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Create Connections between Audiovisual and Finance

Abstract: The finance of the audiovisual industry is essentially self-referential; therefore intermediaries and financial markets have a small influence. The chapter provides an insight on the explanations to the distance between the audiovisual industry and financial markets, considering both the perspective of audiovisual companies and financial intermediaries. It also analyses which reasons call for a deeper connection between audiovisual and financial industry and which requirements should be fulfilled to create a profitable and long-lasting interaction between audiovisual and financial markets.

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2.1 Introduction

The audiovisual industry, as well as the entire cultural industry, has been experiencing for many years the outcomes of several innovations. Typically, they concern procedures, product policies and business strategies. The financial management of enterprises or single projects, on the contrary, is still on the margin of this enhancement process. Consequently, the finance of the audiovisual industry – and in broader terms of the cultural industry – is essentially self-referential; therefore, intermediaries and financial markets have a small influence. This peculiarity can be noticed at an international level, with few exceptions, including the USA, and it is particularly evident in European countries. Several studies and surveys have confirmed this evidence¹.

Why? What is the explanation for the distance among financial markets, intermediaries and audiovisual companies? What reasons would explain a deeper connection between the audiovisual and financial industries? What requirements should be fulfilled to create a profitable and a long-lasting connection? It is worth answering these questions if we want to foster the shift of audiovisual industry, as well as the entire cultural production, from a state of domestic handcrafted market to an industrial international dimension. This chapter provides an insight on the explanations about the distance between the audiovisual industry and financial markets, considering both the perspective of audiovisual companies and financial intermediaries.

In the light of the above-mentioned topics, the positive possible outcomes of an inversion of the trend are described, as well as with reference to the development of an audiovisual financial market.

2.2 The distance between audiovisual and finance: the concerns of audiovisual firms

The audiovisual industry and, in general, the cultural industry, are characterized by an evident fear (Figure 2.1): the access of financial intermediaries to the market would allow them to create a financial seigniorage on artistic production, transforming the cultural industry into a mere shooting ground for the search of new clients and new business opportunities.

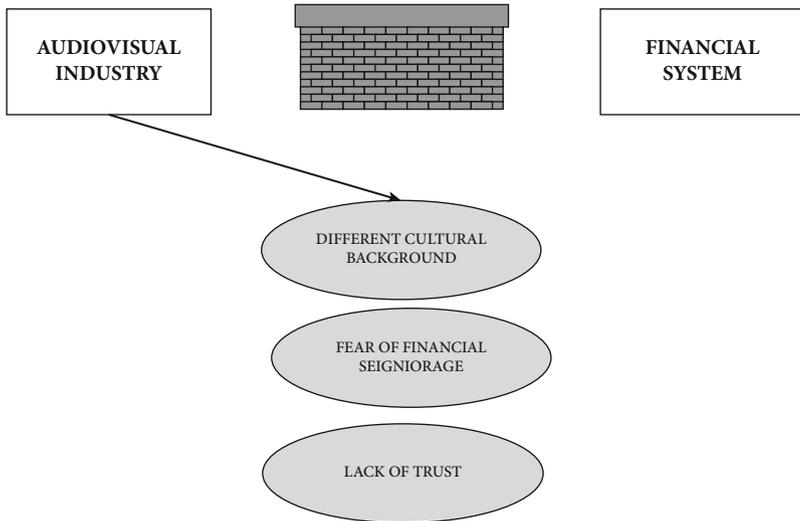


FIGURE 2.1 *The wall between audiovisual and finance: the concerns of audiovisual firms*

The cultural and linguistic shorting out created by audiovisual players' backgrounds, very different from those of finance professionals, has made misunderstandings, increasing the distance between the two realities. The above-mentioned issue is confirmed by a study commissioned by the European Commission², surveying 2,861 firms operating in the cultural industry: in the period of observation, only 38% of total cultural firms and 53% of total audiovisual firms involved in the survey contacted a bank to search for external finance; 67% of cultural firms and 74% of audiovisual firms approached a Government body. About 30% of cultural firms and 29% of audiovisual firms were convinced that contacting a bank is a waste of time; 32% of cultural firms and 48% of audiovisual firms had the perception that banks do not understand their business.

The distance between the audiovisual industry and finance is also due to the peculiarities of the audiovisual industry financial cycle. Sources of finance for the production of an audiovisual work can be identified, theoretically, both in internal and external financial resources. The first type includes equity, personal resources and rights of exploitation pre-sales

on different markets, as well as funds from co-production agreements. The second type concerns public financial support – at a local, national and European level – also including all resources from private investors and financial markets (Figure 2.2).

Audiovisual companies deal with their structural need for financial resources mostly by rights of exploitation pre-sale and achieving public financial support. Firms operating in this sector prefer to substitute market finance with a finance based upon internal resources and on government subsidies, which have acquired the status of private investments “surrogates”. This circumstance has reduced the urgency for audiovisual companies to require bank loans and to access capital markets.

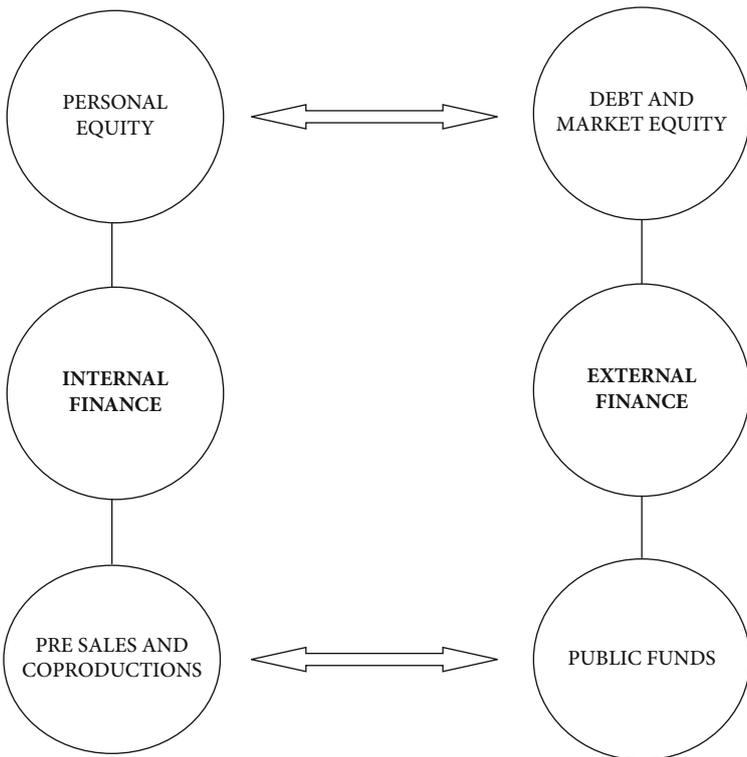


FIGURE 2.2 *Financial resources of the audiovisual sector*

According to the cited IDEA (2013) study, business revenues and subsidies are the two most important financial resources for audiovisual firms and, in general, for cultural industry. This is consistent with the outcomes of other studies. The HKU survey reports that 56% of the cultural firms involved in the interview indicate self-financing as the most important financial resource. Only 12% indicate bank loans as the most important financial resource³. The KEA study confirms that self-financing is the basic financial resource, followed by retained profits: 61% of firms have never benefited from external finance⁴.

Public financial support seems to be very important to start the funding process: according to KEA (2010 a), 59% of firms get access to public funds (57% tax incentives); on the contrary, public financing usually covers a small percentage of total production budget leaving producers with a significant gap financing.

2.3 The distance between audiovisual and finance: the concerns of financial intermediaries

Banks and other financial intermediaries have to deal with a misleading attitude in approaching the audiovisual industry. Except in the USA, very few collaborations have been developed upon the presumption to apply to the audiovisual industry the same financial support, analysis and risk management techniques used for other industrial sectors.

Several causes can explain the caution financial intermediaries have preferred to keep, more or less voluntarily, in their investments in the audiovisual industry. Those reasons refer to psychological and cultural aspects, to the nature of firms operating in the industry, to their balance sheet and to business peculiarities (Figure 2.3).

With reference to psychological and cultural determinants, besides the very well-known concern of stressing the cultural goal to the detriment of economic and financial requirements, it is also worth considering the belief that culture is a high-risk sector. According to IDEA (2013), 42% of cultural firms and 50% of audiovisual firms declare that banks have rejected their loan applications because the investment was considered too risky. Financial intermediaries' poor knowledge of cultural production dynamics, as well as of cultural industry economics, does not foster an objective evaluation of cultural and audiovisual projects. The production and the distribution of cultural products is a peculiar activity, and

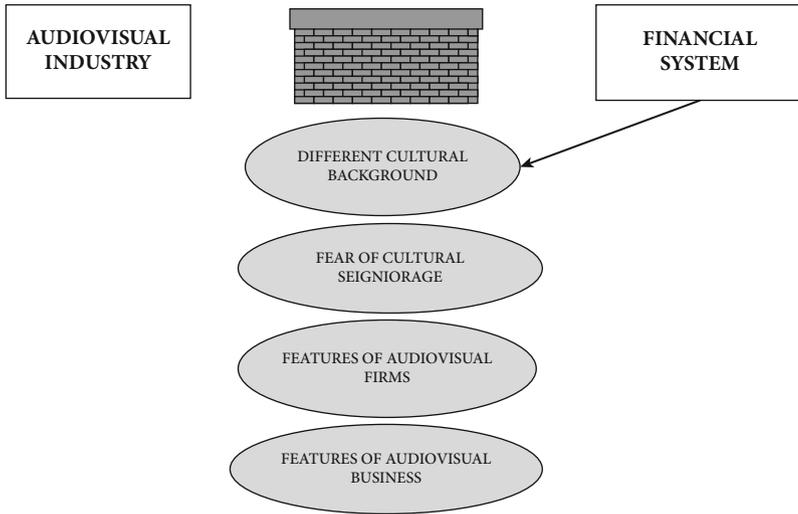


FIGURE 2.3 *The wall between audiovisual and finance: the concerns of financial intermediaries*

this makes such business hardly conceivable and hardly associable to other industries: lending money to a museum, or financing the production of a film, is not the same as granting credit to any other type of business.

Also intermediaries with a good knowledge of the audiovisual industry – and of the cultural industry in general – have to deal with many crucial issues.

Firstly, many criticisms concern market structure, that is to say the nature and the peculiarities of firms. The whole cultural industry, and the audiovisual industry in particular, is characterized by firms with a weak organizational structure; small dimensions, small number of employees and often non-profit oriented missions are the main causes. According to IDEA (2013), almost 30% of cultural organizations are one-person business entities, about 20% have no legal structure and 37% are non-profit organizations. Looking specifically at the audiovisual industry, over half of the firms in the study sample have 1 to 4 employees, 15% have no legal structure and 20% are non-profit organizations. The majority of audiovisual firms (51%) falls in the category of “less than 5 employees”.

These features also affect the efficiency of cultural and audiovisual firms. The management of most cultural firms still does not prove to

be efficient and transparent, and therefore it does not allow financial intermediaries and investors to complete an accurate evaluation of the credit rating of the borrowers. According to Clayton & Mason, only 36% of cultural firms declare to prepare formal business plans, while 35% use no formal ones and 29% have no business plans at all. These results are confirmed by the HKU survey, which shows that 75% of cultural firms make their own business plans and only 20% use professional consultancy services to approach banks and financial intermediaries. IDEA (2013) demonstrates that there is a strict connection between the ability to prepare a business plan and the size of the firm: only 20% of cultural firms with zero employees and 40% of firms with less than five employees (the majority of audiovisual firms) have a three-year business plan. As confirmed by Burrows and Ussher, this results in being one of the main obstacles in accessing external financial resources and, in general, in the interaction with banks and financial intermediaries⁵.

Furthermore, it is also necessary to point out a wide underestimation of firms' equity, as well as their difficulties in providing real guarantees as possible funding collaterals. According to IDEA (2013), 38% of cultural firms and 45% of audiovisual firms declare that banks have rejected their loan applications because they could not, or refused to fulfil, collateral requirements.

Many criticalities concern the nature of business itself. Audiovisual products are often distributed in domestic markets, and this decreases potential revenues. Moreover, the estimation of audiovisual products is quite complex, since this mostly depends on audience appreciation and on the emotional experiences it is able to provide. Therefore, it is difficult to measure it *ex ante* since it cannot be defined based on objective quantitative parameters. Finally, public funding granted to audiovisual companies as non-recoupable financial support creates many constraints to pricing policies and intermediary profitability.

These are among the main reasons for the small amount of private funding granted to the cultural industry – and in particular to the audiovisual industry.

In most cases the audiovisual industry can benefit from short-/medium-term loans, granted to cover a financial gap, often provided based upon pre-sale rights contracts. According to the IDEA (2013) survey, 33% of loans granted to cultural firms show an average maturity of less than 1 year (66% less than three years); the percentage is equal to 26% for audiovisual firms (64% less than three years). Also the amount

of loans agreed on is quite low, on average from 30,000 to 70,000 euros. Concerning the audiovisual industry, those amounts are more relevant, varying from 1.5 to 10 million euros. The explanation can be identified in a higher simplicity for bankers to finance audiovisual companies granting loans secured with pre-sales contracts.

2.4 The determinants for a financial development of the audiovisual industry

What causes can justify, considering the current context, an envisaged connection between audiovisual and finance? What is changing?

During the last few years many criticalities of the financial model adopted by the audiovisual industry have undoubtedly arisen. This model represents the milestone upon which the entire audiovisual industry has based its own survival and development since the post-war years. The recent financial crisis has generated two negative effects: the first one concerning internal financial resources, the second involving public funding.

Changes in trend of the economic cycle have caused an evident decrease in advertising incomes for TV broadcasters. It has negatively affected not only TV companies' balance sheets, but also other players of the audiovisual industry. The financial crisis has also imposed narrower boundaries on public expenditure. In the European Union, the fulfilment of the Stability and Growth Pact requirements has emphasized the need of Member States to reduce public contribution rates intended to support welfare state; cultural industries – primarily the audiovisual one – suffered from this situation.

Firms involved in the audiovisual industry have had to deal with a double financial criticality: with reference to internal sources of funds, it has meant a decrease in advertising incomes; regarding external financial resources, it has meant a reduction in public funding. A partial growth in the number of international co-productions has been the only positive outcome against the gap generated by the new context. The financial stress due to this context is risking to affect audiovisual firms' balance sheets (Figure 2.4).

A wider opening to financial markets, supported by a policy oriented to development of those potentialities still unrevealed by rights

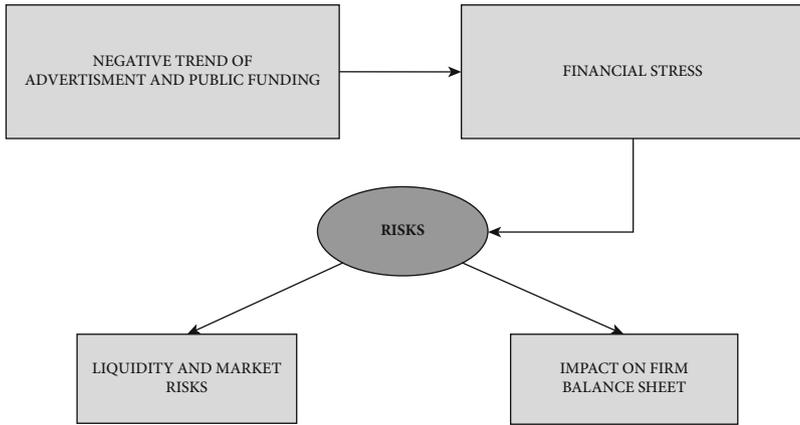


FIGURE 2.4 *The urgency for a new funding process of audiovisual firms*

exploitation markets, both at a national and at an international level, becomes a necessary path.

The existence of a potential market for private finance is also confirmed by the survey conducted by IDEA, which estimates that, in Europe, the financing gap in the cultural industry, considering a seven-year period (2014–2020), ranges from 8 to 13.4 billion, depending on different scenarios⁶.

A new financial network for the audiovisual industry is not only necessary, but also justified by a relevant potential demand, which appoints private finance for the task of providing the necessary coverage to structural financial need of firms active in the industry (Figure 2.5).

Actually, the access to finance would represent for audiovisual companies a chance to enter two different types of market: credit market and capital market (Figure 2.6).

The first one, more traditional, assures bank loans and financial intermediaries support. The second type is related to securitization processes experienced by capital markets. Debt securities, equity instruments and shares are the correspondent financial tools, while financial intermediaries and other institutional investors are to be considered principal investors; private and retail customers will play a less crucial role.

However, in the lack of an effective action by policy makers and market players, it is difficult to envisage a path for a virtuous interaction between

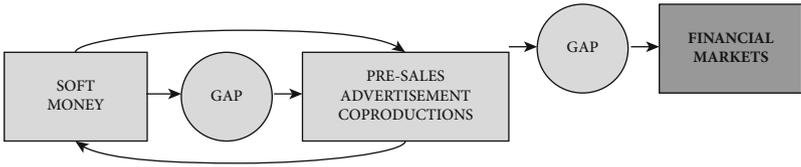


FIGURE 2.5 *Towards a sustainable funding process of the audiovisual firms*

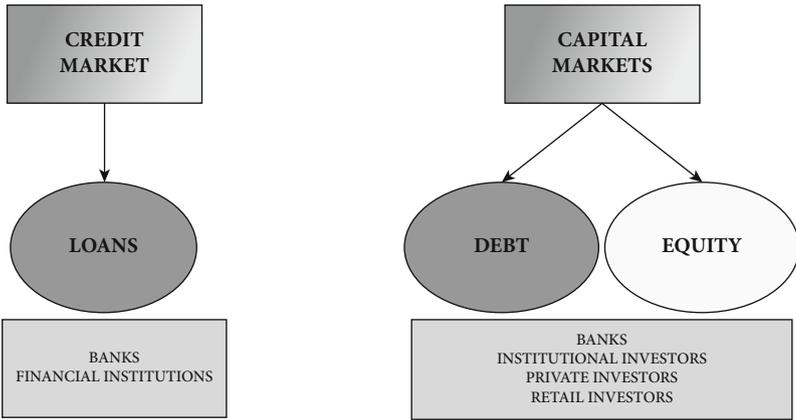


FIGURE 2.6 *Sources of private finance for the audiovisual firms*

financial markets and the audiovisual industry. According to the IDEA survey (2013), 62% of cultural firms have affirmed they would not apply for a bank loan in the upcoming six months. This is clear evidence that something must be done in order to reverse the trend.

Notes

- 1 Among others: Clayton & Mason 2006, HKU 2010, Kea 2010 a, IDEA Consult 2012 and 2013.
- 2 IDEA Consult, 2013.
- 3 HKU 2010.

- 4 KEA 2010a.
- 5 Burrows and Ussher 2011.
- 6 IDEA Consult, 2013.



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