UK Film Council

Response To BIS Consultation:

Financing a Private Sector Recovery

This response is made on behalf of the UK Film Council

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Executive Summary

The UK Film Council is the lead agency for film in the UK ensuring that the economic, cultural and educational aspects of film are effectively represented at home and abroad.

The UK's Film industry acts as a flagship for the broader UK creative and media sector. It synthesises drama, design, performance, music and technology and successfully competes in a global marketplace, consistently delivering a positive balance of payments (an achievement that, other than the USA, few nations can boast) and generating interest, attention and broader economic benefits (e.g. in stimulating and maintaining tourism) for the UK.

Whilst these comments relate to the film industry, we believe they are highly relevant to many other industries in a sector that is almost as large as, and is growing faster than, the UK's financial services sector.

Unfortunately, because previous Government policy has relied too much on geography and size as the key metrics to define UK businesses, the needs of the Creative and Media sectors have been neglected, their access to appropriate finance has been constrained and their potential for growth, especially the potential to exploit digital technology to market and distribute content, has not been fully realised. This is not to say that the scale of typical businesses is irrelevant in forming Government policy or that Government Policy can't be delivered regionally. However, failure to take into account the differences between the industries and sectors that make up the UK economy and distinguish their respective abilities to compete internationally will limit the effectiveness of Government policy and prevent the UK Economy from achieving its potential for sustainable, profitable growth.

We therefore suggest that:

- A review, similar to the 'Dyson Review', is performed to examine the financing needs of the creative and media sectors.

Subject to this review, we believe that

- A sector specific instrument to promote the securitisation and monetisation of intellectual property

  And

- Sector specific funds (e.g. Enterprise Capital Funds) that combine private equity with public sector support and can understand and meet the needs of Film and other creative and media businesses

Are amongst the measures required for the UK film and similar creative and media industries to achieve their full potential for growth.

Comments On The Discussion Document

Small and growing businesses in the UK creative and media sectors are a vital part of the economic recovery and of the future prosperity of the UK. Employment in these sectors was growing at double the rate of the economy as a whole[i].

The UK Film Council endorses the view that, in order to continue growing, businesses need sustainable and secure sources of finances for investment and access to a more diverse range of sources of finance that suits their needs. This is particularly true of the UK's indigenous film businesses, at all points of the value chain from development of a film project to its eventual distribution, exhibition and broadcast.

Recent technological change, in particular the rapid development of the use of the internet as a means of viewing audiovisual content, represents a huge opportunity for UK based media businesses that have adequate resources to exploit it. However the short term impact of these changes had already started to disrupt and constrain the supply of finance to the UK's film industry before the onset of the credit crunch. There has been a marked increase in risk aversion on the part of investors since the global recession and a noticeable downturn in the budgets of UK independent films[ii]. Many UK film businesses have therefore been affected by a 'double whammy' at a particularly important time.

The extent to which current market failures may constrain access to finance for some film businesses risks their future, it is vital that an appropriate range of business finance is available for viable businesses as the economy recovers and new media markets continue to grow.

Film is a complex industry that the majority of financial institutions struggle to understand. Dealing as it does with the creation and distribution of intellectual property, it relies on providers of finance that understand how to value, securitize and monetise such property.

Yet there has been significant disruption to the provision of finance to the UK Film Industry in recent years, in particular a marked decrease in the number, scale and range of providers of debt to fund film projects. We believe the UK film industry, and the creative and media sector more generally, should be one of the sectors that the consultation document[iii] notes as being particularly vulnerable.

As noted in section 3.5, a dynamic, growing SME sector has the potential to make a significant contribution to economic growth. SMEs are a vital part of the UK economy and play an especially significant role in creative industries such as the UK Film Industry.

UK SMEs in general have experienced greater difficulties than their larger counterparts in accessing finance primarily due to the higher risk they represent. For SMEs in creative industries these difficulties have been particularly acute.

As noted in section 3.3, as SMEs suffer from long-standing challenges in accessing bank and equity finance they have historically been the main target of government action, but many of those interventions have not benefited the UK Film Industry.

The UK Film Tax Relief has proven to be an effective means of supporting the production of films in the UK, however this measure is not intended to promote investment in film businesses and often

serves merely to maintain the UK's ability to compete on equal terms in what is a fiercely competitive international market for individual film productions that offer significant benefits to the nations and regions that host them.

The Enterprise Investment Scheme (EIS) has proven a popular means of mitigating some of the downside risk of investing in individual UK film productions, though some of the qualifying criteria make it difficult to apply the relief to larger scale productions.

Aside from these measures, there is little evidence that measures adopted by previous Governments to stimulate and support the supply of finance to businesses in the UK have been effective in improving the supply of finance to UK film businesses.

For example, there is little evidence that Venture Capital Trusts, the Small Firms Loan Guarantee scheme, the Export Credits Guarantee Department or the Enterprise Finance Guarantee have benefited companies in the UK Film Industry.

Whilst the UK Film Tax Relief and the EIS are valuable means of supporting individual film productions, there has been negligible effective support to broaden access to finance for the production of slates of films, the domestic distribution and international distribution of films made in the UK or the growth of the corporations that finance, produce, export and distribute UK films; essential building blocks of a successful UK film industry. Because of the specialist nature of the industry and the complex risk profile associated with investment in it, UK Film businesses struggle to raise the finance they need to grow. The 'equity gap' facing UK Film SMEs appears particularly wide and public sector investment in film businesses, as opposed to film projects, is nugatory.[iv]

As a result, a greater proportion of SMEs in the UK Film Industry than in the UK economy generally do not use formal sources of external finance at all and are forced instead to rely on retained earnings or personal finance to fund investment and grow their business.

Unfortunately these constraints on the supply of finance to the UK Film Industry, like the needs of the Creative and Media Sectors generally, have not been identified or analysed by previous Governments. To date, Government vision appears to have been blinded by a two dimensional view of the role businesses in the UK economy play. Whilst there has been adequate consideration of scale and geographical location of businesses, the particular sectoral needs of businesses, SMEs in particular, have been ignored.

As recently as November 2009, when the Rowlands Review was published, Government policy towards SMEs has failed to gather adequate evidence of sectoral need before concluding on the needs of SMEs.

SMEs in the UK Film Industry, like many in the Creative and Media sectors, face global competition and face financing challenges that are unique to their industry. Many such businesses successfully compete in those global markets and substantial benefits accrue to the UK as a result[v]. There is significant potential for the UK to achieve greater benefit if these businesses are provided with appropriate support in accessing the finance they require to grow. Yet too often there has been an inherent assumption within Government that the needs of creative businesses competing in global markets for intellectual property can be met by measures designed to support domestic or regionally focussed businesses that employ, manufacture or distribute tangible goods.

This is not to say that the geographical location or size of individual businesses in the film industry is irrelevant to their needs, but the fact that they operate in the film industry and that industry is part of a broader creative and media sector is a far more important factor in determining their needs and should be the most important factor in determining how Government responds to those needs. We are also not suggesting that economic policy can't be delivered regionally or that it can't be improved by distinguishing between businesses of different sizes. However, unless it recognises the particular sectoral needs of creative and media businesses, economic policy will be inefficient at best and at worst will completely fail to meet the needs of those sectors, no matter how and where it is delivered.

Governments in other countries have recognised the need for sector specific support for industries that compete globally. For example, France provides 53 times the amount deployed annually by BIS via UKTI to support the export of films, Germany spends 29 times that amount and even Denmark spends 28 times the amount BIS makes available. The exporters of UK films are massively disadvantaged as a result.

We believe there ought to be a specific review chaired by a suitably experienced industry figure of the financing needs of the creative and media sectors of the economy similar to the review of hi-tech industries performed by Sir James Dyson.

Without such a review there appears to be a danger that this failure to account adequately for sectoral needs will continue; for example the consultation document notes 'evidence suggests that financing conditions have improved since the crisis, and that businesses generally are not experiencing severe financial constraints', we do not believe this is the case in the Film industry.

The effective disenfranchisement of large tranches of the UK's creative economy that this failure to analyse sectoral need leads to not only constrains the supply of finance, it distances businesses from the advice and acumen that is associated with investment.

This appears to be particularly true of equity investment in film businesses. Equity investment in film projects has often been provided by 'Angel' Investors, though there is evidence of a decline in the supply of this type of finance since the onset of the recession. Equity investment in film businesses by professional investors is much rarer.

Undoubtedly many Film SMEs are unfamiliar with equity finance and may not be investment ready. However, they are likely to continue to lack both the finance and advice associated with equity investment, compared to more mainstream sectors of the UK economy, without a Government supported measure to stimulate equity investment in film businesses. It is disappointing that the proposal in 'Creative Britain'[vi] to create an Enterprise Capital Fund able to cater for the needs of the UK's Film businesses has still not been adopted.

This is particularly disappointing given that this measure would support a market-led solution developed in conjunction with private equity partners that incentivised success rather than, as is the case with e.g. VCT's, operate to mitigate downside risk. We believe that measures like this meet the criteria for intervention as they would:

- Reflect a realistic expectation that it will successfully address a clearly identified market failure;

- Represent value for money for the taxpayer, and be affordable within the Spending Review envelope set at the June Budget;
- Be timely and time-limited, with appropriate sunset clauses and a clear exit strategy;
- Be compliant with state aids rules;
- Would not crowd out private provision or market solutions (We believe it would increase the attention and interest of private equity in further investment in the sectors it intended to invest in); and
- Would avoid introducing distortions elsewhere in the economy.

We believe the Government should be more proactive in shaping its policy for the creative economy, with a 'Dyson Review', an ECF and a measure to promote securitisation of i.p. for the film industry and the broader creative and media sector as core measures to help support their growth.

Other potential measures are discussed in the answers to the detailed questions overleaf.

Response To Questions

General Evidence Base-

1. Do you agree with the evidence base as set out in this paper? Are there any additional issues that should be considered?

As noted above, the current evidence base fails to account for the particular needs of the film industry and the broader media and creative sectors; parts of the UK economy offering significant growth and employment opportunities.

Certainty Over Frameworks

2. Do you think greater certainty over future tax and regulation would have a significant impact on current demand for or supply of business finance?

The Film industry is highly competitive and largely international in nature, as such certainty over future UK tax and regulation policy as it affects the film industry would have a significant positive impact on current demand for or supply of business finance to the UK film industry.

Equity Markets

3. Are there any regulatory obligations that may disproportionately deter SMEs from listing on exchange-regulated markets such as AIM and Plus Quoted? What can be done to address this?

We believe that the specialist nature of the Film Industry makes it more difficult for growing companies to access exchange-regulated markets in general and this effectively creates a gap in the provision of finance for those companies that is not currently filled by alternative sources of finance.[vii]

5. How can Government ensure that the best small businesses in all parts of the UK are visible to publicly backed venture capital funds? Should Government intervention to address the equity gap focus on the best firms regardless of geography, or seek explicitly to address regional economic disparities? The Government would be particularly interested in views on regional stock exchanges.

As noted above, Government has to date invested too much faith that regional economic policy can meet the needs of different sectors of the economy. More attention should be given to the possibility of creating sectoral stock exchanges and less to regional markets. We believe the potential of a creative and media sector stock exchange in the UK could have a transformative positive impact on the prospects for the UK's economy similar to the benefit the establishment of NASDAQ created for the US economy.

6. How can publicly-backed equity schemes and the Growth Capital Fund make more use of private capital in future? How could the scale and reach of publicly backed funds be improved? Are there any gaps within the portfolio? Does the potential model for the Growth Capital Fund meet the objective of filling a gap in the availability of funding for growth companies? Are there ways in which the potential model could be developed to improve its appeal to investors or its ability to make a material contribution to the funding of growth companies?

As noted above, we believe that only if the Government analyses needs and develops measures on a sectoral basis will high risk-high return sectors of the economy such as the UK Film Industry fulfil their potential for growth.

7. How could more high-net-worth individuals be encouraged to become Business Angels and participate in larger deals through syndicates? Are there specific issues impeding business angel activity that the Government should address, such as investor readiness or the structure of publicly-backed venture capital funds?

The current measures adopted by Government, for example venture capital trusts, encourage investment in generalist funds that tend to avoid investment in creative businesses, especially those that create content. We believe the ECF model is better suited to support investment in areas of the economy with specialised needs, such as Film.

8. How can eligible businesses help themselves to become 'investment ready' for equity finance? Where should this be done by private sector, market-led solutions? What role is there for Government in supporting this, and should intensive Government support be focussed on businesses high growth potential?

As above, we believe the establishment of sector specific funds, such as the ECF envisaged in 'Creative Britain' would act as models for investment in specific sectors and focus the attention of both investors and investees on what is required to stimulate investment and generate sustainable growth. The involvement of professional investors who are encouraged to develop sector specific experience will ensure that the financial and business skills of individual businesses and of entire industries are improved and deficiencies in business models and business practice are eliminated leading to a virtual circle of improved investment readiness leading to increased investment. This will not be achieved by the encouragement of generalist funds.

9. How effective are current tax incentives for equity investment in small businesses, such as the Enterprise Investment Scheme or Venture Capital Trusts?

As noted above, the EIS scheme has been a popular measure to support certain types of film projects. We believe the measure should be reviewed to evaluate the possibility of a Creative-EIS to broaden its use and make it more relevant to more types of investment in core content creation. This could relax some of the constraints that make it difficult to employ the measure to support productions that are intended to generate significant revenues from international markets. It could also introduce higher rates of relief for investment in businesses that take risks in creating or exploiting an intellectual property, with the relief clawed back from the super normal profits that some productions are able to generate.

As measures to stimulate investment in Film Businesses, as opposed to individual film projects, both VCTs and the EIS have largely failed to meet the needs of businesses in the UK Film Industry. Again, we believe a more sophisticated approach would be beneficial; with relief for VCT's and EIS' increasing to, say, 40% for businesses that are designed to invest in higher risk areas of the economy including core content-creating businesses such as film production.

There would seem to be no compelling rationale other than administrative convenience for the Government to limit itself to a 'one rate solution'. In practice this inflexible approach limits a high

risk/high reward investment in intellectual property such as a film production with potential for success on a global scale to EIS relief at 20%, whilst investment in low risk, tangible property backed businesses such as health clubs, pubs and hotels that do not bring revenue into the UK offer VCT investors the opportunity to mitigate higher rate income tax liabilities at 30%.

Debt Capital Markets

10. Are there any steps that industry, financial institutions or government could take to promote access to debt capital markets for a greater number of UK businesses?

As noted above the market for debt finance to support film projects has become severely constrained and existing measures to promote greater access to debt finance are inadequate to meet the needs of the film industry. Film businesses have traditionally struggled to obtain access to corporate debt, principally because of lenders preference for tangible assets over intellectual property as security for lending.

We believe these areas should be the subject of a specific review of the financing needs of Creative and Media businesses similar to the recent 'Dyson Revew'.

Competition

11. What more could be done to promote greater competition in the provision of business finance?

As noted above, we believe the establishment of sector specific funds such as the proposed ECF will act as models for further investment and thereby stimulate increased provision and greater competition.

12. What other actions could be taken to help businesses (of all sizes) access a wider range of different finance options?

We believe these areas should be the subject of a specific review of the financing needs of Creative and Media businesses similar to the recent 'Dyson Revew'.

Addressing Future Risks

13. Looking ahead, what are your views on future risks to the provision of business finance, in particular bank lending? If you have concerns, do these reflect transitional factors in the wake of the financial crisis, or structural factors? Are there steps that the banking sector, regulators or policy makers should be taking to mitigate these risks?

We believe the failure to account for sectoral needs can lead to false conclusions as to the future course of significant parts of the economy. We believe there is a significant structural factor (the uncertainty created by the use of the internet to consume film) that is constraining the supply of bank lending to the Film Industry. Structural factors like this are likely to be missed if the Government continues to prioritise region and scale as measures by which the finance needs of businesses are met.

Banking Sector Environment

15. What options might Government consider to support increased lending to business (including possible expansion of the EFG or of payments to part of the supply chain)? How effective is the EFG in increasing access to debt finance for small businesses? What could be done to improve it and can more cost be borne by users?

The EFG is ineffective in meeting the needs of Film businesses.

16. What steps would be beneficial in making securitisation more attractive to investors and a stable form of funding for lenders? Are there particular sectors or products that this should be focused on?

Whilst not wanting to pre-empt the findings of any equivalent of a 'Dyson Review' for the creative and media sectors, we believe that only if a sector specific initiative to promote the securitisation and monetisation of intellectual property is developed will those sector's potential for growth be realised.

This measure could operate to mitigate the downside risk of investment in individual projects and foster the development of experience and expertise in lending against intellectual property amongst the financial community by offering standby guarantees or similar instruments to approved institutions who demonstrate capacity to invest in intellectual property. The pricing could be designed to break-even across the portfolio of lending so that this 'lender of last resort' to the media and creative sectors would not require an annual grant from the Government. This model has proven to be invaluable in stimulating and maintaining the capacity of competitors to UK based creative and media businesses in other European countries whilst complying with EU state aid requirements.

International Trade

17. Are there significant constraints on access to trade finance for UK exporters? What measures could banks, industry or the government take to increase the availability of trade finance?

As noted above, the UK Film Industry successfully competes in a global market yet the measures promoted to date by Governments do little to support the provision of finance to the businesses involved in exporting UK Films.

Whilst not wanting to pre-empt the findings of any equivalent of a 'Dyson Review' for the creative and media sectors, we believe that only if a sector specific instrument to promote the securitisation and monetisation of intellectual property is developed will the film industry's potential for growth, in particular the opportunities presented by the 'digital age', be realised and exports maximised.

[i] Source; DCMS
[ii] The median budget of UK films (as defined by Schedule 1 of the 1985 British Films Act) was over £3 million in 2004 and 2005. Since then the median budget has fallen steeply to only £1 million. See UK Film Council Statistical Yearbook section 15.5 for more details.
[iii] See section 2.3.1
[iv] See e.g. the report 'Analysis Of The Corporate Finance Of SMEs In The UK Film Industry' commissioned and published by the UK Film Council in April 2010.
[v] In 2008 the value of UK film exports was over £1.3 billion, contributing to a trade surplus in film of £0.5 billion.
[vi] Published by the DCMS, February 2008
[vii] See 'Analysis Of The Corporate Finance Of SMEs In The UK Film Industry' for more details.