Dr Martin Smith, Visiting Fellow in Creative Industries, Goldsmiths, University of London—further supplementary written evidence (CRF0069)

House of Lords Communications and Digital Select Committee inquiry 'A creative future'

Supplementary note of evidence arising from the Committee's second session of 8 November 2022

1. Lord Vaizey's question on investment models

What international examples are there of policy interventions or cultural environments that help creative businesses access investment and scale up? What could the UK learn from these?

The 'route to scale' challenge in the creative industries has been endlessly discussed within industry: it is a tricky set of issues which arguably requires an enquiry of its own, so complex and intertwined are its elements. The overwhelming predominance of micro-businesses employing four people or fewer (*ie* smaller than SMEs as formally defined) is one of the most striking features of the sector and the trend is towards even less scale and more atomisation.

Three explanations may be offered, at least by way of working hypotheses (research in this area is regrettably thin). First, many entrepreneurs split away from existing businesses to 'do their own thing' when they have become experienced: they seek creative and business autonomy and control of contractual conditions and life-style. Being a small producer, even if only for hire by larger companies, can deliver satisfaction and prosperity without the hassle of running a fully scaled enterprise. Producers who have experienced success with one or more 'hit' properties and have made money are often tempted to sell up and cash in – there is a long history of that in the UK. It may therefore be argued that there is an embedded lack of commercial ambition here, especially compared to the USA where the entertainment industries have always primarily been about *business* rather than life-style, and striving to achieve scale is in the bloodstream.

Second, there is a scarcity of specialist banks and fund managers, and therefore 'knowledgeable capital', within the UK's creative sector, broadly defined, and especially outside London (from an investment perspective it is foolish to suggest, as some do, that conditions for development are everywhere the same across the whole country), but that is also true of many other countries. Fund management in the 'creative industries' is difficult and fraught with risk (but note the crucial distinction between *content* and *services* businesses I drew in my written evidence).

There is a chicken and egg problem here: if few fund managers are capable of doing this work profitably and generating track records persuasive enough to enable them to raise new investment funds, whether institutional money or retail funds, the availability of capital outside 'the trade' is always likely to be limited. These issues - availability of specialist venture capital, business management skills, data access, business models and access to capital markets (Lord Vaizey explicitly referenced pension funds) - are fundamentally intertwined, very complex and demand serious scrutiny. There are no simple remedies.

Thirdly, and adjacent to the above, insufficient attention is paid to the issue of *investor-readiness*. Many companies which seek investment finance are, on close examination, not yet in good shape to deploy it effectively. They can be helped into investor-readiness through an iterative process of critical exchange, advice and reworking of business plans, but who is to do that and who is to bear the costs given that we no longer have regional development agencies? The LEPs are obvious candidates, but they vary hugely in capability, scale and resource.

One of the Committee's witnesses, representing the games industry, said that UK venture capital firms, which are also candidates for addressing the investor-readiness challenge and in a select few cases do currently play this role, are too slow to respond, but there is usually a good reason for that: move too fast and you are likely to lose your investors' funds. In the particular circumstances of the games industry business models change so fast that in order to move expeditiously you need very large amounts of capital so as to be able to sustain the inevitable losses. We are relatively weak in this department in the UK, but then so are many other countries.

Having regard to all of the above – and especially the distinction between content and services companies - I don't believe that it is possible or useful to generalise across so many very different creative sub-sectors: *games business is simply too different from, say, architectural practice or crafts or theatre or fashion to be able to make across the board observations (still less recommendations) without repeated qualification.* The domain in which the problem is greatest is the capital intensive 'audio-visual sector' – film, games and TV – to use older language, which has a long history of operating in the shadow of the USA (this is getting better, or worse, depending on your point of view).

The old chestnut of 'access to finance' is not a peculiarly British problem and may be said to be endemic to the creative industries for reasons related to their financial risk characteristics. It was, for example, as I said in oral evidence, addressed by the EU in 2016 in the form of a Cultural and Creative Sector Loan Guarantee facility backed by the European Investment Fund (EIF) in partnership with the Commission. It was rolled out in certain countries in partnership with selected banks, and 5,500 loans worth over EUR 935 million had been granted to more than 4,300 companies by the end of the programme, which, however, was heavily impacted by Covid in 2020. Note well that this is *loan* finance, not equity finance. I have not seen an independent evaluation of the results, especially as regards fund recoupment, which is critical to assessing success/failure.

In her oral evidence Professor Lee said that South Korea is experimenting with a public-private venture capital model, but that this is a relatively new development. This, I emphasise again, is a complex area of investigation – the role of specialist lenders, relations between cultural and financial markets, public-private partnerships and so on. To my knowledge there is no proven model to be followed in other countries, although we should be looking at European examples of co-investment strategies, as well as South Korea and perhaps other Asian models. *I respectfully suggest that this should be a Committee recommendation*.

There is too little curiosity in the UK about how other countries do things and, as Paul Owens of BOP Consulting noted in his oral evidence, a pervasive complacency about 'the UK model' and UK global leadership.

2. Film business data and emerging business models

I referenced the R&D funding problem in relation to the use of data in independent film and business models and the future commercial sustainability of this vitally important sub- sector. The expert in this area is my colleague Dr Michael Franklin Risk in the Film Business: Known Unknowns - 1st Edition - Michael Fra (routledge.com).[1] This challenge was first publicly articulated by Dr Franklin in 2018 in a report and business-supported seminar for the Institute for Creative and Cultural Entrepreneurship (ICCE) at Goldsmiths held with the participation of the British Film Institute (BFI) and the British Screen Forum (formerly BSAC).[2] The importance of this work was immediately acknowledged by the BFI in a subsequent report on the challenges facing the industry also published in 2018.[3]

The challenge has been for this field to secure innovation funding which would enable a Film Data Initiative to be developed by means of a rigorous, commercially focused process of research and development into demonstrator form – *ie* a form which would ultimately be capable of attracting industry buy-in *and ultimately financing itself*. DCMS officials, with the help of then creative industries' Minister, Margot James, pushed the funding proposal with HM Treasury but (as I understand it) narrowly failed in this attempt. Since 2019 the issue seems to have fallen off the departmental radar.

Other sources of funding are theoretically available, including the BFI and the research councils. The BFI has a very wide remit, much of it not industry focused, is cash-strapped and has very limited resources to commit to such work. This is relevant because in France, for example, in the face of the same challenge, work is being led by the equivalent public body, the CNC.[4] (I can provide the Committee with references to comparable work being carried out in other countries, including the USA and China, if of interest).

There is no doubt about the business case, or that this R&D work needs to be done if we are to stay competitive. See for example this excerpt from written evidence submitted to the Committee by the British Screen Forum (BSF):[5]

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1 https://www.routledge.com/Risk-in-the-Film-Business-Known-Unknowns/Franklin/p/book/9780367675301

2 Dr Michael Franklin's ICCE Goldsmiths research welcomed and cited by British Film Institute Commission on UK Independent Film – ICCE Staff Blog

3 BFI Commission on UK Independent Film | BFI

4 https://www.cnc.fr/web/en

…..for companies to attract investment, they need more data on what works and what has been done before. One of the biggest challenges for independent film producers in particular is that private investors are put off by the lack of data in the sector, which makes it hard for them to judge risk for business propositions.

Elsewhere, in a private paper the BSF has called for a mechanism which would:

…..facilitate access to data to allow investors to assess risk and to maximise revenue and profit throughout the value chain. ….this could be done through the creation of a UK Film Data Centre facilitating data exchange mechanisms observing differential privacy – preserving commercial confidentiality and improving aggregate insight across the whole value chain. This is motivated by the principle that for companies to attract investment, they need more data on what works and what has been done before. One of the biggest challenges for independent film producers in particular is that private investors are put off by the lack of data in the sector, which makes it hard for them to judge risk for business propositions. Data-driven analysis of this kind is facilitated by CNC in France and is routinely used by the major US studios. More widely available, technology-driven approaches such as this could help smaller British companies to strengthen their business plans and attract funding, helping them to scale globally over time.[6]

As regards Innovate UK, between 2018 and 2020 I was told repeatedly, but privately, by those in a position to know, that an R&D funding application on this topic would not be well received because it lay outside the organisation's terms of reference/work programme at that time. In these circumstances there was little point in making a formal application for funding. I have not attempted to review the situation since the pandemic broke out.

3. R&D tax credits

On the specific issue of widening the scope of the current R&D tax credit regime to bring it more closely in line with practice in other countries (the OECD principles and Frascati manual) the UK creative sector is united – from Creative UK to the Policy and Evidence Centre (PEC) and the AHRC. The Committee has received several written submissions in support of this proposal.

4. 'Creative R&D' more broadly

I want to make three linked points. First, for historical reasons there is a deeply rooted intellectual bias within part of the research funding establishment against 'creative' (meaning arts or culturally based) innovation and 'R&D' agendas insofar as they *pertain to industry, commerce and cultural enterprise* as distinct from more traditional areas of non-business related scholarly enquiry. This is no doubt partly down to the elusive nature of 'creativity' in fundamentally different settings, varying use of language and distinct research methodologies. But, simply put, from a broad economic perspective it is just as important for UK plc to find the next *Phantom of the Opera* and to help museums to grow their global online audiences and revenue streams as it is to transform the quality of car batteries.

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5 Written evidence submitted to the Committee by the British Screen Forum, p. 87.
6 *A Prospectus for Growth in an Age of Change*, British Screen Forum, July 2022.

The AHRC had zero interest in creative industries until circa 2008. Innovate UK came out of the Technology Strategy Board (TSB, established in 2004 and made independent in 2007) which similarly took no interest in the *cultural* economy or in 'cultural R&D' as I discovered through persistent and fruitless engagement over many years. The change of identity to Innovate UK was dates from 2014, but some habits die hard.

Secondly, I long ago concluded that too much research and development funding in the 'cultural' and creative industries space is framed without reference to the existing needs of industry. A recently announced £75.6m six year flagship R&D programme launched by the AHRC/UKRI, called CoSTAR, is instructive. It is explicitly addressed at the Metaverse technology agenda pushing out way into the future.[7] The case for funding this work is well made by its lead protagonists and Treasury clearly found the business case to be persuasive, but it is technology focused in concept and whilst it may well generate prodigious new future business opportunities it offers no promise of solutions to key *existing* business challenges, of which the Film Data Initiative outlined above is one clear example. We need more R&D funding *for industry*, driven by industry and framed by creative industries' existing needs.

Perhaps, therefore, we should consider a new Cultural and Creative Industries Investment Board/Fund replete with its own 'R&D' remit, possibly even one run on the lines of a public-private partnership (similar to the concept which Professor Lee referenced to the Committee in South Korea). This is certainly not a bonkers idea given that on some projections the global market for cultural goods and services will represent 10% of global GDP by 2030 and as an explicit objective of policy the UK will surely want to maximise its piece of that cake.

Thirdly, yes, there are other small existing pots of cultural 'R&D' money administered by arms' length bodies, including Arts Council England (ACE) and the BFI, and other sources of loan finance available for example from Creative UK. Although welcome and useful, they are all sub-scale and too small to make a significant long-term economic impact.

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[7] Enter the metaverse: Investment into UK creative industries – UKRI.