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**ROOTSTEIN HOPKINS SPACE, LONDON COLLEGE OF FASHION  
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Creative Industry: Fact or fiction  
Some implications for practitioners and educators

Rootstein Hopkins Space, London College of Fashion  
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**Creative Industry: Fact or Fiction**

**Some implications for practitioners and educators**

Professorial Platform Lecture, University of the Arts London

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## INTRODUCTION

In 1998 the UK Department of Media, Culture and Sports (DCMS) under Chris Smith defined the creative industries as:

*"... those industries which have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property."*

The DCMS then went on to list the 'creative industries' as follows:

1. Advertising.
2. Architecture.
3. Art and antiques.
4. Crafts.
5. Design.
6. Designer fashion.
7. Film and video.
8. Interactive Leisure Software (Computer Games).
9. Music.
10. The performing arts.
11. Publishing.
12. Television and radio.
13. Software and computer services.

While this is a perfectly workable definition it is worth bearing in mind that it is as arbitrary as most other definitions.

'Creativity' is – as the word implies – the concept of creating something new, whether totally original (rare) or by combining different pre-existing components (much more common). There are clearly different kinds of creativity, and one interesting perspective is provided by Arthur Koestler (*The Act Of Creation*, 1964) and Paul Birch/Brian Clegg (*Crash Course In Creativity*, 2002) who list three types of creative individual:

Type	Creates	Reaction	Primary sphere*	Primary legal means of protection [if available]*
1. The Artist	Beauty or challenge	"Aaahh!"	Emotional / Artistic	Copyright, Trademarks
2. The Jester	Humour, entertainment	"Ha ha"	Emotional / Artistic	Copyright
3. The Sage	Ideas or solutions	"Ah ha!"	Rational / Scientific	Patents, Copyright

It is worthwhile to note that most people's definition of 'creative business' tends to focus around 'Artist' or 'Jester' type creativity, often excluding the 'Sage'.

For example, of the thirteen creative businesses types listed by the DCMS, only one (#13: Software and Computer Services) is based on pure-play scientific/rational creativity.

Some, e.g. John Howkins, *The Creative Economy*, 2001, would argue that this is a mistake, which skews the picture of creative industry as a whole too much towards the emotional side of creativity. In his list of creative businesses Howkins includes the category R&D, comprised of the (mainly in-house) research and development activities of the world's major corporations, a very major economic activity. Arguably a large number of professional services activities (e.g. legal, consulting, investment banking) also rely on measures of originality similar creativity in the classical sense. One should certainly not assume that 'creativity' is the exclusive realm of the 'creative' professional, however it is easy to fall into the 'everyone is creative' trap that misses the point of a worthwhile attempt to focus on a key driver of future wealth.

In their recent paper *Beyond The Creative Industries*, NESTA 2008, the authors estimate that there are as many 'creative' jobs outside the DCMS categories as there are within – what is more over half the jobs in the DCMS categories are not 'creative' by any definition (just think of the

list of jobs on the credits of any film!). Suffice to say the definition of what is and what isn't a creative business is a matter of degree, however there is no doubt that economic activity that is based upon creativity is central to the success of any 'post industrial' economy like the UK.

### **ANOTHER VIEW**

Another, and also potentially very fruitful, way of looking at creative industries is to look at their underlying economic characteristics, as pioneered by Richard Caves in his book *Creative Industries – Contacts Between Arts And Commerce*, (Harvard University Press, 2001). Caves identifies seven key characteristics: Nobody Knows, Art for Arts Sake, Motley Crew, Infinite Variety, Winner Takes All, Time Flies and Durable and Replicable.

These factors are worth examining in some more detail as they give us a more robust framework for identifying the underlying business models that lie at the heart of creative businesses and hence the managerial levers that can (and cannot) be applied to enhance performance.

## “NOBODY KNOWS”

It is exceptionally difficult to estimate the demand for creative products and services in advance. Consumers will generally only know if they like a creative product or service when they see the fully finished version. This in itself makes creative business riskier.

This risk is compounded by the fact that costs invested in creative production are generally both sunk and fixed. Sunk means that the costs are irreversibly committed – there is no scrap value for a half-finished film or sculpture! Fixed means that the costs do not vary by output – for example producing, marketing and showing a film costs the same regardless of how many people turn up for the show.

There are a number of significant commercial implications for this. Most obviously, the high level of risk means that an organization with a few or just one project is gambling its future on the outcome of every single one. If the project is a success, the shareholders will win big and employees will get kudos (and maybe even a bonus). If it's a flop, the shareholders will lose everything, and the employees will lose their job (and possibly their reputation too). Larger organizations with multiple projects are better able to pool

and distribute risk – this is one driver of concentration in creative industries, and a big factor behind the existence of big film studios.

Another aspect is the value of options in a creative project, or more properly real options, i.e. the right, but not the obligation to proceed with the project at certain milestones. Let's take a film project as an example. Grossly simplified, assume the situation set out below:

We are developing a large-ish Hollywood-style action movie, with a \$75m development and marketing cost. There is a 10% chance of a hit with \$375m revenue, and a 90% chance of a turkey which makes only \$40m revenue. The expected monetary value ( $\$375 \times .1 + \$40 \times .9 = \$73.5$ ) of this project is a negative \$1.5m ( $\$75 - \$73.5$ ), and no sane studio executive would greenlight it.

Let us now consider the real options inherent in this project, and use them constructively. We do this by splitting the projects into separate stages and inserting milestones/ decision points, just like a venture capitalist. The project needs to pass each milestone with flying colours. If it doesn't, we have the option of binning it, saving us throwing good money after bad. We may also have lower risk commercialisation options, e.g. saving money on a global marketing

campaign by going straight to video for a project that is so-so, rather than great. Acting in this way totally changes the economics of the project.

First we have to insert three decision nodes up front, over which we are in control. If the script doesn't look good, even after editing, we'll bin the entire project, and save the shooting and marketing expenses. Painful, but better than shooting and marketing a film with a poor script. If the finished film doesn't look good, we'll stop it there and then, and save marketing expense. If it test screens poorly, we may drop the global marketing campaign and save what we can, by putting it straight to video.

We are still not in control over whether it's a hit or a flop, but by weeding out bad scripts, bad shoots and badly tested movies we have also increased the chances of a hit (in this assumed example from 10% to 20%) giving a positive EMV.

Negotiations and trading of creative options are obviously a critically important subject and at the heart of an efficient 'movie industry' comprising a critical mass of producers, directors, financiers and lawyers thus creating specialist clusters in Hollywood, New York and, some would claim, London.

## **"ART FOR ART'S SAKE"**

While employees working in 'non-creative' industries may (or not!) take great pride in their work, they tend to ultimately believe that satisfying the consumer and achieving commercial success is the real arbiter of quality and performance. A lot of creative people meanwhile, care more about the estimation of their peers than about success in the marketplace. Quite often this will mean diversion of effort from what the customers are willing to pay for to what the creative think is the best expression of his or her creative impulses.

An almost clichéd example is the advertising agency creative director who would rather do a really funny and edgy commercial (and receive accolades in Cannes) than execute on the more humdrum 'busy mom with kids' - testimonials that shift detergent in Croydon. Another is the movie director who wants a dark, despairing ending, while the studio executives want smiles and happiness to maximize appeal to e.g. dating couples. [e.g. Ridley Scott *Blade Runner*].

The commercial implications of this are a need to create the happiest possible compromise between the creatives' need for self-expression

and commercial reality. Too 'creative' could scare away the customers and leave the company a disorganized mess. Too 'commercial' could scare away the creatives and leave the company a soulless hulk with nothing credible to offer. Though of course some creatives are willing to operate where others sneer, as Jack Vettriano, Mills & Boon and the Franklin Mint clearly demonstrate.

#### **"MOTLEY CREW/ WEAKEST LINK"**

Most creative businesses require the input of several different creatives, as well as non-creatives. Think of a movie production, with everyone from directors to actors to special effects producers and production accountants all working on a single project. Every contributor must perform well, for the overall result to be successful.

The commercial implications of this are that team selection and management skills are at a premium. It is very difficult to enforce performance through contracts – if the motivation and talent isn't really there, no contractual obligations can bring it out. Hence people are very much hired by their reputations. Firstly, for the obvious reason that quality people tend to have quality reputations. Secondly, and with a bit more sting in the tail, people who worry

about losing a great reputation will be much more inclined to perform well. The reputation issue is one of the many reasons why newcomers find it so difficult to break into the creative industries.

Another aspect is the value of established teams, who know and respect each other, and work well together. Getting a team on board is much less risky than hiring individuals and expecting them to blend. This is one reason why for example film production and advertising teams may stay together for years, moving between several different employers or projects.

#### **"INFINITE VARIETY"**

Creative products have many more dimensions of difference than normal products and are less amenable to rational comparison. There are two aspects to this. The first is that there is an infinity of creative expressions possible – a blank canvas can be turned into any painting, or even a sculpture. The second is that whether or not creative products are in fact very different or not, it is difficult to rationalize a choice between them (unlike e.g. a lawnmower or a fridge).



The commercial implications of this include the need for expert agents (e.g. art galleries, literary editors) to evaluate the hundreds of thousands of new creative products (paintings, manuscripts) being created each year and choosing a select few for exhibition or publication. For example, out of fifteen thousand unsolicited novel manuscripts received by major US publishers each year, 1 (one) is selected for publication.

Another aspect is the need for a large and diverse stock to cover e.g. the book, music or film market. For example, a book store may have to store dozens of different variants of 'historical dramas' or 'teenage horror flicks' to be reasonably sure of covering demand – just stocking the *Da Vinci Code* does not a bookstore make.

#### **“A-LIST / B-LIST / WINNER TAKES ALL / SUPERSTAR”**

These really are a number of related and similar effects.

The A-list/B-list effect is that creative performers are subject to a rigid (though rapidly changeable!) hierarchy of perceived quality. End consumers generally have a strong preference for A-list performers. The reasons for this include mass psychology and opportunity cost

(you spend the same amount of time at the concert, whether it's Joe Unknown or U2, but seeing Joe Unknown gives few kudos with your mates). The effect of this obviously carries over to creative entrepreneurs/ employers, who build their roster of actors, directors etc., according to what will pull in the consumers.

This all means that B-list (or lower down) performers often aren't really substitutes for A-list stars. Hence, the A-list will earn disproportionately much more than the B-list, and – to add insult to injury – will also be much busier (i.e. attract more bookings). The commercial implications of this is that judicious tradeoffs have to be made between the huge extra costs but also undoubted advantages related to the choice of A-list versus B-list players. And if you are a B-list star, it's worth really making a splash to make it into the A-list (hence why plastic surgeons and scandal magazines are busy).

Note that the superstar effect is not isolated to the creative industries – over the last several decades it has been seen in industries as diverse as share analysts, lawyers, chief executives and business school professors. Also, it is becoming more prevalent, as global communications improve – the bigger the market (and audience) the stronger the effect becomes.

## **“TIME FLIES”**

The profitability of creative projects is highly dependent on strong coordination during project execution and on avoiding delays between completion and going to market.

The coordination aspect is the same as for any large and complex project in any industry. All the pieces and players need to be available at the same time, to avoid inefficiency and waste. For example, movie or recording studio facilities are very expensive, and careful coordination is necessary to avoid costly delays.

Secondly, once the project is ‘in the can’ (and all the costs have been incurred), it is imperative that the project hits the market and starts earning revenue as soon as possible. This will be no surprise to anyone familiar with the concept of time discounting and net present value – a dollar today is worth more than a dollar tomorrow, or in a year’s time.

The commercial effect of this is that any complex creative project needs strong project management to avoid potentially catastrophic waste and inefficiency. The production debacle around Francis

Ford Coppola’s *Apocalypse Now* is not an experience many studio executives would care to replicate.

## **“DURABLE AND REPLICABLE”**

Most creative products can be cheaply stored and easily replicated, particularly now in an era of digital storage and distribution.

The commercial effect of this is that (copy) rights management is key to profitability in the creative product industries. This can be relatively straightforward when there is just one ‘big’ work involved in one geography, but rapidly gets extremely complex with lots of smaller rights of different kinds, in different geographies, collecting maybe just a few pence per work at a time.

For example, the rights administration issues involved in J.K. Rowling’s Harry Potter empire are very considerable. The book rights alone are complex, with the book printed in sixty-one languages, and distributed in two hundred countries. The film rights are held by Warner Brothers, while the toy rights have been licensed by Warner to Mattel, which has sold more than \$150m of Harry Potter toys. The video games right are held by Electronic Arts, and in addition Harry

Potter has been placed on mugs, coasters, balloons, chocolates, a Hornby train set and lots of other products from which the rights owner extracts a (relatively) risk free royalty.

CREATIVE BUSINESSES		
	DESCRIPTION	EXAMPLES
<b>Creative process businesses</b>	<ul style="list-style-type: none"> <li>• <b>Professional services firms</b> delivering a creative service to clients <b>on demand</b>.</li> <li>• Mainly business-to-business.</li> <li>• Do not generally retain IP (but may have it in internal processes).</li> <li>• <b>Strong talent management is key.</b></li> </ul>	<ul style="list-style-type: none"> <li>• Architects.</li> <li>• Advertising / PR / Branding and other marketing services firms.</li> <li>• Design agendas.</li> </ul>
<b>Creative product businesses</b>	<ul style="list-style-type: none"> <li>• <b>'Content' or brand creation businesses</b> – that create a replicable product/output that is usually protected by intellectual property law.</li> <li>• <b>'Hit' businesses - instinct for the winning product and IP protection is key.</b></li> </ul>	<ul style="list-style-type: none"> <li>• 'Content' or Brand creation businesses that create a replicable product/output that is usually protected by intellectual property law.</li> <li>• 'Hit' businesses – instinct for the winning product and IP protection is key.</li> </ul>
<b>Media businesses</b>	<ul style="list-style-type: none"> <li>• <b>Content 'distribution' businesses</b> delivering a creative product to a <b>community or audience, to educate, inform or entertain them.</b></li> <li>• Emphasis on continuous content development or usually purchase from CP suppliers.</li> <li>• Multiple often recurring revenue streams e.g. advertising / subscription / pay per view / ancillary.</li> <li>• More focus on efficient operations than for two other types – <b>timeliness is often key to value.</b></li> </ul>	<ul style="list-style-type: none"> <li>• Newspapers and magazines.</li> <li>• TV and radio broadcast.</li> <li>• Theatres and event venues.</li> <li>• Museums and galleries.</li> <li>• Cinemas.</li> <li>• On-line communities.</li> </ul>
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## CREATIVE BUSINESSES

Applying these criteria to the wide range of 'Creative Industries' laid out by DCMS *et al* provides some useful insights. Reclassifying the long list into three broad groups based on their principle business models i.e. the ways in which they create and capture value and the overall systems by which various types of creative business compete, survive and make a return on the financial or social capital invested in them.

This analysis leads us to the following categories of Creative Process, Creative Product and Media businesses. It is worth noting that only the Creative Product businesses meet the Smith and Caves tests for Creative industries.

## CREATIVE PROCESS BUSINESSES

These are a highly diverse group of professional services businesses ranging in size from one-man consultancies to global behemoths like the WPP marketing services group, with seventy thousand employees spread across seventeen hundred offices in one hundred and four countries.

Their common characteristic is that they deliver a creative service (typically described as projects) to customers (typically described as clients). Unlike creative product businesses, which provide multiple (possibly millions) of impressions of the same creative product, the output of the creative process business is highly bespoke to the individual needs of clients. Another difference is that creative process industries mainly service business customers, whereas the end users of creative product industries are overwhelmingly consumers.

As will be apparent with the other type of creative business as well, only a fraction of the activity of the creative process firm is actually 'creative' in the core sense of the word. In a lot of ways, the creative process firm is actually more similar to much more traditional professional services businesses, such as law firms and accountancies, than to the other types of creative business.

A very significant driver of market structure in the UK creative services industry is the ever-present tension between economies and diseconomies of scale, scope and learning combined with the very low barriers to entry.

Economies of scale occur where you can employ the same asset (e.g. a printing press) to produce more goods/services (e.g. a magazine) at small additional cost. The average cost per copy will be lower, the more you produce.

Economies of scope occur where you can do more (different) things with the same asset. For example, your existing finance department may well be able to also cover financial management of an acquisition you make, enabling you to cut overall finance department costs.

Finally, economies of learning enable you to reduce cost over time, as you learn what works best and weed out inefficiencies in the process. This works in manufacturing but works particularly strongly in services and creative industries. For example, a strong, experienced movie production crew will be much, much more efficient than a set of novices. Similarly, an experienced group of advertising professionals will not only be able to do a better campaign than amateurs – they will also do it much more quickly. A set of established processes gives you a huge head start.

It would seem that economic forces are all on the side of the 'big battalions', and indeed the last ten to fifteen years have seen the rise

of massive creative services conglomerates such as WPP, combining literally hundreds of creative services businesses under one roof. On the other hand, start-ups continue to flourish [though admittedly the downturn from 2000-2004 has proved a rather more bracing climate than most creative services entrepreneurs would have hoped for].

The reason why the companies don't end up as just a few large players in each industry, tempered only by monopoly/competition regulation, is that there are diseconomies of scale, scope and learning as well.

You can grow so large that it becomes difficult to control quality and maintain motivation. Or you may become ever better at efficient delivery of a particular kind of product or service – but in the meantime the marketplace has moved on.

On the one hand, there clearly are benefits from being large in creative professional services. Big clients will consider you more credible for big projects. Over the last decade, big clients have also tended to concentrate their international activities with one or few firms, which has benefited large firms, with international reach. The large company will have more resources to invest in building its

business. It can also benefit from cross-selling between different services, and clients can benefit from having an integrated service provided under one roof. Finally, the large company can offer good quality shared services (for example financial management) that most creatives in smaller firms find a disruptive chore.

It's not all great for the giants however. Firstly not all clients appreciate having the same service provider as competitors, even considering Chinese walls. They might not believe that cross-selling benefits them, and may prefer to mix and match across different providers. Also, the leading edge talent and entrepreneurial types often feel stifled in large organizations. Finally, large companies, containing lots of vested interests and general inertia, will generally just be slower off the mark in capturing new opportunities.

Another factor driving market structure is barriers to entry, i.e. whether it's easy or difficult to become a credible player in the industry.

In general, the barriers to entry in agency type businesses are quite low compared to a lot of other industries. While some years ago you might have required very expensive IT systems to deliver credible Art Design for example, you can now get professional systems for a

few thousand pounds. With IT just getting cheaper all the time, the investment barrier keeps getting lowered.

Similarly, clients (or other agencies) don't actually mind working with very small outfits, as long as they are good. Staff – once they have their basic experience – tend to be very mobile, and very willing to join a new creative bandwagon. The unit of exchange tends to be the teams of possibly no more than four to five people – one of those is quite enough to serve even quite large clients.

Another factor is the lack of professional certification – anyone can set up shop in advertising regardless of degree or no degree or where they trained (or didn't train). There have been some voluntary attempts at creating various professional bodies in advertising, but their real impact on shaping client demand and entry to the industry seems less than decisive so far.

Just compare with the situation for investment banking, where you need massive IT systems and other infrastructure (e.g. equity sales), clients much prefer to work with the global #1 and staff are loath to leave first tier banks for second tier banks, let alone start-ups. Investment banking is also massively regulated, with need for regulatory approvals of activities though their effectiveness may be open to question.

Overall these various factors have combined into maintaining the creative services industry as a fertile zone for entrepreneurial endeavour. So while there is some evidence of increasing consolidation over the last ten to fifteen years, it has probably been concentrated amongst the large players, i.e. the small players remain as fragmented as ever, and there is a constant stream of new entrants to the industry.

### **CREATIVE PRODUCT BUSINESSES**

This is, if possible, an even more diverse group than the creative process industries. It ranges from the struggling 'artist in the attic' to global publishing behemoths like Random House [part of the Bertelsmann Group], fashion giants like Armani, LVMH, Max Mara and Gucci or movie studios like Universal.

Their common characteristic is that they deliver a creative product, either directly to consumers or via a media business intermediary (see the section on Media Businesses below). They differ from creative process industries in delivering a uniform product rather than a bespoke service, and by doing this in (generally) multiple copies, thousands or even millions. Typically creative product industries are consumer industries, unlike the business-to-business oriented creative process industries.

There are in the main two types of business in this space, though the bulk of actual creative product industries combine elements of both.

The first type is the publishing business. A publisher relies on a large, independent external group of artists, writers, singers etc. to provide it with works to evaluate and select from, before proceeding to the production and distribution stage.

The second type is the studio business, which is more in the driving seat in relation to the creative input. The studio business will commission creative work (either in-house or outsourced) to a set of specifications, rather than just wait for appropriate works to pass by, edit until satisfied and then proceed to the production and distribution stage.

Book and record publishers are examples of pure publishing businesses, while computer games businesses tend to be studio based. Other types of creative product businesses tend to fall somewhere between the two, either consistently or on a project-by-project basis.

As stated above, the publishing and studio businesses have slightly different value chains.

In the publishing industry, the creative process is fully outsourced and independent of the publisher. The publisher relies on a group of specialized professionals (e.g. editors in book publishing, Artists & Repertoire (A&R) executives in music publishing) to select potential winners from the vast range available. Often their work is assisted by outside intermediaries (agents), who cut down on the tedious trawling work otherwise associated with identifying potentially interesting works. The average US novel book publisher for example, selects only one out of fifteen thousand unsolicited manuscripts for actual publication.

Having identified a potentially commercially viable work, the publisher will proceed to the production stage, for example jacket design, typesetting and printing in the case of book publishing and subsequently to distribution.

The studio approach is slightly different in that the business defines the creative concept and then sources creative input to deliver it (possibly from in-house teams). This is how most computer games companies operate – they identify a technology platform and creative concept and then source the necessary mixture of creative and non-creative work to deliver it (e.g. computer graphics, programming).

Creative product industries generally have very high fixed costs and very low variable costs relative to turnover. Their opportunity for profitability lies in the possibility of replicating their product in large numbers at low cost and selling at high prices if (and only if) the product becomes a hit.

It is therefore critically important for creative businesses to be able to restrict competitors from replicating their products. Understanding intellectual property rights is a key plank of running any creative product business. However, this is a complex area, and businesses are well advised to seek specialist legal advice for any non-trivial issues.

## **MEDIA BUSINESSES**

We define media businesses as businesses that deliver a recurring media product to consumers, to inform, educate or entertain them. The classic example of media businesses are mass media, i.e. newspapers, magazines and radio/TV. We include theatres and other 'venues' (e.g. museums, galleries and auditoria) and film distribution and exhibition in this category. While they are less recurring than mass media (you do not necessarily go to the cinema every day), they have quite similar business characteristics i.e. they create and 'monetise' audiences.

Media businesses have some similarities with creative product businesses, and the distinction is not always that clear-cut. While media businesses also deliver a creative product, it is much more varied and composed of multiple sources, as well as recurring, not just being a one-off. Any single creative product component – even that amazing Pulitzer Prize winning article – is unlikely to make much of an impact on the overall economics of the entire year. Instead of one blockbuster hit, the success of a media business is composed of more of a hard slog, many little hits, consistently delivered day in day out.

Media businesses share of a lot of issues with businesses outside the creative industries. For example, most media businesses will face the same issues of building strong brands as most (other) fast moving consumer goods (fmcg) businesses. Also, a lot of media businesses face production and distribution issues quite similar to consumer goods businesses. Cinemas meanwhile quite often earn a lot of their profits from movie snacks and hence also operate in the retailing/ fast food business.

There are in the main two types of business in this space.

The first type is the mass media business. These are businesses which deliver a media product they have produced themselves to a mass



audience through a remote medium such as TV, Radio, Broadband, Satellite, Newspapers, Newsletters and Magazines.

The second type is the venue/event business which stage live events in a physical space. Theatres, galleries, museums and stadia involve displays or performances, while events companies organize trade shows, concerts, launch parties and the like. Cinemas are similar to theatres in that they stage performances. However, the cinema performance is 'canned' while the theatre is live, and movies have considerably more mass appeal than stage performances. Hence cinemas are much more of a mass-market, almost industrial, operation.

The value chains of media businesses are fairly straightforward.

The first part is to source the content (e.g. editorial and advertising). The next part is producing it, e.g. layout and print in case of print publication, editing to a master tape in case of broadcast. Final part is distribution – simple for broadcast, major logistical issue for print.

Theatres and event venues can be somewhat simpler. Generally the venue (means of distribution) is at hand or can be rented relatively straightforwardly. Their key focus becomes to get a good script and to execute it well (production).

Cinemas are the simplest of all – here the venue is at hand, and films are produced by someone else (or by another division in a movie conglomerate with an exhibition arm). There are really only two steps, sourcing the films (including negotiating fees) and showing.

### HOW BIG ARE THE CREATIVE INDUSTRIES?

Identifiable by SIC from 2004 Company House Data

Source: FAME, Amadeus

Taking the above classifications we can try and identify exactly how many firms fit into these categories and their economic impact. This was done by taking all the company house records from 2004 and manually allocating firms to the relevant group.

6,208 Companies, £122 bn revenue, 646,413 employees.

	% of companies	% of revenues	% of employment
<b>Creative process</b>	8%	50%	40%
<b>Creative product</b>	36%	6%	7%*
<b>Media</b>	57%	44%	53%
			* 45,250

NB Excludes many micro firms, sole traders (freelancers), partnerships and firms not identifiable by SIC.

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What is immediately obvious is that Creative Product companies (those that *have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property*) represent a very small share of revenue (6%) and employment (7%) but a large number of firms (36%) – i.e. they are mainly small companies, many of whom on further analysis are struggling to attain any meaningful level of profitability or sustainability. However many of these firms and the rich ecosystem of independent creators that surround them, are essential to the health and growth potential of the Creative Process and Media businesses

Identifying, nurturing and applying creativity and providing the best possible chance for it to grow and generate future economic and social returns in the core creative product businesses is the key challenge for maintaining and growing a robust creative economy.

## **GROWTH**

The growth picture across UK creative industries is quite mixed, with some industries growing fast and others stagnating or in decline.

Looking at the period 1997-2002, radio and TV, software, advertising and arts/antiques have grown very fast in revenue terms, at around

10% p.a. sustained for five years. At these growth rates, an industry would more than double in size every seven years. Note that these growth rates do not include the impact of the advertising and general recession commencing in 2001, which have hit both advertising and media businesses very hard. Over the longer term however, the growth trend is real and significant.

At the other end of the spectrum, architecture and designer fashion have stalled. Figures for design were not available, but are likely to have moved more in sync with the economy as a whole.

On the employment side, the industries with growing revenues not surprisingly have increasing employment – though it is notable that employment is not growing as fast as revenues (i.e. businesses are becoming more efficient).

As a result of the high historical growth followed by a marked slow down in the first few years of the new millennium the DCMS initiated an industry wide review of the creative industries (the Creative Economy Programme or CEP) that culminated in a report titled *Staying Ahead: The Economic Performance Of The UK's Creative Economy*. This was published in July 2007 as a precursor to a 'green paper' of revised government policy for the sector. It was hoped (though not highly) that this would focus on three areas:

Management capacity building, regulation to redress competition asymmetry and fiscal incentives to encourage investment in early stage ventures.

Apart from a fairly superficial review of the economic performance of the sector (to a great extent hampered by the lack of reliable, current or comparable data) this report gives a useful snapshot of the 'creative economy' and provides an extensive set of references to other literature of varying degrees of relevance. It and the subsequent report *Creative Britain – New Talents For The New Economy*, DCMS February 2008, can be downloaded at [www.cep.culture.gov.uk](http://www.cep.culture.gov.uk)

However a later report *Beyond The Creative Industries*, NESTA 2008, indicates that growth in the creative sector has stalled at around 7% of the UK labour force.

## GROWTH OF CREATIVE EMPLOYMENT AND SHIFT FROM EMBEDDED 1981 – 2001 BUT LITTLE GROWTH 2001 – 2006

Employment Category/Year	1981	1991	2001	20 year CAGR	LFS 2006	25 year CAGR
<b>Creative industries</b>	445,870	598,900	1,242,811	5.3%	1,285,042	4.3%
<b>Embedded in NON Creative</b>	457,130	524,750	645,067	1.7%	698,244	1.7%
<b>Total Creative Employment</b>	903,000	1,123,650	1,887,878	3.8%	1,983,286	3.2%
<b>UK workforce</b>	22,866,100	23,452,230	26,575,780	0.8	28,165,612	0.8
<b>Embedded share</b>	51%	47%	34%		35%	
<b>Creative Employment as % of UK workforce</b>	3.9%	4.8%	7.1%		7.0%	

*Beyond Creative Industries*, NESTA 2008

## WHAT IS GOING ON?

- Massive investment in and growth of Media businesses up to 2000 but decline of print and increase productivity through technology stagnating employment growth.

- Growth by shift of embedded talent to Process (agency) businesses plus growth in export of services to 2000 but consolidation, international competition and cyclical downturn thereafter.
- Creative Product – < 0.5% of national employment – poorly resourced and poorly managed but critical for the rest – why?

On the basis of these figures, and what we know about the creative product business we can estimate that the number of people engaged in creative product businesses may be around 138,000 (7% of 1,983,286) of whom 45,000 are in formal firms and 93,000 ‘independent’ authors, artists, designers etc. While I would not make any claims for the statistical validity of these figures the proportions ‘feel’ about right. More importantly most of these ‘players’ (apart from the A list e.g. J.K. Rowling, Damien Hirst, Paul McCartney *et filie* etc.) fail to capture much of the value from their efforts.

Sadly this is for perfectly explicable reasons of risk and return.

### RISK IN THE CREATIVE INDUSTRIES

The main sources of risk for the three types of creative industry are audience or market demand; the resources the business needs to

produce creative outputs; and industry structure. The combination of these risk factors contribute to the overall risk profile of particular creative industries and hence the required return that investors of capital (whether it be financial or human) will require to take that risk.

### WHY?

#### INVESTING IN THE CREATIVE INDUSTRIES – THE RISKS

	<b>Demand</b>	<b>Resource</b>	<b>Industry Structure</b>
<b>Product</b>	“Nobody knows” but we must commit capital in advance.	Talent is capricious and expensive.	Gatekeepers have all the power.
<b>Process</b>	Client may reject the pitch, but pitching is cheap.	Can mitigate against key man risk by scaling up.	Can match media owners’ power by scaling up.
<b>Media</b>	Vulnerable to changes in taste.	Media companies are bigger and more powerful than their suppliers.	Scale economies and barriers to entry mean few or no competitors.
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Or to put it more graphically – in a traffic light system where the worst outlook is red, reasonable is amber and benign is green, creative product businesses receive red lights across the board.

## RISK IN THE CREATIVE INDUSTRIES

	Demand	Resource	Industry Structure
Product	●●●	●●●	●●●
Process	●●	●●	●●
Media	●●	●	●
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### DEMAND FAILURE

All creative businesses face the risk of demand failure, the possibility of rejection of the business's offering by its target market.

Creative content businesses feel the risk of demand failure acutely, since it is not feasible to market-test an incomplete creative product until a substantial amount of expenditure has already been incurred. For example, Hollywood test screenings take place after most of the production budget has been spent. The financial and legal strategies employed by creative content businesses to mitigate product failure include staging of investment decisions, deal structure, and portfolio diversification. We illustrate this with an example from the film industry.

Staging of investment decisions means the option during the production process to continue with a project or to kill it. If the script is good, the studio can increase the production budget. If the test screenings are poor, the studio can decide whether to re-edit, or to scale back marketing expenditure. Thus not all the investment required to launch a film need be committed upfront; investment decisions can be revised as new information about the chances of success or failure arrives. This flexibility is a source of value, and means that it may be rational for a studio to go ahead with a production even if it appears on paper that doing so will be unprofitable.

For the creative process business demand failure comes in two flavours: the volatility of demand at the macroeconomic level for the particular service that the business provides (the fluctuating demand for advertising, say, which is highly sensitive to the annual change in GDP), and at the level of the individual business the risk that a prospective client will reject the business's pitch for new work.

While the amount of capital at stake in any one pitch is negligible (the opportunity cost of the account executive who put together the proposal), volatility of demand for creative process output creates a more serious challenge. To grow, the creative process business must invest in human capital – the smart people who will deliver

creative output. But labour is a fixed cost, hard to adjust quickly to rapid fluctuations in revenues. The challenge of adjustment may be compounded if the creative process business decides, having made its investment in recruitment and training, that it is unwilling to let people go when times turn bad.

One way in which the creative process business can address this challenge is by developing strong organisational competencies which enable it rapidly to mould new staff to 'the way things are done here'. With such competencies in place, the creative process business may feel more relaxed about shedding staff if revenues decline. This is essentially the model of many strategy and management consultancies, who are ruthlessly efficient at letting people go during periods of contraction, and equally efficient at rapid recruitment and training when demand for their services pick up.

Historically demand failure has been less of a consideration for traditional media businesses serving mass markets, where these have enjoyed the status of monopoly provider or faced only limited competition. This is no longer the case, as the case of Channel 4 illustrates. The company operates as a publisher, with low overhead

and few assets, outsourcing all programme making to independent production companies. Administration costs are less than 5% of total expenditure, and net operating assets are less than 40% of total revenues. The business runs a lean, asset-light operation.

The channel's viewing demographic is highly attractive to advertisers (18 – 40, ABC1s) and as a result it has outperformed other terrestrial television channels in terms of capturing advertising revenues:

As a result, the channel has been successful financially, earning a return on capital in excess of its cost of capital in three of the past four years, an impressive achievement for an entity with a strong public service remit. However, the NOPLAT margin (net operating profit less adjusted taxes) is tight, and it would take only a small change in the channel's fortunes for profits to turn negative:

Other terrestrial commercial broadcasters are highly likely to find themselves facing a crunch similar to Channel 4's; declining advertising revenues and rising programming costs. The next five years will be unpleasant for investors, suppliers and employees in the TV broadcast sector.

## **RESOURCE RISK**

For creative industries resource risk means above all the challenges associated with managing human capital, and it poses a considerable challenge for creative content businesses, reliant as they are on the whims of capricious talent. EMI's recent experience demonstrates the point. On 7th February 2005 the company announced that albums by two of its major bands – Coldplay and Gorillaz – would be delayed. Late release means cash flows deferred, and hence lower present value today; EMI's share price fell sharply on the news.

For creative process businesses scaling up is one way of mitigating key man risk (the danger of losing a key account executive, say), so that the departure of any one staff member has minimal impact on the enterprise as a whole. As we have already seen, the development of strong organisational competencies that make it easy to slot in new staff members to established creative routines is another. This can be a source of competitive advantage, and hence value, if the business succeeds in developing organisational competencies that customers value and that are hard for competitors to emulate.

The existence of such competencies is a rebuttal to view that creative process businesses are an unattractive investment opportunity

because their most important assets walk out of the door every evening. If the business can reliably replicate the processes that give it competitive advantage, scaling up (and down) as required to meet changing demand, then the source of the business's value lies not in untethered human capital, but in the organisational competencies themselves. A business which possesses such competencies can represent an attractive investment opportunity.

## **INDUSTRY STRUCTURE**

Industry structure again makes life hard for many types of content production companies, since access to markets is controlled by gatekeepers; games developers must rely on games publishers, and film producers on studios to get their product in front of a paying public. The potential for gatekeepers to capture value is illustrated by the computer games industry, where games developers frequently struggle to generate substantial profits, but games publishers can earn a substantial spread above their cost of capital.

Resource requirements and industry structure pose fewer risks to traditional media companies; they have more muscle than their employees (journalists, programme producers), and scale economies and barriers to entry mean they face limited direct competition.

## RISK AND TIME

The combination of demand, resource, and industry structure risk can combine to make life bleak for creative content businesses. However, the outlook is far from hopeless; the risk profile of creative content businesses can change quite markedly over time. Consider a major record label. Each year it releases a certain number of albums by established artists and new bands. At the moment the label agrees to a production deal it cannot forecast with certainty how the album it has contracted to release will perform, but once in the shops the recordings financial performance is known, information that is a reliable guide to its likely future earnings. As the size of the record label's back catalogue grows the business's earnings become more stable, both because sales from risky new titles form a declining proportion of total sales, and because back catalogue sales are less volatile.

Furthermore, once the content has been delivered – the film wrapped, the album recorded – the content business need not worry about the challenge of managing wayward or temperamental talent, thus the content business's resource risk diminishes. Industry structure risk declines too; while gatekeepers hold all the chips when negotiating on distribution terms for new content whose value is

unknown, broadcasters and other distributors are always hungry for proven, high quality content; broadcasters will continue to pay high prices for the rights to The Sound of Music for many years to come. Hence established content businesses, with large back catalogues, can have extremely low risk profiles:

## RISK AND TIME IN CREATIVE PRODUCT BUSINESSES:

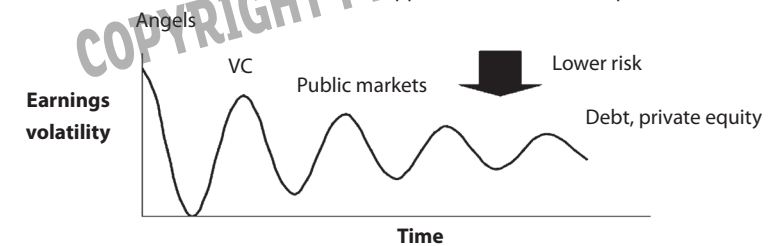
### THE BACKLIST EFFECT

	Demand	Resource	Business Model
Product	●	●	●
Process	Value of product is known	No talent involved once product is made	Gatekeepers are hungry for proven content

Vulnerable to changes in taste.

Media companies are bigger and more powerful than their suppliers.

Scale economies and barriers to entry mean few or no competitors.





As the risk profile of a creative content business changes, so should its sources of capital. An early-stage music label or film production company is best suited to investors with a high appetite for risk; angels and VCs. As the business matures, public equity markets become a more appropriate source of capital. Once it has a substantial back catalogue the business should be generating stable, abundant and predictable revenues. It is not unknown for the managers of such businesses to be profligate, to gamble excess cash on ill-considered investment decisions, or otherwise to waste shareholders' money. The optimal financial structure for such businesses is a highly geared balance sheet, since debt imposes discipline on otherwise profligate managers. Shareholders in such businesses should either press existing management themselves to increase the debt:equity ratio, or sell out to private equity, which will in its turn finance the business with substantial debt.

Creative content businesses which have substantial back catalogues, generating stable, low-risk revenues, and which also continue to invest in new artists, create a conundrum for investors; it is arguable that such businesses should be broken up, as the case of EMI illustrates.

EMI has two divisions. EMI Music generates revenues from the sales of artists' sound recordings by discovering new acts, signing them, and, if they are successful, promoting them and further developing their careers. EMI Music Publishing, the world's largest music publisher, makes its money by acquiring or administering rights in music copyrights and licensing those rights to end users in exchange for royalty payments and/or fees.

Whereas EMI Music's revenues are volatile, those of EMI Music Publishing are stable, predictable and abundant. As a result one would expect the optimal capital structure and shareholder base for each division to be markedly different. Publishing can support high debt levels, and should appeal to shareholders wanting stable returns, whereas Music can't support much debt, and is better suited to shareholders with the stomach for high-risk investments. Furthermore there is good reason to believe that keeping the two divisions together is destroying shareholder value, by creating a conglomerate discount.

The risk profile of creative businesses inevitably has implications for investment strategies, which we now consider in more detail.

## FINANCING THE CREATIVE INDUSTRIES

Investors will only commit capital to an investment which they believe will provide them with a return on capital equal to or (ideally) greater than the cost of capital. That is, investors will only part with their capital if the enterprise generates returns sufficient to compensate them for the risk that all of their capital might be lost. The cost of capital can be thought of as an insurance premium, and the greater the risks faced by the enterprise, the higher the cost of capital will be.

We have seen that creative businesses face demand, resource, and industry structure risk, although creative content businesses can become substantially less risky over time. **Investors will only invest** in the creative industries if they believe that creative businesses have the resources – IP, know how, strategy or organizational competencies – to master those risks sufficiently to earn a positive spread on capital.

We focus primarily on investment in creative content businesses because we believe the high degree of risk and competition asymmetry in these industries make attracting fresh investment a particularly hard challenge.

## CREATIVE INDUSTRY REVISITED

The greatest challenge by far is the formation and growth of new creative product businesses which are at the heart of the so called 'creative' industries of which creativity is the lifeblood.

- The concept of Creative industries is a convenient fiction – it has provided a focus for a debate about the role of creative activity in the economy and an antidote to the manufacturing or services only agenda.
- The reality is that there is a cottage industry of Creative Product firms and an informal ecosystem of creative talent and craft skills.
- This supports much larger, more formal Creative Process and Media industries that are ex growth and desperate for genuinely new ideas- for real creativity!

### SO WHAT?

- Creative output is at the heart of future national cultural and economic wealth – it should be at the heart of our industrial strategy.
- Creators need to learn how to capture more of the value they create – this is primarily a management problem.
- If we focus on an arbitrary 'Creative Industries' we miss the point – the real challenge is that there is a shortage of creativity in industry.

## HOW DO WE PUT THE CREATIVE BACK INTO INDUSTRY

- For practitioners we must recognise creativity is not the same as creative problem solving.
- For educators we must recognise that creativity requires 'open and connected' thinking – not just skills.
- For both we must accept that NOT everyone can be creative – achieving and maintaining the 'defocused attention' required is a talent.
- Developing and nurturing that talent is a huge challenge to accepted business and educational models

## CREATIVITY – ALIGNING THE FORCES

after Teresa Amabile *How To Kill Creativity*



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## MANAGEMENT GOAL UNITY, DRIVE AND COMMITMENT

In any business it is critical that the entire founder and initial management team have the same overall goal for the business and are equally committed to carrying it out.

The first obstacle here is that very many creative business founders are in fact not willing to make the tradeoffs required in terms of business focus, hard work and delegation in order to move from a small lifestyle business to a large, professionally run business. This is a management challenge.

The most obvious candidates for the 'lifestyle' business epithet are those who do not want to give up evenings or weekends to drive the business forward – but they are by no means the only ones. Lifestyle businesses also include a large group of hard-working operators, who however see the business as an extension of their own personality, making them unwilling to provide pragmatic solutions that customers want, or delegating power to professional management.

Situations with multiple founders/ partners can be particularly complicated, as very often they do not want the same thing. Unless

however all active founders/ partners are signed up to the same vision, and equally willing to make sacrifices, there won't be a solid growth foundation for the business.

Fixing this problem requires identifying it and agreeing how to resolve it, for example by drafting a detailed business plan and partners/ shareholder's agreement. However agreeing on how to maintain creativity, particularly creativity in a team environment as the firm grows is crucial.

### CREATIVE TEAMS CAN DO MORE

after Gordon Torr *Managing Creative People*.

Enhancers	Inhibitors
<ul style="list-style-type: none"> <li>• Good project management.</li> <li>• Clear transparent briefings.</li> <li>• Encouragement.</li> </ul>	<ul style="list-style-type: none"> <li>• Constraint (habit, groupthink).</li> <li>• Inappropriate time pressure.</li> <li>• Disinterest.</li> </ul>
<b>The Manger's Job</b>	
<ul style="list-style-type: none"> <li>• Remove constraints.</li> <li>• Provide adequate resources and compensation.</li> <li>• Close off easy exits.</li> <li>• Set realistic timescales.</li> <li>• Monitor and encourage without intrusive surveillance.</li> </ul>	
<ul style="list-style-type: none"> <li>• This is an entrepreneurial challenge!.</li> </ul>	
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### ENTREPRENEURIAL MANAGEMENT

Entrepreneurial managers are those individuals who are responsible for the health and direction of an enterprise i.e. its strategy. The role of a entrepreneurial manager is to create and then execute a compelling overall strategy for the business. It's said there's two keys to execution: leadership and management. Leadership is the ability to enthuse and excite customers, staff and investors about the business, including during difficult times. Management is the ability to 'make the trains run on time' – delivering an effective and efficient organisation. To really be effective, managers need a combination of both. This is Entrepreneurial management.

In most cases this is found not in a single individual but in an explicit or implicit pairing of people – the 'binary stars' that build great businesses. Think of Hewlett and Packard, Honda and Fujisawa (the marketing brain behind Honda's success), Terence Conran and Des Gunewardera, or Julian Metcalfe and Sinclair Beecham (the founders of Pret a Manger who famously said "without me Pret wouldn't exist – without him it wouldn't work").

## ENTREPRENEURIAL MANAGEMENT – CAPTURING VALUE

adapted from Howard Stevenson *The Heart Of Entrepreneurship*.

<b>Creativity and inventiveness</b>	<b>HIGH</b>	Inventor/Artist	Entrepreneurial Management
	<b>LOW</b>	Promoter	Trustee Manager
		<b>LOW</b>	<b>HIGH</b>
		<b>Managerial skills</b>	
© John Bates 2008			

Many founders of creative businesses find Entrepreneurial management a difficult and frustrating role to fill – its very different from the creative disciplines they built their previous career around – finding the right partners and colleagues is central to success.

Common problems in creative businesses are:

- Creative business founders may be very good at their creative function but are disorganized managers and/or uninspired leaders.
- Insufficient focus on proper financial management and controls
- Lack of a focused marketing and sales effort.
- Poor talent management.

There are two main ways of fixing this problem, either to train existing founders/ management or to bring in new, professional management. My preference is for the former.

## THE ROLE OF EDUCATION

The purpose of my New Creative Ventures for Masters level students at LBS and UAL is to facilitate the development of creative business opportunities from their entrepreneurial origins to large-scale, thriving creative businesses. What constitutes large-scale and thriving will vary from business to business, but as rough benchmark going from nothing to a business with thirty employees, £5m turnover and 10% net margin in three to five years would be a reasonable target.

In looking at growth constraints facing creative businesses, there are three overall sets, from which most other problems derive.

1. Understanding the difference between an idea and a real opportunity.
2. Lack of founder/management goal unity, drive and commitment.
3. Lack of execution skills.

Ideas are not the same as opportunities. Anyone can come up with a good idea whereas it takes a real entrepreneur to spot, shape and execute on a business opportunity. Assessing whether an idea is a good opportunity or not is at the heart of entrepreneurship. This topic is large and covered in great detail in John Mullins' book *The New Business Road Test: What Entrepreneurs And Executives Should Do Before Writing A Business Plan*. (FT Prentice hall 2003).

However suffice to say that an awareness of the possibilities and changes that are taking place in materials, technology, society culture and demographics (amongst others) and the ability to spot patterns before others do then act upon them is the heart of both entrepreneurship and creativity. Combining this with a disciplined approach to thinking about the team and organisation that will deliver, the markets the business will serve and the industry that the firm is operating in to build a strong sustainable enterprise is a hard but achievable task.

We can teach entrepreneurial skills across a wide range of courses and programmes. This is about developing a high capacity to:

- Tolerate uncertainty and ambiguity.
- Build a team and provide leadership.
- Deal with failure.
- Seek and use feedback.
- Persistently problem solve.
- Take a long term view forward.
- Not look back (except to learn).

However we can only nurture and enable entrepreneurial attitudes.

- Total commitment, determination and perseverance.
- Desire to achieve and grow.
- Opportunity focused, not risk focused.
- Internal locus of control: accepting responsibility.
- Independent sense of identity.
- Decisive use of urgency and patience.

Are we doing enough to develop these skills and encourage these attitudes in the next generation of leaders in creative businesses?

## JOHN BATES



John Bates is Adjunct Professor of Entrepreneurship at London Business School and a Director of Sussex Place Ventures Ltd. Over the last ten years he has been leading the School's practical initiatives in developing entrepreneurial firms including €20m of 'pre seed' and 'seed' venture capital funds and various networks of entrepreneurs, advisors and private investors associated with the London Business School that have supported over 50 alumni founded companies.

John has been teaching and developing courses at LBS since 1985, while also starting up and running two hi-tech businesses, a consultancy and a venture capital company. His current teaching portfolio includes two MBA electives, New Venture Development and New Creative Ventures and previously the ever popular Managing the Growing Business elective.

John has an active interest in technology and creative firms and is currently on the board or board advisor to a number of early stage companies advising and facilitating management development of their directors and senior staff.

John received his BSc from Nottingham University in 1972. Following a career in the food, scientific equipment and pharmaceutical industries he was awarded an MBA from Harvard Business School with high distinction. After graduating from Harvard in 1979, John was Marketing Manager for Courtaulds Coatings for four years before being invited back to HBS as a lecturer on the MBA programme. Since then he has balanced a career as an entrepreneur, teacher and investment manager.

In addition John is Chairman of the London Technology Network, a visiting Professor at the University of the Arts London, a Director of the Centre for Creative Business and formerly Chairman of Multimap.com (sold to Microsoft in 2007) and a member of the investment committee of the UK National Endowment for Science Technology and the Arts (NESTA).





