Money, Management and Growth
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Discussion Document: A Creative Industries Bank for London
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1.0 Introduction and Objectives

This session of The Mayor's Creative Industries Commission will focus on the role and potential of a dedicated equity fund for the Creative Industries sector in London. A model is presented here to introduce what is achievable and explore possible delivery mechanisms.

The aim, by the end of this session, is to decide firstly if a Creative Industries Bank is needed and, if so, to agree a 'plan of action' for establishing a targeted equity finance initiative and a complimentary investment-readiness programme for potential CI businesses. These issues should be considered in relation to the other intervention areas and cross-cutting themes of the Commission

1.1 Some Terminology…

It is helpful to be clear from the outset in the language we use. In discussing issues around finance, there are a number of terms that are often used inter-changeably but actually have quite precise meanings. For the purposes of this discussion, therefore, the following terms will be defined as follows:

- Funding: Generic term for the transfer of monies and resources from one party to another, with no immediate exchange of goods and services (i.e., not a transaction)
- Grants: Monies given to individuals, businesses and organisations with no expectation of repayment and usually based on an assessed need
- Bursaries: As above, but usually given to individuals and only in relation to a specific, time-limited project or activity
- Loans: A transfer made with the expectation of repayment and interest. Types of loan vary considerably, with 'soft' loans usually describing those with lower interest rates and more flexible repayment conditions
- Equity finance: Monies and resources transferred as an investment – normally in exchange for a stake (minority or otherwise) in the venture and the expectation of a financial return at some future point
- Financial Instrument: a method for transferring monies and resources – this can refer to a loan, grant etc, but also a process or organisation established for the purpose

2.0 The Case

2.1 A Finance Gap…

- There is gap in finance for the CI sector in London: grants, bursaries, micro-credit, 'soft' loans, commercial debt finance and project/revenue funding provide some coverage, with personal/family donations also important. However, there are considerable gaps from the bottom to the top of the 'ladder of finance provision' for the CI sector, with small-sale finance sporadic and geographically specific, and targeted equity finance often unavailable for talented CI entrepreneurs with significant growth potential.

- With appropriate investment, the CI sector has the potential to grow even faster than current rates of 8.5% (faster than any other sector in the London economy), yet the sector is presently 'under-invested' by the public and private sectors.

- Many growing CI businesses remain project-focused, unable to establish sustainable business capacity due to the lack of 'structure-focused' investment.

- More investment flows out of than into London each year, strengthening the case for the public sector investing in the Capital's fastest-growing sector.

- Public sector interventions in equity projects provide opportunities to underpin private investment with public guarantees – allowing investors to focus on the upside rather than downside.

- CI equity finance interventions in the West Midlands, Scotland, Finland and elsewhere have established workable models of intervention, although a London-focused initiative would require significant bespoke elements.

- Finance is only ever part of the 'solution', with business skills, structural issues and entrepreneurial standard more important.

2.2 Current Barriers to Creative Industries Equity…

- There is a general lack of investment-readiness among London's CI businesses – in knowledge of available finance and how to access it; in business and market development skills; in confidence; in ambition to grow; in size/capacity to merge; through a project rather than business-focused planning approach; and through a unwillingness to relinquish levels of ownership and business identity.

- Most CI sub-sectors are made-up of businesses that do not have the capacity to provide necessary deal flow for investors. An equity fund for the CI sector might need to be very targeted, both in terms of structure and its publicity, at the outset to ensure efficient gate-keeping and thus admissible levels of deal flow. Management from experienced venture capitalists will be essential here.

- There is a high level of investor reluctance to provide equity finance for the CI sector. This is due to the above factors, plus potentially high transaction costs; a lack of expertise in levering finance to the CI sector; a perceived lack of critical mass in CI businesses; the absence of a range of content-focused ideas/projects from individual CI businesses; insufficient CI businesses with proven 'track records'; long lag times in investment return; the absence of statutory, well-understood investment vehicles; low level understanding of the potential of the sector; fear of slow deal flow and few guarantees; too many public-sector-led 'restrictions'; the need for over-intensive post-investment 'hand-holding'; and thus an overall perception of risk.

- The CIs are characterised by high levels of risk and collaboration – whether it is in the development of original content, intellectual property transfer, creative and commercial partnerships and commitment to projects. Investors will need to engage with creative businesses and develop high levels of trust if they are to fully exploit the potential of the sector.

2.3 A Position in the Spectrum of Need and Support…

- An equity finance initiative for the CI sector has the potential to accelerate the growth and contribute to the sustainability of the sector, with good quality investment returns. Yet the intervention will be truly effective only in the context of a range of interventions, established as a system of support for the CI sector in response to a broad spectrum in need.

- Any Creative Industries Bank for London should therefore be closely linked with other Creative Industries Commission interventions and cross-cutting themes as part of a multi-focused approach to sectoral support.

- Although there are long-term structural and cultural impediments to CI growth in the UK, in part due to the absence of high quality entrepreneurial skills, creative production chain initiatives and property/cluster development interventions can help to raise CI business capacity towards equity investment-readiness levels.

- The CI Bank should be seen as responding to a specific need in relation to a range of other needs that if not addressed could render the CI Bank ineffective and irrelevant. These include the intervention areas being considered by the Commission, plus a range of CI support services, funding regimes, training programmes, supply chain initiatives, investment strategies and workspace projects that are implemented across London by a myriad of agencies, bodies and institutions.

3.0 The Basic Model: A Creative Industries Bank for London

The following is an outline of a CI Bank for London. Note that what is presented here is not a new idea – the LDA is already exploring various finance initiative options, and this is intended more as a starting point for discussing the feasibility and nature of a CI Bank. The size, focus, time-span, partnership configuration and supporting infrastructure should be considered in relation to what can be delivered through public sector investment and corresponding private sector leverage.

3.1 Size:

- A £10 million venture capital fund would be necessary (from the LDA and other potential partners, such as the DTI). A fund of this size is would improve deal-flow, delay the requirement of seeking roll-on funds, pay for high quality intermediaries and financiers, and provide complimentary support services (see below).

- Minimum investments of £200,000 provide a workable intervention level. Intermediaries supporting the CI Bank will have a fund-raising, signposting and gate-keeping role to ensure businesses that are unsuited to equity finance are catered for elsewhere in the 'spectrum of support'.

- It might be feasible therefore to invest in 20 CI businesses over 5 years. The greater the number, the greater the demand for development support and post-investment management support. This can be a deterrent to venture capitalists.

- Minority stakes will be encouraged but not statutory (this would be unworkable).

3.2 Time-scale…

- The CI Bank will run over as many years as possible, with a 3-5 year return period achievable. It is reasonable to expect returns in year 2, although this depends on target businesses and their 'investment readiness' at point of contact.

- The first year of the fund will focus specifically on investment-readiness and investor confidence issues. This process will continue throughout the lifetime of the fund.

3.3 Targets…

- The CI Bank will target CI businesses across London. An emphasis on the geographical, sub-sectoral and ethnic diversity of beneficiaries will deter many investors and could lead to a lower quality of venture capitalist. This in turn will diminish return. This is a central dilemma for a potential CI Bank.

- Intermediaries supporting the CI Bank should be charged with the responsibility of improving the investment-readiness of Black and ethnic minority (BME) led CI businesses, which are under-supported throughout the ladder of CI finance provision. This will not, however, in most cases lead to the attraction of equity finance.

- A sub-sectoral approach may be required at the outset, minimising intermediary costs by focusing on a narrow section of high growth and more investment-ready firms. It is anticipated that a small minority of high growth CI firms are suited to equity finance. Sub-sectors with most equity investment potential include new media and software (including games), music, film and fashion. Initial targeting may be through potential talent development initiatives proposed by the Commission.

- The CI Bank's position in the 'Spectrum of Support' will ensure that the development needs of non-investment-ready firms are addressed elsewhere.

3.4 Identity and Structural Position…

- The CI Bank will maintain an identity and structural position that is 'arms length' from public sector stakeholders to the extent that the fund must be managed by a panel of experienced venture capitalists with an acute understanding of the market potential of CI businesses, expertise in the leverage of venture capital for CI businesses, genuine embeddedness in private sector investment networks, and key investment-readiness know-how. This panel will report back to public sector investors, but it must not be 'squeezed' into deals.

- This panel will be supported by a team of intermediaries charged with establishing target CI businesses as 'investment ready' (see below).

- The CI Bank will have an identity that stands apart from its public-sector backers.

3.5 Investment Readiness…

- The CI Bank will be linked to an investment readiness programme led by the small, flexible and highly connected team, which will report to the venture capitalists. This will be complimentary to existing investment readiness programmes such as BLfL's 3-tiered 'Access to Finance' programme, 'ground-level' business support agencies and potential LDA CI finance intermediary initiatives. It will work very intensively with business planning, leadership, and market development; with an additional instructive role to encourage acquisitional mergers etc. where desirable.

- This complimentary investment-readiness programme will operate at 2 levels: capacity building/awareness raising for businesses that might be 'investable' in 2-3 years; and intensive 'fine-tuning' for businesses close to an 'investment ready' position.

- The CI Bank will be positioned to compliment The Commission's other intervention areas, to add value to, for example, Creative production chain initiatives.

3.6 A Campaigning Function…

- The CI Bank will be driven alongside a campaigning function, where CI businesses will be made aware of their 'investment-ready deficits' and recruited for bespoke investment-readiness support; and potential investors will be 'courted' to convince them of the investment potential of the CI sector. A significant proportion of the funds will be ring-fenced for this process. This is essential for establishing mutual trust between investors and 'invested'.

- 'Courting' interventions include the establishment of Partnering and Investment fora, where creative professionals are introduced to potential investors; gala events; award ceremonies and creative showcases.

- This will compliment broader CI showcase initiatives, such as those promoted through The Commission's focus on Creative production chains.

4.0 Key Questions for the Commission

- Should equity finance (as opposed to other forms of finance) be a priority for public investment, given the limited funds available, the high cost of establishing a targeted CI Bank, and the very small number of beneficiary companies?

- What is an achievable size for the CI Bank given available/potential public finance?

- How can the 'output agendas' of public sector investment be addressed without impeding the development of high quality, expert-driven intervention?

- Can high quality investments be brokered if the critical insights of experienced and specialist venture capitalists are compromised?

- Can a sufficient number of high quality propositions be brokered from businesses that are often project-by-project driven and without longstanding track records?

- How can investment-readiness processes be built into the CI Bank to ensure targeted gate-keeping and rapid deal flow?

- How can the CI Bank compliment other finance initiatives (and their investment readiness programmes) to ensure a coherent investment system and high levels of 'inclusion' for different CI businesses?