Response to:

Financing a Private Sector Recovery

September 2010

About UK Music

UK Music is the umbrella organisation which represents the collective interests of the UK's commercial music industry - from artists, musicians, record producers, songwriters and composers, to record labels, music managers, music publishers, and collecting societies.

UK Music consists of: the Association of Independent Music representing 850 small and medium sized independent music companies; the British Academy of Songwriters, Composers and Authors with over 2,200 songwriter and composer members; the BPI representing over 440 record company members; the Music Managers Forum representing 425 managers throughout the music industry; the Music Producers Guild representing and promoting the interests of all those involved in the production of recorded music – including producers, engineers, mixers, re-mixers, programmers and mastering engineers; the Music Publishers Association, with more than 250 major and independent music publishers representing close to 4,000 catalogues; the Musicians Union representing 32,000 musicians;
PPL representing 42,000 performer members and 5,000 record company members; and PRS for Music representing 70,000 songwriters and composers and music publishers.

EXECUTIVE SUMMARY

Context:

"Difficulties in raising finance are affecting the ability of the music business to grow and prosper. Particularly worrying is the evidence……of a growing trend in recent years, of a lack of confidence in accessing external finance."

1. So said "Banking on a Hit," published by the Department for Culture, Media and Sport in 2001. Words which resonate just as loudly today as they did almost ten years ago.

2. In the intervening years it would appear that the inability of music industry SMEs to access finance has now become an established and increasingly entrenched obstacle and one which has intensified over recent months as the global financial markets have attempted to re-stabilise.

3. For many music industry SMEs, access to finance might now be described as a systemic and worsening problem, the consequences of which will not only be detrimental to the music industry overall but to the UK's economy more broadly.

4. UK Music welcomes the Government's review into access to finance for business. In particular, we are pleased that Government recognises that an extension of the Enterprise Finance Guarantee or a more permanent successor scheme is likely to be required. Government are asking for views on a successor scheme to the EFG and other finance options to ensure that businesses have access to a more diverse range of sources of finance that suits their needs. We focus our submission on these specific areas.

Conclusions.

5. The music industry has a significant contribution to make in the UK's economic recovery, particularly as a driver of tourism.

6. If Government's ambition is to stimulate economic growth and development through support for SMEs it will be imperative to ensure open and completive access to sources of finance for all industrial sectors, especially those within the creative industries. A dual approach of debt financing for small and micro music industry enterprises and targeted growth based support will be vital.

7. Within the current environment it is clear that music industry SMEs who are ambitious for growth are not reaching their potential, while those for whom sustainability is key are now also being put at risk.

Recommendations.

8. We would urge an immediate and robust investigation into access to finance for music industry and other sector SMEs who may trade upon IP assets. It is our belief that the evidence base required for such a task would need to include aggregated lending statistics from the high street banks, provided on a sectoral basis.

9. The shortcomings of the Enterprise Finance Guarantee must be addressed in any extension of the EFG or a more permanent successor scheme.

10. Government should analyse the system of tax reliefs designed to stimulate investment in innovation and R&D, and assess their impact on the music sector and the wider creative industries. The Enterprise Investment Scheme, for example, requires reform.

11. Government should consider establishing a new source of funding aimed at stimulating investment in new talent and supporting enterprise in the music marketplace.

12. Finally, we would strongly caution Government against pursuing an industrial strategy which focuses intervention solely on high-growth companies. Long term sustainability, rather than rapid growth, is the objective for many small music SMEs. We would ask Government to remain sensitive to this objective when formulating any industrial strategy.

UK MUSIC'S FULL RESPONSE

The music sector's contribution to economic growth

13. The UK's music industry is a valuable cultural and economic national asset. The UK music industry was worth around £4 billion in 2009.[1]

14. The invisible earnings and additional value created by music is potentially immense. Music has driven the growth of digital services like high speed broadband and digital devices like iPods. Music also feeds a host of

[1] *PRS for Music*, *Adding Up The UK Music Industry*, August 2010

businesses such as film, television, games, advertising and fashion which, quite simply, would not be what they are without music.

15. Likewise, music inescapably, intrinsically and advantageously impacts upon the tourism, leisure and hospitality sectors. An ever increasing number of people both within the UK and abroad are choosing to spend their holiday money within the UK attending music events and festivals. Live music in the nation's vast array of music venues and festivals each year attract visitors from all over the UK, Europe and the rest of the world.

16. The O2 arena in London, for instance, since opening has already attracted 12 million visitors and is now the largest ticketed entertainment venue in the whole world. The Cavern Club is at the centre of Liverpool's tourist trade and draws in half a million visitors each year. Glastonbury festival annually accounts for approximately £73 million in spending, £36 million of which is spent directly within the local economy.

17. In absolute terms the UK is the third largest music market in the world while in relative terms, we are the largest. Per capita we purchase and consume more music than any other country in the world while the UK ranks second only to North America in the league of nations who are net global exporters.

18. Latest industry figures show that the UK music industry bucked the global downward trend in 2009 with a return to growth.[2] Added to this background is the prospect that the digital marketplace opens up further growth with the development of new music services, wider markets, and faster distribution. As the industry continues to realise the potential value of music in the digital marketplace and live music continues to expand outwards from London, the ability to access finance becomes even more crucial. The innovators and entrepreneurs from our sector need to be able to finance their ambitions of tomorrow.

Music and access to finance: a structural problem

19. The Government ask for an assessment as to whether the difficulties that SMEs are experiencing in accessing finance are transitional or whether they stem from a structural problem. We provide our analysis in this section.

20. The music industry is characterised by a very small number of large corporate organisations, and a large number of small organisations. This remarkably diverse mix of company structures sustains a vast array of talent.

21. The signature of many of these companies is the long-term development of their relationships with their artists, to support, to nurture, to sustain an artist's career and therefore the company prospects over a number of years. What these SMEs achieve is to create steady employment and the continued production of IP assets and creative goods. Sustainability is key.

22. Their importance as the bedrock of the music industry ecosystem can not be understated and any weakening of their impact will invariably affect the whole music economy. We would strongly caution Government against singularly

[2] Adding up the UK music industry for 2009, Will Page and Chris Carey, *PRS for Music*, *Economic Insight* issue 20, 4th August 2010.

pursuing any industrial strategy that focuses intervention solely on high-growth companies. The thousands of small yet steady musical enterprises for whom rapid growth is not an immediate priority form the backbone of the UK's music industry.

23. In reality the majority of record companies working within our sector would employ less than 10 people. By way of example a recent survey of the 850 companies who make up the membership of the Association of Independent Music showed that the average employee headcount was two people per company.

24. Size has a strong bearing on the ability of a firm to access to finance. The Association of Chartered Certified Accountants states that, "the financing of small businesses is manifestly different from that of large businesses…there have been persistent concerns that the finance markets do not always fully meet the needs of small firms who can find it harder than large firms to acquire finance that is accessible, appropriate and affordable."[3]

25. If only because of their large numbers of small firms, the creative industries may therefore experience greater difficulties in accessing funds.

26. To compound matters, small music firms face additional challeneges to those SMEs in more traditional sectors because of the intangible quality of their assets.

27. While many other small enterprises may trade on intangible assets, such as graphic design or consultancy services, the value of a cultural good can only be approximated in hindsight, that is, after the music has already been created, recorded, released and promoted. The Work Foundation report into the economic performance of the UK's creative industries refers to this underlying problem of market uncertainty as the 'nobody knows anything' scenario'.[4] Other sectors trading in intangible assets would be less exposed to the vagaries of personal taste as those trading in cultural goods, and so are able to tabulate and valuate their assets more predictably.

28. The CBI recently published a blueprint for the creative industries in which it acknowledged that "the unpredictability of consumer reactions can make it difficult to gauge the success of a product before its launch. This can affect access to finance for creative businesses."[5]

29. There are further knock-on effects. The loan applicant's track record is an important criteria that bankers use in making lending decisions. It is likely that many small firms and entrepreneurs in the music business will have 'misses' for every hit. In more traditional industries, such a chequered track record might reasonably serve as a warning against further investment. In the music industry, such a record is the norm and is a less reliable an indicator of risk.

30. The sense that music enterprises represent high risk is exacerbated by the common portrayal of musicians themselves as difficult or unreliable. This

[3] Improving access to finance for small firms, Association of Chartered Certified Accountants, Policy Briefing Paper, March 2006.
[4] Staying ahead: ibid.
[5] Creating Growth: a blueprint for the creative industries, CBI July 2010

perception is a fallacy. The vast majority of musicians are highly motivated and honour their obligations relating to their career and artistic development.

31. One way that banks can mitigate their exposure to uncertainty and risk is by demanding security against assets. However, for many creative businesses, the firm's assets are intangible, tied up as they are in copyrights. Their value can be difficult to gauge at any one point in time, as the value of copyrights can fluctuate. While the income from a few back catalogues have maintained a consistent value over many years, most are less constant. Indeed, the value of a copyright in a piece of music can suddenly rocket in value, for example, if a piece of music is used in a popular film, television series or commercial.

32. These characteristics of our sector – the 'no one knows' factor of a cultural good, an inconsistent producer track record, difficulty in valuing IP assets and offering security – all conspire against our sector *over and above* those experienced by other SMEs in terms of obtaining finance from banks. This is partly because the standard criteria used by banks to assess loan applications cannot usefully gauge whether a proposition represents a reasonable level of risk in our sector. The error will therefore almost always be on the side of caution.

33. The historic difficulties that creative businesses face in security finance is reflected in the Amsterdam Declaration[6] which:

Call upon regions, Member States and the European Commission to take action, firstly, to raise the awareness of investors about the economic value and potential of creative industries and, secondly, to raise the awareness of creative entrepreneurs about the need to be investment-ready at an early stage;

Recognise that lack of access to finance is a core barrier to growth for many businesses in the creative industries and calls upon regions, Member States and the European Commission to facilitate more access to finance for the creative industries companies by, firstly, developing dedicated financial instruments stimulating and leveraging cross-border private investment and access to loans (e.g. guarantee funds) and, secondly, by improving the accessibility and capacity of the horizontal venture capital funds like the European Investment Fund's High Growth and Innovative SME Facility (GIF1) and the High Growth Expansion Phase Facility (GIF2);

34. While the music industry has reported difficulties in accessing finance for many years, the problem appears to have become even more exasperated of late. Several reasons account for this. First is the global downturn.

35. Industries with large numbers of small firms tend to suffer particularly severely in cyclical downturns according to a number of studies.[7] In a letter dated 11

[6] The Amsterdam Declaration is addressed to regional, national and European policy-makers and adopted by the participants of the workshop "Towards a Pan-European initiative in support of creative industries in Europe" organised by the European Commission's Enterprise & Industry Directorate-General in cooperation with the City of Amsterdam, the European Design Centre, the Association of Dutch Designers and IIP Create.

August, the Governor of the Bank of England observed “many businesses have had difficulty accessing bank credit…these appear to have been most testing for small and medium sized firms for which bank lending is a particularly important source of finance.”[8]

36. The CBI also conclude that “the recent credit crisis has added to the already difficult task of securing traditional sources of funding, reducing further the finance options available for the [creative] sector.”[9]

37. Certainly our own research and experience confirms that the difficulties that small music firms report in accessing finance have intensified during the global downturn.

38. Secondly, the music industry is in the midst of significant structural change. One result of this change is that the internal investment model that sustained the music industry in the past is no longer a viable option.

39. To put this in context: historically, there has been an internal investment model within the music industry. Entrepreneurial individuals have started bands, management companies, publishing companies and record labels with personal money or personal borrowing; and have been prepared to reinvest profits into their businesses.

40. Music businesses have also invested in each other, with established companies using their knowledge of the key indicators of success in the music industry to invest in artists or in other small firms. This has provided both equity and debt finance, as well as management support. For example, small record companies have used advances against future income from their distribution companies or collection societies to provide working capital, and have entered into joint ventures or other equity deals with major labels and large independents in order to grow.

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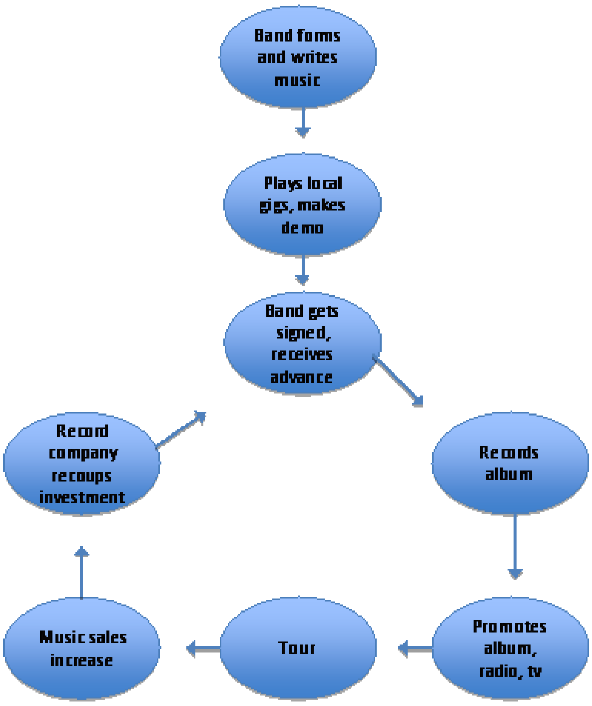
[7] For example, see the conclusions of a survey conducted by IPSOS MORI on behalf of the Institute of Chartered Accountants in July 2009: “The respondents’ overall view is that SMEs clearly have difficulty obtaining financing, but opinions vary as to whether it is merely fairly difficult to almost impossible.” P. 7 See also A Framework for Creative Industries Development in South Hampshire, December 2009 which found: “Across all business sectors access to finance has become a significant concern over the past year.”

[8] Letter from Mervyn King to Feargal Sharkey dated 11 August 2010.

[9] Creating Growth: a blueprint for the creative industries, CBI, July 2010

41. In very simple terms, a typical ‘life cycle’ for a successful pop band went something like this:



42. Record companies used profits from the record sales of their most popular acts to reinvest in new talent, so the cycle continued. For composers and songwriters, the situation was similar.

43. Liquidity for an internal financing model has all but disappeared. Record sales are down nearly 30% from 2004 levels. Sales of digital music and online music services have grown but the revenues generated from digital sales have not made up the shortfall. The live music sector has also grown, but revenues generated from live concerts and festivals do not get reinvested in nurturing a new raft of talent. Concert promoters and organisers do not “sign” new talent or give out advances, as that is not their function. The result is less revenue to go around for investment in new talent.

44. Today, record companies and music publishers are still the primary investors in new music. But they are not able to invest in as many new musicians, and the pressure to back those hopefuls who are most likely to generate a return is considerable.

45. This raises questions about how those that might be termed “experimental” or cutting edge can get the opportunities they need. It also raises questions about how those who are just starting out can get the nurturing they need, as well as ongoing support for those who are able to sustain steady careers.

46. Stepping up into the frame are thousands of small record labels, publishers, band managers, promoters and agents. These small enterprises do not have the ability to negotiate with the major music retailers (such as Tesco) and broadcasters, and so are more likely to pursue alternative approaches to marketing and distribution in order to promote their roster. While there is much innovation, the ability of these entrepreneurs to finance their initiatives is a serious stumbling block.

47. Obtaining finance is particularly difficult when sums of finance required are too low to be of interest to venture capitalists, but deemed too risky to be of interest to high street banks. Music enterprises seeking relatively small amounts of finance, either to ease short-term cash flow issues, or to finance a venture, are finding themselves unable to get the finance they need. This appears to be the case generally, even for those who have demonstrated great entrepreneurial flair in the past, who have a good credit history, and a solid business plan with credible revenue projections.

48. This combination – historical difficulties in accessing finance, exacerbated by more recent developments – is leaving many in the music sector unable to access finance. The current situation is unsustainable.

Case studies that represent typical experiences

49. Government is considering whether there is a clear case for intervention in terms of a national loan guarantee scheme and asks for evidence. In this section we provide case studies of our sector's experience with respect to the workings of the Enterprise Finance Guarantee.

50. The Enterprise Finance Guarantee seemed the perfect finance vehicle to address the difficulties of the music industry in accessing finance. In announcing the money at the start of the scheme in 2008, the European Investment Bank said it would be designed for SMEs throughout Europe to "help them weather the global financial storm." The new loans were to be channelled through existing commercial banks, with the aim of being "simpler, more flexible and more transparent, making it possible to reach a greater number of European SMEs."[10] As the creative industries account for 2.8% of the GDP of Europe, this sector anticipated sharing in this lifeline.

51. In January of 2009 the UK Government announced that the funding would be made available via the new EFGS. Upon initial inspection the EFGS would appear to have been the answer to the historical funding issues within the industry yet this has not provided to be the case. Government also specified that the scheme should be open to artists and songwriters.

52. UK Music investigated the extent to which music enterprises were able to access loans under the Enterprise Finance Guarantee through a survey of our members. We learned that many companies had applied for a loan under the EFG but were turned down. Only one business was offered a loan under the EFG (with on the condition that the applicant's primary residence was provided as security against the loan).

[10] http://www.eib.org/projects/topics/sme/index.htm

53. The difficulties experienced by our sector with respect to the EFG have been recognised recently by the CBI. CBI President Helen Alexander said: "Music, films and books are not seen as safe bets – and so don't attract investment from banks keen to reduce their exposure to risk. The Government's Enterprise Finance Guarantee Scheme is meant to help alleviate this, but evidence on the ground from CBI members suggests this isn't the case... "[11]

54. The following case studies typify the experience of the music industry with respect to the EFG.

CASE STUDY 1: EFG AND ATC MANAGEMENT

The EFGS is proving inaccessible to applicants from the music sector. ATC Management have run a test case with 'the Rifles', applying to every high street bank for a loan for working capital to allow them to record and tour their new album. The EFGS is specifically for viable plans from small businesses without sufficient access to capital to secure their loans. The criteria explicitly include songwriters and artists, and should be the idea vehicle for debt financing in music – but in practise there are no banks willing to back our businesses.

The Rifles, artists managed by ATC Management (management company of well known artists Radiohead and Kate Nash) have applied for an EFG-backed loan of £200,000 to cash flow their second tour and album.

Their proposal is based on a track record of a successful first album and a national tour of venues of 1000-2000 capacity.

Their applications have been presented by ATC director Brian Message. Brian is a chartered accountant and chairman of the trade body for artist managers the Music Managers Forum. He has successfully applied for the Small Firms Loan Guarantee scheme for non-music businesses in the past.

When the EFGS was opened to own-account artists, Brian decided to apply as a test case, hoping that this would be of benefit to managers of other artists with viable businesses who require debt finance to cashflow their businesses.

Over the last 8 months, Brian has applied on 8 occasions to a number of the high street banks for funding for the Rifles business including HSBC, Lloyds, RBS and Barclays. All have been refused an EFG-backed loan for different reasons.

The banks "would offer an EFG-backed loan for a domino's pizza franchise", or "would take a charge over the property of the directors of the management company", but will not lend to a viable small business in the music industry without security.

Even an offer of a deposit of £50,000 (25% of the loan amount) thereby providing the bank with an 100% security when added to the EFG was rejected.

There is frustration in the music sector that the EFGS is effectively closed off to music companies.

[11] CBI Press release dated 9th March 2010, *Helen Alexander sets out CBI priorities for creative industries*

CASE STUDY 2: A RECORD LABEL THAT WISHED TO REMAIN ANONYMOUS

This record label received an EFG backed loan of £50,000 from RBS on the second attempt. Their original application was in September 2009, and their loan was finally approved in May 2010.

One reason for this delay, they felt, was the high turnover of banking staff. Their business relationship manager had only been there a few months. They felt there was also a lack of understanding of the media industries, and that these were not well represented in the knowledge base of the bank.

After their first application was refused, the management developed a more detailed knowledge of EFG with advice from accountants. In their first application, the directors were asked to provide their homes as guarantees. This was despite the rules of EFG, which exclude the main residence of the directors being considered as one of the assets of the company's directors which they can be asked to provide as collateral.

The bank would have accepted a spouse's refusal as a reason why a shared marital home cannot be used as security, and this is typical for non-EFG loans. However in this case two of the directors were married to each other, and shared a home. Therefore the spouse's refusal was not accepted by the bank. In the end, one of the couple ended their directorship of the business, which enabled them to exercise the spouse's refusal, safeguard their home, and access the EFG.

Although this company has now received a loan, they found the process took a very long time, and was unnecessarily difficult. There is no requirement for the bank to explain to businesses why they have been declined. This lack of feedback leaves the company to work it out alone. The business owners had the expectation that a publicly owned bank should do more than this facilitate borrowing. They were left with the impression that the banks are very reluctant to lend, and are only doing so as a result of the pressure the government has applied to them.

They were not willing to reveal the rate on the loan, but they did mention that they had arranged flexible repayments. Their loan agreement allows them to pay off the loan early without penalties when they receive a large lump-sum, as is typical of music companies.

They have a schedule of 3 or 4 important albums in a 12 month period, and expect that this loan will enable them to invest in these products and yield break even or profitability for all the projects within the period.

They are frustrated that banks are not attempting to understand that they are just another business creating a product and selling it. They have to invest in their product, to create it, develop it and market it. The record business is surrounded by controversy in the media, and the media paints a bleak picture about the future of the music industry, falling record sales etc. Banks' assessment of the music industry at the moment can't be very good. At least their company have a track record, relationships and can develop talent.

When asked why they had been successful with a fairly standard business model and no capital, they said they felt their reputation and long track record with the bank were important. They've been with the bank for around 12 years. They had already had a couple of similar loans which they had not defaulted on, and had proven they could manage cashflow and a loan repayment situation. They are also based in one of the smaller nations of the UK, and are “a big fish in a small pond” a successful venture in a high-profile industry for their country, with which the bank would wish to be associated with.

CASE STUDY 3: TRAPEZE MUSIC AND ENTERTAINMENT – JOHN COOPER

John has been in the music industry for decades, and is used to raising money from the city.

He has recently started building back up his company, following the closure of a previous business. They own catalogue, and specialise in the back-catalogue of celebrated artists. They wanted funding to manufacture stock (physical product), it was not speculative (for example the Frank Sinatra catalogue, which will always sell). The bank liked the plan but wanted personal properties as guarantees. They seemed reluctant to operate the EFG, even though excluding their personal properties the directors did not have the assets to secure against the loan.

In the case of Trapeze Music and Entertainment, they were seeking a loan of £50,000 to manage cashflow, but this application was rejected. They approached a further two banks who were also unwilling to lend using EFG. John stated that he is willing to take risks with his own money, and has done so in the past. He has failed from time to time. He is frustrated at the lack of availability of borrowing for small firms.

John agrees that the industry is a factor in the refusal. Banks will not take catalogue as collateral and will only take physical property not intellectual property or stock.

He says: “We applied for a loan from our bank under the government loan guarantee scheme and although they offered us the loan they would not do so under the scheme and looked to me to back the loan with my house. We have a reasonable credit history and a good relationship with the bank but this counts for nothing as they are simply not interested in working within the scheme. I am equally aware that other banks are simply ignoring the scheme.”

CASE STUDY 4: FULL TIME HOBBY, RECORD LABEL

This business has been going for 5 years, and has a turnover of £2 million. They are now at breakeven/profit. 12- 18 months ago the company heard about EFG and decided to apply. They hadn’t applied for a loan before, because of a lack of security. They had been going over three years, and their executives had around 20 years music business experience.

They needed to grow, and applied for £150-200,000 pounds for working capital to be injected 70% over the first year of a 5 year repayment term.

They looked at 2 or 3 banks and approached HSBC, asking to apply for a loan backed by EFG and prepared all the business plans and cashflow forecasts that were required. This was all considered and discussed over a series of phone calls with the bank. At the final stage, they were asked what assets the directors had, and it was made clear that their residential properties would be needed by the bank as security.

If they had had any assets, these would stand before anything else should the loan fail. The directors felt that they would not have applied for EFG had they been in a position to guarantee the loans against their homes – after all, there is a premium paid for EFG. They concluded that the only way EFG would work is if you had no assets.

He also felt that the bank didn't understand IP and that their export business was key.

55. UK Music would like to highlight very strong parallels between the difficulties faced by our sector in accessing the EFG to the difficulties in accessing loans through its predecessor, the Small Firms Loan Guarantee.

56. In 2004, the National Endowment for Science, Technology and the Arts (NESTA) submitted a paper to the Graham Review into the effectiveness of the SFLG. It reported the following:

"As an organisation that deals with innovative business models in science, technology and the arts, we are well placed to recognise where current SME finance does not meet the needs of these sectors…"

"Given that the SFLG is an initiative designed to provide debt finance opportunities to businesses that lack security one might expect it to remove barriers to debt finance for these sectors. However, there is a perception that the banks apply their criteria equally strictly when considering a SFLG loan as they do when providing finance secured against a business's assets. We believe that this represents a failure in the market. It appears that the banks feel unable to undertake an appropriate risk assessment with the High-Tech and Creative Industries due to the unusual characteristics of the sectors. As a result, whilst the SFLG will guarantee 75% of all loans, the banks cannot afford 25% of the loan book to go bad, and they are therefore unwilling to support these sectors. It is important that reform of the SFLG addresses this issue. Put simply, the retail banking system adheres to exactly the same investment criteria for any small business. Unfortunately, our experience, backed up by research, shows that the traditional investment criteria they use are often unmeetable by creative or high-tech businesses, even if they have strong business propositions."

57. It is very unfortunate that the EFG failed to address the problems identified in the operation of the SFLG. We sincerely hope that the Government will now finally correct this historic weakness in state-backed finance.

Banks' lending record to small music businesses against other SMEs

58. There is no lack of evidence of the difficulties in accessing finance from the demand side.[12] What is lacking is statistical evidence from the supply side. However useful and illuminating case studies from our sector are, we need information from lenders, not just borrowers.

59. UK Music sought to obtain data from across a range of lenders in order to aggregate lending statistics, so that comparisons could be made and the results analysed. For instance, we wished to see how many loan applications or overdraft requests have been made by music businesses, how many were granted, the total value of finance made available to music businesses over a given period, and the rate of default. We wished to compare these statistics for music businesses versus statistics for SMEs as a whole.

60. UK Music approached the largest high street banks (Barclays, Lloyds, Santander, HSBC, NatWest) to enquire whether they keep statistics about their lending on a sector basis. However, these banks were not able to disclose whether or not they keep such statistics.

61. UK Music maintains that such data is essential in order to establish whether lending patterns have changed over time, and assess whether music businesses or other IP based firms experience difficulties over and above other sectors.

62. In terms of lending to SMEs overall as a benchmark, latest figures provided by the British Bankers Assocation shows that one-quarter of SMEs surveyed sought finance last year.

- Of those, 21% sought an overdraft, and 3% a loan.

- 71% sought finance for working capital, while 7% sought finance for investment

- 78% of those seeking finance were offered it by the first source they approached.

- 34% of those that obtained a loan in 2009 rejected the offer on the basis that they might not be able to afford the repayments or the arrangement fees and rates were too high.

- 38% of SMES seeking overdrafts or loans reported difficulties obtaining these from the first source they approached. 22% were turned down outright, 10%

[12] For example, see "Access to finance for the cultural and creative industries in the South East of England," commissioned by the South East England Development Agency in December 2009. See also "Creating Growth: A blueprint for the creative industries" published by the CBI in July 2010. And see "Entrepreneurial Reactions to Uncertainty in the Creative Industries" a research paper by Dr Anna Dempster at the Department of Management at Birkbeck College in May 2008. The DCMS commissioned studies into music and access to finance in 2001 ("Banking on a Hit") and again in 2006 ("SME Music Businesses: Business Growth and Access to Finance Report"). Both only surveyed borrowers or potential borrowers, rather than attempting to make an analysis by looking at lending patterns.

obtained some but not all the money requested, 5% obtained the full amount but only with some problems.

- 29% of sole traders that applied were turned down, compared to 13% of micro business and 4% of small and medium sized ones.

- Of those turned down for an overdraft in 2009, the main reasons given for this were having no security (24%), the sector being too risky (13%) and a lack of credit history (10%).

- For loans, the main reasons given for being turned down related to poor business credit history (25%) and poor personal credit history (20%). These reasons mainly affected sole traders. Micro and small businesses that were turned down were more likely to cite lack of security.

- Of the overall SME population, 16% were offered debt finance in 2009, 5% were turned down, and 79% did not apply.

- 40% of SMEs perceive the overall level of security required by banks to have increased since 2007. 38% think it is more difficult to get a loan.

63. These figures provide a baseline for finance to all SMEs. What is now urgently required is more detailed intelligence into how these figures breakdown by sector.

Music Publishing and the Enterprise Investment Scheme

64. Government also asks for views on the effectiveness of tax-based schemes like the Enterprise Investment Scheme at encouraging private sector equity investment in small businesses.

65. To avail of the EIS scheme, the "target" company has to be carrying out qualifying business activities which can comprise not only trade but also research and development which are intended to lead to a qualifying trade. Businesses are excluded which receive royalties or licence fees other than those attributable, broadly, to intangible assets/copyrights owned and created by the business.

66. On first examination, the EIS would seem to be ideal for music publishers. However, to date, music publishers appear to have been excluded from the scheme. It is possible that the nature and variety of music publishing may not have been fully explained to local tax inspectors or been understood by them.

67. There are a variety of music publishing models: catalogue acquisition, catalogue administration, production music and songwriter development. In the latter two cases the publisher is engaged in the creation and exploitation of works which have no value at creation and acquisition by the publisher but the publisher commits his resources to building the value from scratch. At each stage of the business process the publisher is adding value. Our focus in particular is on those micro SME publishing businesses run by passionate musical entrepreneurs who want to take a risk in investing in the future careers of songwriters and composers (classical or otherwise). These

composers will have talent in the creation of music and lyrics but no catalogue of works, no "pipeline" royalty income, no guaranteed cash flow.

68. UK Music's publisher members believe that the Revenue have challenged the risk nature of music publishing arguing that if the value of the work is zero and all the value is added by the publisher then how come the publisher keeps less than 50% of the net revenue and pays the lion share to the composer? The contractual balance of power between composer and publisher has changed over the last fifty years in favour of the composer. This movement particularly in the context of pop composers has been accelerated by litigation but now publishers are comfortable that the partnership results in a fair distribution.

69. We consider that the place of creation of the musical work (original composer or publisher) should not be the determining factor in assessing whether a shareholder in a music publishing company should be entitled to relief. What should be significant is the symbiotic relationship between a composer and their publisher whereby the latter gives significant undertakings to the former (both financial and otherwise) to develop the career and promote and exploit the musical works of the composer and build value.

70. Earning royalties from the use of copyright is not a passive pastime. There is nothing passive about finding ways to generate revenue from the use of music in a modern digital environment. A good publisher will take the creative raw material and add value by applying his "industrial" process. The traditional primary source of revenue for a publisher of popular music from the licensing of music for use on records and being paid per record sold is eroding to be replaced by an uncertain environment where business models reflect the constantly changing digital environment - subscription, download, share of revenue, including advertising revenue.

71. On a more general point, UK Music believes that the current suite of tax incentives and credits aimed at stimulating investment in innovation is designed almost exclusively to support science and technology. All other forms of innovation are effectively under-supported. We fully concur with the conclusions reached by a report into access to finance for the creative industries in the South East:

"Historically the concept of innovation has been inherent associated with innovation in the fields of science, engineering and technology, specifically excluding what are now termed the 'creative industries'. This legacy is reflected in the fact that public sector funds available to support R&D and innovation tend to be largely, if not exclusively, science and technology oriented.

"So, for example, the UK government's key vehicle for supporting and facilitating innovation in UK business – the Technology Strategy Board (TSB) – has a remit to stimulate technology enabled innovation, promoting, supporting and investing in technology research, development and commercialisation. So although the TSB does identify the creative industries as one of its priority sectors, especially the 'technologically-aided' sub-sectors, it invests only in hardware and software technologies engaged by the creative industries in production and distribution, and not in content creation itself."[13]

[13] "Access to Finance For the Cultural and Creative Industries In the South East of England" Report Summary, commissioned by SEEDA, December 2009

72. Given the high expectation that Government on place on sectors such as the creative industries and tourism to drive economic growth in the future, we believe there is a strong case for Government to review its whole system of tax-based investment incentives with a view to extending more support to those investing in creative content. Government may wish to examine the effectiveness of tax credits in other countries as part of this review.[14]

Part V: Options for the future

73. As a first step, Government should obtain lending statistics from high street banks in order to establish the extent of the structural problems faced by the music sector (and other IP industries) in accessing debt finance. The lack of empirical evidence available to inform policy on an issue of such national economic importance is alarming. The same problems that hampered growth in the past risk hampering growth in the future.

74. Government should reform the EFG or its successor so that it specifically addresses the needs of small and micro enterprises that trade in cultural goods and hold intangible assets. One means of achieving this would be to earmark a specific proportion of the successor scheme for music and other IP based industries. In addition, the criteria used to make lending decisions for this ring-fenced finance must be fine-tuned in so that risk assessments are appropriate for sector, and the lending decisions must be informed by industry experts.

75. Some high street banks have conveyed to us privately the view that banks are not the right vehicle for providing debt finance to our sector because of the sector's inherent characteristics. They feel that the obligations on banks to manage risk mean they can never adequately meet the needs of our sector. This view is unfortunately shared by some within our sector, who feel that the problem is so entrenched as to be insurmountable.

76. Government should consider establishing a new source of funding aimed at stimulating investment in new talent and supporting enterprise in the music marketplace. A new fund could be created by reserving a small percentage (2 to 3%) of Government-backed venture capital fund investments and use the revenue to provide debt finance to the creative industries. Lending criteria for the fund should be developed and managed by commercial leaders from within the creative industries who have a significance level of investment experience and success in their relevant sectors.

77. The Government should amend its guidance on the qualifying activities under the Enterprise Investment Scheme so that it is clear that where a music publisher is engaged in production music and songwriter development, such activities would qualify under the EIS for tax relief. Government should undertake a more general analysis of the system of tax reliefs designed to stimulate investment in innovation within the context of the creative industries.

[14] For example, France introduced a new tax credit in 2006 designed to support French and European music production. The tax credit amounts to 20% of the eligible costs incurred in the production of phonographic works (CD or DVD).

78. Our proposals do not represent an additional burden on the public purse and indeed are designed to yield greater returns to the economy over time as the sector fully realises its growth potential. The proposals we make to not give our sector favourable treatment; instead, they remove barriers that have resulted in a market failure for our sector over many years and would put music SMEs on more equal footing for the future.

79. **UK Music wishes to convey to Government that our sector is prepared to work in partnership with Government and the financial sector to establish the mechanisms we propose.**

UK Music

Ends.

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