

**Response to Consultation by Department for
Business, Innovation and Skills
: Digital and Creative Industries Growth Review**

UK Film Council

December 2010

1. Executive summary

- 1.1 The UK Film Council is the Government-backed lead agency for film in the UK ensuring that the economic, cultural and educational aspects of film are effectively represented at home and abroad. It will continue in this role until the British Film Institute takes over as the lead strategic body for film in 2011. In parallel, Film London will assume the responsibilities for inward investment currently held by the UK Film Council.¹
- 1.2 The UK Film Council welcomes the opportunity to respond to this consultation. In our response we:
- Underline the need for effective enforcement of the existing regulatory and competition regime.
 - Reinforce our support for the provisions to reduce significantly online copyright infringement in the Digital Economy Act and the need to ensure, whatever the outcome of the forthcoming Judicial Review, that effective legislation is in place at home and overseas to stem piracy.
 - Emphasise the need for the Government to recognise the specific sectoral needs of film – notably the needs of independent film businesses across the value chain, from development and production through to overseas export, distribution and exhibition.
 - Stress that since export initiatives to support film will not continue to be supported through the reduced money available to film going forward, a new strategy from central Government is required – most especially since the Government envisages an export-led recovery.²
 - Observe that independent film companies exist in a global market so there is a need to benchmark the UK landscape against that in which for our international competitors operate. Existing finance schemes have helped individual films more than the companies handling them. This exaggerates the disconnection between the suppliers and the companies closest to market demand.
 - Underline that UK investors and lenders generally lack depth in understanding intellectual property businesses.

In summary, we believe that the key questions have been identified but we would like to underline the importance of prompt and speedy action if the UK is to seize the opportunities for film and other sectors of the creative economy in the digital age.

2. Responses to specific questions

- Q1 Lowering regulatory barriers, either specific to the sector or that have a very marked impact on it, including employment and environmental rules, and taking account of the cumulative impact of existing and potential regulation, particularly on small companies.*

¹ Film London has made its own separate submission to the Review.

² E.g. as signalled at by UK Trade & Investment events such as <http://www.trade.uktradeinvest.gov.uk/export/countries/americas/item/120174.html>

The UK Film Council believes that effective enforcement of the existing regulatory and competition regime is the best way to help promote the economic growth of the film sector. We have not identified major changes to the regulatory or competition regime which we would like to see implemented at this stage.

Q2 How can the international regulatory regime, including intellectual property, adapt to the rise of the internet and its threat to our ability to protect and monetise creativity?

We strongly support the provisions in the Digital Economy Act aimed at significantly reducing online copyright infringement. According to IPSOS online piracy cost the UK film industry £235 million in 2008.³

³ <http://www.allianceagainstiptheft.co.uk/downloads/reports/Great%20Expectations-%20Economic%20impact%20.pdf>, p.21

A reduction in such infringements will benefit the UK's creative economy by safeguarding existing jobs, creating new jobs through the development of legal services, and incentivising investment across the digital content businesses, including film. We also strongly support the provisions in the Act which are designed to encourage positive changes in consumer behaviour.

We are extremely disappointed that the High Court has granted a Judicial Review of the relevant provisions in the Digital Economy Act. We hope that, whatever the outcome of that Judicial Review, the Government will ensure that effective measures are put in place as a matter of urgency to stem copyright theft and infringement online.

The UK Film Council believes that effective implementation of the DEA needs to be backed up by an international regulatory regime which is consistent with those provisions and fit for purpose. This is particularly the case in countries where piracy is rife such as Russia and China.

Separately, we welcome the Government's recently announced Review of Intellectual Property to be led by Professor Ian Hargreaves and we would intend to take the opportunity to contribute to this to ensure that the twin goals of access to IP and action against copyright theft and infringement are pursued in a complementary fashion.

Q3 How can the competition regime, and its application, be best structured, empowered and guided to deliver a competitive and thriving UK media sector?

See answer to Question 1.

Q4 Removing blockages in the skills system that mean the needs of employers in the sector are not fully met, drawing on UKCES. How can we attract the brightest international talent?

Skillset, the Sector Skills Council for Creative Media, has worked on delivering a highly effective film skills strategy in partnership with the UK Film Council. Skillset's work on film and the creative industries more broadly provides clear evidence of the needs of the sector and the Government should continue to work with Skillset to determine future needs based on evidence.⁴

Q5 Whether there are problems with access to finance and business support that are particularly related to the creative industries.

Q6 Improving international competitiveness – greater opportunities for exports as well as encouraging inward investment – particularly in digital content which is an ongoing area of strength for the UK.

We have taken questions 5 and 6 together. In doing so, we reiterate here the arguments we made in response to the Government

⁴ E.g. see Strategic Skills Assessment for the Creative Industries, January 2010. Skillset and Creative & Cultural Skills. http://www.skillset.org/uploads/pdf/asset_14617.pdf?2

Consultation on *Financing a Private Sector Recovery*.⁵ Small and growing businesses in the UK creative and media sectors, including export businesses, are a vital part of the economic recovery and of the future prosperity of the UK. Employment in these sectors has been growing at double the rate of the economy as a whole.

The UK Film Council believes that, in order to continue growing, businesses need sustainable and secure sources of finances for investment and access to a more diverse range of sources of finance that suits their needs. This is particularly true of the UK's indigenous, independent film businesses, at all points of the value chain from development of a film project to its eventual distribution (at home and overseas) exhibition and broadcast. This is especially needed at a time when it appears, for example, that support for film export initiatives is being withdrawn in the wake of the reorganisation of the delivery of film policy by Government. New strategies to support these areas are required, most particularly as the Government's plan for growth appears to be predicated on an export-led recovery.

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

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

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

Yet there has been significant disruption to the provision of finance to the UK film industry in recent years, in particular a marked decrease in the number, scale and range of providers of debt to fund film projects.

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

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http://www.ukfilmcouncil.org.uk/media/pdf/o/q/UKFC_response_to_Financing_a_Private_Sector_Recovery.pdf

SMEs suffer from long-standing challenges in accessing bank and equity finance. Such SMEs have historically been the main target of government action, but many of those interventions have not benefited the UK film industry.

The UK Film Tax Relief has proven to be an effective means of supporting the production of films in the UK, however this measure is not intended to promote investment in film businesses and often serves merely to maintain the UK's ability to compete on equal terms in what is a fiercely competitive international market for individual film productions that offer significant benefits to the nations and regions that host them.

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

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

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

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

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

Unfortunately these constraints on the supply of finance to the UK film industry, like the financial needs of the creative and media sectors more generally, have not been identified or analysed by previous Governments. To date, Government vision appears to have been blinded by a two dimensional view of the role businesses in the UK economy play. Whilst there has been adequate consideration of scale

and geographical location of businesses, the particular sectoral needs of businesses, SMEs in particular, have been ignored.

As recently as November 2009, when the Rowlands Review was published, Government policy towards SMEs failed to gather adequate evidence of sectoral need before concluding on the needs of SMEs in the UK film industry, like many in the creative and media sectors, face global competition and face financing challenges that are unique to their industry. Many such businesses successfully compete in those global markets and substantial benefits accrue to the UK as a result. There is significant potential for the UK to achieve greater benefit if these businesses are provided with appropriate support in accessing the finance they require to grow. Yet too often there has been an inherent assumption within Government that the needs of creative businesses, including export businesses, competing in global markets for intellectual property can be met by measures designed to support domestic or regionally focussed businesses that employ, manufacture or distribute tangible goods.

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

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

Without such a review there appears to be a danger that this failure to account adequately for sectoral needs will continue.

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

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

- Undoubtedly many film SMEs are unfamiliar with equity finance and may not be investment ready. However, they are likely to continue to lack both the finance and advice associated with equity investment, compared to more mainstream sectors of the UK economy, without a Government supported measure to stimulate equity investment in film businesses. It is disappointing that the proposal in '*Creative Britain*' to create an

Enterprise Capital Fund able to cater for the needs of the UK's Film businesses has still not been adopted. This is particularly disappointing given that this measure would support a market-led solution developed in conjunction with private equity partners that incentivised success rather than, as is the case with e.g. VCTs, operate to mitigate downside risk. We believe that measures like this meet the criteria for intervention as they would:

- Reflect a realistic expectation that it will successfully address a clearly identified market failure;
- Represent value for money for the taxpayer
- Be timely and time-limited, with appropriate sunset clauses and a clear exit strategy;
- Be compliant with state aids rules;
- Would not crowd out private provision or market solutions

We believe it would increase the attention and interest of private equity in further investment in the sectors it intended to invest in and would avoid introducing distortions elsewhere in the economy.

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

Q7 Do we have the right structures in place to allow our creative industries to exploit developments in technology to maximum benefit?

We do not have a view on this question at the present time.

Ends.