

“There’s a growing market for creative businesses who strive to innovate and combine creative excellence with commercial success.”

NESTA, the National Endowment for Science, Technology and the Arts, is working to transform the UK's capacity for innovation. We invest in all stages of the innovation process, backing new ideas and funding new ventures that stimulate entrepreneurship.

NESTA is the single most potent catalyst for innovation in the UK. Our strong evidence base helps to influence policy. Our partnerships and networks broker ideas across sectors, accelerating the process of innovation. Our pioneering models of investment are being adopted by organisations throughout the UK.

Underpinning our work is the fundamental view that successful innovation fuels long-term economic and social progress in the UK. It's an essential ingredient of our competitive edge in the global marketplace.

Foreword

Innovation increasingly occurs where science, technology and the arts meet. The UK's creative industries — from advertising agencies to video game developers — are a significant source of innovation for the UK economy, and have generated millions of pounds in revenue and thousands of new jobs. On one measure, these sectors account for eight per cent of the UK economy and employ more than a million people in over 110,000 businesses — this means that the creative industries are bigger than the financial services sector.

It is welcome that these sectors have received so much attention over the last ten years and that they have been promoted and supported by policymakers across the UK. The UK has led the world in its recognition of the importance of the creative industries, and has made a significant investment in their development.

This report is a commercial analysis of the UK's creative industries, and considers how well-placed these industries are to seize on the opportunities of a growing global market. It does not attempt to capture the cultural and social value of these industries. As it indicates, the future commercial potential of these sectors is immense, but so are the challenges that they face. The reason for this is simple: the global competition faced by the UK's creative businesses has increased alongside the growth in the opportunities in international markets.

This report is published during the Department for Culture, Media and Sport's Creative Economy Programme, which is examining the key drivers of productivity in the creative industries. This programme represents a valuable opportunity to ask difficult questions — of national policies, of the forms of investment and support provided by organisations such as NESTA, and of creative businesses themselves. It also requires us to consider the reality of the UK's creative industries as they are today — both the notable successes and the areas of vulnerability — and to consider the possible consequences of any complacency.

Perhaps most importantly, this requires the UK to be clearer about its ambitions for the creative industries, particularly its economic and commercial ambitions, and how these ambitions might be realised as we look forward to the next ten years.

This report is intended as a positive — but challenging — contribution to this process.

Jonathan Kestenbaum
Chief Executive, NESTA

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The UK has led the world in terms of developing the creative industries as a focus for policy, and there has been a rapid growth in initiatives across the UK

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Executive summary

The UK has a wealth of creative talent and the creative industries represent a significant part of our economy. In the past ten years, UK policymakers have led the world in recognising and supporting the creative industries, and these sectors have been seen as some of the success stories of the economy. A growing international market is there to be won by creative businesses that are willing and able to innovate. Some UK creative businesses are already exploiting these opportunities, but others need more help in order to do so. The UK's creative businesses have the potential for outstanding success, but a renewed approach to policy, one which focuses on innovation and growth, is needed in order to ensure the success of these sectors for the next ten years.

The creative industries matter to the UK

On one measure the creative industries constitute a larger part of the economy and employ more people than the financial services sector. The most recent estimates suggest that the creative industries account for eight per cent of the UK economy — a total of £56.5 billion. Exports by the creative industries contributed £11.6 billion to the UK's balance of trade in 2003. The UK has led the world in terms of developing the creative industries as a focus for policy, and there has been a rapid growth in initiatives across the UK to support the development of creative businesses.

The global market value of the creative industries increased from \$831 billion in 2000 to \$1.3 trillion in 2005. For example, global revenues from cinema admissions amount to \$25 billion, the same size as the market for computer and video games. Similarly, the world market for mobile music is expected to reach \$6.4 billion by 2009.

Policymakers from across national governments, and not just the traditional advocates for these sectors, need to concentrate on the opportunities and challenges facing these industries from an economic point of view.

The UK's creative industries need to be better placed to exploit these opportunities

Evidence suggests that there are reasons to be concerned about the current performance of these sectors, beyond the variations that result from the normal economic cycle. Over the past few years, employment has fallen in advertising, design, film production, games development, music and the visual and performing arts. For example, employment in advertising has fallen by more than 20,000 in just three years, from a high in 2001. This is a reflection of lower revenues and consolidation in these industries. In design, there has been a 31 per cent fall in turnover since 2000. Film production spending was nearly a third lower in 2005 than in the previous year (including international productions filming in the UK). The number of people working in games development has fallen by six per cent since 2000, despite the continued growth in the market.

Policymakers from across the UK need to ensure the development of a stronger evidence base on the creative industries to monitor the economic performance of these sectors and to identify cross-sectoral issues.

The UK's creative industries are facing increasing international competition

In particular, creative businesses and policymakers need to appreciate the scale of the competitive challenges now facing the sectors in the UK. From film production to design, new international centres for creative business are developing rapidly. These are challenging established businesses, including those based in the UK. UK television exports have fallen for the second year running (despite an overall increase since 1998). In design, overseas earnings have halved since 2001, while the value of exports in music, the visual and performing arts in 2003 was down 20 per cent from 2000. International competition is being supported and driven by policies that are often more ambitious than those in the UK. There should be no room for complacency among policymakers or in the creative industries themselves.

Three key issues need to be addressed across the UK's creative industries: the lack of scale of most businesses; difficulties in accessing markets; and a lack of innovation to cope with and exploit structural changes in these industries.

A renewed policy approach needs to have a greater clarity of purpose that focuses on commercial growth, in order to seize on the opportunities in international markets and respond to increasing international competition.

More creative businesses need to prioritise commercial growth

Many creative owner-managers take an "organic" approach to the growth of their businesses, by adding slowly to their customers and clients through the distinctiveness of their creative work. However, the purpose of creative business is to harness and exploit creativity in a commercial context and for commercial ends. Creative businesses in the UK need a greater awareness of business strategy skills and related core skills such as financial planning.

Business support services need to have a deeper understanding of creative businesses and the markets for creative products and services in order to help firms to develop core skills such as business strategy skills, financial planning and marketing. Such services will need to tap into the motivations of creative entrepreneurs and present business skills in a language and in a form that they will respond to. Furthermore, given the range of the support that is available, organisations such as NESTA should act as accessible gateways for creative businesses that are looking for public investment, support and development, and opportunities for networking.

More of these businesses need to grow into world class businesses that achieve significant international success and reach. Too many UK creative businesses have been unable to respond effectively and on a scale that ensures their survival and continued growth in the face of international competition. Policy and support initiatives across the UK need to include a stronger focus on how these types of businesses might be developed. This is not about picking winners. Rather, it is about being more responsive to the actual needs and ambitions of individual creative businesses, some of which do have a strong focus on achieving high growth and international reach.

A distinct system of targeted support for businesses with high growth potential should be developed. This could include the development of Creative Accelerator Funds across the UK to invest in and support these creative businesses. Organisations such as NESTA could help to develop, pilot and evaluate new approaches to investment, support and business development in the creative industries, especially for those businesses with high growth potential.

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International competition is being supported and driven by policies that are often more ambitious than those in the UK

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More creative businesses need to focus on commercial innovation

Creative businesses need to focus on commercial innovation if they are to respond to the challenge of increased global competition. This innovation includes moving into new markets and reaching new customers by exploiting skills and resources developed in existing markets, using digital technologies for distribution in order to bypass traditional distribution channels, and moving from producing to owning intellectual property.

There are many examples of UK creative businesses innovating in their strategies, processes and business models, developing and diversifying their markets and achieving greater growth and profitability. Although these examples are encouraging, the opportunities that exist for commercial innovation need to be better promoted and supported. In particular, there needs to be a much greater focus on the opportunities — and challenges — presented by digital technologies and the internet.

Trade associations and other organisations such as NESTA need to do more to identify and promote these forms of innovation amongst creative businesses. As an example of finding new markets and customers, such organisations could fund and support innovative projects to integrate outputs from the creative industries into products and services from other sectors. Furthermore, a foresight review should be conducted on the innovative exploitation of new technologies by the creative industries, in order to anticipate future trends.

The need for a more coordinated UK agenda for the creative industries

A renewed policy approach must drive an agenda of commercial innovation and growth in the UK's creative industries. This approach requires the better coordination of policy and practice for the creative industries at national, regional and local levels.

A UK policy forum for the creative industries could be useful in sharing best practice ideas and enriching the policymaking capacity for the UK's creative industries. For example, many valuable policy approaches have been developed in Scotland, Wales, Northern Ireland and across the English regions. It would benefit policymakers in UK central government and across the UK to learn more about these approaches, their effectiveness, and how they can be better integrated to present a coherent system of support.

At the same time, a renewed effort should be devoted to supporting the international distribution and marketing of UK creative products and services. This could involve public support for the development of stronger international distribution entities and networks in sectors such as film, television, and computer and video games, where a lack of scale has seriously disadvantaged UK creative businesses in accessing international markets. Furthermore, as part of the development of a stronger evidence base, a series of major reviews should examine access to markets in the different sectors.

The UK has the potential to be one of the most successful creative economies in the world by developing a coherent infrastructure to identify, develop and support future world class creative businesses. This would benefit the UK's creative industries as a whole, and our economy, society and culture as a result.

A growing international market is there to be won by UK creative businesses that are able to innovate and do not see any inherent conflict between creative excellence and commercial success. The ambition to win a greater share of this market will help to ensure that the UK becomes a creative hub for the world.

The creative industries matter greatly to the UK. This also means that the UK is more exposed than other countries to under-performance by its creative businesses

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Background to the report

This research was commissioned by NESTA, the National Endowment for Science, Technology and the Arts. The research was conducted by Burns Owens Partnership and Professor Justin O'Connor (School of Performance and Cultural Industries, University of Leeds) with the Creative Industries Development Service, Manchester. It is part of an ongoing research and policy agenda at NESTA into the commercial potential of the creative industries in the UK. NESTA's previous research has focused on private investment,¹ and how public sector investment and support schemes can better develop new creative businesses in order to provide new wealth and jobs for the UK.² This report takes the agenda forwards by investigating the commercial growth potential of the creative industries.

The UK has led the world in terms of developing the concept of the "creative industries" as a focus for policy.³ This emerged in the mid-1990s, and was first formalised here in the UK central government Department for Culture, Media and Sport's (DCMS) Creative Industries Task Force (from 1997-2000) and the two editions of the DCMS's Creative Industries Mapping Document in 1998 and 2001.⁴ Creative activities have increasingly been regarded as an important and fast-growing part of a modern knowledge economy rather than as essentially subsidised goods supported by arts funding bodies and cultural institutions. Most recently, the Cox Review has considered how best to enhance business productivity in the UK by drawing on creative capabilities, in particular the use made of creative skills by smaller businesses and especially in manufacturing.⁵ The most recent policy rhetoric towards the UK's creative industries in England has emphasised the international dimension, for the UK to become the "world's creative hub".⁶ Following the work in central UK government, there has been a rapid growth in initiatives across the UK to support the development of the creative industries, in order to ensure the greater economic exploitation of these sectors.

In Scotland, the Scottish Executive has proposed the creation of a new Scottish cultural development agency (Creative Scotland), in response to the Cultural Commission's of Review of Culture in Scotland.⁷ This agency would have a remit that includes the development of talent in all branches of the arts and screen industries, promoting effective sector networks, and developing a new strategy for the support for the creative industries. Cultural Enterprise offices were rolled-out from Glasgow to Aberdeen, Dundee and Edinburgh in April 2005, to provide support and business advice tailored more appropriately to the needs of creative individuals and micro businesses; their effectiveness will be evaluated before any further investment is made to extend their role. Scottish Enterprise differentiates between developmental or capacity building activity (through the Cultural Enterprise offices) and high growth activity (through the High Growth team, though this is not exclusive to the creative industries). Further, the Digital Media and Creative Industries Project Fund run by Scottish Enterprise is a project-based (royalty or revenue-based) co-investment fund which private sector investors can use to leverage public funds into large scale projects in film, interactive games, music, television and radio, and publishing.

In Northern Ireland, the Unlocking Creativity agenda has recognised creativity as a significant cross-cutting issue for government and has presented a coordinated strategy for the development of creative and cultural resources.⁸ This includes entrepreneurship and innovation in the creative industries (with a particular focus on digital content sectors) but also the role of education in supporting these. The adoption and launch of the document by four government departments demonstrated the emphasis on a coordinated approach across government. This has been accompanied by the Creativity Seed Fund to assist innovative projects across culture, education and commerce, and Dreamlab, a business development programme for a cluster of creative businesses. This agenda has had a strongly commercial element; Invest NI's targets have included an average 10 per cent growth rate among client creative businesses in key indicators such as turnover and export sales.

In Wales, the Welsh Assembly Government has emphasised the sustainable economic development of the creative industries, as part of economic development in Wales generally. Its strategy published in 2004 explained how the government intended to expand its portfolio of support to encompass the creative industries, and that this is focused on businesses rooted in the exploitation of creative intellectual property (IP).⁹ In particular this strategy emphasised that the creative industries in Wales need to be demand-led, producing more output attractive to UK and international markets, and more profitable, by retaining a proportion of their IP, investing in new products, and entering new markets. This strategy led to the £7 million Wales Creative IP Fund and a new strategic approach to providing business support for the creative industries including specialist support to Wales-based creative businesses. The new Wales Creative Industries' Support Service — the "Hub" — was implemented in December 2005.¹⁰

In the English regions there has also been a proliferation of schemes to support the development of and investment in creative businesses. However, as indicated by NESTA's previous research, many national and regional initiatives have had mixed objectives, including cultural and social outcomes such as regeneration and tackling social exclusion.¹¹ The focus now needs to return to the emphasis that was first set out in the DCMS's Mapping Document in 1998, that is, the ability of creative businesses to "produce wealth and jobs through the generation and exploitation of new intellectual property and content". The UK needs to ensure that policy for the creative industries provides the best possible framework for creative businesses to be as productive as possible.

Section one of this report investigates the current economic performance of the UK's creative industries, by focusing on six key sectors which are generally regarded as having the greatest commercial potential. Given the rather more vulnerable state of these sectors than is often assumed, section two then illustrates how the creative industries can ensure greater growth by providing examples of commercial innovation from selected creative businesses. Section three proposes a renewed policy approach towards the creative industries.

The research is based on a wide range of sources, including official government data, research and survey data from across the creative industries, and interviews with key informants (including creative entrepreneurs and industry representatives). Further explanation of the methodology for this research can be found in appendix two. A list of the organisations, businesses and schemes consulted for this research can be found in appendix four.

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The UK needs to ensure that policy for the creative industries provides the best possible framework for creative businesses to be as productive as possible
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1.National Endowment for Science, Technology and the Arts (2003), *Forward Thinking — New Solutions to Old Problems: Investing in the Creative Industries*, (NESTA, London).

2.National Endowment for Science, Technology and the Arts (2005), *Creating Value — How the UK Can Invest in New Creative Businesses*, (NESTA, London).

3.For example, the DCMS definition has been adapted by the United Nations Conference on Trade and Development (UNCTAD) High-Level Panel on Creative Industries and Development (held in 2004) and the International Forum on Creative Industries (held in 2005).

4.Department for Culture, Media and Sport (1998), *The Creative Industries Mapping Document 1998*, (DCMS, London); Department for Culture, Media and Sport (2001), *The Creative Industries Mapping Document 2001*, (DCMS, London). For background, see Department for Culture, Media and Sport (2002), *Creative Industries Fact File*, (DCMS, London).

5.HM Treasury (2005), *The Cox Review of Creativity in Business: Building on the UK's Strengths*, (HM Stationery Office, London).

6.Department for Culture, Media and Sport (2005), *Making Britain the World's Creative Hub*, Speech by James Purnell MP to the Institute for Public Policy Research, London, 16th June, (DCMS, London).

7.Scottish Executive (2006), *Scotland's Culture: Scottish Executive Response on the Cultural Review*, (Scottish Executive, Edinburgh); Cultural Commission (2005), *Our Next Major Enterprise*, Final Report of the Cultural Commission, (Scottish Executive, Edinburgh).

8.Department of Culture, Arts and Leisure (2000), *Unlocking Creativity — A Strategy for Development*, (DCAL, Belfast); Department of Culture, Arts and Leisure (2001), *Unlocking Creativity — Making it Happen*, (DCAL, Belfast); Department of Culture Arts and Leisure, Department of Education, Department for Employment and Learning, Department of Enterprise, Trade and Investment, and Invest Northern Ireland (2004), *Unlocking Creativity — A Creative Region*, (DCAL, DE, DEL, DETI, Invest NI, Belfast).

9.Welsh Assembly Government (2004), *Creative Success — A Strategy for the Creative Industries in Wales*, (WAG, Cardiff).

10.Welsh Assembly Government (2005), *The New Wales Creative Industries' Support Service*, (IWAG, Cardiff).

11.National Endowment for Science, Technology and the Arts (2005), *Creating Value — How the UK Can Invest in New Creative Businesses*, (NESTA, London).

1. The state of the UK's creative industries

The creative industries matter to the UK. The UK has a wealth of creative talent and the creative sectors represent a significant part of the economy. The creative industries are also key sectors for innovation, in terms of producing new ideas, designs, business models and ways of working. However, while there are notable success stories, a more evidence-based approach to the state of the UK's creative industries needs to be adopted. This section of the report investigates the current economic performance of the UK's creative industries, by focusing on six key sectors that are generally regarded as having the greatest commercial potential. The evidence suggests that these sectors are in a more vulnerable state than is often assumed. In particular, these sectors are under pressure from increasing international competition.

1.1 What are the creative industries?

The term "creative industries" includes a diverse range of businesses in sectors that are commonly thought of as being quite distinct from each other. According to the definition established by the DCMS, the creative industries include the following sectors: advertising; architecture; the art and antiques market; crafts; design; designer fashion; film and video; interactive leisure software (such as computer games); music; the performing arts; publishing; software and computer services; and television and radio.¹² The DCMS definition suggests that businesses in these sectors share a common foundation: they rely on individual creativity and imagination allied with skill and talent, and produce wealth and jobs through the generation and exploitation of new intellectual property and content.¹³ This definition has been useful in reinforcing the importance of these sectors for policymakers and others, especially their economic importance, and in challenging the traditional forms of policy intervention in support of arts and culture (typically, through subsidies and grants).

1.2 How important are the creative industries?

The creative sectors are of great importance to the UK. The most recent UK government estimates suggest that in 2003 these sectors accounted for eight per cent of Gross Value Added (GVA)¹⁴ — a total of £56.5 billion — and that between 1997 and 2002 the creative industries grew by an average of six per cent per annum, compared to three per cent for the economy as a whole.¹⁵ In 2004, there were an estimated 113,000 creative companies and total employment in creative occupations exceeded 1.8 million.¹⁶ Exports by the creative industries contributed £11.6 billion to the balance of trade in 2003, which equated to 4.1 per cent of all goods and services exported.¹⁷ Compared to the financial services sector in the UK, the creative industries constitute a larger part of the economy and employ many more people (although the financial services generate more in export earnings).¹⁸ Such figures need to be subjected to further analysis (see appendix three). Yet they are sufficiently impressive for the UK central government Minister for Creative Industries to have declared that the UK is "...arguably the world's most creative nation".¹⁹ This has an important implication that is often overlooked. This is that in relative terms the UK is more exposed than most other countries to any commercial under-performance by its creative businesses.

12. This is the definition that was adopted by the Creative Industries Task Force and used in the first UK national mapping exercise in 1998, Department for Culture, Media and Sport (1998), *The Creative Industries Mapping Document 1998*, (DCMS, London).

13. p.4, Department for Culture, Media and Sport (2002), *Creative Industries Fact File*, (DCMS, London).

14. GVA measures the contribution to the economy of each individual producer or sector.

15. Department for Culture, Media and Sport (2005), *Creative Industries Economic Estimates — October 2005*, (DCMS, London).

16. Ibid. Note that the employment figures for creative occupations relate to Great Britain only, that is, they do not include Northern Ireland.

17. Ibid.

18. The UK financial services sector in 2003 accounted for 5.3 per cent of GVA, employed more than one million people, and generated £20 billion in exports (7.2 per cent of total UK goods and services exports combined). These figures increase considerably if other services closely associated with financial services are included, such as management consultancy, legal and accountancy services. See HM Treasury (2005), *The UK Financial Services Sector: Rising to the Challenges and Opportunities of Globalisation*, (HM Stationery Office, London).

19. Department for Culture, Media and Sport (2005), *Making Britain the World's Creative Hub*, Speech by James Purnell MP to the Institute for Public Policy Research, London, 16th June, (DCMS, London). Similarly, Lord Sainsbury of Turville has stated that: "The creative industries in the UK are a great success story", see Department of Trade and Industry (2004), *London Design Festival*, Speech by Lord Sainsbury of Turville, 21st September, (DTI, London). Also, Gordon Brown has said: "Today the dynamism of British business is leading the world in many of the most modern and creative industries", see HM Treasury (2005), Speech by the Rt. Hon. Gordon Brown MP, Chancellor of the Exchequer, at the Advancing Enterprise Conference in London, 2nd December, (HM Treasury, London).

This analysis investigates the current commercial performance of six creative sectors: advertising; design; film; music; television; and computer and video games. These sectors have been chosen because they are commonly regarded as having the greatest commercial potential, especially in the context of digital distribution. This analysis includes the most robust and reliable data from the growing body of research and analysis on the creative industries. However, it can only represent an informed snapshot of these sectors. There are of course cyclical variations to which any sector is subject. This analysis attempts to recognise these variations while at the same time asking more critical and fundamental questions about the health of the UK's creative industries than has been the case in most previous analyses.

1.3 A growing market for the creative industries

Any claims for the success of the UK's creative industries need to be seen within the context of a growing market for culture and creative products and services. This growth has occurred as a result of long-term socio-economic trends including the deregulation of national cultural and media policies, technological change, expanding international trade, increased prosperity, greater leisure time and higher levels of education, rather than just the excellence of the UK's creative industries.

The average amount spent on leisure goods and services each week by UK households has increased by over two and a half times from £27 in 1976 to £71.40 in 2000-01 (in 2001-02 prices), from 10 per cent to 18 per cent of total household expenditure.²⁰ At an international level, the rapid (albeit unevenly distributed) growth in the world economy has had the same effect. The creative industries represent some of the fastest growing sectors of the global economy. It has been estimated that the global market value of the creative industries has increased from \$831 billion in 2000 to \$1.3 trillion in 2005²¹ (or more than seven per cent of global gross domestic product²²). It would be very odd if an economy as stable and mature as the UK had not witnessed a growing demand for creative goods and services, and if this demand had not been met in part by domestic businesses. What requires investigation is the extent to which the UK's creative industries have been able to exploit these opportunities in domestic and international markets.

1.4 Advertising

The advertising industry in the UK is in an uncertain state. It has weathered difficult cyclical conditions but it has still to decide how it will cope with some major structural pressures that are likely to change the nature of the industry forever.

1.4.1 The UK as a world leader in advertising

Advertising is one of the largest and most successful of the UK's creative industries. As a sector it has grown faster than national GDP for virtually every year of the last quarter of the twentieth century. Advertising expenditure was £11.23 billion in 2004²³ and 200,000 people work in advertising as a whole.²⁴ London is acknowledged as one of the three global capitals for the industry (along with New York and Tokyo). London has often been used as a base for targeting pan-European and global markets, with two thirds of all international agencies having their European headquarters in the city.²⁵ Table 1 (overleaf) indicates the creative strength of UK advertising worldwide. The table is based on the number of awards won at international industry competitions. UK advertising agencies occupy half of the top ten places.

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The creative industries represent some of the fastest growing sectors of the global economy
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20. Tables 6.1-2, Office for National Statistics (2003), *Family Spending, A Report on the 2001-02 Expenditure and Food Survey*, (HM Stationery Office, London). More recent figures on household spending on "recreation and culture" are available but these are not directly comparable to figures before 2000-01. This is because a new coding frame for expenditure items for the Expenditure and Food Survey (EFS) was introduced in 2001-02. The most recent figures suggest that spending on leisure continues to increase, to £59 a week in 2004-05. See Office for National Statistics (2006), *Family Spending, A Report on the 2004-05 Expenditure and Food Survey*, (Palgrave Macmillan, Basingstoke).

21. United Nations Conference for Trade and Development (2004), *High-Level Panel on Creative Industries and Development*, UNCTAD XI, (UNCTAD, Geneva, Switzerland).

22. Yusuf, S., and Nabeshima, K. (2003), *Urban Development Needs Creativity: How Creative Industries can Affect Urban Areas*, Development Outreach, (World Bank Institute, Washington DC).

23. That is, the total advertising media spend by businesses and the public sector, rather than the total of advertising agency revenue.

ZenithOptimedia (2005), *Advertising Expenditure Forecasts 2005*, (ZenithOptimedia, London).

24. Department for Culture, Media and Sport (2005), *Creative Industries Economic Estimates — October 2005*, (DCMS, London).

25. Department for Culture, Media and Sport (2001), *The Creative Industries Mapping Document 2001*, (DCMS, London).

Table 1: Agencies ranked by creative prizes won worldwide (1999-2003)

Rank	Agency	Points
1.	Wieden & Kennedy (US)	165
2. =	Dentsu (Japan)	150
2. =	Abbott Mead Vickers BBDO (UK)	150
4.	BMP DDB (UK)	148
5.	Lowe (US)	116
6.	Bartle Bogle Hegarty (UK)	107
7. =	Arnold Worldwide (US)	106
7. =	Saatchi & Saatchi (UK)	106
9.	TBWA London (UK)	101
10.	Fallon (US)	100

Source: Flaxman Wilkie.²⁶

Advertising has also had a substantial impact on other creative sectors in the UK. It is a major driver of the creative industries as a whole, since the advertising industry supply chain includes activities such as graphic design, audio-visual production and interactive media (which are to a significant extent dependent on its continued success).

1.4.2 The downturn in advertising

Despite this history of success, more recent years have seen a decline in the industry. This began in 2000 as a result of the dot.com crash, and was followed, in the wake of international tensions, with a widespread fall in consumer confidence. According to the latest figures, advertising's contribution to national GVA has been declining steadily since 2000, from £6.1 billion in 2000 to £5 billion in 2003.²⁷ Employment in advertising has fallen by more than 20,000 in just three years, from its high of 220,500 in 2001.²⁸ This has been accompanied by a drop in the number of businesses from 10,600 in 1996 to 9,800 in 2004. The UK advertising industry's reputation for creative excellence has been founded in part on the strength of the domestic market for advertising (the UK is the fourth largest advertising market in the world in terms of expenditure after the US, Japan and Germany). As table 2 shows, this domestic market has declined in real terms over the last few years (despite an improvement in the last recorded year).

Table 2: Advertising expenditure in the UK (US \$ billion at constant 2004 prices)

Year	2000	2001	2002	2003	2004
Expenditure	20.945	19.666	19.375	19.352	20.575

Source: ZenithOptimedia.²⁹

26. Flaxman Wilkie (2004), *The Gunn Report for Media 2004*, (Flaxman Wilkie, London).
 27. Department for Culture, Media and Sport (2005), *Creative Industries Economic Estimates — October 2005*, (DCMS, London).
 28. Ibid.
 29. ZenithOptimedia (2005), *Advertising Expenditure Forecasts 2005*, (ZenithOptimedia, London).

This decline can be explained in part by general economic trends. Advertising has always been highly sensitive to the economic cycle. The considerable expansion in the sector in the late 1990s was closely associated with comparatively strong economic growth. The sector was always likely to be adversely affected by slower economic growth, and the correction in consumer spending, private investment and the UK equity markets in the early part of the twenty-first century.

1.4.3 Factors affecting growth

However, the advertising industry also faces some major structural pressures and considerable uncertainty as a result of audience fragmentation and new media technologies. This means that advertising agencies can no longer make the same kinds of assurances that they once did to their clients about reaching target audiences, in particular to clients who want to reach very broad audiences. This has particularly affected television advertising, and is especially important because television accounts for more than one third of all advertising spend. Television advertising revenue has declined sharply since 2000.³⁰ Television advertising had 310 billion "impacts" in 2004, down from over 350 billion in 1991 ("impacts" are single viewings of advertisements as reported by the Broadcasters' Audience Research Board, which measures in-home television viewing in the UK).³¹

Mass market television advertising has been undermined by the growth of multi-channel television and by the rise of other media, in particular, the internet and computer and video games.³² The latter has increasingly taken audiences (especially young males) away from mass market broadcasters. The internet is not only a threat in terms of being another source of entertainment and information, but also as a rival channel for advertising. Advertising agencies do, of course, now plan and execute online advertising, but it is significant that the largest generator of advertising revenue on the internet is not an advertising company, but the search engine Google.³³ Internet advertising is predicted to exceed \$12 billion for 2005 and is the only area of advertising expected to increase its market share significantly over the next five years.³⁴ The reach of mass market television is likely to be further threatened by the spread of Personal Video Recording (PVR)³⁵ technologies such as Sky+, which allow viewers to fast-forward through commercials. It has been estimated that PVRs have already deprived advertisers of more than one per cent of impacts (equivalent to £48 million of commercial television advertising expenditure in the UK).³⁶

The largest growth areas in advertising have been in direct marketing, especially interactive marketing, email and text messaging. Sponsorship and sales promotion have also captured share from mainstream forms of advertising.³⁷ While these activities can be included within a broader understanding of the advertising industry, they are not the core business of traditional, large agencies. Yet the traditional 30 second television commercial has barely changed in the last 30 years, despite the fact that interactivity has become a key aspect of contemporary television programming.³⁸

As a result, businesses are starting to question the efficacy of traditional advertising agencies and the impact of established ways of doing things. Creative budgets have been squeezed significantly. Two decades ago the standard commission charged by advertising agencies was 15 per cent of the media spend budget. As a result, UK advertising was able to build a reputation and global success around "the cult of the creative director" and a cadre of highly creative individuals whose ambitions were matched with the necessary funds. Today, as a result of the move towards niche advertising, the standard commission is around eight to nine per cent,³⁹ while the same pressures have acted to depress fees.

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30. Office of Communications/PricewaterhouseCoopers (2004), *Economic Analysis of the TV Advertising Market*, (Ofcom/PwC, London).
 31. Ibid.
 32. "Multi-channel television" refers to networks that are accessible to viewers only via cable (analogue or digital), satellite, or digital terrestrial television. In the UK context, most often this means through services provided by NTL and Telewest, Sky and Freeview respectively.
 33. Google earned profits of \$399.1 million from a turnover of \$3.19 billion in 2004, see Google (2006), *Google Announces Fourth Quarter and Fiscal Year 2005 Results*, (Google, Mountain View, California).
 34. PricewaterhouseCoopers (2005), *Internet Advertising Revenue Report*, (PwC, New York).
 35. "PVR" is the generic term for a device that is similar to a video cassette recorder (VCR) but which records television data in digital format (using a hard disk drive) as opposed to VCR's analogue format. PVRs are also often referred to as hard disk recorders (HDRs) or digital video recorders (DVRs).
 36. Big Picture (2005), *Big Picture Viewpoint – Personal Video Recorders (PVRs)*. This estimate is based on a study by Forrester Research that suggests that exposure to advertising drops 54 per cent amongst PVR users, see Forrester Research (2005), *The Advertising Model for Video On-Demand, VOD Advertising Showcases Will Transform TV Advertising*, (Forrester Research, Cambridge, Massachusetts). The figure for lost impacts is likely to be substantially higher as PVR ownership has continued to increase significantly.
 37. Barwise, P., and Styler, A. (2003), *The MET Report 2003: Marketing Expenditure Trends 2001-04*, (London Business School, 2003).
 38. For a more detailed analysis see Interactive Digital Sales (2004), *Breaking Free from the Ad Break*, (Interactive Digital Sales, London).
 39. Pratt, A. (forthcoming), 'Advertising and Creativity, a Governance Approach: A Case Study of Creative Agencies in London', *Journal of Environment and Planning*.

Some advertising agencies have been slow to adapt to this new environment and its myriad challenges. The focus on creativity in the UK's advertising industry has derived from the positive commercial conditions that have prevailed in the past.⁴⁰ These conditions have changed. The dilemma facing the UK advertising industry is how to retain its creativity while ensuring that it adjusts to new commercial realities.

1.5 Design

As with the advertising sector, the UK has a reputation for creative excellence in design, but it too faces pressures, in particular from increasing international competition.

1.5.1 A world leader in design

The Prime Minister has called the UK "the design workshop of the world".⁴¹ The DCMS has been similarly positive: "...Britain is a top exporter of design world-wide and many design consultancies earn a significant portion of income from work outside Britain".⁴² There is no doubt that the UK has enjoyed a strong reputation for design excellence. The sector has been celebrated for many decades, with its renowned educational and cultural institutions, globally admired design agencies, and a history of quality and inventiveness in activities as diverse as manufacturing, textiles, jewellery, advertising and interactive media.

1.5.2 The challenges facing UK design

However, design agencies are facing some profound challenges (see table 3). Since 2000 there has been a 31 per cent fall in turnover in the industry from £6.7 billion to £4.6 billion, or £2.1 billion in lost turnover.⁴³ This covers the full range of design agencies. While the figures for 2004-05 show a partial recovery, the size of the decline since 2000 suggests that there are factors here that go beyond the normal economic cycle (including the fall in demand for digital and multimedia design following the dot.com crash).

Table 3: Overall turnover of UK design consultancies (£ billion)

Year	2000-01	2001-02	2002-03	2003-04	2004-05
Turnover	6.7	5.9	5.3	3.9	4.6

Source: British Design Initiative.⁴⁴

The total number of agencies has fluctuated over the past few years, with no clear pattern emerging. However, the number of larger design agencies has fallen, as has the percentage of larger design agencies. The number of agencies with a turnover in excess of £1 million has fallen by nearly 30 per cent since 2000, as shown in table 4. The industry is still principally composed of micro businesses, with 55 per cent of agencies employing five people or less; only nine per cent of agencies employ more than 50 people.⁴⁵

Table 4: Number of UK design agencies with turnover in excess of £1 million

Year	2000-01	2001-02	2002-03	2003-04	2004-05
Number of agencies	1,455	793	1,233	945	1,040
Percentage of all agencies	36	21	28	24	23

Source: British Design Initiative.⁴⁶

Unsurprisingly the fall in turnover in the industry is reflected in lower employment.⁴⁷ There were 71,000 people working in design agencies in 2004-05, considerably lower than the 82,000 people employed in 2000-01.⁴⁸

1.5.3 Structural issues in the UK design sector

Research by the Design Council (echoed in interviews undertaken for this research) has identified a number of issues in the industry.⁴⁹ Many of these apply more broadly across the creative industries. They include lack of business skills, inadequately targeted business support, a poor record of continuous professional development, and insufficient levels of awareness and exploitation of intellectual property. This may reflect (and be compounded by) the large proportion of micro businesses and freelancers in the industry, and the relative youth of many design agencies, which are not yet of a scale or maturity to develop their business and managerial processes.⁵⁰ At the same time, there are an increasing number of graduates entering the industry. There were 57,000 students on design courses in 2003-04, a six per cent increase on the year before.⁵¹ Compare this to the number of people employed in design agencies at the moment (71,000) and the increasing number of very small agencies (2,470 agencies employing five or less people in 2004-05, compared to 1,450 in 2001-02).⁵² These trends suggest that the commercial weaknesses in the sector are more likely to be reinforced, rather than resolved, in the near future.

It has been suggested that the industry needs to ensure a stronger differentiation for clients between high-end, strategically-led, user-centred design agencies, and those lower down the supply chain that should provide competent and cost-efficient design and production services.⁵³ In other words, smaller agencies should avoid over-stating their abilities and focus instead on core competencies — including focusing on what their clients actually want.

1.5.4 The impact of international competition

Overseas earnings have halved over the past few years, from £1.4 billion in 2001-02 to £699 million in 2004-05.⁵⁴ A fall of such abruptness and severity warrants further investigation to assess whether it is a long-term trend or the result of more immediate factors, such as less advantageous exchange rates compared to the US. Nevertheless, it is clear that the rise of international competition is a pressing issue for UK designers. According to a recent survey, 17 per cent of design businesses now think that their main competition is from outside the UK, and more than 60 per cent of designers with international clients report that international competition has increased in the past three years.⁵⁵ It is also clear that export earnings are very unevenly distributed across the sector. Only seven per cent of design agencies earn more than 50 per cent of their fees from overseas, while 70 per cent of design agencies earn less than 10 per cent of their fees in this way.⁵⁶

"Off-shoring" is of course a major issue for the UK economy.

Manufacturing, data processing and low-skilled services have all been affected. There are now signs that off-shoring is starting to impact on the design sector, with countries such as China, India and South Korea developing expertise in digital media and design activities. A number of design institutes have been founded in China in recent years, and international students are increasingly applying to undergraduate and masters programmes at many of the UK's leading art and design universities (there was a 32 per cent rise in 2004 in the number of overseas post-graduate students).⁵⁷

Smaller agencies should avoid over-stating their abilities and focus instead on core competencies

47.The Design Council uses a significantly higher figure for "people employed in design", see Design Council (2005), *The Business of Design: Design Industry Research* (Design Council, London).

However, this research uses the figure from the British Design Initiative survey in preference to that from the Design Council because the focus here is on employment in commercial design agencies rather than broader employment in design-related occupations.

48.British Design Initiative (2005), *The British Design Industry Valuation Survey 2004 to 2005*, (British Design Initiative, London). British Design Initiative/Design Council (2002), *The British Design Industry Valuation Survey 2002*, (British Design Initiative/Design Council, London).

49.Design Council (2005), *The Business of Design: Design Industry Research* (Design Council, London).

50.Ibid.

51.Ibid.

52.British Design Initiative (2005), *The British Design Industry Valuation Survey 2004 to 2005*, (British Design Initiative, London). British Design Initiative/Design Council (2002), *The British Design Industry Valuation Survey 2002*, (British Design Initiative/Design Council, London).

53.Horn, M. J. (2006), *Hail the Designer – But Be Careful Which One You Call*, (British Design Initiative, London).

54.British Design Initiative (2005), *The British Design Industry Valuation Survey 2004 to 2005*, (British Design Initiative, London). British Design Initiative/Design Council (2002), *The British Design Industry Valuation Survey 2002*, (British Design Initiative/Design Council, London).

55.Design Council (2005), *The Business of Design: Design Industry Research* (Design Council, London).

56.British Design Initiative (2005), *British Design Industry Valuation Survey 2004 to 2005*, (British Design Initiative, London).

57.Design Council (2005), *The Business of Design: Design Industry Research* (Design Council, London).

40.Ibid.
41.p.3, Foreign and Commonwealth Office (1998), *Britain's Design Industry*, (HM Stationery Office, London).
42.p.5, Department for Culture, Media and Sport (2001), *The Creative Industries Mapping Document 2001*, (DCMS, London).
43.British Design Initiative (2005), *The British Design Industry Valuation Survey 2004 to 2005*, (British Design Initiative, London). British Design Initiative/Design Council (2002), *The British Design Industry Valuation Survey 2002*, (British Design Initiative/Design Council, London).
44.Ibid.
45.Ibid.
46.Ibid.

The challenge to the design industry is not merely that production activities are migrating to international competitors; it is that the value-added creative activities will follow. New businesses from around the world are now challenging UK companies on the very basis of what have been regarded as UK design characteristics: an inventive user-centred approach to problem-solving, high production values and a strong sense of style.

1.6 Film

The UK film industry has been described as "...the most important film industry in the world after the US."⁵⁸ However, the UK creative talent in film masks some challenges in the domestic industry. The UK remains an important centre of production, but this may be vulnerable in an increasingly competitive global market, especially because the UK lacks power in the distribution of films.

1.6.1 The growing market for film

Cinema attendance in the UK has tripled over the last twenty years. Total revenues for cinema exhibition were £770 million in 2004, up from £356 million in 1995.⁵⁹ This is expected to reach £1 billion by 2008 from over 200 admissions.⁶⁰ Film is also undergoing strong international growth, with gross global box office revenues estimated at \$25 billion in 2004.⁶¹ Worldwide admissions increased 10.5 per cent in 2004, to a total of 9.56 billion.⁶² The industry has also exploited new sources of revenue. Rental and "sell-through" (purchase for home viewing) of films now generate more revenue than cinema exhibition. The total value of the UK home video (VHS and DVD) market was £3.13 billion in 2004, equivalent to over three times the value of the UK theatrical market (film accounted for 85 per cent of this).⁶³ The global market is estimated at \$25 billion. Furthermore, the growth of multi-channel television has created additional revenue streams (for example, dedicated subscription film channels, pay-per-view and video-on-demand services).

1.6.2 The sustainability of the UK film industry

The UK is a major international centre for the production and post-production of films, including for digital special effects.⁶⁴ This creates employment for UK creative talent, and work for facilities companies and post-production houses. The full impact of this investment is considerable.⁶⁵ However, it is problematic for the UK industry to rely on inward investment, that is, foreign producers (predominantly major American studios) filming in the UK, even though this contributes significantly to export earnings. Filmmaking is highly mobile. Other countries are competing against the UK's relatively high cost base by developing local skills, support structures and public subsidies. Total production spending in the UK at nearly £560 million was 31 per cent lower in 2005 than in the previous year (inward investment was £312 million in 2005, down from its high of £730 million in 2003).⁶⁶ This drop was due in part to uncertainties regarding tax incentives for production in the UK (see below). According to national statistics, employment in the industry is lower than in 1995.⁶⁷

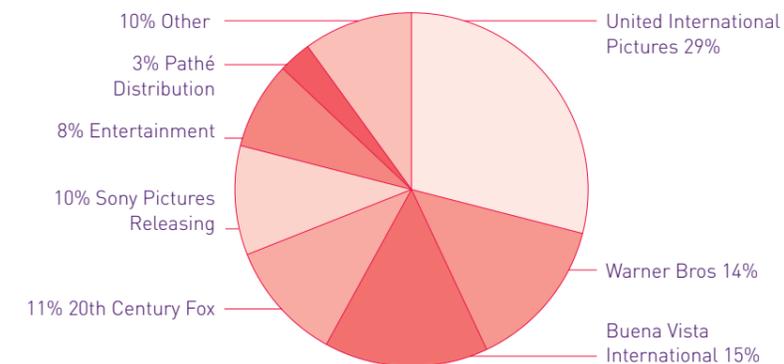
Furthermore, the UK market remains dominated by American-financed films; these accounted for 73 per cent of the UK box office in 2004, even though they represented only 40 per cent of releases.⁶⁸ Production of wholly UK films has varied significantly over recent years, again in part due to uncertainties regarding tax incentives. There were 37 wholly UK films in 2005, an increase on the previous year but lower than ten years previously and considerably lower than the peak of 84 in the late 1990s.⁶⁹ UK co-productions, other than inward investments, continued to fall from 86 to 62, with UK spend dropping from £146 million to £91 million.⁷⁰ The UK does not tend to be the major funder in co-productions in which it is involved (in 2005 the UK was the lead funder in 27 out of 103 co-productions to which it contributed some funding).

Given the dominance of American films in the UK market, it is not anachronistic to try to retain the idea of a "UK film", and by implication, a UK film industry. If the UK industry is to have a more sustainable future, it must be in the development, finance, production and distribution of its own film content — and at a sufficient scale to access international markets while retaining a greater share of the revenues. This would translate into earnings worth millions of pounds for the UK economy. Yet this is only likely to happen if fundamental issues that afflict the UK industry are addressed.

1.6.3 Structural issues in the UK film industry

The UK's creative and technical talent in film has not created a strong domestic industrial sector that produces sustainable commercial growth. This is because the UK industry is vulnerable in structural terms. It is organised primarily around individual film projects rather than sustainable production and distribution companies, as in the US.⁷¹ A key cause of this is the concentration in the distribution of films. The five largest distributors accounted for 80 per cent of the box office share in the UK and Ireland in 2004 (figure 1).⁷² Distribution is not just a matter of logistics; it is the distributor that, through marketing, creates the vital awareness of and interest in seeing a new film.

Figure 1: Film distribution and share of box office



Source: UK Film Council.⁷³

The major distributors are very effective in promoting the relatively small number of films that they are responsible for. This helps to explain why the most successful one hundred films released theatrically typically receive the overwhelming majority of the revenues (93 per cent in the UK in 2004-5).⁷⁴ Further, these revenues are concentrated in a handful of films; the top 20 films released in the UK in 2005 (out of 467 releases) received 55 per cent of the total box office.⁷⁵ This leaves hundreds of other films sharing relatively little revenue.⁷⁶

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 The UK's creative and technical talent in film has not created a strong domestic industrial sector that produces sustainable commercial growth
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58. UK Film Council (2006), UK Film Council Welcomes New Tax Relief System for British Film Industry, (UK Film Council, London). However, the biggest film industry by volume is in India ("Bollywood"), followed by the US and China.
 59. UK Film Council (2005), UK Film Council Statistical Yearbook Annual Review 2004/05, (UK Film Council, London).
 60. Dodona Research (2005), Cinemagoing 14, (Dodona Research, Leicester).
 61. UK Film Council (2005), UK Film Council Statistical Yearbook Annual Review 2004/05, (UK Film Council, London).
 62. Motion Picture Association of America (2005), International Theatrical Snapshot, (MPAA, Encino, California).
 63. British Video Association (2006), Strong Growth in DVD Despite Difficult Trading Conditions, (BVA, London).
 64. London has consolidated its position as the third busiest production centre in the world, behind Los Angeles and New York, see Film London (2005), Industry Facts, (Film London, London).
 65. Oxford Economic Forecasting (2005), The Economic Contribution of the UK Film Industry, (Oxford Economic Forecasting, Oxford); Cambridge Econometrics (2005), Economic Impact of the UK Screen Industries, (Cambridge Econometrics, Cambridge).
 66. UK Film Council (2006), Da Vinci Code, Basic Instinct 2 and Stormbreaker Take Film Production in the UK to £559 Million in 2005, (UK Film Council, London), also UK Film Council (2005), UK Film Council Statistical Yearbook Annual Review 2004/05, (UK Film Council, London).
 67. Department for Culture, Media and Sport (2005), Creative Industries Economic Estimates — October 2005, (DCMS, London).
 68. UK Film Council (2005), UK Film Council Statistical Yearbook Annual Review 2004/05, (UK Film Council, London).
 69. UK Film Council (2006), Da Vinci Code, Basic Instinct 2 and Stormbreaker Take Film Production in the UK to £559 Million in 2005, (UK Film Council, London). Also UK Film Council (2005), UK Film Council Statistical Yearbook Annual Review 2004/05, (UK Film Council, London).
 70. UK Film Council (2005), UK Film Council Statistical Yearbook Annual Review 2004/05, (UK Film Council, London).

71. See the evidence and submissions to the UK Parliament's Culture, Media and Sport Select Committee's report in 2003, see Culture, Media and Sport Select Committee (2003), Sixth Report, The British Film Industry, (HM Stationery Office, London).
 72. UK Film Council (2005), UK Film Council Statistical Yearbook Annual Review 2004/05, (UK Film Council, London).
 73. Ibid.
 74. Ibid.
 75. The Film Distributors' Association (2006), FDA Yearbook, (FDA, London).
 76. The Digital Screen Network initiative, led by the UK Film Council, will support the exhibition of specialised films by creating a network of digital screens where there is no current provision, but by definition this will not address the dominant position of American films targeted at mainstream audiences.

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The challenge for the UK industry is familiar but immense: to create a commercially sustainable and growing distribution-led industrial sector with international reach

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77. There is no sign of this improving; one of the largest UK distributors, Redbus, was bought by US producer Lions Gate Entertainment in November 2005.

78. For example, *The Constant Gardener*, the independent UK-US-German-Canadian Oscar and BAFTA-nominated co-production, was distributed in the UK by UIP (owned by the Hollywood studios DreamWorks SKG, Paramount Pictures and Universal Pictures) and internationally by Focus Features (owned by one of these studios, Universal Pictures).

79. This is why there is an important distinction to be made between classifying films as “British” in order to encourage more production in the UK, and believing that for example *Batman Begins* is a “UK film” when it is financed by a major American studio (Warner Bros) and a US production company (Legendary Pictures). See Department for Culture, Media and Sport (2005), *Cultural Test for British Films: Final Framework*, (DCMS, London), and UK Film Council (2006), *Da Vinci Code, Basic Instinct 2 and Stormbreaker Take Film Production in the UK to £559 Million in 2005*, (UK Film Council, London).

80. In December 2005 a new film tax credit was announced in the Pre-Budget Report, with 16 per cent relief on production costs spent in the UK for larger budget productions (of £20 million or more) and 20 per cent for smaller productions. Foreign producers will be eligible for this tax relief.

81. Neither has the funding of three “film franchises” in the mid- to late-1990s in order to spread risk; this period was especially dominated by the over-production of UK films. A forthright analysis can be found in a speech by the former chairman of the UK Film Council, see Parker, A. (2002), *Building a Sustainable UK Film Industry*, (UK Film Council, London).

82. UK Film Council (2003), *Response to the Culture Media and Sport Committee Enquiry “Is There a British Film Industry?”*, (UK Film Council, London).

83. An account of the US government’s recognition of the economic and cultural strategic significance of film can be found in Puttnam, D. (1997), *The Undeclared War, The Struggle for Control of the World’s Film Industry*, (Harper Collins, London).

84. BPI (forthcoming), *Statistical Handbook 2006*, (BPI, London).

Furthermore, only one of these major distributors is UK-owned (Entertainment).⁷⁷ Four of the other six major distributors are American, one is French, and one is owned by a Japanese parent company. They can repatriate the profits from distribution in the UK market back to their foreign parent companies.⁷⁸ All of these foreign-owned distributors are integrated vertically into financing and production (the UK has only one vertically integrated distributor of significant size in Entertainment). This means that they can use repatriated profits from distribution — focusing of course on films that they have financed and produced — to invest in future productions and in their own industrial infrastructures.⁷⁹ Their buying power also means that they are best placed to distribute the most likely successes from independently-produced UK films. UK independent distributors are unable to match the majors in the scale of their marketing efforts and so do not earn the same profits from these activities. This reinforces the structural weaknesses in the UK industry and ensures a continued dependence on foreign investment.

This is why public incentives (such as tax rebates for production) have been such a focus; the structural weakness in the UK industry means that there is comparatively little private sector investment, and so it tends to be highly sensitive to any changes in public support.⁸⁰ One result is that the UK industry continues to lack an understanding of the market, in particular regarding the selection and development of scripts based on commercial considerations and recognition of the importance of effective marketing. It is possible for UK producers to develop commercially attractive projects and to gain distribution deals with the major distributors, but isolated successes do not ensure the development of a stronger infrastructure in the UK.⁸¹ Much of UK film remains a “cottage industry”.⁸²

The challenge for the UK industry is familiar but immense: to create a commercially sustainable and growing distribution-led industrial sector with international reach. The structural issues will need to be addressed if the UK industry is to develop into an international creative hub in the form of the “Hollywood of Europe”.⁸³

1.7 Music

The illegal copying of music has been a major focus for discussion regarding the state of music industries across the world. However, this has served to distract from the difficulties faced by the UK industry in growing its international sales.

1.7.1 The importance of UK music

The UK has played a key role in the development of contemporary popular music. Music is one of the UK’s largest creative industries, and has long been considered an economic as well as cultural success story. In 1965, The Beatles were awarded the Queen’s Honours for their contribution to export earnings. The UK music industry continued to flourish for the next three decades, with rapid growth throughout the 1980s and into the mid 1990s. However, the market in music sales in the UK has been flat in recent years, as shown in table 5.

Table 5: UK music sales (£ billion at 2004 prices)

Year	2000	2001	2002	2003	2004	2005
Turnover	£1.284	£1.327	£1.282	£1.259	£1.214	£1.176

Source: BPI.⁸⁴

The number of businesses in music, the visual and performing arts has fallen by almost 10 per cent since 1996, while the value of exports in 2003 (£240 million) was down 20 per cent from 2000.⁸⁵ There are now 20,000 fewer people working in these industries than there were in the peak year of 1999.⁸⁶ The growing practice of illegal copying and distribution of music has been blamed for this decline.

1.7.2 The problem of piracy and illegal file sharing

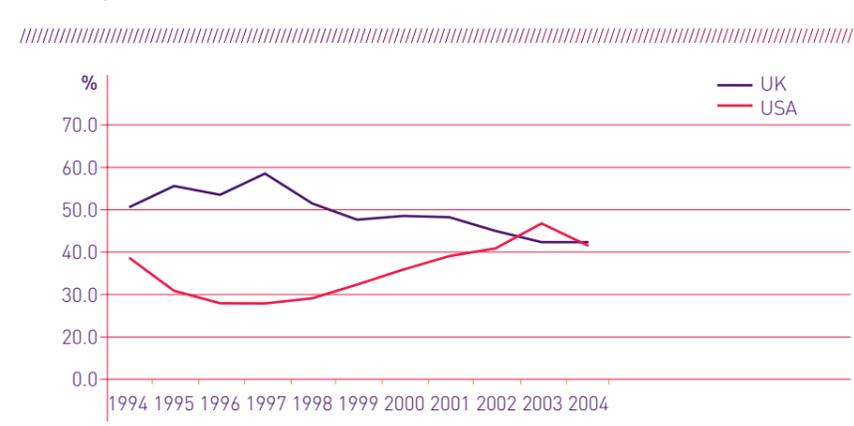
Music piracy has been a significant issue, especially since the widespread adoption of digital file formats (CDs, MP3s, and so on) and the use of the internet for illegal file sharing. It has been suggested that illegal file sharing has cost the UK industry £654 million in lost sales since 2003.⁸⁷ This is also a significant problem in international markets, with piracy widespread in many parts of the world as a result of weak or poorly enforced copyright laws. As a result, markets with major growth potential for UK artists remain undeveloped, particularly in Eastern Europe and South East Asia.

However, the UK industry’s performance in recent years cannot be attributed solely to piracy, and digital distribution does of course also offer opportunities for growth. Legal downloading became a mainstream and rapidly growing market in the UK in 2004. In that one year download sales of singles rose from three per cent of all sales to more than half (52.5 per cent).⁸⁸ On a global basis digital sales grew by an estimated 1,000 per cent in 2004.⁸⁹ Mobile music also offers significant commercial opportunities (that is, music distributed to mobile phones, whether as ring tones, full tracks or as music videos).⁹⁰ The UK industry is in a comparatively strong position to develop this market given the relatively high levels of technology adoption in the UK. The UK is the fastest-growing online music market in Europe and the third largest in the world after the US and Japan.⁹¹

1.7.3 The relative performance of the UK music industry

Despite this, the UK industry has struggled to grow sales. (The focus here is on recording labels rather than publishing or live music companies). First, the UK industry has been slipping in the domestic market. Figure 2 shows the market share of the UK industry compared to US competitors since the mid-1990s. The decline since 1997 is equivalent to £175 million in lost value for the UK industry. The latest figures do suggest an improvement in performance, but still represent a smaller market share for the UK industry than in the mid-1990s.⁹²

Figure 2: Album sales in the UK by artist nationality 1994-2004 (percentage of units)



Source: BPI.⁹³

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The UK is the fastest-growing online music market in Europe and the third largest in the world after the US and Japan

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85. Department for Culture, Media and Sport (2005), *Creative Industries Economic Estimates — October 2005*, (DCMS, London). Note that the DCMS figures do not differentiate between music, the performing and visual arts, making it difficult to analyse the performance of the music industry on the basis of official figures.

86. Department for Culture, Media and Sport (2005), *Creative Industries Economic Estimates — October 2005*, (DCMS, London).

87. Based on a two-year research study conducted by Taylor Nelson Sofres for the BPI. See BPI (2005), *Court Orders Naming of Another 33 Illegal Filesharers as Record Industry Counts £650m Cost of Internet Piracy: 19:4:2005*, (BPI, London).

88. BPI (2005), *Statistical Handbook 2005*, (BPI, London).

89. Ibid.

90. Mobile music accounted for 10 per cent of the total music market in 2004 in Europe, the Middle East and Africa, and is predicted to grow to nearly a third of the total by 2009 (to \$6.4 billion), see PricewaterhouseCoopers (2005), *Global Entertainment and Media Outlook: 2005-2009*, (PwC, New York).

91. International Federation of the Phonographic Industry (2006), *IFPI:06 Digital Music Report*, (IFPI, London).

92. BPI (2006), *Sales of UK Artists Are Booming*, Says BPI, (BPI, London).

93. BPI (2005), *Statistical Handbook 2005*, (BPI, London).

Second, the UK industry has been struggling in the US market. This market traditionally accounts for more than a third of global sales revenues and has been one of the cornerstones of the UK music industry's success.⁹⁴ It is the most important international market for the UK industry (although continental Europe is now almost as significant). The UK industry has been renowned for its ability to produce the kind of acts that could succeed in the US and across a range of genres, from The Beatles to Led Zeppelin, Pink Floyd, the Bee Gees, Motörhead and Sting. However, from the mid-1990s onwards the UK has failed to produce a major international act of comparable stature as rap, soul and RnB became leading music forms among young American consumers. In 2002, for the first time since 1964, there was not a single UK act in the US top 100 singles chart. The top 10 UK artists in the US in 2005 (table 6) suggests a continued reliance on some well-established acts in addition to the more contemporary performers.

Table 6: Top 10 albums by UK artists in the US 2005

1.	Coldplay - X&Y (Capitol)
2.	Gorillaz - Demon Days (Parlophone/Virgin)
3.	Rod Stewart - Stardust, Great American Songbook Vol III (J/RMG)
4.	Joss Stone - Mind Body & Soul (S Curve)
5.	Bee Gees - Number Ones (Polydor/Universal/UME)
6.	Keane - Hopes and Fears (Interscope)
7.	Rod Stewart - Thanks for the Memory, Great American Songbook Vol IV (J/RMG)
8.	Rolling Stones - Best Of, Jump Back (Virgin)
9.	Rolling Stones - A Bigger Bang (Virgin)
10.	Def Leppard - Rock of Ages, Definitive Collection (Riffola/UME/IDJMG)

Source: BPI.⁹⁵

Half of these acts are signed to UK music groups, while others such as Dido are signed to UK-based subsidiary labels, and hence still generate revenues for the UK. The figures for 2004 are more encouraging than those of recent years, but compare poorly with the situation ten or twenty years ago. Today, one or two new UK acts might manage to achieve notable success in the US in any given year, but this does not represent the successive "UK music invasions" of previous decades. The UK still produces major international acts, but it does appear to have had a problem in this most crucial market. This is not due solely to changing musical tastes; it also reflects structural issues.

1.7.4 Structural issues in the UK music industry

The industry in the UK is made up of thousands of micro-businesses and sole traders, but it is dominated by four vertically integrated record labels, owned by major media and entertainment conglomerates. Only one of these is UK-owned (EMI Group). These labels account for three quarters of the UK's recorded music market and a higher share of the global market (80 per cent).⁹⁶ These are the companies with the greatest resources to sustain nationwide marketing and traditional distribution channels, and have the kind of bargaining strength with retail outlets that smaller companies may lack.

94.Ibid.
95.BPI (forthcoming), *Statistical Handbook 2006*, (BPI, London).
96.BPI (2005), *Statistical Handbook 2005*, (BPI, London).

The major labels tend to be conservative in their outlook and it may not be coincidental that the last major growth period in the UK recorded music industry (the "Britpop" era of the mid-1990s) was pioneered by independent labels such as Creation, which were subsequently acquired by or affiliated to the majors. Independent labels are particularly important domestically because of the UK market's rapid turnover of fashions, styles and genres. forty per cent of all new artists that generated gold albums (100,000 UK sales) in the 1990s were signed to independent labels. Yet these independent labels, publishers and managers lack sufficient skills and knowledge to operate effectively in the US market, at the same time as they have faced higher marketing costs, an increasingly consolidated but fragmented radio market, and greater incentives for American companies to prioritise their own artists and writers.⁹⁷ As a result some labels have been tempted to opt for short-term licensing to the detriment of sustainable business growth. What this suggests is that a similar situation exists in music as in film: the UK has lost its structural position in market and is struggling to produce higher growth as a result.

1.8 Television

Television production is widely seen as one of the success stories of the UK's creative industries. However, there are indications that the UK industry needs a greater focus on international markets in order to drive growth.

1.8.1 Television production in the UK

The UK television industry spends almost £5 billion on programming each year; of this, around £2.6 billion represents spending on original programming.⁹⁸ This means that UK viewers enjoy one of the highest levels of domestically originated content in the world.⁹⁹ Furthermore, it is often thought that the UK industry is internationally renowned for the quality of its productions. Television and radio combined employed more than 110,000 people in 2004 and generated £1 billion in exports in 2003.¹⁰⁰ (It is however important to note the major position of the BBC in these figures, which employs over 27,000 people). Technological innovation and regulatory changes, particularly following the 2003 Communications Act, have fostered a new climate of growth and interest in investment in independent television production.¹⁰¹ The latest official figures suggest a strong growth in GVA by the UK industry (up to £7.8 billion).¹⁰² However, a closer analysis suggests that the industry must overcome some challenges if it is to achieve its full commercial potential.

1.8.2 The challenge of the global market

The UK's demand for international programming substantially outweighs the international demand for UK programming. The negative balance for international transactions was £436 million in 2004.¹⁰³ This situation is of course not unique to the UK. The UK industry is the largest in Europe and second only to the (much larger) US industry. The increasing number of channels in the UK has created a substantial need for new content. However, it is often foreign (and especially American) imports that have met this increased demand. The UK television industry has managed to increase its volume of exports, but the volume of imports has increased by a far larger amount.¹⁰⁴ Further, UK television exports have fallen for the second year running (despite an overall increase since 1998), to £664 million in 2004 from £684 million in 2002.¹⁰⁵ Meanwhile, imports were £1.1 billion in 2004 (table 7, overleaf).

97.British Council (2002), *Make or Break, Supporting UK Music in the USA*, (British Council, London).

98.Office of Communications (2006), *Review of the Television Production Sector, Consultation Document*, (Ofcom, London).

99.Ibid.

100.Department for Culture, Media and Sport (2005), *Creative Industries Economic Estimates — October 2005*, (DCMS, London).

101.The Communications Act 2003 required that free-to-air broadcasters (the BBC, ITV, Channel 4 and Five) standardise their terms of trade with independent producers to separate out the rights to programmes, so that producers can decide how they wish to exploit the non-primary programme rights (after the first showing).

102.Office for National Statistics (2005), *Annual Business Survey, Section O — Other Community, Social and Personal Service Activities*, (ONS, London).

103.Office for National Statistics (2005), *First Release, International Transactions of the Film and Television Industries*, (ONS, London). The Office for National Statistics balance of trade calculation captures a broader range of activities than figures published by the DCMS and the British Television Distributors Association (now part of PACT, the independent producers' trade body).

104.These figures include the import of feature films by UK channels. If this is excluded the UK industry is in a much smaller deficit.

105.Office for National Statistics (2005), *First Release, International Transactions of the Film and Television Industries*, (ONS, London). The PACT figures show an overall increase in export earnings in 2004, see Department of Culture, Media and Sport (2005), *Strong DVD Market Boosts UK TV Export Revenues*, (DCMS, London). However, this is due to the inclusion of eight TV distribution companies in the data; the figures also reveal a decline in exports to the US (the most important market for UK producers).

Table 7: International transactions in television content 1998–2004 (£ million)

Year	1998	1999	2000	2001	2002	2003	2004
Exports	444	440	551	673	684	677	664
Imports	692	843	767	1,007	1,237	1,142	1,100
Exports less imports	-248	-403	-216	-334	-553	-465	-436

Source: Office for National Statistics.¹⁰⁶

Even a relatively small improvement in export activity could mean significantly increased earnings for the UK, given the size of the international market for television. There are three key issues that need to be addressed for this to happen.

First, more UK television producers need to be more attuned to foreign markets. UK television production has a tendency to be insular, producing parochial content and series that do not fit with the requirements of overseas broadcasters in terms of running time and the number of episodes per series.¹⁰⁷ This might in some cases be an informed cultural choice, but it is not a successful commercial one.

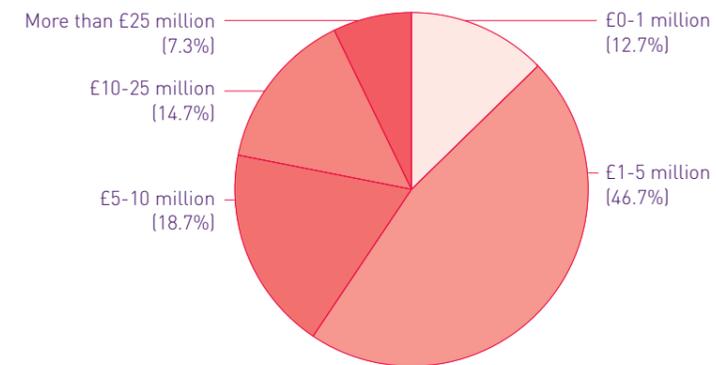
Second, UK productions often suffer from lower production values compared to the most successful American content. US drama series such as *24*, *The West Wing*, and *The Sopranos* have raised the expectations of viewers as to what they can expect from premium television content, in terms of writing and filming.

Third, UK productions can appear derivative. The international market is increasingly competitive. It is especially important that the UK industry is able to create original and distinctive content. UK producers have become well-known for so-called “reality television” and factual formats, and some of these have generated significant commercial returns.¹⁰⁸ UK television exports are increasingly comprised of sales of rights to formats rather than finished programming.¹⁰⁹ However, such formats have very little resale value to consumers, whereas high-quality drama series can be exploited through re-runs (repeats) and DVD/VHS rental and sell-through markets. Long-term sustainable growth in international markets is likely to be best ensured through a combination of creative and commercial excellence.

1.8.3 The “super indies”

The UK’s independent television production sector has been the subject of much positive comment recently, in particular the most successful and fast-growing producers, the so-called “super indies”. However, independent television production in general remains relatively fragile, with significant variations in the extent and quality of business planning, marketing and networking activities.¹¹⁰ The super indies may be more commercially focused and ambitious, but the majority of them are relatively small businesses in comparison to those in many other sectors. More than 80 per cent of companies have a turnover of less than £10 million, and just four companies have a turnover in excess of £100 million (see figure 3).¹¹¹ Even some of the larger companies are dependent on one or two high-profile hit shows. In short, similar issues of scale exist in independent television production as in film.

Figure 3: Turnover among the top 150 independent production companies (£ million)



Source: Broadcast.¹¹²

The super indies have led the way in trying to retain more control over the intellectual property (IP) that they produce, and the increased exploitation of these rights is likely to be the key area for future growth.¹¹³ This will require more producers with the necessary skills and awareness of rights management. Even so, the UK television production industry faces challenges in creating sustainable commercial growth, especially in increasingly competitive international markets.

1.9 Computer and video games

The UK has been at the forefront of computer and video game production. However, developments in the global industry now mean that the UK industry is in a vulnerable structural position, despite its creative and technical excellence.

1.9.1 The global market in games

Computer and video games are a global industry that rivals film and music in size. The global market was \$25.4 billion in 2004, an 11 per cent increase over the previous year, and is predicted to increase by more than 16 per cent per annum until at least 2009.¹¹⁴ The UK has experienced similar increases and is the largest market in the world after the US and Japan.¹¹⁵ The UK entertainment and leisure software market grew to a new record size of £1.35 billion in 2005.¹¹⁶ This growth is mirrored in the increasing technical sophistication of games. The latest personal computers (PCs) and game console systems have markedly increased processing power, so they can handle faster and more complex game scenarios and graphics. High-profile so-called “AAA” games demand increasingly large production and marketing budgets in order to reflect this. Such titles are often launched across many different game platforms at once. These developments mean that the economics of the industry have changed radically in a short period of time, equivalent to a change from craft-making to film production within the past 20-25 years.

1.9.2 Structural issues in the UK games industry

The UK has slipped as a major centre for games production, albeit in the context of an industry-wide consolidation. Spending on games development in the UK has fallen by 18 per cent and the number of people working in development has fallen by six per cent since 2000.¹¹⁷ The UK’s production facilities mean that it is still a net exporter of games, generating a positive trade balance of £197 million in 2003.¹¹⁸ However, the structural power in the industry lies in owning and publishing games, rather than just developing them.

The UK entertainment and leisure software market grew to a new record size of £1.35 billion in 2005

106.Ibid.
 107.This has been noted in successive official reports, for example, UK Trade & Investment (2005), *Rights of Passage, British Television in the Global Market*, (HM Stationery Office, London). Also Department for Culture, Media and Sport (1999), *Building a Global Audience, British Television in Overseas Markets*, (DCMS, London).
 108.UK Trade & Investment (2005), *Rights of Passage, British Television in the Global Market*, (HM Stationery Office, London).
 109.British Television Distributors Association (2004), *UK Television Export Statistics 2003*, (BTDA, London).
 110.See for example a study of regional independent producers, The Research Centre for Television and Interactivity (2002), *Risky Business: Inside the Indies*, (The Research Centre for Television and Interactivity, Glasgow).
 111.Broadcast (2005), *The Annual Survey of the UK’s Independent TV Producers*. Only one more company reached the £100 million mark in the latest figures from this survey for 2006, see Broadcast (2006), *The Annual Survey of the UK’s Independent TV Producers*.

112.Broadcast (2005), *The Annual Survey of the UK’s Independent TV Producers*.
 113.This is an area of dispute between broadcasters and producers, and subject to further consultation and review by Ofcom, see Office of Communications (2006), *Review of the Television Production Sector, Consultation Document*, (Ofcom, London). See also a report commissioned by PACT, Oliver & Ohlbaum Associates (2006), *UK TV Content in the Digital Age — Opportunities and Challenges*, (Oliver & Ohlbaum Associates, London).
 114.PricewaterhouseCoopers (2005), *Global Entertainment and Media Outlook: 2005-2009*, (PwC, New York).
 115.Screen Digest/Entertainment and Leisure Software Publishers Association (2005), *Interactive Leisure Software: Global Market Assessment and Forecasts to 2007*, (Screen Digest/ELSPA, London).
 116.Entertainment and Leisure Software Publishers Association (2006), *Record Sales for Games Market*, (ELSPA, London).
 117.Screen Digest/Entertainment and Leisure Software Publishers Association (2005), *European Interactive Games — The 2005 State of the Industry Report*, (Screen Digest/ELSPA, London).
 118.Screen Digest/Entertainment and Leisure Software Publishers Association (2005), *Interactive Leisure Software: Global Market Assessment and Forecasts to 2007*, (Screen Digest/ELSPA, London).

Almost all of the major development studios and publishers in the UK are now foreign-owned

The UK has failed to cope with one of the key commercial developments in the global industry in the past ten years: the tendency for publishers to buy out or build up their own development arms. (Publishers have been the key distribution channel to market and are equivalent to a combination of a film studio and distributor given their role in the financing and marketing of games). Almost all of the major development studios and publishers in the UK are now foreign-owned or dependent on large American, Japanese or continental European publishers. Many of these publishers are themselves part of larger media-entertainment conglomerates, or contract with these companies to make games that are tied to existing films, brands, books and other licensed entertainment. These are the games that dominate sales. This is illustrated by the UK sales chart's top 10 for the end of November 2005 — a key trading period in the run-up to Christmas (table 8).

Table 8: UK top 10 games for the Sony PlayStation 2 (week ending November 26th 2005)

Position	Title	Publisher	Developer
1	Need For Speed: Most Wanted	Electronic Arts	EA Canada
2	WWE Smackdown! vs Raw 2006	THQ	Yuke's Entertainment
3	50 Cent: Bulletproof	Vivendi Universal Games	Genuine Games
4	FIFA 06	Electronic Arts	EA Chertsey
5	Call of Duty 2: Big Red One	Activision	Treyarch
6	Harry Potter and the Goblet of Fire	Electronic Arts	EA Chertsey
7	Pro Evolution Soccer 5	Konami	Konami Corporation
8	Star Wars: Battlefront II	LucasArts	Pandemic Studios
9	Peter Jackson's King Kong: The Official Game of the Movie	Ubisoft	Ubisoft
10	From Russia With Love	Electronic Arts	EA Redwood Shores

Source: ELSPA.¹¹⁹

The charts are dominated by foreign publishers and studios, in this case with no single UK-owned publisher or development studio featuring. Of the top-ten selling games at the end of November 2005, four are based around film titles, two are licensed from sports franchises, and one to a music act (who also had a film based on his life story released only two months later). The remaining three titles are sequels to previous best-selling games that have developed strong brand loyalty. Not a single game based on a studio's original concept features in the top ten.

119. Entertainment and Leisure Software Publishers Association (UK) Ltd © 2005, chart compiled by ChartTrack.

For an independent development studio, breaking into the market on the basis of an original game concept is a considerable challenge. The cost of producing games is increasingly prohibitive. The average budget for a console game is in the region of £1.5-3 million.¹²⁰ This is predicted to rise steeply with the launches of the next generation of console platforms, to an average budget of £3-5 million and in some cases more than £35 million.¹²¹ These platforms demand new development skills and tools, requiring massive investment and retraining. It has been estimated that by 2008 the required average break-even market share for an individual game could have nearly tripled to 0.31 per cent (from 0.11 per cent in 1993), meaning that the number of profitable titles per year could be as low as 80.¹²² This increases the pressure to produce hits, which further advantages the existing major players.

Increased international competition has added to the difficulties facing the UK industry. American and Japanese companies have always played a leading role in the global industry. However, more game production companies are emerging from countries in Asia and Eastern Europe, offering high-quality development work at a much lower cost. UK studios are in a double-bind: struggling to win commissions on the basis of originality of concept and high-quality design, but unable to compete on price. It is therefore no surprise that within the past two years respected UK development studios such as Lost Toys, Rage, Argonaut, Computer Artworks and Silicon Dreams have gone into administration. The creative talent of UK developers is undoubted, but many independent studios are facing considerable problems in raising finance, maintaining clients and bringing new games to market. It is extremely difficult for an independent studio to produce and release its own titles, rather than work on commissions from a publisher and therefore forego rights earnings.

Again, the issue here is industrial scale. In contrast to the situation in the UK, France now boasts two of the world's largest publishers (Ubisoft and Infogrames Entertainment) and dominates games publishing alongside Japan and the US. This has been achieved without the UK's tradition of game development and with a smaller domestic games market. These publishers have taken over many of the UK's games studios, hold the licenses to a number of leading titles, and earn significant revenues worldwide. The absence of publishers of international stature represents a substantial loss of earnings for the UK, with the danger that its games industry will be left as little more than a "creative and technical bodyshop".¹²³ Developers and independent publishers will have to ensure an enhanced commercial professionalism in order to survive in this challenging context.¹²⁴

1.10 Key issues facing the UK's creative industries

It is clear from this research that the UK's creative industries face three common challenges. These are: the scale of businesses; access to markets; and innovation in order to cope with and exploit structural change. These issues are discussed overleaf.

120. Screen Digest (2005), Games Software Publishing: Strategies for Market Success, (Screen Digest, London).

121. Ibid.

122. Ibid.

123. A point argued in a key DTI report in 2002, see Department of Trade and Industry/Spectrum Strategy Consultants (2002), From Exuberant Youth to Sustainable Maturity, Competitiveness Analysis of the UK Games Software Sector, (DTI/Spectrum, London).

124. A point made repeatedly from a DTI mission to the North American and French game industries, see TerKeurst, J. (2003), Creativity is Not Enough, Global Best Practice in Digital Game Publishing, (IC CAVE, Dundee).

1.10.1 Scale

Most UK creative businesses lack scale in terms of size and reach. Many creative businesses are under pressure from increased international competition, and the vast majority of these are unable to respond effectively because they are too small. Any improvement in the performance by creative businesses in these sectors could generate significant additional revenues for the UK economy, particularly if this growth occurred in international markets.

There is no evidence that this lack of scale is related to any lack of creative talent. It is a commercial issue. Specifically, it is a matter of the size, positioning and reach of the UK's creative businesses – and especially the extent to which creative businesses are positioned towards international markets. In short, not enough UK creative businesses are “world class”. World class in this context means being UK-owned but having achieved significant international commercial success. This is also likely to mean having a strong position in distribution, where appropriate. This is important because such businesses are powerful enough in their respective global markets to generate sustainable growth and to cope with the normal economic cycle. Further, this analysis suggests that international competition is likely to continue to intensify. The UK may have played a leading role in the development of policy towards the creative industries, but other countries have now developed their own approaches.

Where does scale come from? One starting-point is ambition, that is, the commercial focus and the skills to drive and support the growth required to build more world class businesses. However, a recurring finding from the consultation sessions held in the course of this research, with both entrepreneurs and those working to support the creative industries, is that many owner-managers of creative businesses do not prioritise commercial growth. Many of them work incredibly hard and are passionate about their professions. However, they have a range of different ambitions which they want to fulfil through their business. These include developing their own creative practice (their craft), “doing good work”, gaining the respect of their peers, and personal cultural fulfilment, while maintaining an intimate working environment and ensuring that their businesses are socially responsible. Many owner-managers take an “organic” approach to the growth of their businesses, by adding slowly to their customers and clients through the distinctiveness of their work. However, the purpose of creative business is to harness and exploit creativity in a commercial context and for commercial ends. This can be enhanced by a more formalised approach to business strategy and supported by investment in the appropriate skills and technologies.

As yet there has been no comprehensive study of entrepreneurial attitudes and awareness among creative professionals, but much of the research that has been done supports this finding. A survey commissioned by NESTA, of small creative businesses (with fewer than 50 employees) in the sectors that are the focus for this research, suggests that only 35 per cent of businesses have established specific financial goals for the future – and less than two-thirds of these have included the goals in a formal business plan or strategy.¹²⁵ Surprisingly, even one-third of creative businesses with turnovers of more than £1 million have no financial goals. More than half of the creative businesses surveyed do not have any senior managers who have received any training in business strategy; in nearly 90 per cent of these businesses less than half of the senior managers have received any training of this kind. Again, surprisingly, this also applies to creative businesses with turnovers of more than £1 million; on average less than half (44 per cent) of the senior managers in these businesses have received any training in business strategy.

125. ICM (2006), *Creative Businesses Survey*, (ICM, London).

These findings are supported by other sector-specific studies. A survey of television and film producers in the North East region found that 90 per cent of businesses felt “uncomfortable” expressing their goals in commercial terms (despite only 10 per cent of the firms surveyed being “not for profit” enterprises).¹²⁶ Work undertaken by Skillset on a national basis found that two thirds of independent television producers lacked a business plan, and 40 per cent stated explicitly that their businesses are “not primarily about making money”.¹²⁷ According to a recent survey undertaken for the DCMS, less than 29 per cent of music industry small enterprises have a formal business plan, and only 53.5 per cent have clear financial goals for their company, with nearly 18 per cent stating that their business is “not about making money”.¹²⁸

It should be noted that there is no evidence that the issues faced by creative businesses are exclusive to the creative industries or are any more pronounced in the creative industries compared to other sectors of the economy. That is, the creative industries are not exceptional in the issues that they face, but the issues that they face in terms of commercial growth are significant.

The question of entrepreneurial attitudes is a complex one, but this issue requires more attention. How is it possible to reconcile policies dedicated to economic growth with sectors that, in some part, may not be motivated primarily by growth? The issue here is not necessarily that too many owner-managers might have mixed objectives for their businesses, but rather that too many policies and support schemes have assumed that all owner-managers are focused on high economic growth. That said, it is time to question the seemingly widespread cultural assumption that commercial success is antithetical to creative success. As the analyses in this section suggest, UK creative businesses will not succeed by being less creative. Originality is still where the money is, especially in the context of increased international competition. The point is that the creative industries should represent creativity that is exploited in a commercial context and for commercial ends. A sharper focus on commercial opportunities might help to enhance the attractiveness of creative businesses to private investors. However, there remains the structural issue of access to markets.

1.10.2 Access to markets

Commercial success obviously depends on how well an enterprise can access, maintain and develop its routes to customers and clients. Without this access there can be no prospect of significant growth, and so investment is less attractive. That so many markets for creative products are so consolidated presents profound challenges for many creative businesses, particularly start-ups and small or independently owned businesses. This point has been made repeatedly in the course of this research by creative businesses, as well as by trade associations and industry commentators. It is also supported by the survey of creative businesses commissioned by NESTA: 40 per cent of businesses identify difficulties in accessing potential customers as a key barrier to growth (this was the most commonly identified barrier).¹²⁹

The top 20 selling products for a variety of UK creative markets illustrates this point (table 9, overleaf). In each case, the “gatekeeper” is the distributor owner – the channel which a creative producer must usually go through in order to reach the market. Every content industry is typically structured around these gatekeepers, whether they are record labels, book publishers, broadcasters or film distributors. In many cases, these gatekeepers are agglomerated into sector or even cross-sector groups. For instance, well-known record labels such as Decca, Island, Mercury and Polydor are part of the Universal Music group, which itself is part of the global media and entertainment corporation, Vivendi Universal.

126. Pembridge Partnership (2004), *The Moving Image Sector in the North East of England: Mapping, Benchmarking and Economic Impact Report*, (Pembridge Partnership, London).
127. Skillset (2005), *Independent Business Development Scheme: Report on Company Profiling* (internal report, Skillset, London).
128. DCMS (2006), *SME Music Businesses: Business Growth and Access to Finance* (DCMS, London).
129. ICM (2006), *Creative Businesses Survey*, (ICM, London).

The eight largest book retailers have just under two thirds of the UK's overall book market

Table 9: Creative best sellers

Top 20 chart	Number of gatekeepers
Album sales 2004	6
Single sales 2004	8
Album sales (Amazon UK, 5th December 2005)	6
Cinema box office 2004	8
DVD sales (Amazon UK, 5th December 2005)	9
VHS sales (Amazon UK, 5th December 2005)	11
Book sales (Bookseller magazine, w/e 26th November 2005)	9
Book sales (Amazon UK, 5th December 2005)	11
Children's book sales (Amazon UK, 5th December 2005)	12
PlayStation 2 full-price (ELSPA, w/e 26th November 2005)	13
PlayStation 2 budget (ELSPA, w/e 26th November 2005)	9
All games full-price (ELSPA, w/e 26th November 2005)	12

Sources: Nielsen BookScan, ELSPA, BPI, UK Film Council, Amazon UK.¹³⁰

Obviously, this table presents a partial picture, focused as it is on the very highest sellers within any given industry. In many cases, a number of small and independent businesses operate profitably by producing niche products which generate significant revenues. Nevertheless, the proportion of best-selling titles owned by a small number of publishers and distributors (not to mention retailers) poses a major challenge for independent producers. In fact, this data belies the dominance of an even smaller number of players. Electronic Arts is responsible for a quarter of the top 20 video games. More than 80 per cent of music sales in Europe are controlled by the four major labels. The eight largest book retailers have just under two thirds of the UK's overall book market. Six film distributors account for 87 per cent of the UK's box office share.

These are significant levels of consolidation. Research and policy around growing the creative industries has tended to assume that access to market is a given, and that commercial rewards are won by those businesses that are the most creative or entrepreneurial. Similarly, support for creative businesses has tended to focus on the supply side – improving creative and technical skills or building managerial capacity, and ignoring the very real structural constraints that characterise these sectors. Perhaps it might not be such a cause for concern if more of the gatekeepers were UK businesses generating more revenue for the UK.

1.10.3 Innovation

Many of these sectors are in a state of flux. There are major structural changes that have occurred or are underway in these sectors, often caused by technological change. Given this, and the difficulties in accessing markets, more UK creative businesses need to find new and innovative ways of reaching existing and potential customers.

However, the survey of creative businesses commissioned by NESTA as part of this research suggests that many creative businesses are struggling to do so; less than half of these businesses have ever developed a new product or service in order to generate greater commercial returns.¹³¹ Further, more than 60 per cent of these businesses have never participated in any networks of similar businesses – a key source of intelligence and new ideas. Only a small minority (16 per cent) do so on a regular basis.

More creative businesses need to focus on innovation if they are to respond to the challenges identified in this report. This innovation needs to marry commercial imperatives with creative development, rather than focusing on the latter to the effective exclusion of the former. This means innovating in terms of business models, access to and relationships with customers (including international customers), awareness and exploitation of intellectual property, strategic and fundamental business skills, and networking within their sectors and beyond.

Some of these challenges have been driven by advances in technology. The impact of technology is often complex and multi-faceted. In some sectors, new technologies give consumers more choice and influence, and this can lead to tighter budgets (for example, the consequences for television advertising of PVR technologies). In other sectors, new technologies are demanding increased budgets (for example, new hardware platforms for computer and video games). Furthermore, any sector that includes the digital distribution of content must cope with the increased threat of piracy.

At the same time, new technologies offer the creative industries massive opportunities for future growth. The UK's creative industries need to anticipate and exploit these developments. In particular, these new technologies open up many opportunities for UK creative businesses to counter and circumvent the disadvantages they face in distribution (for example in film distribution and game publishing).

The UK retains many valuable advantages with regards to the creative industries. It has a wealth of creative talent, a sustained interest in the creative industries from national and regional policymakers, a strong reputation for creative subjects in higher education, and well-known creative companies and brands. There is now a need to leverage these advantages to ensure that the UK maximises the economic potential of its creative businesses. In particular, it should focus on the development of more world class creative businesses. Even relatively small improvements in export activity across these sectors could mean significantly increased revenues for the UK, given the size of the international market for creative products and services (estimated for the media industries alone to be \$1.8 trillion by 2009¹³²). A growing market is out there to be won by businesses that are willing and able to innovate, and that do not see any inherent conflict between creative and commercial excellence. The next section of this report illustrates some of these businesses.

131. ICM (2006), *Creative Businesses Survey*, (ICM, London).
132. PricewaterhouseCoopers (2005), *Global Entertainment and Media Outlook: 2005-2009*, (PwC, New York).

130. Nielsen BookScan; Entertainment and Leisure Software Publishers Association (UK) Ltd © 2005, chart compiled by ChartTrack; BPI (2005), *Statistical Handbook 2005*, (BPI, London); Amazon UK.

2. Innovation in the UK's creative industries

Creative businesses need to innovate in order to achieve commercial success. There are many instances of creative enterprises innovating in their strategies, processes and business models, developing and diversifying their markets, and achieving greater growth and profitability. Many of the UK's creative businesses are operating in highly dynamic environments, facing new challenges and competitors, but also new markets and opportunities. In order to drive economic growth in the sector, more companies must be encouraged to take advantage of these opportunities, and to embrace the innovation, risks and leadership necessary to grow.

This section of the report aims to make a positive and practical contribution to this task, by highlighting a range of (predominantly UK) creative businesses that are innovating for growth. There are five areas of innovation illustrated here, which show how businesses can innovate in their processes and business models, develop and diversify their markets, and achieve greater profitability and growth. This report highlights those areas where growth is particularly promising, and showcases those businesses that are demonstrating new ways of achieving growth. This is not confined just to the businesses themselves; in many cases, support structures, public agencies and industry associations are innovating along with the businesses, and are working to encourage businesses in their efforts.

2.1 Innovation at the business level

The focus here is on creative approaches at the strategic and organisational level of businesses, rather than at the level of products or services. This can mean radically re-engineering such core activities as production processes, business models, recruitment policies, target markets and business relationships.

The five areas of innovation discussed here are:

- innovating into new markets;
- disrupting the value chain through digital technologies;
- diversity;
- from IP producers to IP owners;
- collaborating to compete.

2.2 Innovating into new markets

Innovating into new markets involves creative businesses finding new customers for their products, whether they are providing services, content, experiences or "originals". For example, Hemingway Design has been able to take innovative design skills honed in the retail fashion industry, and sell services to the construction industry.

2.2.1 Background

The ability to innovate has long been identified as the key to competitiveness in a global economy. Of course, many creative enterprises innovate as a matter of course. The shelf life for many creative products is short, and enterprises are continually creating new products and services for clients and commissioners. However, there are different types of innovation, ranging from incremental changes to an existing product or marketing strategy, through to the development of entirely new products, markets and business models. It is this latter type of innovation (sometimes called "discontinuous" innovation) that can in particular lead to significant increases in productivity and economic growth.

2.2.2 Key drivers

There is extensive research on innovation, with much discussion on the factors that encourage innovation. Within the creative sector, key drivers of innovation tend to be the following:

- Competition — the more competitive the sector, the more businesses are forced to differentiate their products and offering, in order to open up new markets for themselves.
- Markets — a discriminating and demanding customer base, which values originality and is willing to try new types of product and service.
- Human resources — an educated workforce, which is well-grounded in the principles and possibilities of their practice, rather than simply meeting narrow occupation skills requirements.
- Technology — the tools and distribution channels that allow creative professionals to conduct affordable experiments in their production processes.
- Investment — a managerial culture and fiscal regime that encourages research and development.

2.2.3 Innovators

The West Midlands Serious Games Cluster

The West Midlands is a recognised centre for the production of video games. But more recently, studios have begun to adapt their technologies, design and production techniques in order to develop "serious games"; games-based simulations with a serious purpose, such as training and modelling. This has enabled the studios to develop markets beyond the leisure games sector, reaching out to new clients/commissioners in sectors such as education, health and defence. Advantage West Midlands has been quick to respond, and is already putting in place a showcasing and investment strategy to help the region's studios take full advantage of this rapidly growing new market.

Hemingway Design

Wayne Hemingway is best known for his fashion label Red or Dead, an award-winning business with a £10 million turnover and 13 shops. In 1999, Hemingway sold his business to seek out a new pursuit. He found it in the construction industry, seeking to challenge what he saw as the prevalence of mass-produced, unimaginative housing.

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The shelf life for many creative products is short, and enterprises are continually creating new products and services for clients and commissioners
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In collaboration with Wimpey, Hemingway began with a swathe of industrial wasteland in Gateshead that had stood empty for 12 years. With the same style and inventiveness he had brought to fashion, Hemingway worked with architects, designers and house builders to design a community with individual terraces built round communal courtyards with parking areas, paths and imaginative play areas. The project has been a great success: the first phase sold within six hours and 800 homes have been built. Since then Hemingway Design has gone from strength to strength. It is now working on 3,000 new homes in Lothian, 1,200 affordable and social housing units in north London, and it is helping to come up with a new masterplan for Skelmersdale's 1960s town centre, as well as being closely involved in Europe's largest development, the Thames Gateway Project.

live|work

live|work is a creative agency founded three years ago to extend its expertise into "service design", that is, the services that organisations and people experience and use. For live|work, the commercial imperative to move into service design was clear — the service sector accounts for approximately 70 per cent of the UK's overall GDP and the trend towards a more service-oriented economy is expected to continue. Already, live|work has built up an impressive client list from across the private and public sectors, as people begin to appreciate the value that good design can bring to the delivery of both new and existing services.

live|work's team has a background in a range of creative practices, such as architecture, product, industrial and interaction design. With such a new discipline, recruiting is difficult, while adapting existing skills and methods is not always straightforward. In response, the agency has established a culture of reflective practice, ensuring that team members draw lessons and progress as they work.

One of the challenges facing live|work is innovating ahead of the market — developing processes, solutions and language that many clients know little about or are uncomfortable with. The agency has invested considerable time into helping to build the sector, working with industry commentators and even potential competitors to educate clients, improve understanding and promote the concept of service design.

2.2.4 Interventions

Encouraging innovation is not easy, and has been a major priority for successive governments. Much of the attention has been on fiscal policy and tax credits, as well as broader work around education and encouraging a culture of risk-taking and inventiveness. However, in recent years there have also been more specific initiatives targeted at the creative industries.

The University of Warwick Science Park

An intensive approach to encouraging innovation has been pioneered by the University of Warwick Science Park. Its "micro cluster" initiative brings together small enterprises to exchange knowledge and develop new products. The enterprises are drawn from a range of sectors which, although regarded as distinct, offer rich possibilities for cross-fertilisation and collaboration, such as software, video games, digital design and medical imaging.

Many of these enterprises are small and highly specialised, and it does not occur to them that there are businesses in the neighbourhood, or even in the same incubator, with whom they can work. The micro cluster acts as a broker, identifying and introducing enterprises in a neutral and friendly atmosphere, in which they can build up trust and explore areas of mutual interest. In many cases, the products being developed are new and highly innovative — more innovative, in fact, than the market may be ready for. In this case, the micro cluster works with all of the participating enterprises to build up a joint marketing platform: promoting a new product range, educating clients and growing the critical mass that is needed for a new type of product to take off in the marketplace.

BBC Innovation Labs

Established by the BBC and a consortium of regional development agencies in England (RDAs), the Innovation Labs are workshops intended for interdisciplinary teams of media, design and technology producers. The teams participate in intensive creative workshops with peers and industry mentors, with the chance to develop new projects that can then be pitched to a panel of BBC New Media commissioners.

This participatory lab model was first developed for the media industries some years ago and, although it has evolved, its basic objectives remain: to provide a hot-house development environment for innovative products, bringing together creative producers with advisors, mentors and commissioners. The workshops are designed in such a way as to encourage bold and original thinking, while remaining focused on real markets. The model has been replicated across the world, for instance at the American Film Institute in Hollywood and Cross Media Lab in Australia, and is a powerful way of rapidly testing and developing innovative ideas.

Gateway2Innovate

Supported by East of England Development Agency, Gateway2Innovate (G2I) is a business support agency which encourages businesses in the East of England region to develop new products, services, processes and ways of doing business. Established in May 2004, G2I is a project run by the six Business Links in the region and St John's Innovation Centre in Cambridge.

G2I is aimed at small-to-medium enterprises and matches businesses with expertise. It has a list of hundreds of the region's experts and organisations whose accumulated knowledge provides a pool of valuable advice to the business owner. For example, an enterprise that needed use of a nanotech chamber would be put in touch with laboratories that provided that service. G2I's trained consultants will listen to their needs, clarify their understanding and use their list of contacts to connect them with regional sources of expertise.

2.2.5 Key questions

Discontinuous innovation isn't easy. Having the kind of imaginative idea that leads to a new business model or market is only the beginning. There are many challenges to sustained commercial success. Yet this kind of innovation is a major source of economic growth. So the key questions for policymakers are: how can a culture of commercial innovation be supported? How can potential customers (especially in different sectors) be encouraged to try new types of product? And which are the most promising areas for discontinuous innovation?

There has been a massive growth in non-retail distribution channels for games

2.3 Disrupting the value chain through digital technologies

Disrupting the value chain through digital technologies is a major area for innovation for creative content businesses in particular.

2.3.1 Background

A common challenge facing many creative enterprises is how to reach clients and customers when the principal routes to market are dominated by a small number of gatekeepers (whether retailers, publishers or distributors). These gatekeepers often control much of the industry, shaping which products can come to market and imposing aggressive terms of trade on their suppliers. In many cases, commercial success depends upon securing a deal with a gatekeeper. It can be a real challenge for the small independent producer and new entrant simply to attract their interest, as they are often in a weak position when it comes to negotiating fees and revenue shares.

However, the rise of digital communications and the proliferation of wireless and other media devices has led to a variety of new ways in which businesses can interact, market and sell to customers and clients. In particular, businesses are starting to by-pass the gatekeepers, and conduct transactions directly without going through existing distribution and sales channels.

There is also an increased awareness of what has been called the "Long Tail".¹³³ This is the idea that digital technologies increasingly enable creative content producers to earn revenues from a large number of relatively small-selling niche products rather than from a handful of heavily-marketed blockbusters. Previously these could not have been stored within a single physical retail space or broadcast spectrum, but digitalisation and e-commerce mean that producers can sell a much larger and more varied selection of content in a profitable way.

2.3.2 Key drivers

In recent years, the emergence and widespread adoption of digital technologies have provided opportunities for creative entrepreneurs and businesses to develop new business models, and find new, more direct ways to reach the market. The key driver of this had been the expansion of information and communication technologies (ICT) usage across the UK and internationally. There were over 7.5 million broadband homes in the UK by May 2005, and by the end of 2005, 99.6 per cent of UK homes were connected to a broadband-enabled exchange.¹³⁴

2.3.3 Innovators

Valve Corporation and Introversion Software

There has been a massive growth in non-retail distribution channels for games. This "network games market" includes games for mobile platforms, games that are accessed through interactive digital television, and Massively Multiplayer Online Games (MMOGs) for PCs. This market is growing at more than seven times the rate of the traditional retail-based games market. By the end of 2005 the network games market is estimated to constitute 15 per cent of total games software sales in the western markets (Europe and North America).¹³⁵

Industry commentators were intrigued when the American games studio Valve Corporation, producer of the Half-Life and Counter-Strike games series, dissolved its relationship with publisher Vivendi and announced that it would be selling its games directly to consumers over its online distribution system called Steam. Customers buy games directly from Valve through Steam, with no income going to a third party publisher. Doubts have been expressed about how replicable this model is, given that Valve had already established successful franchises through the traditional developer-publishing relationship. However, the small UK developer Introversion Software has recently begun using the Steam service to sell its games, allowing it to reach millions of gamers who otherwise would be unaware of its products (given its limited marketing budgets and the lack of retail space for smaller developers and publishers in traditional outlets). Introversion's innovative game (Darwinia) sold more copies through Steam in its first three weeks on the service than it had done in the previous 10 months in which it has been available through its own website. Significant opportunities exist for smaller developers through the online distribution mechanisms established by key industry players, including in the console market.

Reverb

Advances in digital printing have meant that the expensive and time-consuming printing runs of large-scale lithographic printing are no longer a necessity. A new generation of publishing companies have emerged, with greatly diminished start-up costs. Reverb is one such example. Founded in 2004, it uses print-on-demand technology to publish contemporary literary fiction quickly and at low cost. Reverb claim that, once edited, they can turn a manuscript into book form in just two weeks at a cost of just £60, thanks to digital production and printing. The challenge for Reverb and others is, however, not in producing books but rather in getting them to market. Many small publishers have struggled to secure deals, or even to attract the interest of large book chains, and are focusing instead on online sales, particularly through Amazon. The Amazon platform and relationship with digital printers means that once a book is ordered it can be printed and delivered in seven to eight days. However, distribution is only part of the story. Promoting book titles, getting reviews and coverage are all expensive, and it is difficult to compete with established publishers who have extensive marketing resources, and are able to secure favourable positions and promotional offers with both the high street and online retailers.

2.3.4 Interventions

The most powerful means of addressing issues relating to routes to market is through regulation and anti-monopolistic policies, but these tend to be politically contentious and difficult to achieve, with negotiations and agreements often required at a European level. However, there are instances where public sector and industry initiatives are helping to level the playing field, and help to ensure that new entrants and independents are able to reach the market.

Digital Screen Network

In a typical year more than 400 films are released, but the top 100 take more than 90 per cent of the box office. Independent films struggle to reach a small number of screens outside of central London and other major metropolitan areas. Part of the problem is the existing delivery mechanism: 35mm celluloid prints are expensive to produce and can discourage the distribution of specialist films. The UK Film Council is addressing this with its Digital Screen Network — a £12 million programme that enables existing cinemas to upgrade to digital exhibition facilities. In return for the UK Film Council's contribution, cinemas agree to set aside a proportion of their schedules to independent films.

In a typical year more than 400 films are released, but the top 100 take more than 90 per cent of the box office

133.A term first coined by journalist Chris Anderson in 2004, see: www.wired.com/wired/archive/12.10/tail.html
134.Office of Communications (2005), *The Communications Market 2005*, (Ofcom, London).
135.Screen Digest/Entertainment and Leisure Software Publishers Association (2005), *European Interactive Games — The 2005 State of the Industry Report*, (Screen Digest/ELSPA, London).

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Digital technologies
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Association of Independent Music

Founded in 1999, AIM campaigns and negotiates on a number of issues facing independent music labels. Recently it has been especially concerned with the opportunities that digital technologies are bringing to music enterprises, so it has established AIM Digital to help its members better understand and benefit from new media. In particular, AIM's collective licensing deal has enabled independent labels to secure distribution deals and more robustly negotiate revenue shares with the major download sites.

Pocket Shorts

Filmmakers in the North of England and Scotland are being encouraged to exploit the opportunities brought by mobile distribution platforms through Pocket Shorts. In this scheme, filmmakers, digital artists and animators can apply for production funds (provided by NESTA) to create short films for mobile phones with capacity for video. The production teams are partnered with a mentor, while workshops are held to give people a better understanding of what can be done with the medium. All Pocket Shorts films are showcased at UK film festivals, via a mobile content distributor. For filmmakers, the scheme provides a means of creatively exploring the platform and reaching audiences outside the traditional film distribution channels.

2.3.5 Key questions

Digital technologies are transforming creative production and changing how creative goods are sold and consumed. Business support has tended to focus on management issues rather than routes to market, but creative businesses need help and advice to take advantage of these opportunities. Key questions for policymakers concern how businesses can be helped to take advantage of these new digital distribution platforms, and how best to protect IP at the same time.

2.4 Diversity

Creative companies are identifying new audiences for cultural experiences and different kinds of creative content by adopting a genuine and substantive approach to diversity.

2.4.1 Background

The UK is becoming more ethnically diverse. The proportion of minority ethnic groups was nine per cent in England in 2001, an increase of 50 per cent from 1991.¹³⁶ In London the figure is just under 30 per cent. More than 1.5 million people in the UK describe themselves as Muslim, making it the second most common religious grouping after Christianity. A much higher proportion of young people are from minority ethnic groups, with half of all those with a mixed race background aged less than sixteen.

136.All of these figures are from the National Census in England and Wales 2001, see: www.statistics.gov.uk/census.

2.4.2 Drivers for change

Creative businesses are starting to recognise greater diversity. This is for hard-nosed commercial reasons rather than as part of a corporate social responsibility programme: as the UK becomes more culturally diverse, the market for creative products and services is getting more varied. The combined disposable income of ethnic minorities in the UK has been estimated at £32 billion.¹³⁷ Feltham's Cineworld is said to be one of the most commercially successful cinemas in the UK, due to the screening of Bollywood films popular with Hounslow's British-Asian population. The push to recognise diversity is given a further impetus by emerging markets around the world. As economies grow rapidly throughout Asia and Latin America, it is expected that they will become increasingly important markets for creative goods and services, with particular opportunities for those UK enterprises that can make the most of their diversity to break into these.

2.4.3 Innovators

Choice FM

Arriving in London from Jamaica in 1963, Neil Kenlock became a photographer and journalist, co-founding Root Magazine, the UK's first black magazine in 1979. Committed to the development of black communities and businesses, Neil moved into radio broadcasting, and in 1990 launched the Brixton-based Choice FM, successfully securing a South London community radio licence. A station devoted to broadcasting black music and culture, Choice FM was only able to obtain a start-up loan when a white director helped front the application. However, over the past fifteen years its championing of black urban music has proved to be highly successful, attracting substantial advertising revenues and building up audiences from across London. In 2004, Choice FM was bought by the Capital Radio Group, valuing the company at approximately £15 million.

Penguin

The publishing house Penguin (part of Pearson) has established a graduate programme with the School for Oriental and African Studies, to challenge the "Oxbridge monoculture" which characterises so much of book publishing. For Penguin, there are clear commercial motivations behind this scheme. With a diversifying readership, they need to foster editorial and marketing staff that can best understand these markets, and are able to identify, develop and promote the kinds of new literary talent which can meet their demands.

2.4.4 Interventions

The UK has a history of attempting to diversify the UK's workforce on the basis of social justice and equal opportunities. However, recent initiatives are building upon this and now starting to engage with the business case for diversity.

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Creative businesses
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137.Institute of Practitioners in Advertising (2003), *Ethnic Diversity in the UK* (online guide at www.ipa.co.uk/diversity/diversity_intro.html)

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The BBC wanted to get past a tokenistic approach to diversity and the scripts and casting stereotypes common to many ethnic minority productions
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Bollywood Shorts

The BBC wanted to get past a tokenistic approach to diversity and the scripts and casting stereotypes common to many ethnic minority productions. Working with a number of partners such as ABi Associates and Film London, the BBC sought out talented individuals and teams to explore the creative potential of the Bollywood genre from the British-Asian perspective.

Four independent, black and ethnic minority-led production companies from around the UK were commissioned to make 10-minute films, which tackled contemporary themes through the Bollywood genre. Although using many Bollywood motifs (Technicolor film stock, romance, dancing), the production teams were given the freedom to be inventive, and the films all attempt to challenge, develop and even parody the form. Many of the filmmakers are third generation British-Asian and they drew upon a range of cultures, styles and film genres as well as Bollywood.

The result is four “Bollywood shorts”, which have already won awards at film screenings and are intended for broadcast on national television. They suggest strong creative and commercial possibilities for those able to exploit the cultural richness and diversity of the UK.

Fishing Rod Experience (FRE)

The Fishing Rod Experience (FRE) has established itself within the London training market, specialising in training and work placements for the creative industries. Having researched levels of diversity in the sector, FRE confirmed that black and ethnic minorities were poorly represented and that recruitment methods within the sector served to perpetuate this. However, creative businesses expressed a strong desire to address this, recognising that they could benefit in the process. Young people from varied backgrounds are trendsetters, valued by media and advertising agencies, and can help enterprises stay in touch with rapidly evolving fashions and culture, which is so important to success in the creative sector.

Rich Mix

The Bangladeshi community of Tower Hamlets has already contributed to the emergence of a major cultural quarter, with Brick Lane now a firmly established part of London’s evening and visitor economy. The Rich Mix Building, which opens in 2006, is a bold attempt to blend this cultural diversity with enterprise. The building will be a performance and exhibition venue with bars and cinema screens, but crucially it will also provide workspace and act as an incubator for local creative and media businesses. It will have a particular emphasis on those entrepreneurs working in fashion, music and other forms of cultural production strongly associated with Bangladeshi style and culture. Through a programme of business training, mentoring and media labs, Rich Mix hopes to hothouse the creative businesses of the future, helping ethnic minority enterprises to develop their creativity and achieve their commercial potential.

2.4.5 Key questions

Despite these innovators, levels of diversity within the creative sector remain low. For instance, ethnic minorities make up seven per cent of the audio-visual industries as a whole, but this figure covers considerable variation across different activities and occupations. For instance, while 24 per cent of cinema cleaners are from ethnic minority groups, just five per cent work in production, animation and post-production roles.¹³⁸ More needs to be done if the UK’s creative industries are to exploit the increasing diversity of the general population. Again, the issues for the public infrastructure relate to how businesses might be most appropriately assisted in this area, and how the business case for greater diversity can be better promoted.

2.5 From IP producers to IP owners

By becoming IP owners, more creative businesses can generate ongoing revenues from the content they create.

2.5.1 Background

Many creative enterprises find themselves in a production trap — a continuous cycle of development, pitching and production, in which they are forever dependent on winning the next job, and profits are squeezed by the resources required for research and development, and producing content. One way out of this trap is through the retention and exploitation of IP, enabling a business to generate a wide range of different and scalable revenue streams. However, as discussed above, the consolidation and dominance of gatekeepers to markets in the creative content sectors makes it difficult for IP producers to profit from the rights to their own creations. Yet some producers are managing to overcome these challenges by developing innovative new approaches and business models, and there are opportunities for such models to be adopted more widely.

2.5.2 Key drivers

The Communications Act of 2003 has brought particular opportunities for TV production companies to develop revenue streams through their ancillary rights. Once a programme is shown on terrestrial television, the rights revert back to the maker, allowing companies to generate revenue by selling the show to foreign networks, licensing the format to other broadcasters, or selling the show on new platforms. However, there are concerns that these rights are not yet being exploited more fully; research has suggested that 54 per cent of production companies were generating less than one per cent of their turnover from royalties.¹³⁹

2.5.3 Innovators

RDF

Eight years ago, production company RDF was run out of an old church and employed 20 people. Today it has 350 employees and sales of £50 million. RDF was voted Broadcast’s best independent production company in 2004 and boasts offices in London and LA, having recently sold 20 episodes of its show Wife Swap to the US in a deal worth \$7.5 million.

Much of RDF’s success has come from pioneering one of the key trends in contemporary television: the development and exploitation of television formats for a global market. RDF has developed a number of highly successful formats, such as Wife Swap, Holiday Showdown, and Faking It, which have been exported internationally. This strategy takes full advantage of the new legislative climate allowing independent producers to hold on to secondary rights.

¹³⁸.Skillset (2005), Employment Census 2004, (Skillset, London).
¹³⁹.Skillset (2005), Independent Business Development Scheme: Report on Company Profiling (internal report, Skillset, London)

The move towards producing formats locally, as opposed to merely licensing product, indicates that the market is maturing and UK producers are growing more confident, leading the way in international format development and production. Recent research shows that the UK is the world leader in the creation and distribution of international formats, securing a 45 per cent share of the international format market by hours and a 49 per cent share by the number of titles across the channels studied.¹⁴⁰ As already noted, however, there can be some concern about an over-reliance on reality formats. It is, then, important that RDF is actively exploring multi-platform opportunities for its formats including web-based and mobile content, telephony income and sponsorship.

Antony Topping

In the past eighteen months, literary agent Antony Topping has begun to represent not just authors, but independent television production companies, many of whom are exploring opportunities for developing books which are based around the television concept and content.

According to Topping, many of these books have strong commercial potential, as being trailed and broadcast on national television provides valuable exposure. In addition to the well-established cookery genre, recent television shows such as *Supernanny* and *What Not to Wear* have spawned best-selling books that have generated significant revenues for both the publisher and the production company.

However, turning a television show into a book is by no means straightforward. Production companies lack the in-house expertise to value their rights, to sell to and negotiate with publishers, let alone translate a television concept into a viable book. It is here that agents such as Topping provide a vital role, and are using their specialist expertise to help independent production companies to maximise their revenues in the book market.

LSO Live

The London Symphony Orchestra (LSO) has been making classical recordings since 1913, and has an international reputation. In 2000 it launched its own music label, LSO Live, in order to produce and sell its own recordings. Previously, all recordings had been commissioned by other labels with the musicians usually foregoing their rights in lieu of an upfront fee. With LSO Live, the orchestral players, conductors and soloists become stakeholders, taking a share of the recording rights and earning a profit share on an ongoing basis. Given the commercial longevity of classical music, with certain recordings made in the 1960s still selling well, successful LSO Live productions offer the prospect of long-term revenue streams, both for the LSO and the musicians.

According to Chaz Jenkins, head of LSO Live, technological advances have made the enterprise possible. Recording live performances previously required expensive equipment and considerable technical resources. Although specialist expertise is still needed, the reduction in costs means that it is now practical for an orchestra to make its own high-quality recordings and capture the excitement and energy of a live performance. In many other ways, LSO Live functions like other independent music labels, and has secured deals with distributors to sell CD recordings in over 30 international markets. In addition, it is opening up new revenue streams through digital downloads, e-commerce and even ringtones.

¹⁴⁰ UK Trade & Investment (2005), *Rights of Passage, British Television in the Global Market*, (HM Stationery Office, London).

2.5.4 Interventions

Discussions around intellectual property legislation tend to be complex and lengthy. Anyone wishing to tackle the UK's IP framework will have to engage with the European Union, the World Intellectual Property Organisation (WIPO) and a plethora of interest groups, as the debate continues as to the respective rights of consumers, originators, copyright owners and the public domain. In the meantime, support agencies have focused on the more immediate opportunities. For many creative enterprises it is not so much legislation that determines how effectively it can exploit IP, but rather knowledge and good business practice.

Own-It

Own-It was established in 2004 to address the growing needs of creative enterprises as they attempt to understand and make the most of their intellectual property rights. It is based at the London College of Communication, part of the University of The Arts, London, and with support from Creative London. Own-It works across the sector, advising freelancers, entrepreneurs and small businesses on how to retain, defend, negotiate, value and exploit their intellectual property. It has developed partnerships with industry associations and leading law firms, in order to provide tailored support for enterprises as diverse as music labels, television production companies and visual artists. The huge demand for these services has been demonstrated by Own-It's immediate success: in just one year, it has run 45 events, and 5,000 creative professionals have benefited from its activities. Own-It is currently working with its partners to deliver more intensive and bespoke services for creative businesses.

ACID (Anti Copying in Design)

ACID is a trade association combating plagiarism in the design and creative industries. It was established in 1996 by a group of designers, who were becoming increasingly concerned about copyright theft and its impact on small enterprises and sole traders who often lack the resources to defend themselves, particularly against large organisations. ACID works to raise levels of understanding and awareness among designers themselves, as well as providing access to legal services, lobbying for legislative protection, and pursuing and deterring infringers. Over the past ten years, ACID has grown into an important and widely recognised body, with its logo a familiar site at design retailers, markets and industry events.

2.5.5 Key questions

Much of the value of a creative enterprise lies in its intellectual property, and acquiring, defending and exploiting these rights is critical to its success. This is something that both industry and policymakers alike have only begun to realise in recent years, and it presents important questions as to how enterprises can best be supported. In particular, these concern the most effective models for providing affordable access to intellectual property advice, and how intellectual property advice can be better integrated into mainstream business support, alongside finance, management and other business practices.

2.6 Collaborating to compete

Creative businesses can collaborate with the customers they sell to, in order to develop competitive new products and services.

2.6.1 Background

Much of the interest in recent years has been around investment-fuelled growth: how start-ups and young companies can acquire managerial expertise and investment in order to expand their operations and markets. However, businesses don't exist as separate entities; they operate within a rich ecology of neighbours, freelancers, suppliers, competitors and customers. All of these are also potential collaborators — organisations and individuals with whom creative enterprises can work to innovate, learn from and use to access new markets.

2.6.2 Key drivers

The creative economy is becoming more specialised. It is becoming increasingly challenging for a single enterprise to make sense of it all, with new technologies, distribution platforms, production tools, fragmented audiences and emerging national markets. Some media commentators refer not to convergence, but rather to divergence — the need to adapt content and fully exploit the creative potential of different media channels. In this environment, partnerships with other enterprises can be an important means of learning and growing.

2.6.3 Innovators

NeoWorks and Lateral

In the rapidly evolving new media industry, agencies face a constant challenge to adapt and exploit the latest technologies and proliferation of platforms and channels. One strategy for independent agencies is to form partnerships, enabling them to develop their specialisms while offering a wide range of services to potential clients.

Lateral and NeoWorks are a successful example of one such new media partnership. Lateral is an award-winning digital communications agency, well known for its creativity and interface design. NeoWorks is a software solutions consultancy that has established a strong reputation for its innovative backend solutions, providing the technology that underlies and enables interactive media products. Through their association, both have been able to broaden their market and compete against the larger full-service agencies. Already, they have won high-profile work with broadcaster Channel Five. Lateral provided the digital strategy and design of the Channel Five website, while Neoworks provided the content management and supporting back office systems. Both Lateral and Neoworks have enjoyed sustained business growth through a partnership that has provided real value to their clients.

Id Software

A number of computer and video games producers have pioneered a business paradigm which points to a radical new means of growing through collaboration. For these companies, innovation takes place across networks, and is embedded in the development process. This is an "open innovation" business model that involves the game playing community directly in the research and development of new products. Classically the development cycle for a computer game is 18 months, with production typically involving a team of 12-20 people and costing up to £3 million. But there is a new development process emerging, which operates outside of these traditional boundaries and involves a continuous feedback loop between the developers and the players.

Id Software have made use of the collective intelligence of the gamer community by releasing the source code of the successful first person shooter, Doom, and encouraging users to improve it in future iterations of the product. One of Quake II's major features was a plug-in called ReaperBot, an artificial intelligence (AI) opponent created by gamer Steven Polge. The code for this innovation was released to the gamer community who worked to improve it, transforming the player population from consumers into active creative partners in the content creation of a game. From a business point of view this can mean thousands of developers working in research and development, motivated not by money, but rather enthusiasm and interest in experiencing a better game.

2.6.4 Interventions

Clearly such collaborations have many potential pitfalls, but they do offer a potentially valuable and efficient route to product development. Traditional business support has focused on the single enterprise, with a mentor or personal business advisor helping on issues such as finance or marketing. More recently a new form of business support has emerged: advising businesses not by sending in an "expert", but rather encouraging peer-to-peer support and recognising that the people who can most help a business are actually other businesses. This approach works particularly well in the creative industries, where there is a limited history of interaction with generic business support agencies, but a strong degree of respect for other, successful creative practitioners. Network-based support models are considered to be more responsive and adaptable to the changing needs of the sectors they serve than traditional, "top-down" support models.

The Design Bureau

For many years policymakers have been interested in how the UK's manufacturing sector, with its relatively high labour and production costs, can compete on the basis of quality and creativity. In particular, there has been a focus on encouraging collaboration between designers and manufacturers, with support agencies developing programmes to foster commercial partnerships and product innovations. The Design Bureau, run by Mazorca Projects, is a good example of this. Designers need a manufacturer to make up batches of products, while manufacturers need to move into design-led products. The Bureau helps the two sides work together by helping manufacturers to put together design briefs, sourcing designers to fulfil the briefs, assisting designers to think about design from a manufacturer's point of view and helping both sides with promotion and routes to market. According to Dieneke Ferguson, Director of Mazorca, this last point is critical – unless a relationship is undertaken with a clear commercial objective, and within the context of a potential customer, it is very difficult to motivate enterprises to collaborate.

Creative Industries Development Service

The Creative Industries Development Service (CIDS) works to help new and established creative businesses in Greater Manchester. It does this by a strategic approach to establishing and supporting industry networks. These can be based around specific industries, such as computer games or fashion, or cross-sector networks of companies at a particular stage of maturity. CIDS assists the networks to develop information and communication systems, as well as helping them to identify specific support requirements and make collective actions, such as producing joint marketing materials, running events or organising trade missions. By coordinating these networks, CIDS provides an environment in which creative professionals and owner-managers from across the sector can learn from one another, generate business leads and develop commercial partnerships.

2.6.5 Key questions

Many creative enterprises are growing through partnership — whether in the form of informal or ad hoc partnerships, working with communities of practitioners, or through more formalised arrangements, such as contractual agreements, or even mergers and acquisitions. Support agencies are recognising this, but little is known about how to help the development of open innovation communities, and how support can move beyond the focus on individual business and towards developing creative clusters and networks.

These types of commercial innovation need to be more widespread within the creative industries. The key questions raised by this research are: how can policymakers and the public infrastructure respond to the challenge of international competition and ensure the fullest exploitation of commercial value for the UK economy?

3. A renewed approach for the UK's creative industries

From the evidence gathered in this research, it is clear that the UK needs a renewed policy approach for the creative industries, in order to ensure that what has been described as a “genuine threat” to these industries is not realised.¹⁴¹ This approach should focus on the construction of a coherent infrastructure to identify, develop and support future world class creative businesses. Such an infrastructure would have many dimensions, from education and training, to business support, investment incubation, expert consultancy, to support for exporting and international trade regulations. The discussion here regarding the implications of this research for policy focuses on key aspects of this infrastructure, in particular business support. By necessity, the discussion is conducted in general terms across the creative industries; however, some issues may apply in particular to specific sectors and the precise implications may differ for these sectors.

3.1 Establishing a stronger evidence base for policy

A strategic approach to the creative industries needs to be informed by the development of a stronger evidence base on the creative industries. The current evidence base, in particular regarding commercialisation and business growth, isn't sufficient for sectors of this size and importance. For example, the creative industries are not well represented in national statistics.

National governments, the research councils and funders, and the research community need to coordinate the development of a stronger evidence base, particularly in response to the needs of policymakers. This could include major reviews which examine access to markets in the creative industries, and a foresight review on the innovative exploitation of new technologies by the creative industries.

A more comprehensive evidence base will be crucial for the development of stronger and more appropriate policy, better systems of public investment and support, and more innovative and successful creative businesses. In particular, future research should focus on the actual commercial conditions in markets, the threats and opportunities from new technologies, and international developments in policy. A stronger evidence base would better enable advocates for the creative industries to make the case for investment and support across national governments in the UK, especially departments responsible for spending priorities and leading on science and technology-based innovation. Such work needs to be based on a refined model of the creative industries that is a better foundation for policies that can help to drive the commercial growth of these sectors (such as the model presented in appendix three).

141. Department for Culture, Media and Sport (2005), *Making Britain the World's Creative Hub*, Speech by James Purnell MP to the Institute for Public Policy Research, London, 16th June, (DCMS, London).

3.2 Creating a greater clarity of purpose

A more strategic and coherent infrastructure for commercial innovation and growth in the creative industries in the UK requires a stronger shared purpose. It is useful to note that a number of international approaches appear to be more advanced in terms of the commercialisation agenda than the current initiatives in the UK. They have a greater focus on commercial value (especially from content industries), an emphasis on cross-sectoral working (within and beyond the creative industries), and a desire to identify and exploit emerging opportunities (including export markets). For example, in Singapore the Creative Industries Development Strategy in 2002 identified the creative industries as one of three priority areas of the “service economy” for the development of a more entrepreneurial and globalised economy.¹⁴² This includes an explicit objective to double the contribution of the creative industries to GDP, to a level comparable to the US and the UK. Industry-specific blueprints have been formulated within this overall strategy, including for design and media. The political context may be very different in other countries, but approaches such as these will increasingly inform the competition faced by UK creative businesses in the international market.

The UK needs to respond in kind, with a renewed focus on commercial growth in the creative industries. Fundamentally, if the creative industries fail to exist on a sound and sustainable commercial basis, they won't be able to make any of the other contributions for which they are valued, whether to local, regional or national culture, or to economic and social regeneration. Further, if the creative industries aren't primarily about making money, they represent merely a re-branded cultural sector. As part of this greater clarity, it would be useful for policymakers, trade associations and other relevant parties to identify the key commercial objectives for each sector for the next 10 years, and to consider what these objectives will require from related policy areas, such as education and skills, and science and technology research and development.

A more coherent infrastructure for the creative industries needs to encompass education and training, business incubation, investment, expert advice and consultancy, networking, and support for exporting. It is not possible to identify the implications for all of these areas within the scope of this research. Rather, the focus here is on the development of the necessary skills for growth. There are two aspects to this focus on growth. The first is helping more creative businesses to grow. The second is helping more of these businesses to grow into world class businesses.

3.3 Supporting stronger growth across the creative industries

The renewed approach needs to ensure that more creative businesses are encouraged to prioritise commercial innovation and growth, and supported in the process of achieving it. More creative businesses need to be alive to the changing dynamics and opportunities within their sectors led by technological advances, global markets, increasingly demanding customers, international competition, and legislation.

However, the current support infrastructure for the creative industries in the UK is disproportionately focused on start-ups. This has had the effect of emphasising creativity without a stronger understanding of industrial structure. A greater emphasis needs to be placed on helping more businesses to grow based on the realities of these sectors, in order to strengthen the stability of the UK's creative industries. Moreover, the infrastructure should enable businesses to more easily find sources of advice, investment and support that are appropriate to their ambitions, stages of growth and markets.

142. Ministry of Trade and Industry (2002), *Creative Industries Development Strategy*, (MITA, Singapore).

First, the infrastructure should do more to encourage and support the development of business and commercial skills in creative entrepreneurs. Creative businesses in the UK need a greater awareness of business strategy skills and related core skills such as financial planning. The lack of appropriate skills in many UK creative businesses is a key cause of the vulnerability of these sectors. Businesses need to acquire the right skills that will enable strategic business development and innovation, and the full exploitation of their assets. For such skills to take hold, business support services must tap into the motivations of creative entrepreneurs and present business skills in a language and a form that they will respond to.¹⁴³ This approach needs to begin in creative subject disciplines in higher education.

Second, support initiatives must be based on an understanding of the different growth patterns and business models that underlie specific sectors of the creative industries, and the different stages at which individual businesses might need different types of assistance. There is no single route to growth. A more refined model of the creative industries needs to inform a more differentiated approach to value creation and value chain positioning (see appendix three).

For both of these reasons, there is a strong argument for specialist brokerage and support. The experience of the creative industries over the past ten years has demonstrated that conventional and generic business support structures alone are not effective in promoting growth. The current re-organisation of the Small Business Service (SBS) in England is likely to provide regional and local intermediaries for the creative industries with an opportunity to work in a benchmarking, diagnostic and brokerage capacity. Appropriate intermediaries need to be provided with the right levels of funding, resources, training and support to enable them to carry out this work to the highest standard. Further, expert mentors need to be used more in business support services. These mentors can respond much more effectively to the specific needs of individual businesses.

A greater emphasis on commercial innovation and growth is unlikely to harm the diversity of businesses in the creative industries; indeed it is more likely to encourage greater diversity by ensuring that there are enough larger creative businesses that require the services of many smaller creative businesses. As part of this, the apparently widely-held assumption that creative and commercial excellence are unlikely to co-exist (or be mutually-supportive) needs to be challenged.

At the same time, it is important to acknowledge the mix of commercial, personal and social factors that inspire many creative start-ups and young enterprises. It may only be later that owner-managers start to consider their motivations differently and develop more long-term commercial objectives, once their businesses achieve sustainability and they employ more staff. In many cases, creative businesses start to perform better when they are of a sufficient size to separate the business management role from that of the creative director.

143. NESTA's Creative Pioneer Programme presents one approach to how this can be achieved. More higher education institutions have begun to incorporate elements of entrepreneurship education into creative subjects, but as yet there is no body of effective practice in this area. NESTA is currently conducting a major research study on this issue with the Art, Design and Media Subject Centre of the Higher Education Academy, and other partners.

3.4 Developing world class creative businesses

As well as being more commercial, this renewed focus needs to be more ambitious. In particular, it needs to inform the construction of a more coherent system to encourage, identify, develop and support businesses with high growth potential; in other words, the world class creative businesses of the future. A distinct system of targeted support for businesses with high growth potential is needed. This could include the development of Creative Accelerator Funds across the UK to invest in and support high growth potential creative businesses, drawing on effective practice from existing schemes targeted at such businesses. Furthermore, organisations such as NESTA could develop, pilot and evaluate new approaches to investment, support and business development, especially for creative businesses with high growth potential.

As suggested previously, "world class" in this context means being UK-owned but achieving significant international commercial success. First, the UK needs to nurture and support a new generation of creative entrepreneurs who place strong and sustained commercial growth alongside creative expression at the top of their ambitions. Second, these potential world class businesses will benefit from clearly differentiated systems of investment and support. This support needs to be intensive and highly ambitious, to grow the UK's creative economy within the context of international markets and supply chains. The aim must be to develop the kinds of media-entertainment conglomerates and brands that can challenge existing players in the global market and generate significant jobs and wealth for the UK economy.

World class businesses don't develop by accident. They grow from strong commercial, as well as creative, ambitions and an enabling policy environment. This is not about picking winners. Rather, it is about being more responsive to the actual needs and ambitions of individual creative businesses, some of which do have a strong focus on achieving high growth and international reach, instead of assuming that all creative businesses in all sectors are essentially the same. This may require looking beyond creative businesses for the management capacity to plan and manage growth. Many creative practitioners may not be the best people to grow their own enterprises; instead talented management from other sectors could be brought in to help achieve this. There are already models for this from other sectors, such as software and bio-technology.¹⁴⁴

3.5 Addressing key issues in industry structures

UK national governments need to address a range of key issues in the structure of these industries. This includes consolidation in distribution, which is a particularly complex and politically sensitive issue. Many of the most important decisions around regulation and competition now take place at the trans-national and European Union level. Nonetheless, it makes little sense to develop an approach intended to grow more creative businesses in a more intensive manner while at the same time allowing sales and distribution channels to become (or remain) blocked. This is why this issue now needs to become a focus for greater intelligence-gathering and research, policy development, advocacy and lobbying within government. There needs to be a much stronger understanding of the extent of the consolidation in different distribution and sales channels, and also the multi-faceted impacts from these developments. The complexity of these issues is beyond the scope of this research, but this issue needs to be considered in more detail if we are to ensure there is a world class competitive business environment in the UK for the creative industries. This needs to start with a thorough review of the realities of many markets for the products and services of the creative industries.

144. For example, the London Technology Network runs a programme of activities bringing entrepreneurs and managers together with academics working at London's universities and research institutes.

In the meantime, a renewed effort is needed to support the international distribution and marketing of creative products and services by UK creative businesses. The mechanisms will differ by sector, but these need to promote and support a stronger understanding of international markets amongst UK creative businesses. This could involve public support for the development of stronger international distribution entities and networks in sectors such as film, television, and computer and video games, where a lack of scale has seriously disadvantaged UK creative businesses in accessing international markets. Such entities would inform more UK creative businesses about international markets, and encourage a distribution-led approach.

3.6 Promoting networks and integration

A greater emphasis is required on promoting innovation in the creative industries and the potential benefits, as demonstrated by the examples of commercially-minded innovation featured in this report. The UK has a diverse set of creative industries, but it is not drawing sufficiently on the richness and inventiveness of these sectors. More creative businesses should seek complementary partnerships with other creative businesses, and look to see what value their business can add to other sectors of the economy, particularly those based upon the exploitation of knowledge. More networks and collaborative activities need to be supported.

However, in the course of this research it has become clear that the trade associations and other networks in the creative industries vary widely in terms of their capacity across the sectors and across the UK — hence their varying degrees of success in lobbying, acting as hubs for intelligence-sharing, and monitoring the commercial conditions within their sectors. Greater networking and intelligence-sharing between these sectors will be vital if the UK's creative industries are to innovate and grow. Agencies at national and regional level should do more to develop knowledge-sharing networks between similar types of business or businesses in particular industries, and also approaches that lead to collaboration on particular projects. Again, a refined model of the creative industries would be valuable here, in informing the creation of networks that are based on how commercial value is created.

A second issue is integrating the sector more effectively with other parts of the economy. The richness and inventiveness of the UK's creative industries is not being exploited fully. The closer integration of the creative industries into the UK economy is crucial, not just for the future of the creative industries but to realise the advanced knowledge economy to which the UK aspires. This will be dependent on more creative businesses being able to serve a wider range of clients in other sectors. In turn, this requires more creative businesses with enhanced business skills, professional ways of working, and a greater understanding that not every client demands cutting-edge creative experimentation. Business development services should help to develop these skills in creative businesses, and stronger networks beyond the creative industries. Furthermore, trade associations and other organisations such as NESTA could fund and support innovative projects to integrate outputs from the creative industries into products and services from other sectors.

3.7 Simplifying schemes in support of creative businesses

NESTA has suggested previously that there is a lack of strategic coherence and clarity in public sector investment and support for creative businesses across the UK.¹⁴⁵ Individual creative businesses can find it difficult to find their way through the current landscape of investment, support and development schemes. Organisations such as NESTA need to act as accessible gateways for creative businesses looking for public investment, support and development, and opportunities for networking. In addition, public monies for the development of creative businesses need to be spent as efficiently and effectively as possible. There is a pressing need to identify which approaches are most effective, to invest more heavily in these approaches, and to ensure that there is a greater coherence to the infrastructure as a whole.

3.8 Creating a stronger UK-wide agenda

A shared sense of purpose is needed between the UK nations and regions. This is for a number of reasons that have already been identified, including the need to develop a stronger evidence base, to address key structural issues, promote networks and integration, to lead the de-proliferation of schemes, and most importantly to promote a greater focus on growing UK businesses and supporting stronger skills for growth.

Senior policymakers from across the UK (in UK central government and in the devolved governments) should develop a more coherent and coordinated UK-wide strategic approach for the creative industries that emphasises commercial innovation and growth. It is for policymakers from across the UK to determine the best ways to achieve this, but a UK policy forum for the creative industries could be a positive initiative. This would be useful in sharing best practice ideas and increasing the policymaking capacity for the UK's creative industries. Many valuable policy approaches have been developed in Scotland, Wales, Northern Ireland and across the English regions. It would benefit policymakers in UK central government and across the UK to learn more about these approaches, their effectiveness, and how they can be better integrated to present a coherent system of support.

4. Conclusion

The UK has a wealth of creative talent and the creative industries represent a significant part of our economy. In the last ten years, the UK has led the world in how policy has recognised and supported the creative industries, and these sectors have been seen as some of the success stories of the UK economy. Now, a growing market is out there to be won by creative businesses that are willing and able to innovate, and that do not see any inherent conflict between creative and commercial excellence. Some UK creative businesses are seizing these opportunities, but others need more help in order to do so. The UK's creative businesses have the potential, and policymakers have already demonstrated their commitment to renewing the policy approach, to ensure the continued success of these sectors. This report is intended as a positive contribution to this work.

¹⁴⁵ National Endowment for Science, Technology and the Arts (2005), *Creating Value — How the UK Can Invest in New Creative Businesses*, (NESTA, London).

Appendix 1 — NESTA and the creative industries

NESTA and the creative industries

NESTA aims to transform the UK's capacity for innovation. Our work in the creative industries sector has involved:

Developing creative entrepreneurs

NESTA's Creative Pioneer programme has developed a new model for identifying talent and providing the business coaching and financing needed to help new creative businesses off the drawing board. Elements of the programme are now being used as a model for entrepreneurship in higher education.

IdeaSmarter is a major three-year project that will be led by NESTA in Scotland in partnership with the 6 Cities Design Festival and Highlands & Islands Enterprise. It will stimulate enterprise and help to build the skills of up to 300 budding entrepreneurs working across science, technology and the arts. The project builds on three existing pilot projects: the Creative Pioneer programme Academies; Insight Out (the undergraduate programme piloted with Glasgow School of Art); and Ideasmart (early stage support for creative businesses)

Other business development initiatives include Small/Medium/Large, which helps to fast-track business in the creative industries, and Pocket Shorts, which offers production funding, a film industry mentor and distribution support to new filmmakers experimenting with mobile technologies.

NESTA is also leading the way in the supply of seed funding for early-stage ventures. We combine risk capital with access to specialist mentors, other potential investors and a wide range of sector networks.

Promoting and supporting discussion

NESTA has published two reports on investing in creative businesses (2003, 2005) and used them as a basis for discussion between practitioners and policymakers across the UK. We will do the same with this new report. Research on the role of higher education in encouraging entrepreneurship, undertaken with the Higher Education Academy, will be published later in 2006.

NESTA is helping to create networking opportunities between creative entrepreneurs, investors, sector specialists and business support agencies. We developed the Creative Entrepreneurs Club in Scotland with The Lighthouse, Scottish Enterprise and the Scottish Executive, and others have since been launched in the West Midlands, Northern Ireland and Wales.

NESTA co-chairs a Parliamentary forum on the creative industries, bringing together leading practitioners with politicians to discuss policy issues affecting the sectors.

Appendix 2 — Project aims and methodology

NESTA commissioned the Burns Owens Partnership and Professor Justin O'Connor (School of Performance and Cultural Industries, University of Leeds) with the Creative Industries Development Service, Manchester, to investigate business growth in the creative industries in the UK.

Given the issues with the evidence base as discussed in the body of the report, the approach for this research was to follow the official data as far as it is useful, but complement this with a range of other sources and informants. These can be broken down into two main areas, as below.

Desk research

- Analysis of official data: the DCMS publishes its Creative Industries Economic Estimates on an annual basis, and the figures for October 2005 were the starting point for this inquiry, in conjunction with a range of data sources from the Office for National Statistics.
- Literature review: the collation and analysis of a wide range of data sources, sector studies and policy documents. This includes both published and unpublished research work from academia, trade associations, regional agencies, industry press, government departments (DCMS, DTI) and non-departmental public bodies either specifically concerned with the sector (for example, the UK Film Council) or with a more general remit (for example, the Learning and Skills Council).

Field research

- Face-to-face and telephone interviews with key informants: these are individuals who have particular sectoral knowledge, and are in a position to provide opinions, overviews and insights into the sector. These were drawn from creative professionals, usually senior decision-makers within their organisations, who drew directly on their current experience, as well as sector trade associations, journalists, commentators and those working to support the sector. In most cases a standard pro forma was used, which served as the basis for discussions. The list of key informants can be found in appendix four.
- Consultation groups: evening sessions were held in Manchester with small groups (5-6 people) of creative owner-managers. Two sessions were held – one with relatively young enterprises and another with more established enterprises. Although structured around an agenda, these were more fluid meetings, in which the conversation covered a wide range of issues facing the independent creative enterprise.
- Conferences and seminars: in the course of the study, the research team attended a number of sector events, convened by academic institutions and other public agencies. These informed the study and provided useful opportunities to raise many of the issues discussed in the report.

Further, a workshop session was organised at the Creative Clusters conference held in Belfast, on 25th October 2005. The interim findings from the study were presented by the research team and discussed with 15-20 peers, mainly drawn from research, academia, development and policy.

Appendix 3 — A refined model of the creative industries

Issues in the current definition of the creative industries

The DCMS definition of the creative industries focuses on the creative industries from an economic perspective. However, there are a number of respects in which the definition fails to ensure that the resulting analysis of the creative industries is primarily economic and sufficiently precise.

First, the definition is too broad. The “creative industries” is taken to include sectors and activities that would not commonly be regarded as creative. The most obvious example is the inclusion of software and computer services in the DCMS figures. This sector accounts for up to 37 per cent of GVA (£20.7 billion), 33 per cent of employment, and 43 per cent of the total number of businesses in the creative industries as a whole.¹⁴⁶ Further, the frequently quoted figure of 1.8 million people employed in creative occupations consists of nearly 770,000 people who are employed outside of the creative industries.¹⁴⁷ These jobs have not been generated by the creative industries, and so cannot be regarded as directly indicative of the economic significance of the creative industries.

Second, the definition does not differentiate between sectors on the basis of their size. Some of the sectors are comparatively small. Even with high rates of growth, sectors such as these are unlikely to be the major contributors to overall economic growth or employment in the future. For example, the art and antiques sector is comparatively small (employing 22,500 people in 1,700 businesses in 2004), and makes a limited contribution to GVA (0.07 per cent).¹⁴⁸

Third, the definition is descriptive rather than analytical. Although the DCMS definition was not intended as an analytical model of the creative industries, it has had implications for how the creative industries have been conceptualised. The DCMS definition is based around creative outputs (in many cases, products). This in effect makes creativity the only determinant for inclusion because it does not differentiate between the sectors on the basis of the typical commercial value chains that exist in each sector. (A value chain is the series of linked business processes that create value in the products and services which are delivered to the customer¹⁴⁹). In other words, the definition does not focus on how economic value is created. Most significantly, it does not recognise differences in market structures, distribution mechanisms and consumption patterns between the creative sectors.

One practical outcome is that the definition does not differentiate between sectors on their capacity to generate high levels of commercial growth. Some sectors have significantly less commercial capacity, for a number of reasons. The production methods in these sectors may be primarily artisan-based rather than industrialised. Value in these sectors is derived primarily from creating uniqueness and authenticity, rather than reproducing and delivering products to mass markets. The most obvious example is the crafts sector, but this also applies to the art and antiques sector, and to some extent designer fashion and the performing arts. Some of these sectors have traditionally depended on public sector subsidy, such as parts of the performing arts. Such sectors also tend to be characterised by highly fragmented markets and to lack well-established distribution channels.

¹⁴⁶These DCMS figures combine the software and computer services and interactive leisure software sectors and so it is not possible to determine the precise effect of removing the former from the overall figures for the creative industries. Department for Culture, Media and Sport (2005), Creative Industries Economic Estimates – October 2005, (DCMS, London).

¹⁴⁷Ibid.

¹⁴⁸Ibid.

¹⁴⁹Pratt identifies a creative industries value chain as containing four key links: creation/content origination; manufacture (of prototypes and production instruments); distribution and mass production; and exchange (exhibition and retailing). See Pratt, A. (2004), 'Creative Clusters: Towards the Governance of the Creative Industries Production System?', Media International Australia, 112, pp.50-66.

A refined model of the creative industries

A renewed policy approach to the creative industries requires a refined model of the creative industries. Such a model is not intended as a suggested replacement for the DCMS definition, which has been important in many ways. Rather, the model is necessary as a useful tool in further policy development, for three main reasons. First, to incorporate a greater awareness of the differences between the sectors. Second, to incorporate a greater awareness of the differences within the sectors. Third, to draw out commonalities based on the ways in which commercial value is created, where this value is located, and consequently how it can be enhanced (through advice, support and investment). In short, the model needs to be useful in an analysis of the creative industries as industrial sectors rather than as a set of creative activities based on individual talent.

The refined model suggested here segments the creative industries into four groups, bringing together those sectors that have sufficient commonalities (in terms of business models, value chains, market structure and so on) as to warrant a common approach for policy. These groups are described below.

Creative service providers

Creative service enterprises are those based around providing creative services for clients, earning revenues in exchange for devoting their time and intellectual property (IP) to other businesses and organisations. Creative service enterprises tend to be concerned with maintaining cash flow. Creative service enterprises typically include advertising agencies, architecture practices, design consultancies, and new media agencies.

Creative content producers

Creative content enterprises produce IP, usually copyright protected, which is distributed to customers or audiences thereby earning revenues through a variety of related business models such as sales, advertising or subscription. These enterprises invest capital upfront in order to develop creative projects prior to any revenues. Creative content enterprises typically include film, television and theatre production companies, computer and video game development studios, music labels, book and magazine publishers, and fashion designers. Depending on the sector this upfront investment can be substantial, and so as a result the investment often takes place on a project-by-project basis rather than in the context of an ongoing and sustainable business. Hence within this group a loose but important distinction can be made between those enterprises that focus on the next individual creative project and those that are structured to develop a sustainable “production line” of creative products and an increasing body of IP for renewed exploitation.

Creative experience providers

Creative experience enterprises sell the right for consumers to experience or witness specific activities, performances or locations which are consumed at the time and place of performance, rather than through recordings or broadcasts. Creative experience providers typically include theatre, opera and dance production companies, and live music organisers and promoters. Clearly there may be a relationship here between experience providers and content producers, for example, a musician may be involved in producing a recording, and then perform pieces of this recording in front of an audience.

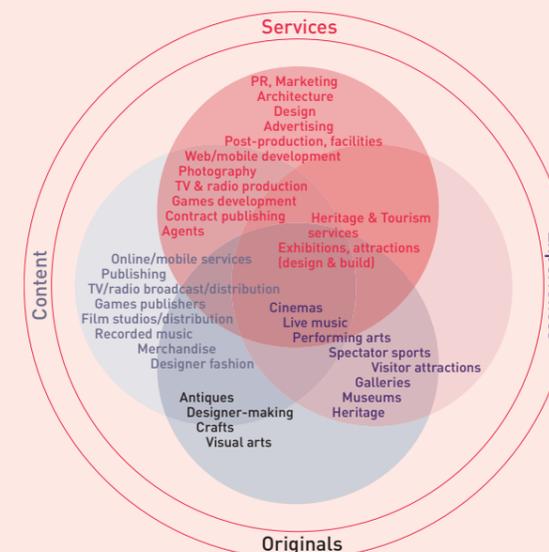
Creative originals producers

Producers of creative originals are involved in the creation, manufacture or sale of physical artefacts, the value of which derives from their perceived creative or cultural value, exclusivity and authenticity. That is, they are not mass-produced, but as one-offs or in limited production runs. For this reason producers of creative originals typically offer less opportunity for commercial growth because they are artisan-based rather than industrialised. Producers of creative originals typically include crafts makers, visual artists and designer-makers (for example, of clothing).

Each of these four areas of the creative industries to varying degrees includes or relies on manufacturing and distribution sub-sectors. For example, the film sector includes film processing services, distributors, exhibitors (cinemas), and other ancillary services such as equipment hire. However, such sub-sectors are not the focus of this research, since they do not in themselves create new content but rather support the creation of new content. It is in the creation of new content (whether as part of a service or as a product) that commercial value begins.

This model acts as an aid to identifying the areas with the greatest potential for economic growth, because it separates creative service providers and content producers from experience providers and producers of originals. The former two areas create and in some cases own IP, and it is this IP that can be more easily reproduced and exploited in order to drive sustained economic growth for the UK. The latter two areas typically offer fewer opportunities for such growth, because they are based on uniqueness rather than reproducibility. Creative content producers typically offer greater capacity for profit growth because of the easily exploitable nature of IP (once created, produced and manufactured, such IP can often be reproduced at minimal cost, for example, CDs and DVDs). Creative service providers typically offer greater capacity for employment growth, because any significant increase in demand from clients normally needs to be met by an increase in staff to serve the clients. For these reasons, this model also better reflects the perspective of private investors in the UK. Larger private investors (that is, venture capital funds) have tended to focus on creative content producing enterprises, particularly television production companies and television and radio broadcasters, rather than creative services or creative products. Again, this is because creative content producing enterprises are better placed to exploit the IP that they have generated. Figure 4 represents this refined model of the creative industries.

Figure 4: Refined model of the creative industries



Appendix 4 — Key informants

Conversations were conducted with the following individuals in the course of this research, either in telephone or face-to-face interviews or as part of a group discussion. The research team would like to thank them for their time. In addition, special thanks must be made to the organisers and participants of the session at the Creative Clusters conference.

Mark Adams, Pembridge Partners
Toby Barnes, Pixel Lab
Mark Beaumont, Dinosaur
Chris Bilton, University of Warwick
Marc Boothe, film producer
Frank Boyd, Creative London
Jonathan Briggs, OTHER Media
Mike Butcher, new media journalist
Paula Butterfield, Butterfield MacPherson
Ravinder Chahal, Special Edition Films
Andrew Chapman, Reverb
Marice Cumber, Own-It
Chris Downs, livelwork
Kate Drewett, Moonfish
Karen Durham-Diggins
Dieneke Ferguson, Mazorca Projects
Nick Fry Undercover Design
Clova Fyfe, British Phonographic Industry
Niki Gomez, Rich Mix
Mark Gorton, Multimedia Arts
Chris Green, British Phonographic Industry
Dave Green, Channel 4
Wayne Hemingway, Hemingway Design
Dale Hicks, Creative Industries Development Service
Edward Huggins, Business Link for Suffolk
Toby Hyam, Kirklees Media Centre
Chaz Jenkins, LSO Live
Alison Johnson, Love
Mandy Knight, Publishers Association
Jessica Koravos, Anschutz Entertainment Group
Paul Lenz, Reverb
Daniel Letts, livelwork
Andy Lovatt, North West Development Agency
David McCall, OMI
Nico Macdonald, design journalist
Victoria Marks, Fishing Rod Experience
Hugh Mason, Pembridge Partners
Danny Meaney, NMP
Jon Miller, Ogilvy
Natalie Melton, Arts and Business
Adam Minns, PACT
Emmanuel Ohajah, Culture Online
Greg Orme, London Business School
James Plummer, Prospect
Andy Pratt, London School of Economics
Keith Randle, University of Hertfordshire
Mike Ryan, Idaho
Sam Shemtob, Association of Independent Music
Gerry Smith, ABi
Will Strauss, Broadcast
Bill Taylor, University of Warwick Science Park
Antony Topping, Greene and Heaton
Ben Turner, Cosgrove Hall Films
Hannah Weimers, New Media Knowledge
Nikkan Woodhouse, TIGA
Simon Worthington, Mute Magazine
Phil Wright, Bright Sparks Entertainment