

In addition, music businesses use trade credit to finance their growth more than small businesses generally.

### Important Trends

Analysis of financial data for music businesses of different ages revealed a number of important trends. There is a decreasing use of retained profits for development, which is directly related to the increased use of personal savings. This suggests that music businesses are finding it harder to grow profitably than they were five or ten years ago. Other trends include a decreasing use of bank finance for development (including

both overdrafts and loans), and more use of regional finance initiatives and other grants or subsidised loans by younger businesses at start-up. Whilst the music industry's relatively high adoption of web sites is indicative of its progressive nature, the industry has been slow to take up current Government-sponsored schemes that target small businesses, such as the Small Firms Loan Guarantee Scheme.

### Start-Up Finance

The types of finance sought by music business owners depend to some extent on whether the enterprise is just starting-up or looking to expand

## TYPES OF FINANCE REFUSED AT START-UP AND DEVELOPMENT (% OF MUSIC BUSINESSES)

Type of Finance	Start-up	Development	SME Sector In general*
Loan from Bank	6.8	5.5	9.0
Overdraft from Bank	4.8	4.8	
Any other Government-sponsored Scheme	3.9	1.3	
Loan from another Financial Institution	1.6	1.6	
Venture Capital from a Finance Company	1.3	0.6	
Venture Capital from a Business Angel	1.3	0.3	
Other	1.3	1.0	
Venture Capital from Business not in Music Industry	0.6	0.0	
Leasing or Hire Purchase	0.6	1.3	
Other Grant or Subsidised Loan	0.6	1.9	
Venture Capital from another Business in the Music Industry	0.3	0.6	
Regional Finance Initiative	0.3	0.6	

N=310 BUSINESSES

\*The comparative figure for SMEs refused finance from a bank is taken from the British Chambers of Commerce Finance: Small Firms Survey (1999) p.16. Information on refusal of other types of external finance was not available.

and grow. A number of patterns clearly emerge in terms of those businesses starting-up. 77% of music businesses used personal savings, and well over a half of the music businesses used less than £10,000 in total to start-up the business.

The minimal use of equity finance (venture capital) corresponds to an increasing use of bank loans and a decreasing use of bank overdrafts – a trend shared by the small business sector overall.

## TYPES OF FINANCE USED AT START-UP AND DEVELOPMENT (% OF MUSIC BUSINESSES)

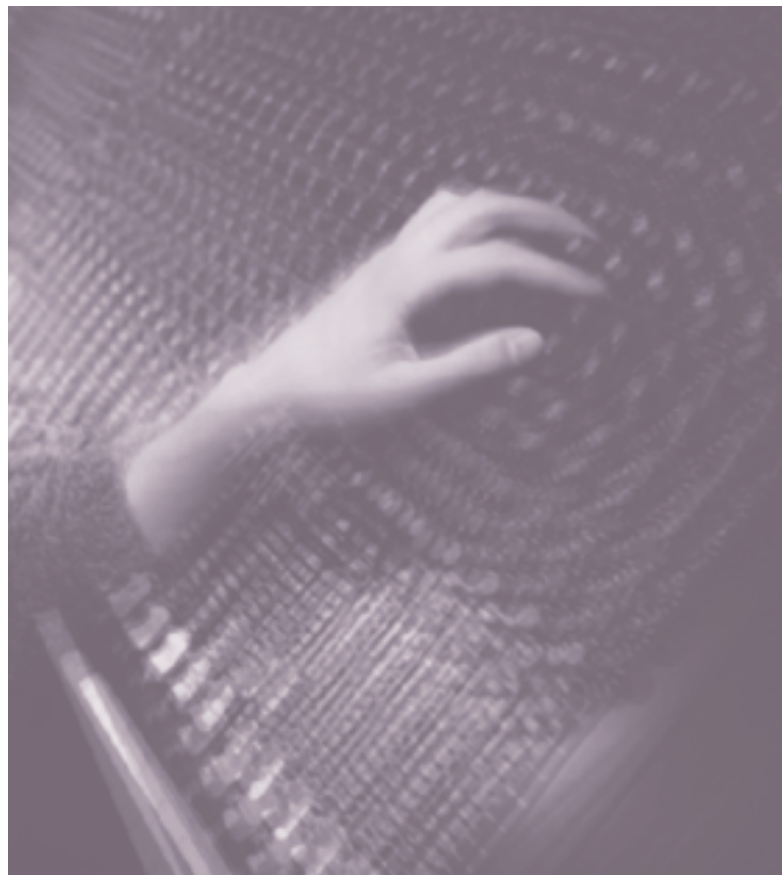
Types of Finance	Start-up	Development	SME Sector in general*
<b>DEBT</b>			
Injection of capital by owners, or personal savings	77.4	36.5	39.0
Retained profits	–	75.5	66.0
Overdraft from bank	19.7	24.8	59.0
Loan or gift from family or friends	15.8	6.1	13.0
Loan from bank	11.9	21.6	41.0
Loan from owners or directors	10.3	7.7	3.0
Loan from other financial institution	3.2	5.5	–
<b>EQUITY</b>			
Venture capital from another music business	1.3	1.9	5.0
Venture capital from business not in the music industry	0.6	1.6	
Venture capital from a finance company	0.3	1.3	
Venture capital from a business angel	0.0	0.6	
<b>OTHER TYPES</b>			
Leasing or hire purchase	6.1	11.3	36.0
Trade credit	–	8.4	–
Other grant or subsidised loan	3.5	4.8	–
Any other Government-sponsored scheme	3.5	1.0	5.0
Regional finance initiative	3.2	3.5	–
Advances from other music businesses	2.9	5.2	–
Other	2.6	1.6	–

N=274 businesses at start-up and 269 businesses at development.

Does not equal 100% because respondents used more than one type of finance.

\*The comparative figures for the SME sector are taken from the Lloyds TSB Small Business Research Trust, (2000)

Sources of Finance: *Quarterly small business management report* (p7).



## Development Finance

Nine out of ten music businesses surveyed had required additional finance to develop their business since start-up. The most important source of finance was retained profits, used at least in part by three-quarters of businesses (75.5%). There was little use of venture capital at development, with the most widespread source being ‘venture capital from another music business’ (6 businesses). Businesses used more finance for development than start-up, with 82% using more than £10,000 in total. As for start-up, the ‘main’ uses of finance at development were for providing working capital

### USE OF FINANCE AT START-UP AND DEVELOPMENT (% OF MUSIC BUSINESSES)

Use	Start-up	Development	SME sector in general*
Providing working capital	63.2	55.2	35.0
Equipment and machinery	56.8	53.5	53.0
Marketing or advertising	37.4	39.7	8.0
Premises/furnishings	31.3	28.4	23.0
A & R (artists and repertoire)	30.3	32.3	7.0
Internet development and IT	13.2	28.1	21.0
Innovation (product development)	–	23.5	8.0
Other	8.7	9.0	–
Acquiring a back-catalogue	7.1	7.4	–
Consultants	5.5	9.4	–
Recruitment and training	3.5	9.7	6.0
Acquiring another business	1.3	2.6	5.0
Don't know	0.6	0.3	–

N=310. Does not equal 100% because respondents had multiple uses for finance.

\*The comparative figures for the SME sector are taken from the British Chambers of Commerce *Finance: Small Firms Survey (1999)* p. 11-12. This comparison is indicative only, since figures do not always correspond to direct matches between responses (e.g. ‘investment in R & D’ for SME sector has been matched with ‘A & R (artists and repertoire)’).



(25% of firms) and buying equipment and machinery (22%). Importantly, less bankable expenditure such as A&R and marketing are also key uses of development finance. Finally, there were discernible differences between industry sub-sectors, with recording services firms, for example, having the highest take-up of bank loans at development (29.4% compared with 23.3% for record companies).

## TO WHAT EXTENT DO MUSIC SMEs ENCOUNTER PROBLEMS IN ACCESSING FINANCE?

### Introduction

Overall, the research findings suggest that music businesses are choosing not to seek external finance rather than being prevented from using these sources. Whilst there are clearly exceptions, the element of a proactive choice should not be overlooked when attempting to explain problems encountered by music businesses in accessing finance.

However, this report identifies three types of factors that can adversely influence access to finance in the music industry. These are ‘internal

perceptions within the music industry’, ‘external perceptions of the music industry’, and ‘structure of the music industry’.

## INTERNAL PERCEPTIONS OF THE MUSIC INDUSTRY

### We are ‘different’ and ‘complicated’!

The view that music businesses are somehow different from other small businesses stems from the often highly vocational nature of the business. The research suggested that where there are complexities within the music industry, these could sometimes be used unwittingly as a form of barrier to potential investors.

### The Culture Gap

The research identified concerns about the inability of the music industry and the finance-providers to ‘understand’ each other. 40% of music businesses recommended that banks should gain a better understanding of the music industry. This view was endorsed externally, with the majority of bankers (56%) maintaining that bank lending officers would benefit from more training about the music industry. 18% of bank managers believed there was specialist music industry knowledge at branch level, compared with 46% at regional level, and 68% at head quarters.

### The Comfort Factor

The choice of finance at both start-up and development was based on the degree of comfort felt with that particular option by business owners.

This highlights the importance of proactive choice rather than a reactive response to market restraints in accessing finance.

## **EXTERNAL PERCEPTIONS OF THE MUSIC INDUSTRY**

### **The Problem of Valuing Intangible Assets**

The intangible nature of music presents difficulties when ascribing a value to a catalogue or business. 75% of bankers agreed with the idea that 'it is difficult to make lending decisions to businesses in the music industry when based on valuation of intangible assets'. 41% of bank branches surveyed included intangible assets such as copyrights, licences, royalties etc. in their lending criteria.

### **The Problem of Auditing Royalty Streams**

Whilst complexity in music industry contracts (particularly over allocation and control of royalty rights) emphasises the importance of effective due diligence, this can act as a potential barrier to accessing finance. Banks and other investors may not be willing to carry out detailed due diligence if the expected returns are not sufficiently high. In the main, difficulties associated with auditing royalty streams stem from general SME issues of control and scale.

### **Negative Perceptions of Music Industry Management Skills**

The research highlighted the need for a change to the out-of-date perception that there are generally

poor management skills within the industry. At least two-thirds of owners/managers of businesses in all sectors rated their financial skills as 'skilled' or 'very skilled'. These self-perceptions were endorsed by the finding that 41% of owner/managers of businesses established since 1998 have some kind of business related qualification or training. Also, 65% of the owners/managers of young businesses surveyed had had previous experience of starting up a business. In addition, the increasing use of online music can be seen to encourage 'new entrepreneurs' to spread good management practice from the dot.com community across the industry.

### **Lack of Support**

Almost half the owners/managers of music businesses surveyed had never sought external advice or information about financing their enterprise. This points to a potential gap in support, stemming from a combination of inadequate industry-specific support and music businesses' mistrust of current advice. 60% of those owners/managers that did seek external advice or information on finance used their accountant, and 47.5% used their bank. Trade associations were currently unable to provide the kind of financial advice required by business owners, with only 7% of music businesses having received financial advice from them.

### **Perception that the Industry is too high a risk**

The research indicated that there is a widely held perception of the music industry as being 'high risk'. For example, the most widespread reason