

A outline for three Pilot Programmes to develop connections between investment structures and the Creative Industries in Yorkshire

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This document is an overview of a longer report prepared for SYIF as a result of a piece of research into the opportunity for increased investment in the Creative Industries in the Yorkshire region and the developments that would be needed in order to bring CI and investment processes together to achieve the necessary deal flow for success. This overview may also be read in parallel with the summary of the recommendations which have shaped the three pilot ideas.

## Executive Summary

As the Creative Industries (CI) and the sectors and businesses within them continue to grow so does their need for appropriate sources of finance & investment. The South Yorkshire Investment Fund (SYIF) has recognised this need and whilst it has already provided finance to businesses such as Zoo Digital (over £900,000 in equity related and loan based finance) SYIF wishes to specifically address the finance needs of the Creative Industries in Yorkshire and Humber.

The Creative Industries in Yorkshire & Humber currently turn over some £11 billion which is generated by some 23,000 companies in the region (a 23% growth rate since 2006)<sup>1</sup>. Approximately 90% of these businesses employ less than 10 people. Whilst this is a common profile for the Creative Industries it is an uncommon sector profile from an investment perspective. However it is the growth and future potential which makes it a sector worthy of specific focus for investors going forward. Unlike many of the sectors which SYIF has worked with to date there are very few corporate financiers or advising

accountants firms who have specialist knowledge of the CI's and their needs. Furthermore the business and social networks of the CI's and the investors do not overlap at present so the benefits of investment and the returns this could achieve are simply not well known to any except the most specialist of investors. These are key reasons why investment in this sector has not grown thus far but need not be major obstacles to growth in deal flow going forward.

The Creative Industries are known for their rapid & iterative development processes, their use and progression of technology and their dependence on a highly skilled labour force. Whilst intellectual property has a role to play it is often not the foundation upon which a company is built. Creative companies are more commonly built around a creative process than a market opportunity in their early stages. The barriers to entry in many creative sectors are relatively low i.e. little is required in the way of manufacturing assets to get to market. Both the nature of the sectors in the Creative Industries and the processes & business models which they use mean that there is often little in the way of tangible assets. Once the creative entrepreneur starts considering profit rather than cashflow, growth rather than subsistence then they may start to review the customer base and USP and their position in the market.

These make for challenging investment conditions as the Creative Industries provide few of the normal opportunities for risk mitigation or security – no IP to sell off, no manufacturing assets to buy out and the competitive advantage being held in the heads of the employees.

In addition to this few Creative Industries entrepreneurs have worked for venture capitalist backed firms or have others in their network who've been through the investment process. The impact of this is

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<sup>1</sup> Quoted from 'The Creative & Digital Industries in Yorkshire & Humber: 1998-2006', prepared by BOP for Yorkshire Forward

that they are relatively unlikely to have witnessed the difference between businesses that have bootstrapped their way through growth vs. those who have taken in investment. It doesn't necessarily occur to creative entrepreneurs to look at investment finance as a possible growth route for their business, their network doesn't extend into it and they don't know how to articulate the investment opportunity in terms that would appeal to an investor. The Creative Industries are in this sense an immature investment market.

## Aligning the regional CI need with the investment criteria

The interviews with development organisations indicate that there is a increasing demand for structures which enable investment in those companies who have outgrown the project support funds and whose investment needs now run to hundreds rather than tens of thousands. The SME's at this level have already become familiar with the preparation of business plans and are better equipped to predict the likely return on investment that they could achieve. The larger equity and loan funds within the SYIF portfolio would be the most appropriate fit for these firms.

Whilst the microfinance & seedcorn areas are where the majority of new deals would come from in the Creative Industries in Yorkshire the new and growing area of work is the next stage on of larger scale investments. The interviews with development organisations made it very clear that there is one gap in particular which SYIF would be well placed to fill – companies with a turnover in the region of £250-750,000 who are on the verge of a significant growth spurt but who currently do not have the financial resources to make the investments necessary for growth. Investing in companies with this profile would fit well with Yorkshire Forward's strategic priorities, would marry

up with the outputs from more project based activities supported through organisations such as Screen Yorkshire and MELT and would match up with the focus of locally focussed organisations such as Creative Sheffield and Electric Works. The goal would be to invest in these firms so that they grow to the £1-3m turnover level where they would be more likely to be successful in bidding into framework agreements and other large project structures which would then help them support their own growth through the profits from larger contracts.

This regional CI growth opportunity is likely to yield SME's with a company profile which meets SYIF's investment criteria and, provided that SYIF works in collaboration with regional CI development organisations, SYIF can be confident that it will be able to access appropriate sector experts and non-exec directors to help assess and later manage investments made.

## Three Ideas to Pilot

Working more closely with the Creative Industries offers SYIF the possibility of increased deal flow with this growing sector and offers the Creative a missing piece of the puzzle which is needed for individual firms to expand. Whilst the main focus will be on growth stage SME's links into the earlier stage firms through microfinance opportunities also need to be built into SYIF's plans.

A single strand of activity is unlikely to reach enough of the businesses or development organisations and risks so three pilot activities are proposed:

- **A sector lead approach**
- **A geographically or space based approach**
- **A micro-finance approach**

The region has demonstrated a commitment to the screen based industries

over a number of years both through programme lead activities such as MELT and now 4IP but also through the strength of leadership of the sector bodies such as Screen Yorkshire. This means that the businesses in these sectors have had exposure to investment processes and are perhaps more investment ready than their counterparts in other sectors. It makes sense to build on this strength by working with key sector organisations such as Screen Yorkshire and Just B to assist those firms who've already benefited from project funds to prepare for a next round of investment in the firm itself. This pilot would target those companies who are already stable and sustainable enough to take in a combination of equity and debt investment which would be used to either take new products to market or to expand the reach of the sales & marketing operation.

There are a number of physical hubs for Creative Industries firms in the region such as the Media Centre in Huddersfield and the Workstation and Electric Works in Sheffield. Whilst the cost/sq ft and lease terms mean that the constituent businesses may vary dramatically between different hubs there is very clearly a sense of community in each cluster. Entrepreneurs benefit from being able to see how investment has assisted other similar firms in their growth. By working with a hub and the community of businesses associated with it SYIF can not only build local case studies but also leverage the word of mouth grapevine that operates in these micro-climates to identify potential investment clients. The main target would again be businesses who are ready for a significant growth spurt but need an investment in order to achieve their potential.

Both of these pilots would also benefit from the close and detailed knowledge that both sector development organisations and hub managers have of their client base.

This would help in the process of identifying investment ready businesses as well as in the assessment of risks and management of the ongoing relationship with investees.

If the first two pilots offer depth & focus the third offers breadth and easier access for SME's at an earlier stage of development.

Organisations such as CIDA and Inspiral interact with a very broad range of Creative Industries businesses across many sectors but in particular have working relationships with a large number of micro-businesses. They are therefore well placed to work with SYIF on the expansion of the reach of the micro-loan fund. The benefits in the short term would be to familiarise and prepare micro and small businesses with mechanisms of financing growth beyond the limited grant based approach. In the long term the building of a set of relationships with early stage, micro and small businesses would probably increase the deal flow of CI businesses into other fund areas within the SYIF portfolio.

Each pilot would have an agreed set of targets in terms of numbers of investments, profile of businesses etc. Each pilot would need to run for 2-3 years in order to embed it in the sector and deliver measurable benefit within the time scale of the pilot.

Whilst each pilot would be run separately there would of course be benefit in these being joined up activities and marketing them as such. Clearly it would make sense if all those involved in the pilots met periodically to discuss the challenges and successes to date and to exchange learnings from each pilot as it proceeds.