance because ‘banks are not risk takers. We felt that seeking out credit from banks was a waste of time.’ Neither did they seek out public grants because they: ‘always shift the goal posts slightly; good ideas don’t meet pre-existing criteria’. Picklive values the support and ideas its investors bring to the table: ‘They are terrifically helpful, they deserve to be knighted.’

Some wanted investment and didn’t find it, and feel this has slowed their pace of growth. Adrian Pope of PIAS told us,

Investment would have allowed us to grow more quickly... [the lack of it] is frustrating. We are not talking big money, but it would have allowed us to get up the curve of services, skill set and infrastructure faster than we did.

In contrast, and as with many successful fashion businesses, credit works well for Lulu Guinness’s business model. Overall the company is a profitable business with no borrowings (no debts). However, there are two cash-flow cycles of ‘cash out’ each year, when stock arrives from manufacture, before it is shipped

to retail. Lulu Guinness finances this cycle through trade invoicing – lending secured against invoices.

Even our smallest business, sole trader milliner J Smith, acknowledges the importance of having someone on top of the numbers, saying that he has a ‘great accountant’.

Finally, a number of our interviewees come directly from the finance world: Robert Tateossian of Tateossian spent nearly a decade working in finance and investment banking, and left to start his own business, putting together a business plan to target a niche he saw in the accessories and jewellery market. Meanwhile TwoFoldTwenty combines chair Stefan Kosciuszko’s direct expertise working in investment banking, including raising equity capital and private equity, and CEO Neill Watson’s experience working in venture capital.

Relationships

As Mark Hawkins of TwoFour says, ‘business is about people’, and all our interviewees described the importance of creating and building human relationships as a key factor in the success of their business. This is true of relationships with partners, employees, suppliers and customers, and with those who can advise and support a business as it grows.

Martin Mason from Lulu Guinness talked about the importance of ‘investing in relationships when you don’t want anything from someone – they will be much more willing to help you when you do’. Mason also spoke about using available support to explore international potential and build relationships in new markets. He highly praised UK Trade & Investment (UKTI) and British embassies for their willingness to help and assist in every global market, and suggested that this was an under-used resource: ‘For any company that is willing to exploit it, if you can afford the airfare, the British business consulate will see you, provide briefings on what it going on in the local market, and set up meetings.’ In other sectors, especially TV and video games, business managers mentioned that they were aware that UKTI supported businesses going to international trade fairs, but that these offers of support often came too late.

Recommendation 6: The Government should raise awareness in the creative industries sector of the support UKTI offers to businesses abroad, and task UKTI to work with sector trade bodies of the creative industries to ensure they provide rolling programmes of support that enable long-term strategic planning

Thomas Benski of Pulse Films talked of how much he valued having a good relationship with his investors, and the creative talent the company works with. Talking about one of his investors Sir Harry Solomon as well as the creative talent his company works with:

I was never made to feel that the plug would be pulled or that there would not be access to capital if needed and this, as an entrepreneur, is so empowering, because I was able to make decisions medium term, I was able to allow [others] to make decisions medium term, rather than 'shit I don't know if I've got a job in 2 months'... High-end talent feels more comfortable with us because they feel a little bit more connected... They feel here things can happen for them.

Richard Craig, managing director of Margaret Howell, emphasised the relationship the company has with its customers. When the label entered the menswear market the company noticed that nearly all of their clothes were being purchased by a select group of men. The label learned who these men were, what they wanted, and catered specifically to them to earn their loyalty. Martin Mills of Beggars described how the company's growth from being a shop to promoting artists to signing artists to their own label to buying other labels had helped them keep in mind what music lovers (and their customers) want. He talked on the one hand about the importance of 'being a place that artists like to be' and on the other about working with business partners that have the right ethos, and understand that growth may take time and be bumpy. Stephen Garrett of Kudos emphasised the importance of building the right creative team of people in the company and creatives (writers, directors and actors) to bring into projects.

Neill Watson and Stefan Kosciuszko from TwoFoldTwenty emphasised the importance of being honest and taking time with

international partners: ‘You need to invest in the partnerships – not “over-egg” expectations. This can result in something that has more substance and stickiness than other corporates that try to do the “in and out” approach.’ Even the banks advise that there is ‘a business advantage in having a closer relationship’ with your bank.

Finally, companies in video games and fashion particularly mentioned the importance of skilled talent: Tim Morgan from Picklive told us: ‘There is a shortage of excellent, young, software developers. And the brightest and best will be encouraged to take a safe job with a big tech company like Google, or a bank.’ Anya Hindmarch talked of the importance of education and mentoring to help a new generation of fashion designers and entrepreneurs with business rather than design skills.

Innovation and adaptability

Most importantly you have to offer something that is different, unique, that is innovative – all the time.

Robert Tateossian

Businesses develop over time, as do market conditions, sometimes with breath-taking speed. Successful organisations adapt to changing situations in order to thrive, and our studies exposed how in practice these adaptations varied between creative sectors. In the fashion sector we saw a business move from designing own-label creations to designing more accessible clothing for third-party manufacturing and distribution. This was a highly calculated growth strategy involving tailoring the right designs to suit a new market as well as partnering the right retail channels from the outset. Those running small and large businesses, from Pistol Panties to Lulu Guinness, talked about the growth of direct online sales.

People we spoke to in all the ‘content’ businesses (video games, TV and film, and music) had a clear sense of the dramatic and ongoing impacts brought by technology. For many this change offers thrilling opportunity to innovate. In the video

games industry, from Picklive (enabling real-time social gaming on mobile phones) to PlayGen (using the power of gaming in social gaming, training and advertising) there is a distinct user-centred approach to gaming development. Companies use data, incremental feedback and ongoing validation to predict consumer behaviour. The end result is that in a highly competitive industry these companies can stay relevant to what the market and consumers dictate.

In the TV and film world converging media and cross-platform services are permitting original content to yield revenues from a range of previously untapped sources such as Netflix. Managers of several of the businesses with the largest employee and turnover numbers we interviewed focused on new opportunities brought about by technological change, for example entertainment tech company TwoFour, which makes TV for broadcast but also offers agency services for clients, which range from large brands to museums and arts galleries. They were in the mobile technology content market before the iPhone hugely expanded opportunities there. They see themselves as delivering ‘entertainment experiences’: it is the content that matters, not the device or chosen medium of the user. We found this in the work of TwoFoldTwenty, developing multi-platform entertainment, and Pulse Films, integrating talent management and content production across advertising, fashion, film, music and TV, exploiting intellectual property across platforms. Studio Lambert is more squarely focused on TV production, but also talked of the increasing importance of revenues from online streaming services such as Netflix.

In music, as Adrian Pope of PIAS pointed out, ‘what a [record] label was, and now is, are two very different things’. Beggars and Full Time Hobby talked of offering promotion and artist management as well as producing and selling music. Beggars started out this way with retail shops (Rough Trade is now part of the group), moving into signing and releasing artists later, rather than vice versa. Indeed, Beggars observed that although the company has been running for 30 years, its most successful decade artistically and creatively was the 2000s, a period in which the music industry experienced significant

revenue declines as the online world disrupted its business model.

Martin Mills speculated that this success could be explained because the company's business model happened to suit the new post-CD trading environment. He suggested two possible reasons for this: Beggars' size and scale suits the new environment, and Beggars has always focused on 'music for music lovers'. He suggests that passionate music lovers who follow record labels and artists are more likely to have thought about the ethics of music piracy, and are less likely to take part in it; indeed many are aspiring musicians themselves.

Retaining ownership of intellectual property

Finally, we turn to the lessons from the TV sector to explore the impact on growth of the enterprise that creates intellectual property retaining an ownership stake in that intellectual property. The broadcast sector in the UK has a high degree of government intervention. Despite the deregulation of the last ten years, the Government still sets the terms by which the BBC engages with the market through successive Communications Acts and the renewal of the BBC Charter. The Government created the BBC, ITV, Channel 4 and Channel 5. It also sets the rules on media ownership, which affect commercial broadcasters beyond terrestrial television such as BSkyB. In the past 30 years, the Government has used its power wisely, with four key policies, which have stimulated the creation and growth of an independent TV production sector in the UK:

- In the 1980s, it created Channel 4 as a public service broadcaster funded by advertising revenue but not for profit, and as a publisher-broadcaster with a team of commissioning editors who would commission programmes from outside, rather than in-house (as they were produced at the BBC).
- The Broadcasting Act 1990 required all public service broadcasters by law to commission a minimum of 25 per cent of their non-news programmes from independent producers (in effect, requiring the BBC and ITV to do this, as Channel 4

already commissioned 100 per cent of its non-new programmes from this source).

- The Communications Act 2003 introduced codes of practice for public service broadcasters, which enabled independent TV producers to retain control of a share of intellectual property rights when they create programmes for broadcasters. This move was explicitly recommended by the Independent Television Commission ‘to promote growth in the independent sector’.
- Finally, following a 2005 green paper, the BBC put forward a plan to introduce a window of creative competition, which identified a further 25 per cent of BBC commissions over and above the 25 per cent minimum quota for which all producers, in-house and external, can compete.⁴⁷

Figure 21 shows the impact of the last two of these interventions on the independent TV sector.

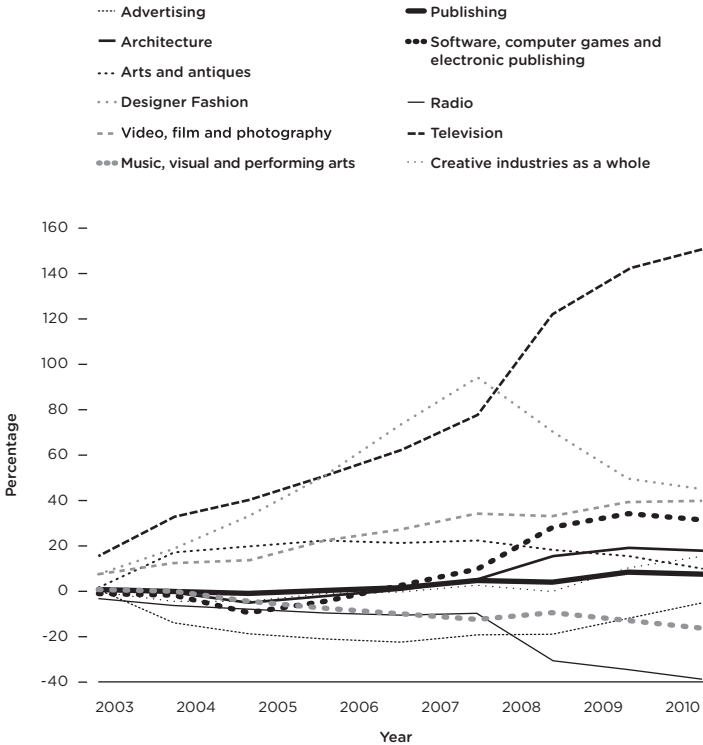
Since 2001 the number of companies in the sector has doubled, from 2,600 companies in 2002 to 5,600 companies in 2010. Figure 21 shows the yearly percentage change, with clear increases in growth following the 2003 Communications Act, and the introduction of the window of creative competition at the BBC in 2007.

Table 4 shows how the number of TV companies in the UK has grown between 2002 and 2010. Although most growth was among sole traders, there was also significant growth in micro businesses (with two to nine employees), small businesses (with 11–49 employees) and medium businesses (50–249 employees). There has been considerable consolidation in this sector in the past decade, with many successful production companies being bought by groups, which explains the slight decline in the number of larger companies.

Pact Census data show an increase in total independent sector revenues from £1.5 billion in 2004 to £2.2 billion in 2009, with growth from international revenues making a significant contribution, up from £215 million in 2004 to £329 million in 2009.⁴⁸

We suggest these data show that, in the long term, growth for individual companies and the sector as a whole is stimulated

Figure 21 Cumulative growth in numbers of companies, by creative industries sector



by creative businesses retaining a stake in their intellectual property (equity). Consider the contrasting fortunes in the UK of TV and film. The TV sector is growing and successful, but the film sector continues to lurch from one funding crisis to the next, collectively and individually, despite producing a stream of (creative) hits. Clearly, the difference between the two is not the creative talent in each sector – indeed many practitioners move between the two. Rather, the difference in outcomes between the

Table 4 **Number of TV companies in the UK, 2002 and 2010**

Year	2010	2002
Sole traders or partnerships	1,391	3,938
Number of employees		
2-4	503	1,130
5-9	144	252
10-19	90	154
20-49	63	92
50-99	19	47
100-199	19	12
200-249	*	*
250-499	11	*
500+	15	11
Total	2,255	5,645

* A number less than ten. ONS data protection requires these values to be protected. They have not been included in the totals.

two sectors is their ability (or lack thereof) to retain an equity stake in their creations. As Adam Lambert of Studio Lambert commented, ‘The rights position [for TV] is fantastic, which has attracted external investment money into the sector.’

We believe the above data show that in order to stimulate economic growth the Government should structure its support for the sector to enable or encourage business creators to retain at least a partial stake in their creations. How the Government might do this clearly varies from sector to sector:

Recommendation 7: The Government should seek to extend the principle behind the codes of practice in TV – intellectual property ownership – to other sectors to enable creative companies working in TV, radio, games, photography and websites to retain and exploit a share of the intellectual property they create for public sector broadcasters. As intellectual property ownership is a key driver of growth this should also apply to work commissioned by other public bodies.

The BBC and Channel 4 are already commissioning games, websites and photography. As the convergence of previously distinct media (TV, radio, the internet) gathers pace they are likely to continue to do so. As an aside, this point also applies to the apps, games, websites and so on designed by creative companies for public bodies and government departments.

Recommendation 8: The Government should consider ways that the BBC can encourage creative competition, building on the success of and extending the window of creative competition, not just in TV production, but across all other creative content production (radio, online, gaming) in the next BBC charter renewal. In the meantime, the Government should ask the BBC to do this voluntarily, to stimulate growth in the creative industries.

Ensuring that video games developers and photographers commissioned by public service broadcasters retain a stake in their own intellectual property and are freed to exploit it elsewhere offers an exciting growth opportunity to other players in the wider creative industries sector. The Government should discuss with the BBC how it can best enable economic growth through its approach to the wider creative industries sector. While the BBC's first priority is to create great broadcasting for licence-fee payers, the BBC is a UK public asset and should maximise its positive impact on the creative economy wherever possible.

Currently, BBC Worldwide is involved in overseas activities such as overseas channels and production, largely on the basis of fulfilling the BBC's public purpose of bringing the UK to the rest of the world. While desirable, this public purpose is perhaps overplayed, given the wider need to drive UK economic growth. Should BBC Worldwide be investing in overseas channels and production, or developing licensing spin-offs of BBC programmes through overseas companies? Does this investment maximise returns to the BBC to reinvest in UK public service broadcasting, or enable UK companies to develop spin-offs of BBC programmes and by extension stimulate UK economic

growth? This should be a key issue for debate in the renewal of the next charter.

Recommendation 9: All public support for the sector should be structured to enable creators to retain an intellectual property or equity stake in their work.

Funding in film comes from several sources: the tax credit, BBC Films, Film 4 and the BFI film fund. Each of these should be examined so that, for example, the tax credit operates as the equity stake for the producer, rather than as a discount for other funders; BBC Film and Film 4 enable producers to share in the success of their films; and BFI funding provides producers with a share of revenues from successes for them to reinvest in further UK films. This will enable UK production companies to demonstrate to potential investors that they have a viable asset – and will benefit when they have a successful film – and will in turn therefore attract further investment into the UK film sector from private sources.

As this model becomes successful, the Government could consider prioritising the first-time producers as those who are successful ought to be building up their own bank of intellectual property equity, which will enable them to seek other sources of funding. After all, to return to the example we gave in chapter 1, this is the role that Arts Council funding plays in the creation of a production such as *War Horse*. If the National Theatre can retain a stake in the rights to its international theatre hits and earn a share of the profits, as it has with *War Horse*, so can British film producers. To come full circle, *War Horse* is currently being developed into a film.

The situation is more complex in the purely private sector. While small videogame developers, musicians or writers may wish to retain their own intellectual property and copyright, in theory if not always in practice, it is something it is possible to negotiate, at a price. This is different from the situation in the TV and film industries where the taxpayer is investing in the wider public interest; the condition the public extracts for that investment includes support for independent creatives through

allowing them to keep their intellectual property. Our point is that the value to the creative sector from this arrangement in publicly supported TV and film needs to be maximised.

Box 2 **Intellectual property and piracy**

In the last ten to 15 years, the ability to protect and control design and copyright has changed significantly with the rise of the internet; this has had an impact on the whole sector and may have contributed to a decline in revenues in music and film in particular. There has been considerable debate about what could or should be done about this, with rights holders (in particular record labels and film studios) pressing governments to make it easier to protect their rights, and telecoms networks by and large resisting on the basis of cost (it is too difficult or costly for us to do this) and principle (it is not our concern what our customers are doing on our networks). There is also a philosophical debate around the issues, with some suggesting that the inevitable consequence of the internet is that information (and intellectual property) cannot and should not be controlled. This debate is not the focus of this paper; although the impact of the paradigm shift occurring, especially in the markets for music and film and TV, cannot be ignored as we consider the ingredients for success, and the risk factors facing these industries. In this context we set out the following overview of our perspective on that debate.

We believe that artists and creators have a moral right to decide what happens to their work: where it is shown, played, worn or watched, by whom, and for what. This is a matter of principle, and we see a role for government, legislation and law enforcement to ensure that artists' and creators' wishes for their work are respected in a changing media environment. Once a workable legal framework for this has been created in the online world, it may be that some artists and creators choose to sell their work online, possibly working with a manager, music company, film or TV company to represent, develop and market their creations. In our view, the role of government begins and ends with protecting the rights of

creators, rather than protecting any company or interest group's business model. Once workable rules are established, the forces of supply and demand will determine the size and scope of any market.

Credit or investment?

Credit

Of all the sectors we looked at, credit worked best for fashion businesses as a funding mechanism, both to manage cash flow and to fund expansion. Indeed, a spokesperson for Lloyds TSB highlighted that they had worked with the British Fashion Council to use the Enterprise Finance Guarantee Scheme to loan to several fashion businesses, adding that the business to business orders many fashion companies receive from retailers make them a good candidate for credit.

As we have shown in chapter 2, the sector ought to be as attractive as any other to creditors and investors when measured by its business outcomes. However, in May 2011, the Department for Business, Innovation and Skills (BIS) published research on whether businesses in the creative industries experienced a higher rate of loan refusals than other businesses:

Creative Content sectors, in particular: Software and Other Creative Content sectors (consisting of Publishing; Video, Films and Photography and Radio and TV) are more likely to have their finance applications rejected by finance providers than non-CIBs with similar risk profiles.⁴⁹

The report suggests this may be because finance providers are more risk averse towards these businesses in the creative industries because of their uncertainty or moral hazard, although it offers no evidence for this.⁵⁰ We note that the researchers suggest that loan–risk assessments may be less relevant for creative industries businesses; even so the report's findings and the explanation it offers are contradictory.

We put forward three possible solutions to the difficulties experienced by businesses in the creative industries when attempting to access credit that the BIS research revealed:

- Banks need to work with credit rating agencies to improve their understanding, assessment and analysis of businesses in the creative industries to make their rating more useful to banks.
- Our extensive interviews show that simply spending half an hour talking to a business owner is sufficient to understand their plans and intentions. It did not seem to us that any of our interviewees, even the sole trader, were suffering from moral hazard. Surely banks are able to undertake such interviews; indeed we would expect them to be a standard part of assessing a loan application.
- Help businesses to identify the correct type of funding; if their business model is based on a stream of new and unpredictable creative products we have observed that credit is much less likely to be available, especially to new and small businesses, unless personally guaranteed. In these cases, equity investors may be more willing and likely to offer finance.

Recommendation 10: The Government should take seriously the recommendations of the BIS Select Committee report on government assistance to industry⁵¹ and review the accessibility of the Enterprise Finance Guarantee Scheme to creative industries. As part of this undertaking the Government should facilitate shared understanding between industry, government and finance on which type of businesses are suitable for credit funding

Investment

Our interviewees were split in their understanding of investment. While video games businesses understood how investment worked and have attracted it, as have some TV companies, other TV companies and all the music companies we interviewed either had not chosen to seek external investment, or did not think they could. In contrast, the larger fashion companies we interviewed understood investment well, describing setting up international joint ventures to expand abroad. None of our 20 interviewees had used the Enterprise Investment Scheme to incentivise investment, and had little awareness of what the scheme was, and whether it might work for their business. A contact in one music

company said, ‘I have heard of it, but I don’t know how it works. It seems very complicated.’

However, many of the businesses we interviewed fulfil the qualifying criteria for the EIS scheme. The company must:

- be unquoted at the time shares are issued
- not be controlled by another company
- be a ‘small company’ by a gross assets test (the gross assets of the company must be less than £7 million before the share issue, and £8 million after it) and an employee number test (must have fewer than 50 employees)⁵²

Fashion and content companies both qualify, the latter if they receive revenue through royalties or licence fees, providing the company itself created the intellectual property asset.⁵³ This final point should be clarified by the Government as royalties in the creative industries are often retained by the individual writer, composer or musician. The minimum investment is £500 and up to £1 million can be raised. The scheme is highly attractive for investors as it offers income tax relief on the initial investment, capital gains tax exemption on any subsequent gains on the value of the shares at disposal (sale), loss relief against income tax if the shares are disposed of at a loss and capital gains tax deferral relief.⁵⁴

There is a big missed opportunity here for businesses in the creative industries and investors. The Government should urgently seek to work with the creative industries sector to improve understanding of investment financing in general and the opportunities of the EIS in particular.

Recommendation 11: The Government should work with HMRC’s Small Companies Enterprise Centre and sector representatives to explore how the Enterprise Investment Scheme can enable small enterprises ambitious for growth in the creative industries sector to attract investment. In particular Government and HMRC should clarify the rule around earnings from royalties to enable creative industry content companies to access the scheme.

Overall, the findings from our interviews are that the business acumen and approach of successful business managers in the creative industries are robust and well informed, and they have detailed knowledge of how to turn a profit. However, we acknowledge that businesses engaged in creating and bringing to market a constant stream of new and unpredictable creative products are a high point of risk given the frequency and lack of predictability of their core business. This may mean they have more difficulty than others in the sector in securing the capital they need to grow.

Record labels are by definition new and unpredictable creative product businesses, so they are unlikely to be able to access debt finance until they have built up assets of sufficient value to borrow against, and a track record of success. Music used to be a sector wealthy enough to self-invest in new talent (new intellectual property production) in a relatively closed model of ‘advances’ paying a band or smaller label in advance to get a record made. Martin Mills of Beggars described how in the past the company has used advances from larger labels to fund expansion. As the sector’s wealth has been hollowed out by piracy, this source of funding has shrunk. As we have seen, credit is unlikely to be available to a small or start-up record label or management company seeking to back a new act or release.

Martin Mills suggested that the drive for swift growth from external investors may be incompatible with the fluctuating revenue of record labels (or other new and unpredictable creative product businesses in film or TV). He pointed out that a successful label may have high earning and lower earning years, depending on which artists release material (although, again, we are not clear what the point of difference is: many companies with investors have varying revenues, and sometimes, and sometimes do not, pay dividends for investors). More compelling was his observation that external investors may push labels to over-exploit their artists (for example, licensing a track for a big Christmas advert) to drive short-term revenues at the expense of long-term value. These kinds of challenges may also be present for video games companies (will they ever build an *Angry Birds*?) or a TV or film company (will they ever make a hit?).

Recommendation 12: The Government should re-visit plans set out in its consultation on the patent box⁵⁵ and extend the scope of this box to include new creative intellectual property and trade-marked designs, allowing a reduced rate of corporation tax to apply to profits derived from copyright and trade-marks registered in the UK. Such a system could be linked to the R&D tax credit, creating a virtuous circle of investment, innovation and growth. The Government should also simplify the R&D tax credit, make it more straightforward for companies to claim under, and consider expanding it to cover more of the creative sector.

Recommendation 13: the sector trade bodies should accelerate their efforts to learn from and model peer success stories in mentoring promising businesses, nurturing business skills, and enabling and mediating discussions between these businesses and creditors and investors.

Recommendation 14: The Government and the sector should discuss with relevant third sector bodies such as Nesta and UnLtd whether recommendations (5) and (13) can be best achieved by creating a programme of business skills workshops and business mentoring support that also offers entry level loans following the model of the Prince's Trust Enterprise Scheme. This could be funded by sponsorship, from third sector bodies, from government or a combination of these options.

Box 3 **Common traits of successful businesses in the creative industries**

Video games

- *Have a great idea and develop it; prove it works, and that there is or could be demand for it.*
- *Build relationships in the investor community, possibly by working for another start-up.*
- *Write a robust business plan that includes space to fail.*

- *Have business skills and investment know-how to support your tech and development team.*
- *Retain a stake in intellectual property and exploit it globally.*
- *The most suitable source of finance is investment.*

Music

- *Decide on a business model: retail, promotion, management distribution and artists and repertoire (A&R), or a combination.*
- *Create a proven track record of profitably bringing new acts to market.*
- *Have business skills, credit and investment expertise in senior management.*
- *Work with like-minded business partners and investors who understand that revenues and growth will fluctuate.*
- *Remember who your customers are (music lovers and the artists you represent) and focus on long-term rather than short-term success to create a sustainable business.*
- *Retain a stake in intellectual property and once scale is achieved use credit to fund expansion.*
- *The most suitable source of finance is investment when small, and credit or investment when larger.*

Fashion

- *Decide on a business model: small and artisan, consultancy or own label hybrid, establishing a label for long-term growth based on wholesale and retail sales.*
- *Ensure there is a business director working in partnership with the creative director, and that both understand the company's governance and model.*
- *Clarify who owns intellectual property when entering into joint ventures, commissioned work and collaborations.*
- *Use sales data from the previous season as a guide to the following season.*
- *Once business to business orders from reputable companies become regular, fund expansion through credit.*

- *Consider investment and joint ventures for further expansion on a global level.*
- *The most suitable source of finance is credit when small, and investment when larger.*

TV and film

- *Start small, pitching ideas until one or more are successful.*
- *Retain a stake in intellectual property; exploit this as far as is possible.*
- *Have a small, creative and business core team and scale up with freelancers to deliver projects to keep costs flexible.*
- *Be aware of revenue potential from new platforms, and consider multi-platform opportunities.*
- *The most suitable source of finance is investment when small, and credit when larger.*

4 The map

There can be no economic analysis without classification. Only a classification can give precise enough meaning to the terms that crop up so often in economic reports – ‘textile industry’, ‘furniture’, ‘steel industry’ and the rest. Classifications play an absolutely crucial role, but they tend to be dismissed as tedious. They consist of tiresome lists with only the occasional intriguing oddity to break the boredom. A classification specialist is seen as a real technology geek.⁵⁶

So said three French economists in a 1971 essay on industrial classifications. They discussed their philosophical and sociological significance and history, quoting Heidegger, Bourdieu, Foucault and Jorge-Luis Borges:

According to Heidegger, ‘for someone who wears glasses – a device which, depending on the distance, may be so close to him that it “sits on his nose” – the device is, in terms of his environment, more remote than the picture on the opposite wall. It is so close that it passes unnoticed.’... This explains why the problems inherent in classifications appear superfluous, boring and pointless. It is not because they are unimportant; on the contrary, it is precisely because they are fundamental. An economist – if we may use this image – is not interested in the glasses through which (s)he sees the economy; (s)he is, however, greatly interested in what (s)he sees. If we want to see the glasses we are wearing, we first have to take them off, and that blurs our vision. Similarly, discussions of classifications lead us to view as fragile, malleable and ultimately questionable those aggregates whose robustness we used to take for granted.

Picking up from the discussion in chapter 1 on how to classify the creative sector, in this chapter we set the Government’s approach to defining and measuring the creative

industries sector into an economy-wide historical context of how all primary economic data are collected and organised.

We will show how the system used for collection and organisation of official data operates as a map to the economy, and how the poor visibility of the creative industries on this map is a key reason for the confused and poor understanding of the sector.

Standard Industrial Classification (SIC) codes provide a framework for collecting and presenting data on businesses and economic activity. In practice, SIC codes are allocated to the data on revenue, employment, turnover and profit by every firm that is registered with and files accounts at Companies House, or files a Value Added Tax (VAT) return.

The SIC system is hierarchical. Each code may be up to five digits long, with broad sectors of the economy (such as manufacturing or retail) being identified by the first and second digit of the code, down to increasing levels of detail in the third, fourth and fifth digits.⁵⁷

History

The SIC system was first introduced into the UK in 1948 for use in classifying business establishments and other statistical units by the type of economic activity in which they were engaged.

SIC codes as we know them were first implemented in a standardised way by the US Federal Government, towards the end of the Great Depression,⁵⁸ when the Federal Government found following the 1929 crash that it did not have enough accurate data to know what was going on in the economy.⁵⁹ The SIC code system was developed to remedy this, and was first adopted in the USA in 1937:⁶⁰ ‘The estimation of national income and the national balance sheet was initiated during the 1930s when the lack of comprehensive data frustrated the efforts of Presidents Hoover and Roosevelt to design policies to combat the Great Depression.’⁶¹

The UK faced similar problems and introduced its own ‘Census of Production’ in 1935, formally introducing the SIC system in 1948.⁶²

Now, as then, detailed and accurate knowledge of what is going on in the economy is critical to developing effective policies that support and enable economic growth. As our economic predicament since the credit crunch is the most serious since the 1930s, it is an appropriate time to look once again at the systems of data and collection the Government uses today, and to consider how well they describe and enable us to understand the drivers of current economic activity.

UK statisticians were involved in the development of the first version of the current International SIC, issued by the United Nations in 1948. The first SIC codes introduced to the UK that year and all those since have followed the same broad principles of international systems.⁶³

In 1958 and 1968 UK codes were updated following UN revisions of the same years. The UK joined the European Economic Community (EEC, now the European Union) in 1973 and from 1980 onwards the principal objective of the revision of the UK SIC was to ‘examine and eliminate differences from the activity classification issued by the Statistical Office of the European Communities (Eurostat) titled “Nomenclature générale des activités Économiques dans les Communautés européennes” [NACE]’.⁶⁴

In 1990 the first revision of NACE was made by EC regulation and this legally required all member states to introduce a corresponding SIC system. This revision took place in the UK in 1992.

Since then UK revisions have followed European revisions, which in turn follow UN revisions. Accordingly, revisions to the codes were made in 1997, 2003 and most recently in 2007. In 2011 the Government’s Blue Book of economic data will for the first time be published entirely using the revised 2007 SIC codes.⁶⁵ To summarise, SIC codes are internationally set, and revisions take time to be negotiated and implemented.

As we shall see, SIC codes and their history are relevant for two reasons:

- They set a framework for primary economic data.

- As time passes and the world changes from the era in which they were introduced, even with revisions they become increasingly out of date.

Table 5 shows 1948 and 2003 UK SIC two-digit broad sectoral definitions of the economy in the two left-hand columns, mapped across the primary areas of research focus of leading research and analyst companies.

As the SIC system was developed in the 1930s and 1940s, it maps the economy of that era: one focused on primary and secondary industries, such as mining, quarrying and manufacturing. Despite regular updates and revisions, as the table shows, the two-digit codes that distinguish broad sectors of the economy have changed very little since they were first introduced in 1948.

As table 5 makes clear, the broad sectoral definitions in the SIC system frames not only government thinking about the economy, but also the way other leading economic, business and investment analysis institutions organise their approach to sectoral research. This is hardly surprising as the primary source of sectoral economic data for all these companies is government-issued data. Therefore as the Government does not publish economic data for the creative industries as part of its standard ONS schedule it is hardly surprising that analysts publish little research on the sector.

Newer sectors of the economy such as the creative industries are entirely missing from the top level sectoral distinctions in the SIC system. Moreover there are many gaps and inadequacies at the level of four and five-digit codes that should map economic activity in some detail. For example, in the 2003 SIC code system there are still 242 detailed manufacturing codes compared with 76 for retail, three for post and telecoms and 12 for financial services. The DCMS definition of the creative industries covers 34 codes including full data from 14 and partial data of between 0.5 per cent and 50 per cent for the remaining 20.

Even in the most recent update of 2007, there are 281 detailed manufacturing codes, 114 retail codes, with 36 codes in a

newly distinct two-digit information and communication sector and 40 in the expanded financial services sector. The DCMS definition of the creative industries uses 49 SIC codes, including full data from 29 of them, and partial data of between 81.6 per cent and 0.5 per cent from the remaining 21.

The creative industries are not the only sector poorly served:

Over time [the SIC code system] has been increasingly criticised for failing to reflect the rapid changes in the industrial focus of the various economies. Particular problem areas include data for the growing service industries such as information services and consultancies.⁷³

A new hope?

Internationally, the most vocal criticism of the SIC came from America, where in the 1990s the Federal Government became so disillusioned with the International SIC system that it began developing its own alternative.

This led to the creation of a new system, which was introduced in the USA in 1997, called the North American Industrial Classification System (NAICS). Every sector of the economy has been restructured and redefined: a new information sector combines communications, publishing, motion picture and sound recording, and online services, to accommodate the North Americans' information-based economy. Manufacturing has been restructured to contain new high-tech industries. A new sub-sector is devoted to computers and electronics, including reproduction of software. Retail trade has been redefined. In addition, eating and drinking places are transferred to a new accommodation and food services sector. The difference between retail and wholesale is now based on how each store conducts business; for example, many computer stores are reclassified from wholesale to retail. Nine new service sectors and 250 new service industries have been recognised.

NAICS uses a six-digit hierarchical coding system to classify all economic activity into 20 industry sectors. Five sectors are mainly goods-producing sectors and 15 are entirely service-producing sectors. This six-digit hierarchical structure allows

Table 5 **Definitions of the UK economy mapped across the primary areas of research focus of leading research and analyst companies**

UK 1948 SIC	UK 2003 SIC ⁶⁶	British Venture Capital Association ⁶⁷	Accenture ⁶⁸	Boston Consulting Group
Mining and quarrying, treatment of non-metalliferous mining products	Mining and quarrying	Basic materials, - oil and gas		Metals and mining
Building and contracting	Construction	-	-	-
Insurance, banking and finance	Financial services	Financials	Banking	Financial institutions, private equity
11 sections cover manufacturing in detail	Manufacturing	Industrials	Aerospace and defence, airline, automotive	Automotive, biopharmaceuticals, engineered products, project business, process industries
Distributive trades	Wholesale, retail, certain repair	Consumer goods	-	Retail, consumer products
Under miscellaneous services	Hotels and restaurants	-	-	Travel and tourism

Deloitte ⁶⁹	KPMG ⁷⁰	Deutsche Bank ⁷¹	Lloyds Banking Group ⁷²
-	-	-	-
-	Building construction	Construction and real estate	Building construction and real estate
Financial services	Financial services	Services and professions	Financial institutions
Manufacturing	Automotive, chemicals, pharmaceuticals, electronics	Industrial sectors	Manufacturing
Consumer products, retail	Retail, food, consumer goods	-	Retail and consumer products
Tourism, hospitality and leisure	-	-	Leisure

Table 5 **Definitions of the UK economy mapped across the primary areas of research focus of leading research and analyst companies - *continued***

UK 1948 SIC	UK 2003 SIC ⁶⁶	British Venture Capital Association ⁶⁷	Accenture ⁶⁸	Boston Consulting Group
Transport and communications	Transport, storage and communication	Technology, telecommunications	Media and entertainment	Transport, technology and software, telecommunications, media and entertainment
	Real estate, renting and business	-	-	-
Public administration and defence, professional services	Education, health and social work	Healthcare	Health and public service	Healthcare payers and providers, medical devices and technology
Gas, electricity and water	Electricity, gas and water supply	Utilities	-	Energy and environment
Miscellaneous services	Other	Other	-	-
	Creative industries (no two-digit SIC code)			

Deloitte ⁶⁹	KPMG ⁷⁰	Deutsche Bank ⁷¹	Lloyds Banking Group ⁷²
Transportation, technology, media and communications	Software and services, communications and media, infrastructure, transport	Transport	Business services and technology, transportation
-	Real estate	-	-
Public sector, Life sciences and healthcare	Government, healthcare	-	Health, public sector
Energy and resources	Energy and natural resources	Energy sector, environmental protection	-
-	-	-	-
		other sectors	

greater coding flexibility than the four-digit structure of the SIC. NAICS allows for the identification of 1,170 industries compared with the 1,004 found in the SIC system.⁷⁴ Now used by the USA, Canada and Mexico, the NAICS system is reviewed every five years for updates and changes.

In contrast, the UK has remained within the UK SIC, European NACE and UN ISIC framework. There are some good reasons to do this: UK data are comparable internationally and over time, which is useful for studying and understanding longitudinal trends and making international comparisons. Moreover, even if the UK was inclined to break from the internationally comparable SIC system and follow the NAICS system, it is unable to do so. EU legislation currently prevents the UK Government from making such a change, even if it offers the promise of a better mapping of our modern economy at a time when investigating the drivers of economic growth is more important than ever before.

And yet, for new and fast-growing sectors of the UK economy, invisibility in the official SIC framework is an increasing problem. Because the creative industries are not on the SIC map, good quality data on the sector are difficult to compile. And because the sector is not on the map, seeking out and analysing data about it is a low priority for expertise and manpower in government and private sector research.

In this knowledge vacuum it is easy for assertions and opinions about the creative industries – however well meant – to become generally accepted ‘truths’ about the sector.

What can be done?

There is some good news. The 2007 revision of SIC codes is the most significant for some time. Although adopted ten years later than the US changes, and only fully implemented four years after that, the 2007 codes are a significant improvement for much of the creative industries sector. The introduction, for the first time, of a two-digit level code for the ‘Information and communications’ sector should work better for music, TV, film, software, video games and publishing.

The Government has heeded input from the fashion industry and included an additional code, 15.12 (manufacture of luggage, handbags and the like, saddlery and harness), in the DCMS definition of the sector. This includes the design activities of leading accessories and bag brands such as Mulberry, Lulu Guinness and Smythson in the Government's definition of the sector for the first time.

However, problems still remain. The new 2007 codes are still inadequate for music in particular. The current coverage of the music industry in the new and previous UK SIC coding systems makes it near impossible to separate out data on the commercial music industry from other areas of the performing arts.⁷⁵

In contrast, the US 2007 NAICS system offers much better coverage. While both systems split the sector between two top line sectors – 'Information and Communications' and 'Arts, Entertainment and Recreation' in the UK, and 'Information' and 'Arts, Entertainment and Recreation' in North America – in both sections the NAICS system offers a greater level of detail. Under 'Information' it has a further four-digit sub-heading 'Sound Recording Industries' with which there are four further, detailed six-digit codes for: 'Record Production', 'Integrated Record Production/Distribution', 'Music Publishers', 'Sound Recording Studios' and 'Other Sound Recording Industries'. Likewise, under 'Arts, Entertainment and Recreation' under a number of four-digit sub-headings there are a number of six-digit detailed codes, which distinguish between performing theatre companies, dance companies, musical groups and artists, and other performing arts companies, as well as codes for promoters with and without facilities, agents and managers, and independent artists, writers and performers (although these last three offer no distinction of which market the company is operating in, also including sports promoters and agents of athletes and public figures, as well as entertainers).

In contrast, even the new UK 2007 codes offer only two codes for recorded music: 'Sound recording and music publishing activities' and 'Reproduction of sound recording'. The five further codes that cover the sector – 'Performing arts,

Support activities to performing arts, Artistic creation, Operation of arts facilities, Motion picture, television and other theatrical casting' – make it impossible to separate the activities of the (commercial) live music sector from theatre or dance (commercial and publicly funded). In future revisions to the SIC system, the Government should seek to address this inadequacy in the current coverage of this sector.

Moreover, 13 years after its own, laudable, attempt to define and map the creative industries, it is high time the Government revisited its definition of them to see if it is still an appropriate and helpful definition. Think of the dramatic changes that have taken place and affect this sector more than any other: in the 13 years since 1998, mobile phones have gone from being a rare luxury to being ubiquitous; and the internet and having access to email from being novel in 1998 but essential for many today. During this period billion dollar companies such as Google and Facebook have become established, and revenues of the recorded music industry have declined as the once lucrative CD market has been hollowed out by easy to come by, often unpaid for, digital music files, while music itself is more popular than ever.

Video games have broken out of their console format onto our phones, laptops and, increasingly, tablet computers. Cross media convergence is an exciting and growing area: Video games and music have married and had children: think of the runaway success of *Singstar* or *Guitar Hero*. Where does cloud gaming fit in? We can watch films, TV and listen to music and the radio not only on our computers, but on our phones. It has been a period when British fashion designers and the British approach to fashion have had worldwide influence, from the recently departed John Galliano at Dior and Katie Grand styling in the luxury sector to Philip Green's transformation of Topshop: high design and style at reasonable prices. This is now available online too, from the success of Netaporter at the high end, to Asos on the (online) high street. Little if any of this activity – surely some of the most dynamic and innovative of the economy – is reflected by the current government definition of the sector. It is surely time for a new mapping project by the Government, which attempts to understand the sector as it currently stands, and in

particular its relationship with tech companies and phone network companies as a key driver of demand.

The DCMS's 2010 *Creative Industries Economic Estimates* use the 2007 SIC codes for the first time. A note on video games states, 'The 2007 SIC codes have improved our ability to measure this category considerably, as we can now better exclude businesses whose main activity is not creative,'⁷⁶ when explaining why that year's total gross value added (GVA) was lower at 5.2 per cent than previous years, when the figure had been put at 6 per cent.

This is surely the wrong direction of travel. The software, games and apps sectors are some of the most rapidly developing parts of our economy. How many of us have a smart phone with multiple apps today, something that was unheard of just four years ago? If the developers of app games like Angry Birds are registering under the new 2007 'Publishing of computer games' code, does this mean that a company developing apps that allow you to access the London tube map on your phone should not?

And what of fast growing (and European) companies like Spotify, a music company that provides an app, indeed a service, over the internet? Would that fall under the 'Sound recording and music publishing activities code'? Probably not, since Spotify is not signing and recording new artists. Would it fall under one of the 'Computer programming, consultancy and related activities' codes, some of which fall into the DCMS's 13-year-old definition of the 'Creative industries' under video games, and some of which do not? Clearly, Spotify is a music company, and one with a potential for significant growth, but it is highly unlikely it appears in the current government definition and data for the creative industries.

And what, to push this argument wider still, of our ever-growing demand for bandwidth – fixed line and mobile, and new technology? What is driving our desire for a tablet with wi-fi or another smart phone if not the ability to listen to music, watch film and TV shows, and play games, anytime, anywhere? Increasingly, we read newspapers and books on them too. These gadgets that started life so we could check our work emails in the evenings and at the weekend are morphing into personal entertainment portals.

Even fashion, a sector seemingly less touched by technological innovation, is drawn in: the fastest growing area of fashion retail is online; think of companies like Asos and Netaporter. Yet there is no code appropriate for online retail in either the 'Retail' or 'Information and communications' sectors of the 2007 codes.

For fashion in general, the DCMS aims to isolate the economic activity of fashion designers. Hence a very small proportion, just 0.5 per cent of activity of the ten SIC codes that cover fashion manufacture, are counted. Retail is left out entirely, so in the Government's understanding of the sector, (designer) fashion is seen to be small, contributing just 0.01 per cent to the UK economy. When retail is included – and after all, demand for fashion (clothes) in retail is created by fashion design – the sector contributes £20.9 billion a year, an estimated 1.7 per cent to UK GDP.⁷⁷

Some 7,700 retailers sell video games, of which over 1,000 are video game retail specialists and yet it is far from clear looking at the detailed SIC codes for retail where this activity is being recorded.

In chapter 1 we recommended that the DCMS definition of the creative industries should be reviewed to include more economic activity driven by fashion design in manufacturing and retail, on the grounds that the production and consumption of TV and film, for example, is within the definition. The Government should also take the opportunity to review inclusions and omissions in its definitions of software and electronic publishing, and digital and entertainment media. Drawing on the discussion above, we also make the following recommendations.

We have argued that the Government should ensure that the civil service resource devoted to analysing the creative industries corresponds to its size and potential, and that departments that originate relevant policies have an appropriate number of civil servants with sectoral expertise (recommendation 2). As it starts to use 2007 SIC codes in its official data, it is the perfect time for Government to re-examine and rearrange the civil service resource it allocates to the creative

industries. Whitehall should improve its expertise in new and growth areas, and those like fashion manufacturing and retail that have been ignored for too long. There is no need for this to attract an extra cost; it is merely a matter of requiring the civil service to reallocate its resources in a way that is most appropriate for a twenty-first-century economy.

Updates to the SIC system come around every five to ten years so reform and change is a long-term effort; nevertheless, there are good grounds for a sustained campaign to push for further amendments to bring the system further up to date by increasing the detailed coverage of sectors in information and communications. These are significant growth areas of our economy and yet are poorly served by even the most recent revision to SIC codes, as the sector was not consulted.

Recommendation 15: The Government should consult the sector to establish where the current SIC system is lacking and how it can be improved. The Government should press for international reform through the EU and the UN to enable the system to better reflect the reality of the UK economy.

This is urgent and essential because lenders, investors, analysts, HMRC and government departments all use the economic data produced by the SIC system to understand the sector and wider economy. While the system is poorly reporting sectors of the economy that have the most potential for growth, it makes it more difficult for creditors and investors to understand the opportunities and for Government to develop informed policies that are workable for the sector.

Music is in clear need here, but developments in software, electronic publishing and digital and entertainment media are likely to continue to be rapid. The UK Government can find common cause here with other advanced economies, which are poorly served by a system that has 322 detailed four-digit codes covering agriculture and manufacturing compared with 76 detailed codes covering information and communications, and financial services. The problems created by the invisibility of the

creative industries sector in statistics has been discussed in various EU policy and discussion papers, which leads us to believe that there is good reason for the UK to push for changes to be made to address this at an international level.⁷⁸

The fact that the SIC system is internationally set, and slow changing, is no excuse for inaction. While it argues for revisions to be made internationally (which could take years, if not decades), the Government should create signifiers of its own for important sectors which are poorly reported in the current system.

Therefore, as we argued in chapter 2, the Government should immediately instruct the Office for National Statistics (ONS) to introduce the automatic sorting of data on its (updated) definition of the creative industries as an interim measure to further SIC reform, and to publish these statistics quarterly and annually as a satellite account to Blue Book economic data. The Government should also instruct the Department for Business, Innovation and Skills to publish regular aggregated data sets on creative industries in its business surveys (recommendation 3).

Recommendation 16: Government should task its statistics agencies to make it easier for the ONS and external researchers using government data to track and study new and important sectors of the UK economy, including the creative industries, which are not well served by the current SIC system.

The Government should ensure that this automatic sorting of the data on the sector and sub-sectors is available in all its databases, enabling its own and external researchers to examine trends of and within the sector more easily. This is likely to stimulate considerable research work by external researchers at universities, think tanks and in the commercial analysis and research sector, acting as a multiplier effect on the Government's efforts to understand the sector better.

The UK is a world leader in the creative industries; the UK Government should seek to become a world leader in the way it

defines, tracks, studies and engages with this sector, in order to harness and build on our current successes.

Endnote

In all areas of policy, having a shared analysis is a necessary first step to agreeing what needs to be done. There has been a huge gap in analysis around the creative industries sector, with disputes as to its size, the nature of the businesses within it and in particular their riskiness. This pamphlet attempts to shine a spotlight on what is really going on, so as to provide a better backdrop for policy makers to make decisions about how best to support a sector that undoubtedly has a big part to play in Britain's economic future.

Our overriding observation is that successful creative businesses share more in common with other businesses than they would instinctively care to admit. There has been a lack of understanding of this point in government, finance and the sector itself. Bringing people together to understand how to make money in, for example, fashion, music, video games, film and TV is a good first step to spreading success more widely. Therefore the Government should invest in providing greater capacity to understand what makes these industries tick, and record their successes more comprehensively by reforming the system of data collection and reporting. The first step in better supporting the creative industries is better reporting them.

Our second observation is that, even before the various business models in the sector are understood, there is nothing inherently riskier about trying to make money out of creativity than trying to do it any other way. Businesses in the creative sector do not exhibit higher failure rates than the average business in other sectors, even if the nature of some business models in the sector may make them less suitable for debt finance at an early stage. In fact, there is some evidence from the data and our qualitative interviews that creative industries might be less risky, perhaps as a result of the passion, dedication and

skill of the individuals involved. Some individual businesses in the sector may have a higher risk profile than others because their business model is based on bringing a stream of new and unpredictable products to market, rather than because they are 'creative'.

These insights should provide confidence to those in the sector, government and finance, and encourage them to realise that if a business proposition does not work, it can be improved and ultimately succeed. Misunderstandings can be corrected, experience can be gained, business plans can be rethought, management teams can be rebuilt; there is nothing intrinsic about being creative that means a business is doomed to fail. So, if prejudice against the sector does exist, that is simply a missed business opportunity by a funder or investor.

Finally, and on an optimistic note, this means that UK plc has a real opportunity. Success, once it is achieved and understood, can be replicated. It has been true, to paraphrase William Goldman, that nobody knew anything. The purpose of this pamphlet has been to create a bit more knowledge derived from data, and extrapolate the policy recommendations that follow from this. As a result, we now know what it is we need to do.

Appendix: companies surveyed

Interviewees

While some of our interviewees elected to stay anonymous, we are grateful for the time and insights of the following organisations:

Creative Industries Businesses

Anya Hindmarch
Beggars Group
Full Time Hobby
J. Smith
Kudos Film and TV
Lulu Guinness
Margaret Howell
PIAS
Picklive
Pistol Pancies
Playgen
Pulse Films
Studio Lambert
Tateossian
TwoFoldTwenty
TwoFour

Creditors and Investors

Angel Capital Group
British Private Equity and Venture Capital Association
Edge Group
HSBC
Lloyds TSB

Other respondents

Bethnal Green Ventures

Method Design Lab

Nesta Start-Up Factories

The Prince's Trust

Notes

- 1 David Cameron's speech to the CBI on 25 Oct 2010, www.epolitix.com/latestnews/article-detail/newsarticle/prime-minister-cbi-speech-in-full/ (accessed 9 Sep 2011).
- 2 DCMS, *Creative Industries Economic Estimates (Experimental Statistics)*, full statistical release, 9 Dec 2010.
- 3 On his Radio 4 show *The Bottom Line* Evan Davis dedicated a whole programme to 'how clothing and fashion differ from other businesses' around nine minutes in. See www.bbc.co.uk/programmes/boozm326 (accessed 9 Sep 2011).
- 4 See Nesta's statement on its research into early stage investment in the creative industries at www.nesta.org.uk/library/documents/Investors_Poll.pdf (accessed 9 Sep 2011).
- 5 "The cultural and creative industries (hereafter, "CCIs") represent highly innovative companies with a great economic potential and are one of Europe's most dynamic sectors, contributing around 2.6 per cent to the EU GDP." See European Commission, *Unlocking the Potential of the Cultural and Creative Industries*, Brussels, COM (2010) 183. Some data suggest that in the USA the contribution might be as much as 11% of GDP: see bar chart on the web page WIPO, 'Economic contribution & mapping', World Intellectual Property Organization, www.wipo.int/ip-development/en/creative_industry/economic_contribution.html (accessed 9 Sep 2011). However, these data are several years old (US data are from 2004), and it is not clear what definition the USA is using. The WIPO study was looking at the economic contribution of 'copyright industries', which probably includes tech industries left out of the UK definition of the creative industries. In any case, the USA in particular uses a

different system from European economies for collecting and analysing economic data, as we shall see in chapter 4.

- 6 Nesta forecast (in 2009) that the creative industries in the UK will grow on average by 4 per cent from 2009 to 2013 (more than double the rate of the rest of the economy), generating £85 billion in GVA (up from £59 billion). By 2013 it expected the sector would employ 1.3 million people, more than the financial sector. See Nesta, 'UK Creative Industry to Drive Significant Growth in UK Economy', 19 Feb 2009, www.nesta.org.uk/areas_of_work/creative_economy/past_projects_creative_economy/starter_for_six/assets/features/uk_creative_industry_to_drive_significant_growth_i (accessed 14 Sep 2011).
- 7 HMT and HMRC, *Consultation on the Patent Box*, London: HM Treasury and HM Revenue and Customs, 2011, www.hm-treasury.gov.uk/d/consult_patent_box.pdf (accessed 8 Sep 2011).
- 8 'Gross value added is the difference between output and intermediate consumption for any given sector or industry. That is the difference between the value of goods and services produced and the cost of raw materials and other inputs which are used up in production.' See ONS, *Productivity Handbook*, Office for National Statistics, section 1.2.1.2, 'Gross value added', www.ons.gov.uk/ons/guide-method/user-guidance/productivity-handbook/index.html (accessed 15 Sep 2011).
- 9 See European Commission, *Unlocking the Potential of the Cultural and Creative Industries*.
- 10 DCMS, *Creative Industries Economic Estimates (Experimental Statistics)*, full statistical release, 9 Dec 2010.
- 11 'Our creative industries have grown twice as fast as the rest of the economy.' See DCMS, *Creative Britain: New talents for the new economy*, London: Dept for Culture, Media and Sport, 2008.

- 12 DCMS, *Creative Industries Economic Estimates (Experimental Statistics)*, full statistical release, 9 Dec 2010.
- 13 Art and antiques and music, visual and performing arts are the two sectors with most of the charity and not-for-profit organisations. They accounted 0.03% (art and antiques) and 0.3% (music, visual and performing arts) of GVA in 2008. See DCMS, *Creative Industries Economic Estimates (Experimental Statistics)*, full statistical release, 9 Dec 2010.
- 14 D Moyo, *How The West Was Lost: Fifty years of economic folly – and the stark choices ahead*, London: Allen Lane, 2011.
- 15 DCMS, *Creative Industries Mapping Document 2001*, London: Dept for Culture, Media and Sport, 2001, http://webarchive.nationalarchives.gov.uk/+www.culture.gov.uk/reference_library/publications/4740.aspx (accessed 9 Sep 2011).
- 16 Ibid.
- 17 DCMS, *Creative Industries Economic Estimates (Experimental Statistics)*, full statistical release, 9 Dec 2010.
- 18 British Fashion Council, *The Value of the Fashion of the UK Fashion Industry*, London: British Fashion Council, 2010.
- 19 For a full list of 2003 and 2007 SIC codes included in the definitions and proportions taken, see DCMS, *Creative Industries Economic Estimates (Experimental Statistics)*, full statistical release, 9 Dec 2010.
- 20 Data on the rest of the economy are sourced from publicly available BIS data. See BIS, *Small and Medium-sized Enterprise Statistics for the UK and Regions*, Dept for Business, Innovation and Skills, <http://stats.bis.gov.uk/ed/sme/> (accessed 9 Sep 2011) and BIS, *Business Population Estimates for the UK and Regions*, Dept for Business, Innovation and Skills, <http://stats.bis.gov.uk/ed/bpe/> (accessed 9 Sep 2011).

- 21 GVA data are made available more slowly than raw data on company numbers, hence at the time of writing (summer 2011) the latest data available for GVA relate to 2008, despite data on numbers of companies being available for 2010. See DCMS *Creative Industries Economic Estimates (Experimental Statistics)*, full statistical release, 9 Dec 2010.
- 22 Data on the rest of the economy sourced from publicly available BIS data. See BIS, *Small and Medium-sized Enterprise Statistics for the UK and Regions* and BIS, *Business Population Estimates for the UK and Regions*, <http://stats.bis.gov.uk/ed/bpe/> (accessed 9 Sep 2011). <http://stats.bis.gov.uk/ed/sme/> and <http://stats.bis.gov.uk/ed/bpe/>
- 23 Business Link has lost its funding, although apparently small business support will be 'delivered online'. See J Hesse, 'Business Link: never fit for purpose', 30 Jun 2010, http://realbusiness.co.uk/leadership/business_link_never_fit_for_purpose (accessed 9 Sep 2011).
- 24 DCMS press office.
- 25 Department for Business, Innovation and Skills, Parliamentary Written Answer, 4 Jul 2011, www.theyworkforyou.com/wrans/?id=2011-07-04b.63437.h&s=speaker+percent3A24744#g63437.q0 (accessed 9 Sep 2011).
- 26 British Fashion Council, *The Value of the UK Fashion Industry*.
- 27 HMT and DCMS, *The Plan for Growth*, London: HM Treasury and Dept for Culture, Media and Sport, 2011, http://cdn.hm-treasury.gov.uk/2011budget_growth.pdf (accessed 9 Sep 2011).
- 28 DCMS press office.
- 29 E Wild, *Creating Growth: Improving access to finance for UK creative industries*, CBI Briefing Paper, London: CBI, 2011, http://creativeindustries.cbi.org.uk/media/17642/creatives_finance_brief_v7.pdf (accessed 9 Sep 2011).

- 30 Ibid.
- 31 See Nesta's statement on its research into early stage investment in the creative industries at www.nesta.org.uk/library/documents/Investors_Poll.pdf.
- 32 BIS and DCMS, *Appendix 1: Access to Finance for Creative Industries Businesses: Econometric Analysis from the UK Survey of SME Finances*, Dept for Business, Innovation and Skills and Dept for Culture, Media and Sport, www.bis.gov.uk/assets/biscore/enterprise/docs/a/11-899-access-to-finance-for-creative-industry-businesses-appendix-1 (accessed 9 Sep 2011).
- 33 For further detail on these acronyms see R Holden, 'Make sure your business plan packs a winning punch', FranchiseWorld, 2010, www.franchiseworld.co.uk/Buying_a_franchise/How_to_prepare_your_business_plan_for_a_loan_from_a_bank.html (accessed 9 Sep 2011).
- 34 Over half (54%) of the creative and cultural industries are below the age of 40, and the largest single age group (15%) are aged 25–29 according to the report of Creative & Cultural Skills, *Creative and Cultural Industry: Impact and foot print 2008–2009*, although we note that it uses a different definition of the sector, which leaves out some sectors included in the Government's definition. See www.ccskills.org.uk/LinkClick.aspx?fileticket=fariQAqmP%2bU%3d&tabid=600 (accessed 9 Sep 2011).
- 35 There is a full explanation of this, with worked examples, in Dambisa Moyo's book *How The West Was Lost*.
- 36 A birth is defined as a business that was present in year t , but did not exist in year $t-1$ or $t-2$. Births are identified by making a comparison of annual active population files and identifying those present in the latest file, but not the two previous ones. Births do not include entry into the population as a result of mergers, break-ups, split-offs or other restructuring. There is more in the UK National Statistics' 'Topic guide to: Changes to Businesses', www.statistics.gov.uk/hub/business-energy/businesses/changes-to-businesses (accessed 9 Sep 2011).

- 37 The starting point for demography is the concept of a population of active businesses in a reference year (t). These are defined as businesses that had either turnover or employment at any time during the reference period. Births and deaths are then identified by comparing active populations for different years. 'A death is defined as a business that was on the active file in year t but was no longer present on the active file in year $t+1$ or $t+2$. In order to produce more timely statistics, the UK method diverges from the Eurostat manual at this point. The Eurostat manual requires a check to be made against the two years following a death to identify and remove any reactivations. (Following the Eurostat methodology would mean a delay of up to three years to allow checks to be made before publishing business death data.) The UK Business Demography publication contains a preliminary death indicator, which includes an adjustment for estimated reactivations. This estimate is subject to revision. Inclusion of this adjustment allows UK users to access more timely data.' From the glossary section of UKNS, 'Topic guide to: changes to businesses', UK National Statistics, www.statistics.gov.uk/hub/business-energy/businesses/changes-to-businesses (accessed 14 Sep 2011), which has more on this subject.
- 38 The ONS's 'Business demography 2009' shows that in 2009 total business deaths (279,000) exceeded the number of total business births (236,000) for the first time since data began to be provided in 2001. See House of Commons Library, *Economic Indicators, December 2010*, www.parliament.uk/briefing-papers/RP10-80.pdf (accessed 15 Sep 2011).
- 39 We excluded 2002 as data were not available at the five-digit level, making the accurate identification of the creative industries sector more difficult. Data for 2009 are currently for births only; data on their survival in year 1 are not yet available, making 2008 the last year for which relevant data are available in summer 2011.

- 40 DCMS, *Creative Industries Mapping Document 1998*, London: Dept for Culture, Media and Sports, 1998, http://webarchive.nationalarchives.gov.uk/+www.culture.gov.uk/reference_library/publications/4740.aspx (accessed 9 Sep 2011).
- 41 DCMS definitions of the creative industries with 2003 SIC codes and 2007 and a suggested approach of adjusting between the two are given in DCMS, *Creative Industries Economic Estimates (Experimental Statistics)*, full statistical release, Dec 2010. In one case – SIC code 78.10/1 – ONS provided totals for the five-digit code, which were not available to DCMS, so we included the whole code, rather than taking a small proportion of the much larger four-digit code as DCMS did.
- 42 See the section on yearly totals of births and deaths across the economy below for more detail.
- 43 Technology Strategy Board, *Creative Industries: Technology Strategy 2009–2012*, 2009, <http://195.88.100.72/resource/files/2009/11/02/creative%20industries%20strategy.pdf> (accessed 9 Sep 2011).
- 44 HMRC, ‘Are your workers employed or self-employed for tax and National Insurance contributions?’, HM Revenue & Customs, www.hmrc.gov.uk/leaflets/es-fs2.pdf (accessed 9 Sep 2011).
- 45 UKNS, ‘Topic guide to: Satellite Accounts’, UK National Statistics, www.statistics.gov.uk/hub/economy/national-accounts/satellite-accounts (accessed 9 Sep 2011).
- 46 ‘The biggest obstacle to private-sector loans is the difficulty of gauging future income flows and assessing the risk of an investment. In the underfunded segments there is no basis for comparison to be able to judge these factors: with company start-ups in other sectors banks can draw conclusions about the prospective success of the company being founded from their experience with established customers from the same sector. In traditional industrial sectors, for example, new clients can be compared with existing clients. In the creative industries, though

companies are distinguished by the individuality of their ideas: products and services are less similar than in other branches of the economy. This means that conventional assessment procedures provide less meaningful prognoses of future business success. One possible solution in this case could be to convene a committee of experts who are widely knowledgeable about the creative industries. This committee could provide advice to banks on their lending decisions and assume the task of forecasting the success of a given project.' See Deutsche Bank Research, *Cultural and Creative Industries: Growth potential in specific segments*, 2011.

- 47 Further detail of all of these interventions can be found in a helpful summary, 'A brief history of British television' in the House of Lords Communications Select Committee Report into British Film and Television Industries 2009. www.publications.parliament.uk/pa/ld200910/ldselect/ldcomuni/37/3707.htm (accessed 9 Sep 2011).
- 48 Oliver & Ohlbaum Associates, *Independent Production Sector Financial Census and Survey 2010*, www.oando.co.uk/publications.php (accessed 15 Sep 2011).
- 49 BIS and DCMS, *Access to Finance for Creative Industry Businesses*, final report, London: Dept for Business, Innovation and Skills and Dept for Culture, Media and Sport, 2011.
- 50 Ibid.
- 51 See BIS, *Government Assistance to Industry*, Business, Innovation and Skills Committee, Third Report, 2011, www.publications.parliament.uk/pa/cm201011/cmselect/cmbis/561/56102.htm (accessed 9 Sep 2011). 'The Enterprise Finance Guarantee Scheme should be available to all sectors of the economy. It is therefore unacceptable that the creative industries sector – which generates around £4 billion a year in the United Kingdom and is one of the six sectors designated by the Government as a growth sector – is effectively being excluded from this avenue of funding. We recommend that the Government, as a matter of urgency, ensure that the criteria for receiving EFG funding [are]

- sufficiently flexible to accommodate the creative industries. We expect the Government, in its Response to this Report, to set out clearly how it will achieve this aim.’ (Ibid).
- 52 HMRC, ‘The kind of company which can use the scheme to raise money’, HM Revenue & Customs, www.hmrc.gov.uk/eis/part2/2-1.htm (accessed 9 Sep 2011).
 - 53 HMRC, ‘Trading activities’, HM Revenue & Customs, www.hmrc.gov.uk/eis/part2/2-4.htm (accessed 9 Sep 2011).
 - 54 HMRC, ‘The tax reliefs available’, HM Revenue & Customs, www.hmrc.gov.uk/eis/part1/1-2.htm (accessed 9 Sep 2011).
 - 55 HMT and HMRC, *Consultation on the Patent Box*.
 - 56 B Guibert, J Laganier and M Volle, ‘An essay on industrial classifications’, *Economie et statistique*, 20 Feb 1971, http://ec.europa.eu/eurostat/ramon/other_documents/index.cfm?TargetUrl=DSP_ESSAY_IND_CLASS (accessed 9 Sep 2011).
 - 57 ‘The system works by classifying businesses in a hierarchical manner, starting at a very basic (1 digit) level, then classifying them in more and more detail down to the lowest (5 digit) level possible. However, even at this level of detail it is not practical to have a code for every single individual industry (some codes are simply too small), and so some industries may be put together with others to make up a category.’ See National Statistics, *UK Standard Industrial Classification of Economic Activities 2007 (SIC 2007): Structure and explanatory notes*, 2007, www.businessballs.com/freespecialresources/SIC-2007-explanation.pdf (accessed 9 Sep 2011).
 - 58 ‘Standardization of the United States Government Industrial Classification originated in a recommendation on the subject made at an Interdepartmental Conference on Industrial Classification held in 1934. This recommendation, which was transmitted to the Central Statistical Board, suggested that there should be established continuing committee machinery to

- explore the problems of industrial classification of statistical data.' See E Pearce, 'History of the Standard Industrial Classification', 10 Jul 1957, www.census.gov/epcd/www/sichist.htm (accessed 9 Sep 2011).
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- 61 Moyo, *How the West Was Lost*.
- 62 ONS, 'UK Standard Industrial Classification (UK SIC): Archive', Office for National Statistics, www.ons.gov.uk/ons/guide-method/classifications/archived-standard-classifications/uk-standard-industrial-classification-1992-sic92/index.html (accessed 15 Sep 2011).
- 63 Ibid.
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- 68 Accenture, *Reshaping the Business for Sustainable Digital Growth*, 2011, www.accenture.com/SiteCollectionDocuments/PDF/Accenture-Entertainment-High-Performance-Study-2011.pdf (accessed 9 Sep 2011).
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- 76 DCMS, *Creative Industries Economic Estimates (Experimental Statistics)*, full statistical release, 9 Dec 2010.
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The creative industries are the UK's 'Cinderella sector'. While the economy is currently growing at a snail's pace, there are very few conventional policy levers left for politicians to pull. One of the economic sectors with the greatest potential for growth is the creative industries – which include the music, fashion, video games, radio and TV production, and advertising industries.

But this success is put at risk by a combination of disinterest and misunderstanding. There is a persistent prejudice that the sector is inherently risky; that creative entrepreneurs are only in it due to their passion, not their business sense. This myth is dispelled in this pamphlet, which demonstrates that on average, creative enterprises are more likely to still be in existence after five years than other businesses. Their disadvantage is compounded by the Government's myopia towards the sector. The system of SIC codes in economic reporting neglects the creative industries, leading to a lack of reliable information and sound policy for the sector.

Risky Business argues that a first step for government should be to develop a better understanding of the creative industries, through dedicating more civil servants to the sector and regularly publishing data on trends within it. This will help to encourage both appropriate policy and private sector investment, allowing the creative industries to realise their potential and make their maximum contribution to the UK's economy.

Helen Burrows and Kitty Ussher are Demos associates.

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