The financing of UK Creative Industries SMEs

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Technical Abstract

The study reports an indicative meta-analysis of existing data gathered for the purpose of stimulating company growth. Statistics are reported for a sample of Small- to Medium-sized Enterprises spanning several major sub-sectors of the UK Creative Industries regarding their use of debt, equity finance and business plans. The data suggest differences in these factors significant at the p=0.05 level between sub-sectors and between SMEs of different sizes, whether size is measured in terms of turnover or number of employees. It is concluded that Creative Industries SMEs are not homogeneous in their requirement for and access to finance, with needs and access varying according to both size and sub-sector.

Executive Summary

This study is based on data originally gathered from 635 UK Creative Industries SMEs for purposes such as giving them individual feedback and/or benchmarking. The dataset is comprehensive but has limitations in being truly representative of the full population. Nevertheless, we report here a statistical overview of patterns in that data, focussing in particular on the way that such SMEs finance themselves and some indicators of their attitudes to business planning.

We analysed the type of debt finance used across the sample, where it was used, and where we had explicit data to illustrate underlying patterns. In summary, for SMEs that used debt:

- Overdraft facilities were most popular (29.6%)
- 18.2% used equipment leasing / hire purchase
- 13% had equity finance
- 9.8% had long term bank loans
- 1.5% used invoice factoring

We inferred cross-correlations between groupings of SMEs. The statistics suggest with 95% confidence that:

- Use of debt to finance business varies significantly between different sub-sectors in the Creative Industries.
- Use of debt to finance businesses rises significantly with the size of SMEs when size is expressed in terms of turnover
- The culture of business planning appears to be significantly different between different sub-sectors in the Creative Industries.

Conclusions

1. Creative Industries SMEs cannot be considered as a block in terms of their requirement for and their access to finance. Generalisations about such issues are likely to be misleading.

2. SME needs for and access to finance in the Creative Industries vary according both to size, sub-sector, and their position in the value chain that stretches from creator to consumer.

3. We propose that the differences identified between SME subsectors can be explained in large part by the profound differences in their underlying business models.

4. We suggest that greater awareness of the need for business planning in SMEs could help to establish their credibility when seeking finance.

5. We propose that shifting the focus of public intervention in the sector away from start-ups and early stage businesses towards a group of SMEs which appear from our data to be 'stuck' at a turnover range around £300-400k might offer a better return on investment.

Context

This short-term study was commmissioned by the Access to Finance and Business Support Working Group, Creative Economy Programme, Creative Industries Division, Department for Culture, Media and Sport. It was executed by Burns Owens Partnership Limited ("BOP")and Pembridge Partners LLP ("Pembridge").

Acknowledgements

This study is based on data gathered for numerous individual business profiles and studies[1] executed by BOP and Pembridge through their joint-venture work to help boost the strength of UK Creative Industries[2] Small-to Medium-sized Enterprises[3] ("SMEs") on behalf of clients including: Northern Film and Media, Southwest Screen, Business Link for London, Screen Yorkshire, NESTA, Media Training Northwest, Skillset, the Music Industries Forum and the DCMS. The authors are grateful to these organisations and the individual SMEs who shared their intimate company data for permission to re-use that information anonymously.

Methodology

Pembridge and BOP have jointly developed a company profiling tool called Creative Company Profiling ("CCP") aimed at helping Creative Industries SMEs to grow. Since CCP development began 2003, over 600 SMEs have benefitted from using the tool or variants of it, which typically involves them submitting two years' audited accounts for analysis and participating in a standardised telephone-based interview lasting approximately 30 minutes. During the analysis of accounts and the telephone interview, around 50 quantitative data points were recorded for each participating SME together with qualitative data about each SME's vision, ambitions and the issues holding back its growth. Together this data represents a succinct but comprehensive picture of the state of that SME's commercial development. Each participating SME received an individual automatically generated report using that data to show its management team how it compares to its peers and where its Strengths, Weaknesses, Opportunities and Threats might lie, together with suggestions regarding how barriers to growth might be addressed.

This study represents a meta-analysis of selected data points for each SME drawn from the total database built up through CCP to date, specifically:

- Company Turnover
- Company Subsector classification
- Company Size (full time permanent employees)
- Has the company got a business plan?
- Has the company ever tried to raise equity finance?
- Does the company make use of debt finance?

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[1] A list of the programmes executed to make up the data set is included as Appendix A.

[2] DCMS Creative Industries Mapping Document 2001: The Creative Industries are 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, viz: Advertising, Architecture, Art and Antiques Market, Crafts, Design, Designer Fashion, Film and Video, Interactive Leisure Software, Music, Performing Arts, Publishing, Software and Computer Services, Television and Radio.

[3] For a definition, see European Commission Recommendation 2003/361/EC, 6 May 2003

Limitations of the data set

SMEs are included in this data set because they put themselves forward as being actively interested in growth, or because they were nominated as such by the public sector bodies that commissioned and subsidised the cost of the profiling. This means that extrapolation from the data is subject to several limitations:

1. The selection of participating SMEs is not random and cannot therefore be said to truly represent a balance of all UK Creative Industries SMEs. Rather the sample is biased towards those companies that actively want to grow.

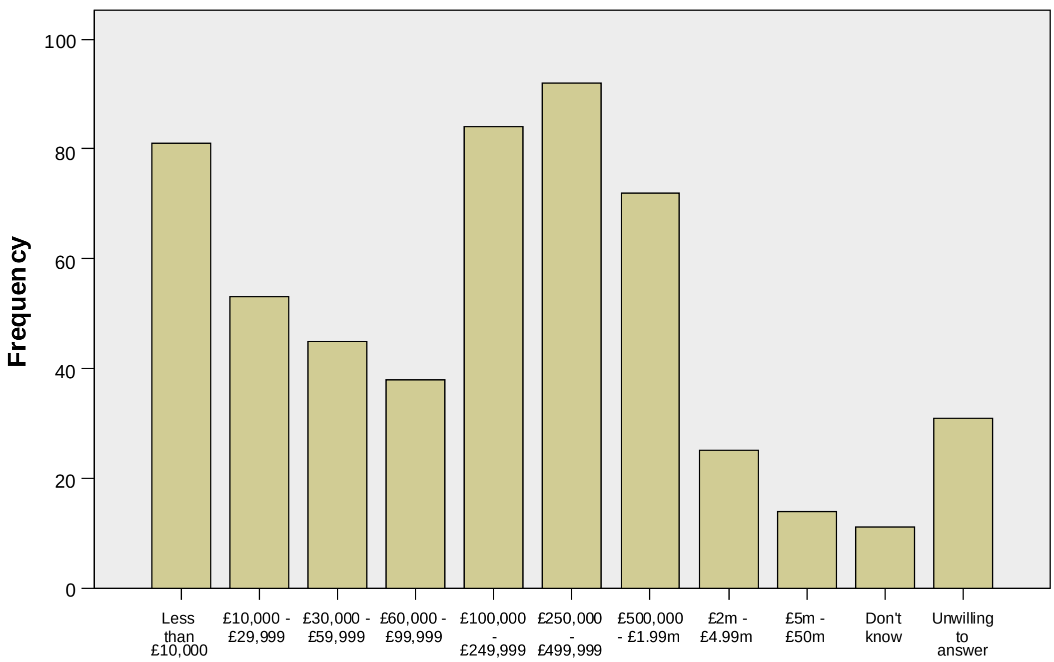
2. The sample does not reflect all sub-sectors of SMEs active in the UK Creative Industries equally. Rather the sample reflects those sub-sectors within the total population that public sector bodies perceive to offer the highest potential for growth.

3. While the questions asked in telephone interviews were generally standardised and consistent, a specific wording difference exists in relation to the working definition of debt finance between the music sector data and the rest of the sample. Music sector SMEs were asked whether or not they used debt finance within the last three years and equipment leases/hire purchase were excluded from the definition of 'debt', whereas the rest of the sample does include leases on equipment and hire purchase as an option and no time limit was given.

Overview of the sample

Figures 1-4 illustrate the breakdown of the sample respectively by turnover, number of employees, by Creative Industries sub-sector and age.

Figure 1 Sample SMEs banded by turnover (N=635)



Definitions of 'Small- to Medium-sized Enterprises' vary but typically exclude companies with more than £20m turnover. Figure 1 suggests that our sample generally fits most definitions of the category.

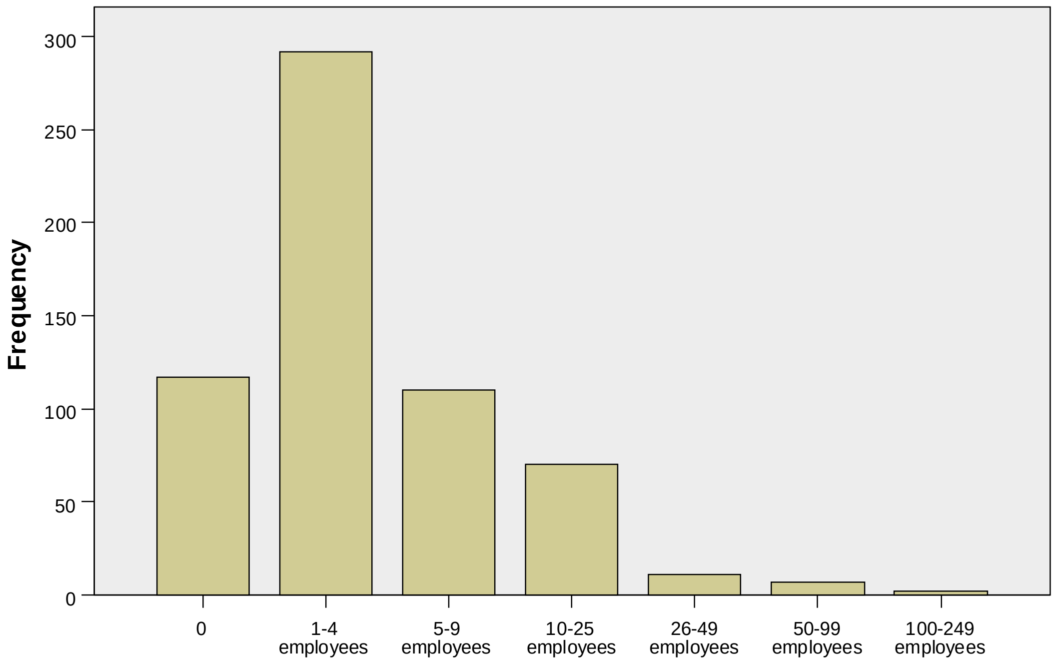
While the limitations of the dataset mean that it is not possible to generalise with statistical confidence about the total population of companies from Figure 1, we speculate that it may be possible to interpret it as two features superimposed:

- An underlying inverse power law-type relationship between number of SMEs in the sector and turnover, ie a large number of small, micro and startup businesses with a much smaller number of high turnover SMEs.

- Superimposed on that relationship, a peak representing SMEs that have reached a plateau around £3-400k turnover.

Further research with a randomised sample would be required to verify that these speculations are truly representative of the further population. However, they do concur with the anecdotal and undocumented experience of Pembridge in its business mentoring work with several hundred companies over five years.

Figure 2 Sample SMEs banded by number of full-time employees (N=635)



Most definitions of "Small- to Medium-Sized Enterprises" exclude those with greater than 250 employees. Figure 2 shows that our sample generally fits most definitions of the category and, on the basis of empirical evidence, we believe that the distribution of SMEs by number of employees is reasonably representative of the national population.

Figure 3 Sample SMEs banded by Creative Industry sub-sector (N=635)

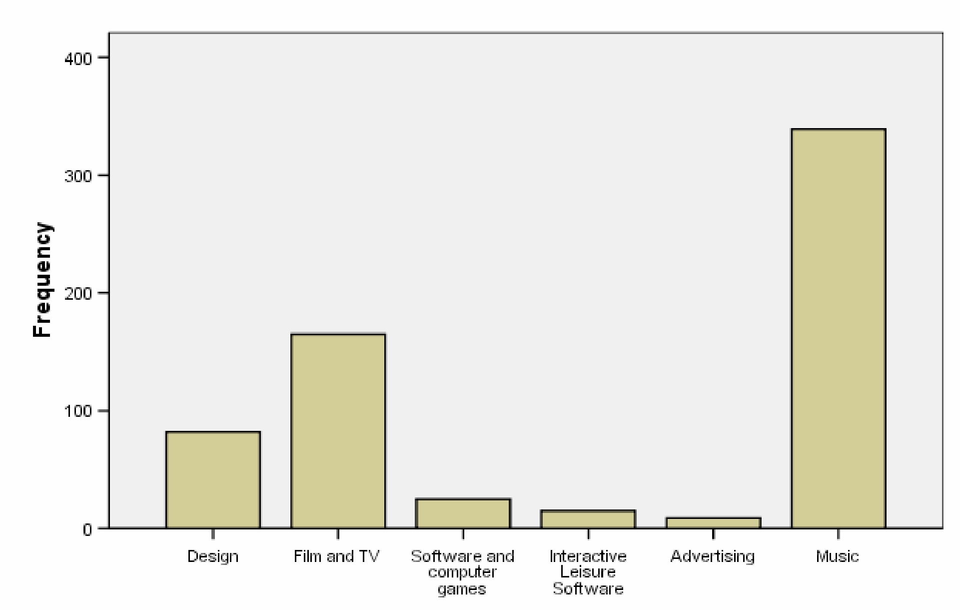


Figure 3 indicates that our sample is dominated by music, design and Film & TV SMEs and is not representative of the larger population of all SME sub-sectors.

Figure 4 Sample SMEs banded by Age of Company (N=635)

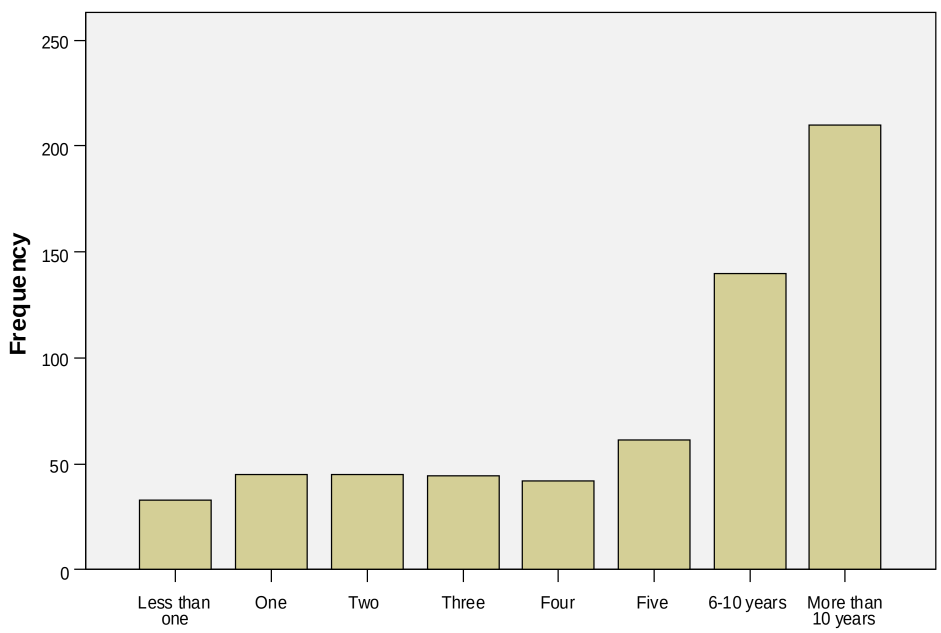


Figure 4 shows that the sample disproportionately represents mature SMEs. This is partly becaues our work with music SMEs drew in many that have been operating for more than 10 years.

Findings from questions asked of the sample

Tables 1-8 aggregate results across all sub-sectors in the sample.

Table 1 Do you use debt to finance your business? (N=635)

Yes	59.7%
No	40.3%

Use of debt appears widespread. It is hard to infer that there are major structural issues around access to debt finance in the sector overall

Table 2 Have you ever tried to raise finance for the business itself, as opposed to finance for an individual project? (N=296)

Yes	37.2%
No	62.8%

Around a third of businesses have tried to raise finance. We do not have data indicating why the remainder have not but our anecdotal experience of mentoring companies suggests that lack of ambition for growth in a significant number of SMEs may be a factor.

Table 3 Has anyone invested cash in your business in exchange for shares? (N=609)

Yes	13.3%
No	86.7%

Around 1 in 8 companies has secured external investment in return for equity. We infer from this that there is a significant proportion of the sector which was perceived as investment ready, though some of the investment indicated may be by directors rather than external investors.

Table 4 Does your business have an overdraft facility? (N=361)

Yes	29.6%
No	70.4%

Overdraft facilities are used by Creative Industries SMEs. The limitations of our data set make it difficult to infer whether or not there are structural issues around access to debt finance in the sector.

Table 5 Does your business use invoice factoring? (N=132)

Yes	1.5%
No	98.5%

The low use of invoice factoring suggests a lack of awareness of this method of financing amongst SMEs, or a perception amongst financiers in that market that businesses do not have the necessary level / volume / security of incoming cash to make such a facility work for both parties.

Table 6 Does your business have a long-term bank term loan? (N=132)

Yes	9.8%
No	90.2%

The relatively low uptake of structured long-term debt suggests either that SMEs do not perceive a need for such finance, or that banks may not perceive that Creative Industries SMEs can offer the security and serviceability required to make such a facility work for both parties.

Table 7 Does your business use equipment or lease finance? (N=132)

Yes	18.2%
No	81.8%

We suggest that uptake of equipment or lease finance is likely to vary significantly between subsectors because some (eg digital animation) require significant capital expenditure on physical equipment whereas others (eg public relations agencies) have relatively low requirements for capital expenditure.

Table 8 Do you have a business plan? (N=607)

Yes - a formal plan	35.9%
Yes – some ideas written but not formal	34.9%
No	29.2%

We suggest that the low use of business planning by SMEs in this sector may be a significant factor impeding growth.

Cross-correlation analysis

Our final stage of analysis sought to infer cross-correlations between groupings of SMEs. We report below the correlations that were statistically significant at the level p=0.05 (Chi-squared test), with the implication that we can be 95% certain these findings represent a true picture in the population represented by the sample.

Use of debt finance by different sub-sectors

Table 9 suggests that use of debt to finance business varies significantly between different sub-sectors in the Creative Industries.

Table 9 Have you any Debt Finance by Subsector (N=517)

		Debt?		Total
		Yes	No	
Design	Count	55	27	82
	% within Sub-sector	67.1%	32.9%	100.0%
Film and TV	Count	58	107	165
	% within Sub-sector	35.2%	64.8%	100.0%
Music	Count	31	239	270
	% within Sub-sector	11.5%	88.5%	100.0%
Total	Count	144	373	517
	% within Sub-sector	27.9%	72.1%	100.0%
	% of Total	27.9%	72.1%	100.0%

Use of debt finance by SMEs of different sizes

Table 10 suggests that use of debt to finance businesses rises significantly with the size of SMEs when size is expressed in terms of employee numbers.

Table 10 Have you any Debt Finance by Employee Size (N=433)

		Debt? Yes	Debt? No	Total
1-4 employees	Count	72	193	265
	% within employee band	27.2%	72.8%	100.0%
5-9 employees	Count	41	60	101
	% within employee band	40.6%	59.4%	100.0%
10-25 employees	Count	35	32	67
	% within employee band	52.2%	47.8%	100.0%
Total	Count	148	285	433
	% within employee band	34.2%	65.8%	100.0%

A similar picture emerges in Table 11 when SME size is expressed in terms of turnover, with businesses with higher turnover more likely to have debt finance.

Table 11 Have you any Debt Finance by Turnover Size (N=416)

		Debt? Yes	Debt? No	Total
Less than £10,000	Count	12	55	67
	% within turnover band	17.9%	82.1%	100.0%
£10,000 - £29,999	Count	5	40	45
	% within turnover band	11.1%	88.9%	100.0%
£30,000 - £59,999	Count	6	36	42
	% within turnover band	14.3%	85.7%	100.0%
£60,000 - £99,999	Count	7	27	34
	% within turnover band	20.6%	79.4%	100.0%
£100,000 - £249,999	Count	24	52	76
	% within turnover band	31.6%	68.4%	100.0%
£250,000 - £499,999	Count	30	50	80
	% within turnover band	37.5%	62.5%	100.0%
£500,000 - £1.99m	Count	37	35	72
	% within turnover band	51.4%	48.6%	100.0%
Total	Count	121	295	416
	% within turnover band	29.1%	70.9%	100.0%

Prevalance of Business Planning

Table 12 suggests that the culture of business planning appears to be significantly different between different sub-sectors in the Creative Industries.

Table 12. Have you a Business Plan? by Subsector (N=558)

		Business Plan?			Total
		Yes - a formal plan	Yes - some ideas written but not formal	No	
Design	Count	38	26	18	82
	% within Sub-sector	46.3%	31.7%	22.0%	100.0%
Film and TV	Count	67	58	40	165
	% within Sub-sector	40.6%	35.2%	24.2%	100.0%
Music	Count	90	111	110	311
	% within Sub-sector	28.9%	35.7%	35.4%	100.0%
Total	Count	195	195	168	558
	% within Sub-sector	34.9%	34.9%	30.1%	100.0%

Conclusions

Creative Industries SMEs cannot be considered as a uniform block in terms of their requirement for and their success in gaining access to finance. Generalisations about such issues are likely to be misleading. Rather, the needs for- and access to- finance amongst Creative Industries SMEs vary according to size, sub-sector and their position in the value chain that stretches from creator to consumer.

The non-random nature of our data set limits the generalisations that can be made about the full population, but if our speculative interpretation of Figure 1 can be substantiated by further research, we suggest it may have significance for policy formation, specifically that:

a) the real challenge for growth in this sector is not start-ups or early-stage businesses, but established SMEs aged 3 years and older, stuck at the limits of a lifestyle model of working in the turnover range £300-400k, with perhaps 8-10 staff.

b) we suggest that the current focus of much public intervention on early stage and start-up businesses risks merely adding to this group of 'stuck' SMEs. Rather, the potential return on investment (in terms of gross value added to the national economy) could be greater if public intervention were focussed on helping that small number of the 'stuck' SMEs that are serious about growth to move onwards and upwards, because i) they have the foundations for growth in place, and ii) the number of SMEs required to be engaged is much smaller.

Appendix A

A list of BOP and Pembridge studies from which the source data set was drawn:

NESTA, Small/Medium/Large 2005

47 design businesses went through the CCP process over a four week period, 10 design businesses received intensive mentoring over a six month period

NESTA, Small/Medium/Large 2006

50 design businesses went through the CCP process over a six week period, 8 design businesses will receive intensive mentoring over a six month period

Media Training North West, Vital Statistics scheme 2004

20 Film & TV production companies went through the CCP process over a five week period

Skillset, Indie Business Development Scheme 2005/2006

92 Film & TV Production companies went through the CCP process over a seven week period

Northern Film and Media, Creating Success 2004

52 Film and Media companies went through the CCP process over a four week period

Skillset South East, Business Development Scheme, Interactive Media and Computer Games

18 Media and Games companies went through the CCP process over a two week period

Film London, Independent Cinema Business Development Scheme

4 Independent Cinemas went through the CCP process over a two week period

Cheshire And Warrington Creative Industries Network

15 Creative Services companies went through the CCP process over a four week period

DCMS – & the Music Business Forum

335 Music businesses directly answered questions from the CCP diagnostic online over a four week period