Multinationals in the UK Creative Industries

A REPORT PREPARED FOR DCMS

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Executive summary

DCMS is undertaking a comprehensive review of the UK's Creative Industries. This review is focusing on:

- defining the characteristics and performance of the Creative Industries; and
- understanding which factors may be driving performance.

Previous analysis suggests that multinational firms may play an important role in the Creative Industries[1]. Specifically, it has been suggested that relationships with multinationals are vital to the success of small and medium sized creative enterprises (SMEs) because they provide access to, for example, finance, distribution, production and retail networks. If this is the case, it will be important to understand whether and how the UK has a comparative advantage in terms of its ability to attract multinationals.

DCMS and UKTI would like to explore these issues in more detail. To do so they have asked Frontier to consider the following questions:

- What are the characteristics of the UK's foreign owned multinational firms?
- What is their contribution to the UK economy?
- What drives these firms to locate in the UK?
- Which factors would make these firms consider leaving, or investing less, in the UK?

We have sought to answer these questions using a combination of statistical analysis of foreign owned multinationals using the Inter Departmental Business Register (IDBR)[2] and in-depth case studies with UK based multinationals[3]. Our key findings are discussed below.

THE CHARACTERISTICS OF MULTINATIONAL FIRMS IN THE CREATIVE INDUSTRIES

Our statistical analysis focuses on layer one activities of the Creative Industries. Previous analysis has categorised Creative Industry firms in terms of whether

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1 Frontier Economics, Comparative Analysis of the UK's Creative Industries, August 2006. Available at http://headshift.com/dcms/mt/archives/blog_36/Full%20Frontier%20Report%20-%20Annex%20A.pdf

2 The IDBR is the most comprehensive available database for UK firms. It allows firms to be tracked over time for their employment and turnover performance. It also allows firms that are foreign owned to be identified.

3 DCMS sent letter to 16 multinational Creative Industry firms asking them to participate in this study. As a result, six firms agreed to take part in the study.

their activities are layer one or outer layer activities[4]. Layer one activities are those which sit at the top of the industry supply chain – such as writing for the publishing industry and composition for the music industry. A more detailed description of the definition of the Creative Industries is contained in Annexe 1 and Annexe 2.

We estimate that there are approximately 1,500 foreign owned multinationals in layer one of the Creative Industries[5]. These account for 1% of all firms in layer one of the Creative Industries.

The majority of these firms operate in the Software and Computer Games, Advertising and Film industries:

- 68% of foreign owned multinationals operate in the Software and Computer Games industry;
- 11% of foreign owned multinationals operate in the Advertising industry; and
- 7% of foreign owned multinationals operate in the Film industry.

In terms of their average size relative to UK owned firms, foreign owned multinationals are significantly larger than UK firms:

- **Turnover:** The turnover of foreign owned multinationals is on average 37 times greater than the turnover of UK owned firms; and
- **Employment:** Foreign owned multinationals employ, on average, 24 times more people than UK owned firms.

CONTRIBUTION TO THE CREATIVE INDUSTRIES

Foreign owned multinationals' contribution to the Creative Industries can be broken down into:

- **Direct contribution:** Overall contribution to total Creative Industry turnover and employment; and
- **Indirect contribution:** Development of the UK Creative Industry supply base.

Direct contribution of multinational firms

Foreign owned multinationals are an important part of the Creative Industries. For example, multinationals in layer one of the Creative Industries:

- employ 148,000 people (20% of total layer one Creative Industry employment); and

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4 Frontier Economics, Creative Industry Performance - a statistical analysis for DCMS. Forthcoming.

5 Layer one is defined as those firms which produce the creative element of the Creative Industries' output. In general these activities are situated at the top of the industry supply chain - for example, composition or graphic design.

- generate turnover of £28bn (28% of total layer one Creative Industry turnover).

The majority of these firms are based in the Software and Computer Games industry. Foreign owned Software and Computer Games firms:

- employed 106,000 individuals (71% of total layer one Creative Industry employment of foreign owned multinationals); and
- had a turnover of £18bn (64% of total layer one Creative Industry turnover of foreign owned multinationals).

Previous analysis suggests that the majority of these firms will be from the Software rather than the Computer Games industry.

Indirect contribution of multinational firms

Foreign owned multinationals also appear to make a significant indirect contribution to the Creative Industries. The evidence from our in depth case studies with six multinational firms suggests that these firms may contribute to the success of Creative Industry SMEs in the following ways[6]:

- **Supporting the local supply base:** Purchasing goods and services from the UK's Creative Industry SMEs; and
- **Acquisition:** Potentially improving the productivity of small UK firms through acquisition (though it is possible that foreign owned firms are cherry picking the best performing UK firms).

Supporting the local supply base

All six case study firms said they used local suppliers and that their presence had created a market for these firms. These suppliers included both firms within the Creative Industries and firms outside of the Creative Industries They believed that many of these UK suppliers would not have existed in the absence of foreign owned multinationals. This is primarily because many of these small UK firms do not have a comparative advantage in terms of the service they offer.

The key exception to this applies to UK suppliers within the Software and Computer Games industry. In this case, UK firms' comparative advantage appears to extend beyond their location to factors such as expertise in niche technical programming skills.

Acquisition

Our case studies suggest that UK firms may benefit from being acquired by foreign owned multinationals. This appears to be due to several factors including:

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6 The case studies were not intended to produce statistically significant results. 16 firms were contacted and six firms agreed to participate. The results were used to provide a preliminary indication of the issues which may be most relevant to foreign owned multinationals' decision to locate in the UK.

- UK firms acquiring management expertise and potentially more reliable future income streams; while
- retaining their brand identity and their management and employees.

Our statistical analysis may also support the case study findings on acquisition. On average, we find that small UK owned firms perform better (in terms of employment and turnover growth) if they are acquired by a foreign owned multinational than if they remain UK owned. For example, firms in the Software and Computer Games industry that were acquired by foreign owned multinationals have grown nearly twenty times faster over the last ten years than firms in the industry that remained UK owned.

This analysis does not tell us why firms that are acquired by foreign owned firms perform better than firms that remain UK owned. One potential reason is that foreign owned firms acquire UK firms that are already successful. Alternatively, the success of these acquired firms may be due to the skills they receive as a result of the acquisition. It is not possible to tell from the data which explanation is most valid.

WHY MULTINATIONALS INVEST IN THE UK

In light of the benefits that foreign owned multinationals may bring to the UK's Creative Industries, we have explored why these firms have located in the UK and what would make them leave (or reduce their investment). These factors can be thought of in terms of:

- supply side factors;
- demand side factors; and
- other factors.

Supply side factors

The case studies identified the following supply side factors as important to attract multinationals to the UK:

- the UK skills base; and
- the UK supplier base (for the Software and Computer Games industry).

These are summarised in Figure 1 below. Each block in the figure represents a positive unprompted response by one of the cases study firms.

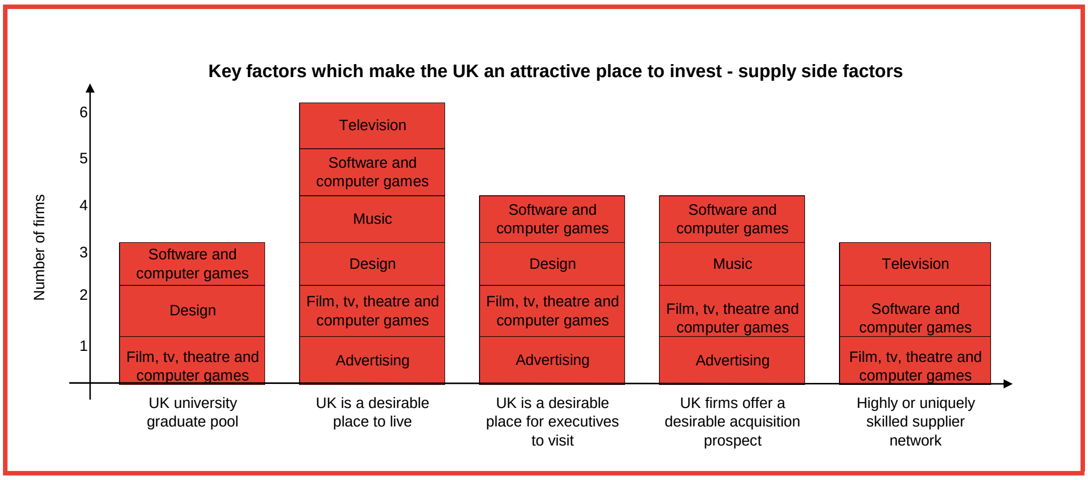

Figure 1: Key supply side factors which may attract foreign owned Creative Industry multinationals to invest in the UK

Source: Frontier

One of the key factors that attracts multinational firms to the UK appears to be the availability of skills. This appears to be driven by:

- the quality of the UK further education system (both for academic and vocational courses); and
- the UK's ability to retain top graduates in the UK.

For example, one of the case study firms highlighted that whilst other European countries typically have one school of excellence in Design, the UK has six. In addition, many of the case study firms had located in the UK because senior executives and top graduates were unwilling to leave the UK.

The presence of UK firms offering niche technical services (such as computer programming for computer games and animation and special effects for television) appears also to be a draw for multinationals. In many cases, these UK firms offer services which complement multinationals activities. In this case, the multinational will contract with these firms and move some of its development capacity to the UK to service the contract. In other cases, UK firms may offer services which overlap with the key activities of multinationals. In these cases, multinationals may choose to acquire the UK firm.

Demand side factors

The following demand side factors may also be important in terms of their ability to attract foreign owned multinationals to the UK:

- a large established UK customer base;
- English language; and
- early adaptors (for Design industry).

These are illustrated in Figure 2 below.

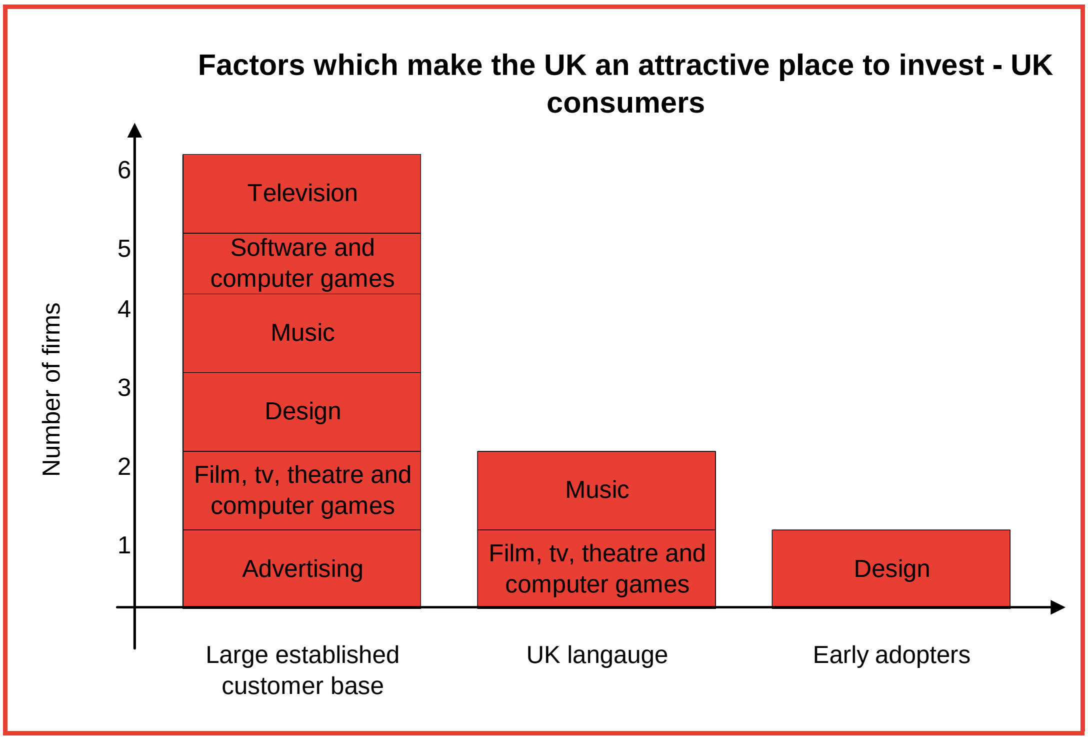

Figure 2: Key demand side factors which may attract foreign owned Creative Industry multinationals to invest in the UK

Source: Frontier

The UK has a large, well educated and relatively wealthy consumer market. This has been stated as a key reason for locating in the UK by all the firms we spoke to. However, the investment required to serve the customer market typically would only extend to marketing and distribution activities. Each of the case study firms had carried out significant investment beyond that of the sales and marketing activities. The case studies suggest that it is the other factors listed above that have driven these decisions.

Other factors

The final set of factors which may be important in terms of their ability to attract foreign owned multinational firms to the UK are:

- the UK's business operating environment; and
- the UK's cultural facilities.

These are illustrated in Figure 3 below.

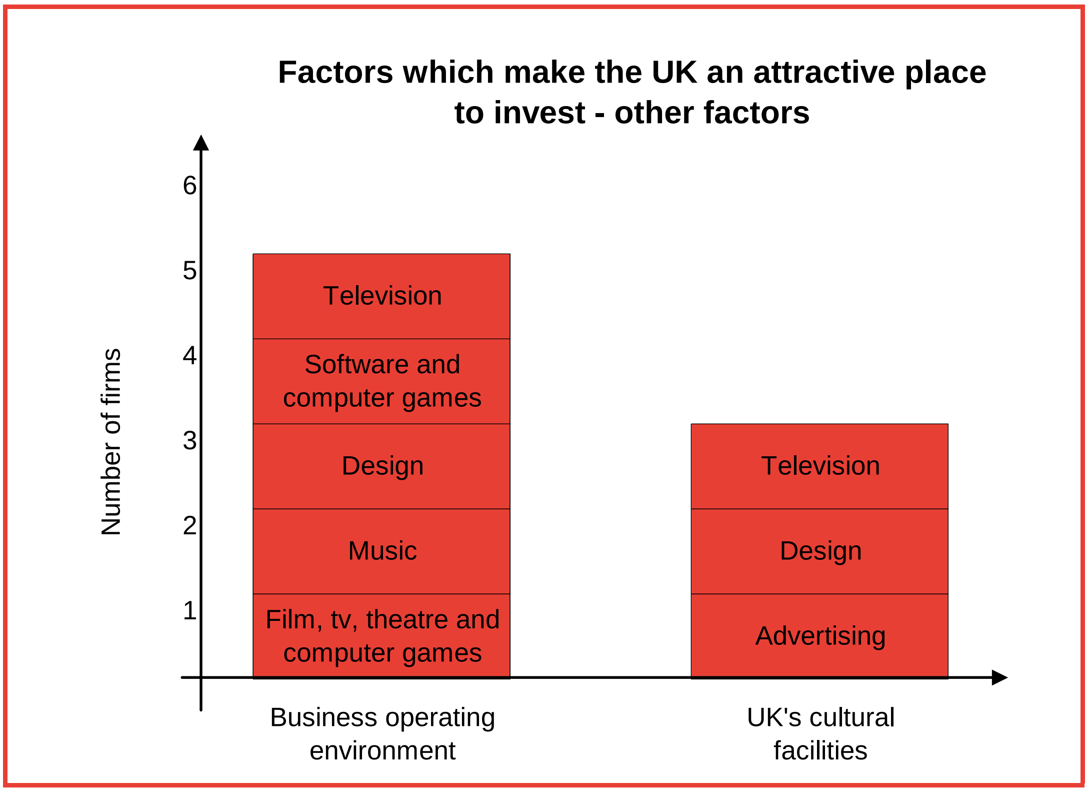

Figure 3: Other key factors which may attract foreign owned Creative Industry multinationals to invest in the UK

Source: Frontier

Fiscal factors (such as tax relief for film production and research and development), the ability of firms to protect their Intellectual Property Rights (IPR) and the UK's relatively liberal labour laws were cited as particularly important.

The UK's cultural facilities were also recognised by firms as being important inputs to the production process. For example, London's art galleries and museums provide inspiration to designers in Advertising and Design. In addition, experts based in these facilities are hired as advisors by Creative Industry firms for their projects.

WHY MULTINATIONALS WOULD LEAVE THE UK

Multinationals identified three factors that would be significant in any decision to exit the UK:

- changes to the UK's fiscal environment;
- lower supply of technical skills; and
- lower levels of consumer demand.

The six firms we spoke to highlighted particular concerns in terms of the high cost of running a business in the UK (especially in London, where the majority of creative firms appear to be based) and the potential future shortage of appropriate technical skills. It appears likely that consumer demand would affect only the distribution and marketing activities of these firms in the UK.

NEXT STEPS

Identifying and understanding the benefits that multinationals bring to the UK and those factors which attract these firm is complex. This study has enabled us to draw up some initial hypotheses. It has also raised a number of interesting questions which could be addressed through further research and analysis:

- Why are UK firms that are acquired by foreign firms more successful than firms that remain UK owned?
- How significant is the role of culture in attracting and retaining talent and which aspects of culture are most important?
- Which skills are most attractive to Creative Industry multinationals?
- How important is consumer demand in terms of attracting multinational firms to carry out layer one Creative Industry activities in the UK?

Each of these questions could be addressed through further in-depth case studies with firms in the Creative Industries, sector skills councils and UK universities. In addition, we would recommend the use of large scale survey to explore the role of culture in attracting and retaining talent in the UK and a wider review of the economic literature on the impact of multinational investment on firm performance.

1 Introduction

DCMS defines the Creative Industries as the following 13 industries - advertising, architecture, art and antiques, craft, design, designer fashion, film and video, interactive leisure software, music, performing arts, publishing, software, television and radio. Collectively the Creative Industries form an important part of the UK economy, representing 7.3% of total UK Gross Value Added in 2004[7]. In 2005, the Creative Industries employed 1.8 million people directly and indirectly – a growth of 16% since 1997[8].

Previous analysis of the Creative Industries has suggested that foreign owned firms, or multinationals, play a significant role in the UK's Creative Industries. However there is currently little evidence on the characteristics or behaviour of these firms[9].

This study therefore aims to improve our understanding of the role of multinationals in the Creative Industries. To do this we have sought to address the following questions:

- What benefits do multinationals bring to the UK's Creative Industries?
- What are the key factors that attract these firms to the UK?

1.1 OUR APPROACH

To answer these questions we have carried out two key pieces of analysis:

- a statistical analysis of foreign owned and UK owned firms in layer one of the UK Creative Industries; and
- a series of in-depth case studies with foreign owned and UK owned firms operating in layer one and the outer layers of the Creative Industries.

The concept of layer one and outer layers is discussed in detail in section 2.1. In short, Creative Industry layer one activities are the most creative activities of an industry. These include writing for the publishing industry and composition for the music industry. Outer layer activities include activities such as distribution and manufacturing.

Using the IDBR database, we have been able to analyse the characteristics and performance of foreign owned firms in the UK's Creative Industries and compare these with UK owned firms. This has provided us with an overview of

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7 This is the latest available statistic and excludes the crafts as data was not available. Source: DCMS, Creative Industries Economic Estimates Statistical Bulletin, September 2006. Available from http://www.culture.gov.uk/NR/rdonlyres/70156235-8AB8-48F9-B15B-78A326A8BFC4/0/CreativeIndustriesEconomicEstimates2006.pdf

8 Source: Table 3, DCMS, Creative Industries Economic Estimates Statistical Bulletin, September 2006. Available from http://www.culture.gov.uk/NR/rdonlyres/70156235-8AB8-48F9-B15B-78A326A8BFC4/0/CreativeIndustriesEconomicEstimates2006.pdf

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the UK's multinational firms. It has also provided us with an understanding of the direct contribution (turnover and employment) that foreign owned multinational firms have made to the UK economy over the last ten years.

To understand the indirect benefits that multinational firms bring to the UK economy and the key factors that attract these firms to invest in the UK we have engaged in in-depth discussions with six multinational Creative Industry firms. All of these firms are carrying out layer one and outer layer activities in the UK.

The remainder of the report is structured as follows:

- Section 2 discusses the information sources used in this study.
- Section 3 presents our findings on the direct and indirect contributions of foreign owned creative firms to the UK's Creative Industries.
- Section 4 considers which factors may be critical to attracting foreign owned Creative Industry firms to invest and locate in the UK.

2 Information sources used in this study

We have used quantitative and qualitative information sources to carry out this analysis. In particular we used a firm level database called the Inter-Departmental Business Register to conduct a quantitative analysis of the UK Creative Industries. We have supplemented this analysis with a series of in-depth interviews with six UK based multinationals in the Creative Industries.

These sources are described in more detail below.

2.1 THE IDBR DATABASE

Frontier has used the Inter-Departmental Business Register (IDBR) to carry out this analysis. This is the most comprehensive and disaggregated database available for UK firm level statistics. Overall its coverage of UK firms is estimated at 99% of all economic activity in the UK[10].

The data Frontier has been provided with contains information on employment and turnover for 1995 – 2005. It also provides information on the firm's industry and country of ownership for each year during this period. From this we can understand whether a firm listed in the database was in the Creative Industries and whether it was UK or foreign owned in any particular year.

To undertake analysis of Creative Industry multinationals requires a statistical definition of the Creative Industries. The current DCMS definition, which applies percentages to selected 4-digit SIC codes, does not allow detailed structural analysis to be undertaken[11]. Previous analysis has defined the Creative Industries at the 5-digit SIC code level[12]. This selects individual firms for inclusion in the Creative Industries on the basis of their position within the industry supply chain. In particular:

- the most creative activities - e.g., composition and writing – are assumed to take place at the top of each industry's supply chain; and
- the least creative activities – e.g., retail sale of creative output to consumers - are assumed to take place at the bottom of the supply chain.

Our analysis considers only the most creative activities from the top of each supply chain. These are collectively referred to as 'layer one' activities in our analysis. More information on our approach to defining the Creative Industries for statistical analysis is contained in Annexe 1. In addition, details of the 5-digit

10 Source: National Statistics

11 Each four digit SIC code data covers a broad range of activities. Some of these activities could be considered creative, whilst other may not. For example, the 4-digit SIC code which represents film casting also represents 'all other recreational activities'. The current approach which applies percentages to 4-digit SIC codes means that individual firms cannot be identified for further detailed analysis, as the approach effectively requires us to include a percentage of all firms that fall under the code.

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SIC codes that are used to define each Creative Industry are contained in Annexe 2.

2.2 CASE STUDIES WITH CREATIVE INDUSTRY FIRMS

To supplement this analysis we have carried out a series of in-depth case studies with firms in the Creative Industries. A short list of firms was drawn up to cover all the key industries whose contribution to the UK Creative Industries was significant and whose output was felt to be internationally tradable.

The intention was to carry out 10-15 case studies. To maximise the response rate, Ministerial letters were sent to 16 Creative Industry firms. These contacts were then followed up by email or telephone, or a combination of both. As a result, six firms agreed to participate in the case studies.

Case studies were based on semi-structured interviews held over a number of hours. The information received from the case studies was not intended to be statistically significant. The in-depth nature of each case study meant that the case studies could be used to highlight and explore issues which may be play a leading role in multinational location decisions.

Some of the firms we spoke to during the case studies asked not to be named in the study. Therefore firms are represented simply by their industry name in this report. The characteristics of these firms are discussed below in Table 1.

Industry (country of ownership)	Description of the case study firm
Advertising (France)	This is a French owned advertising agency. It is one of the largest firms operating in the UK market with a share of around 10% of the UK's £19bn market (as estimated by the UK Advertising Association).
Design (Japan)	This Design studio is Japanese owned and represents one of its firm's six global design studios. It was established in 2002 and employs 60 permanent staff. It is the largest design studio of its kind in the UK, with a market share of around 30-40%.
Film, Video, Performing Arts and Computer Games (U.S)	Established in the UK in the 1930s, the firm has expanded its investment to include consumer product development and sales, computer games development, marketing and sales, an internet site, mobile operating arm, a television broadcasting channel, film distribution and marketing. The firm employs approximately 2,500 people in the UK directly.
Software and Computer Games (U.S)	This firm was established in 1982. It employs 3,000 people in the UK. Its key functions are: sales, customer service and support for its software; a gaming division; part of the European HQ; Computer Games Development; blue skies research.
Television (U.K)	One of the UK's largest independent television production groups and distribution firms. It currently employs around 1,000 people throughout the group. The group consists of several UK production firms as well as a series of overseas firms. In addition it has an international distribution arm.
Music (U.K)	This firm is one of the largest UK independent record labels. It was established as a record label in the mid 1970s and since then has grown to encompass six record labels. The firm also operates a distribution and marketing arm. It employs around 60 people in the UK.

Table 1: Case study firms

Our case study discussions were based on a questionnaire. This is provided in full in Annexe 3 of this report. In brief this questionnaire sought to cover the following aspects of each firm's business:

- an overview of the firm's business in terms of its size globally and in the UK, its market share, who its suppliers and customers are;
- why the firm invested in the UK – or if the firm was UK owned – what it felt were the key advantages of being based in the UK;
- the wider benefits the firm provided to the UK economy, for example, networking and training opportunities; and

Information sources used in this study

- issues that would make the firm consider leaving the UK.

Information sources used in this study

3 The contribution of multinational firms to the UK economy

This section considers the contribution of foreign owned multinational firms to the UK economy. There are a few key ways in which multinational firms may contribute to the UK economy. These are:

- **direct effects** such as employment and any profits that are not repatriated to owners or shareholders outside the UK; and
- **indirect effects** such as supporting other firms in the industry through supply contracts, acquisition or clustering effects.

Our analysis and key findings are described below.

3.1 THE DIRECT CONTRIBUTION OF FOREIGN OWNED FIRMS

This section considers the direct contribution of foreign owned firms to the Creative Industries. To do this we have defined each Creative Industry in terms of its layer one activities (i.e., the production of original, creative ideas) and a series of outer layer activities (i.e., those activities such as hardware manufacture and marketing which take these original, creative ideas to market). We provide more detail on how we have defined the Creative Industries in Annexe 1 and Annexe 2.

We start by providing a brief overview of the number of foreign owned firms in layer one of the Creative Industries. Next we consider the turnover and employment contribution of firms in layer one of the Creative Industries. In doing so we look at:

- the total contribution of foreign owned firms in layer one of each Creative Industry; and
- the average size of foreign owned firms.

We then compare these results with those if we widen our definition of the Creative Industries to include both layer one and the outer layers (i.e., if we also include firms which engage in activities such as manufacturing, distribution and retail).

3.1.1 Number of foreign owned firms in the Creative Industries

Our analysis of the IDBR estimates there to be 1,500 foreign owned firms in layer one of the UK Creative Industries. This is equivalent to 1% of all of Creative Industry firms in layer one.

Figure 4 below shows how this total breaks down by industry for foreign owned firms.

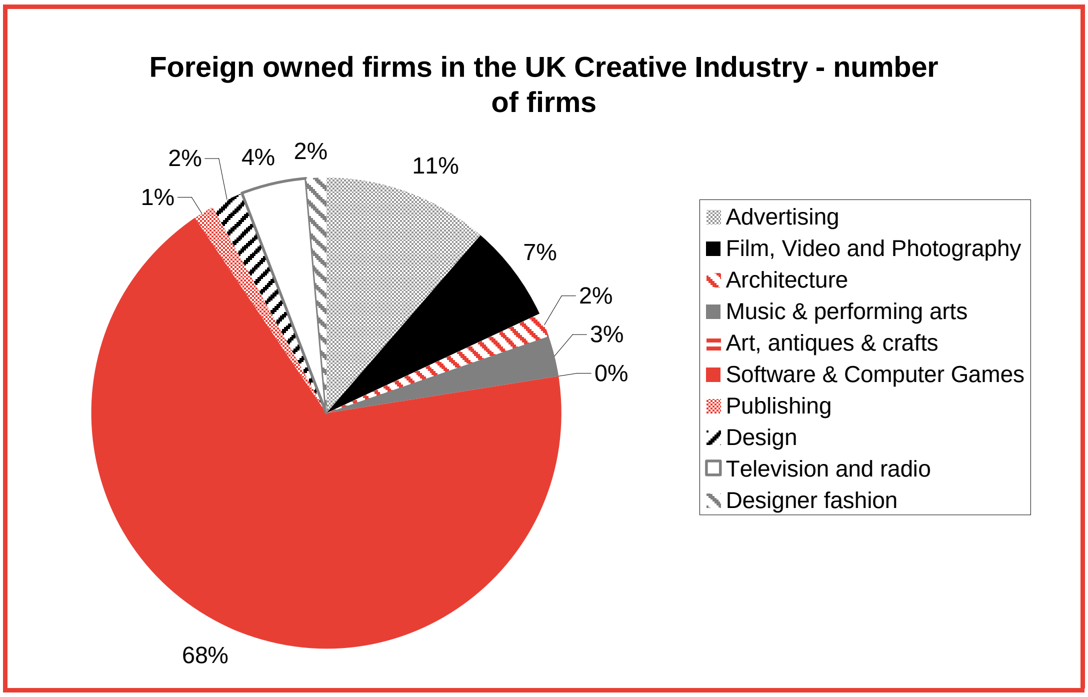

Figure 4: Location of foreign owned firms in layer one of the Creative Industries

Source: IDBR and Frontier analysis

Figure 4 shows that 68% (or 1,030) of foreign owned firms in the Creative Industry layer one are in the Software and Computer Games sector. The figure also shows that foreign owned Advertising firms account for 11% of foreign owned Creative Industry firms and foreign owned Film, Video and Photography firms make up 7% of all foreign owned Creative Industry firms in layer one. Overall, these three industries account for 86% of all layer one foreign owned Creative Industry firms.

3.1.2 The Contribution of foreign owned firms to employment

Our analysis of the IDBR data shows there are 1,500 foreign owned firms in layer one of the Creative Industries employed 148,000 people. This is equivalent to 20% of total layer one employment in the Creative Industries.

Figure 5 below breaks this information down by Creative Industry.

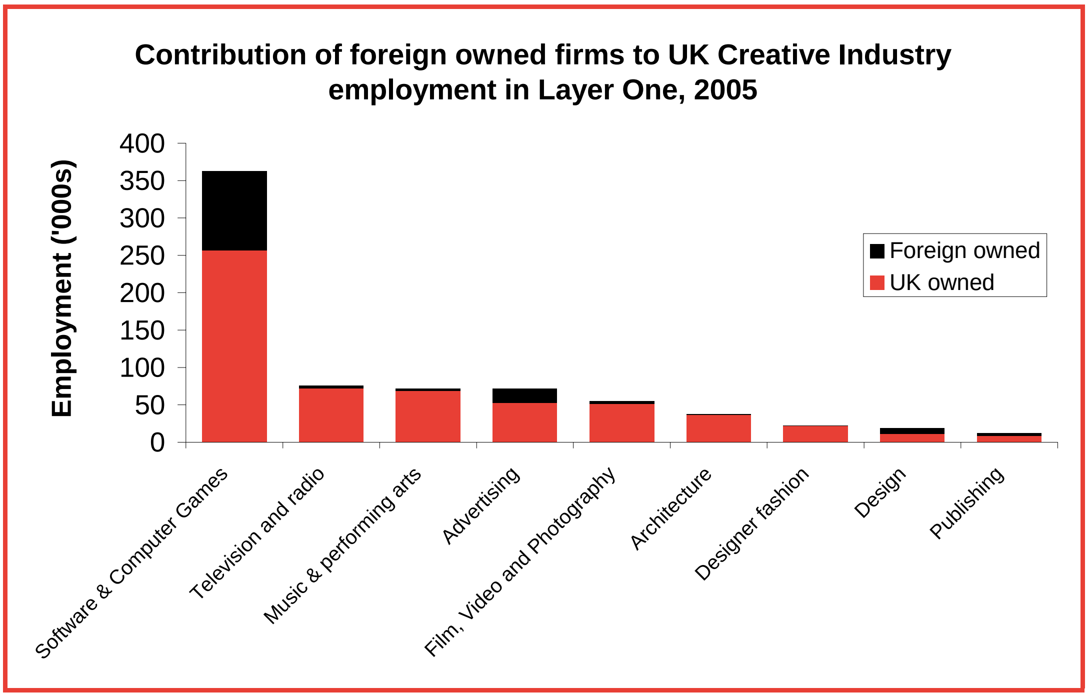

Figure 5: Contribution of foreign owned firms to UK Creative Industry employment in layer one, 2005

Source: IDBR and Frontier analysis

The analysis in Figure 5 shows that:

- foreign owned firms in layer one of the Software and Computer Games industry made the largest contribution to Creative Industry employment, employing 106,000 individuals;
- the next largest contribution is made by Advertising firms which employed 19,000 individuals; and
- foreign owned firms' contribution in layer one of the Design industry is also relatively high, employing 8,000 individuals in 2005.

Figure 6 below analyses the average size of foreign owned firms in layer one of the Creative Industries in 2005.

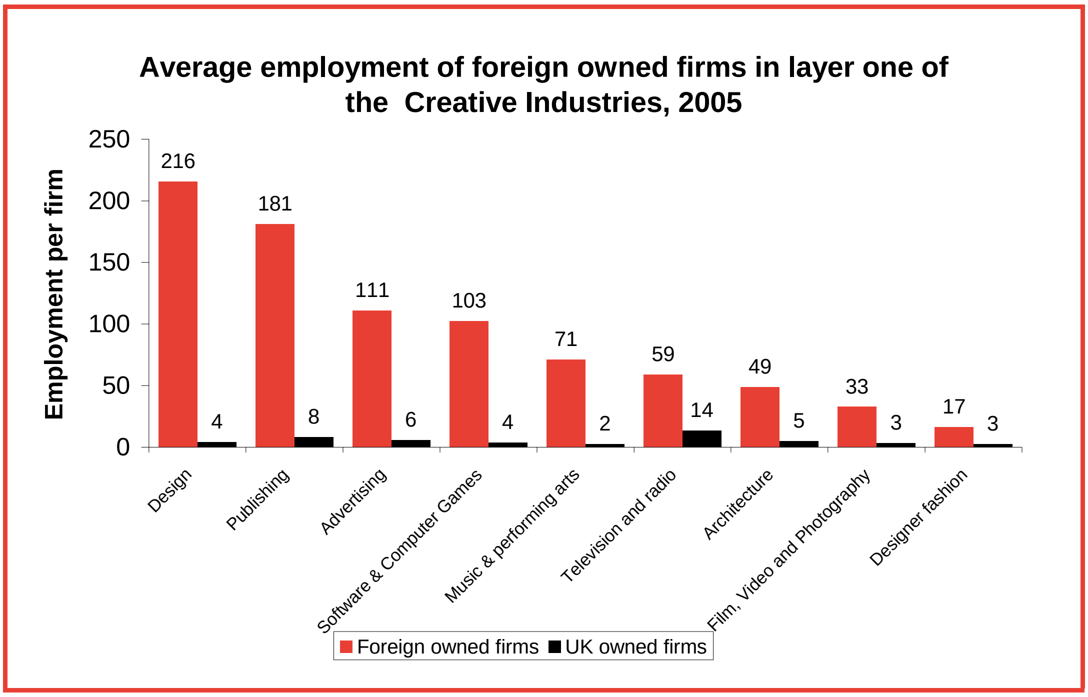

Figure 6: Average employment in foreign owned layer one Creative industry firms, 2005

Source: IDBR and Frontier analysis

This analysis shows that foreign owned firms tend to be large. This is particularly the case for the Design, Publishing, Advertising and Software and Computer Games layer one firms.

- The largest foreign owned firms are Design firms. Average employment in the 36 foreign owned Design firms was 216 employees. This compares with an average firm size of four employees for the 2,600 UK owned Design firms that we identified. Again of the ten largest Design firms, eight are foreign owned[13].
- Foreign owned Publishing firms also tend to be large. Our analysis shows that the 20 foreign owned firms employed an average of 181 employees. This compares with an average employment size of eight employees for UK owned firms in layer one. Of the largest ten Publishing firms in layer one, eight of these are foreign owned.
- Foreign owned firms in the Advertising industry employ on average 111 employees. This compares with an average size of six employees for UK owned firms in layer one. Six of the largest ten Advertising firms are foreign owned.
- Foreign owned firms in the Software and Computer Games industry employ an average of 103 employees. This compares with an average size of four

[13] We define firm size in terms of their annual turnover in 2005.

employees for UK owned firms in layer one. Six of the 10 largest firms in this industry are foreign owned.

Foreign owned firms in the wider definition of the Creative Industries

If we widen our definition of the Creative Industries to take into account all of the outer layers we find that relative to their contribution to layer one, foreign owned firms are less important to the Creative Industries:

- foreign owned employment in layer one and outer layers was 523,000 - or 14% of total Creative Industry employment; whilst
- foreign owned employment in layer one was 148,000 – or 20% of total Creative Industry employment.

Figure 7 below illustrates these results below.

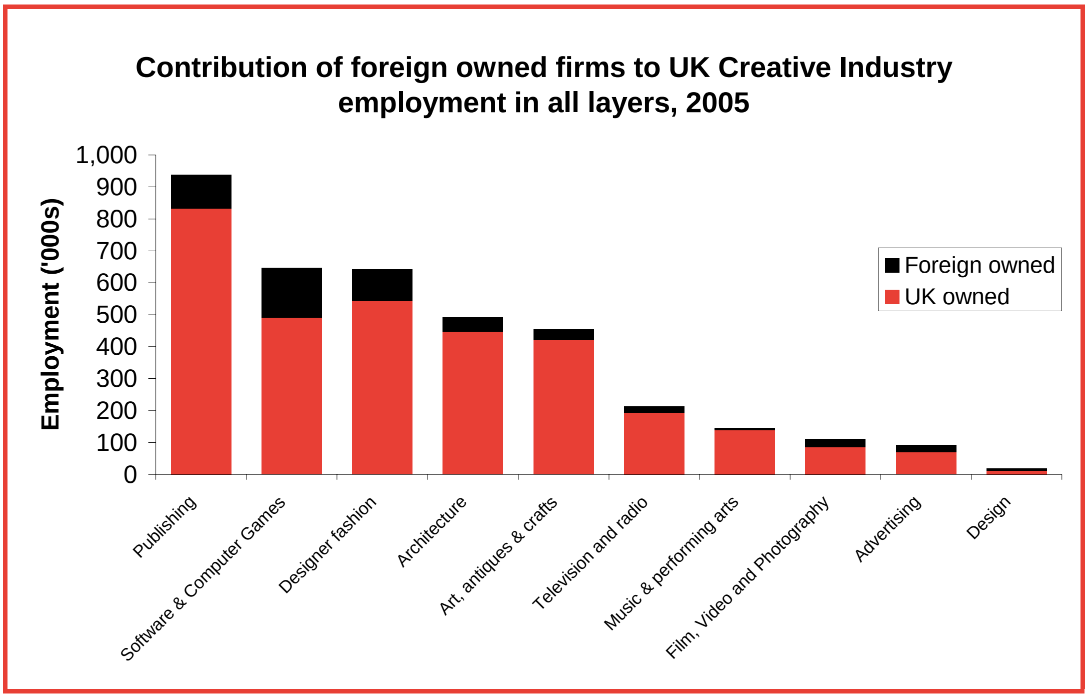

Figure 7: Contribution of foreign owned firms to UK Creative Industry employment in all layers, 2005

Source: IDBR and Frontier analysis

The overall result is however largely driven by the Software and Computer Games industry and does not apply to all the Creative Industries. Whereas, for example, foreign owned Software and Computer Games firms make a larger proportional contribution to layer one (29%) than to all layers of the industry (24%), foreign owned firms in other industries such as the Film, Video and Photography industry make a larger contribution to all layers of the industry (24%) than they do in just layer one (6%).

In absolute terms, foreign owned employment is significant for the Software and Computer Games industry, the Publishing industry and the Designer

Fashion industry. Figure 7 above shows that employment by foreign owned firms in the Software and Computer Games industry was 156,000. Employment by foreign owned firms in the Publishing industry becomes significant when the outer layers are taken into account. Foreign owned publishing firms employed 106,000 individuals. Similarly, foreign owned firms in the Designer Fashion industry employed 100,000 individuals in 2005.

3.1.3 The Contribution of foreign owned firms to turnover

Foreign owned firms in layer one of the Creative Industries had a total turnover of £28bn. This is equivalent to 28% of total layer one turnover in the Creative Industries.

Figure 8 below presents this information in terms of the contribution made by foreign owned firms to layer one turnover, by Creative Industry.

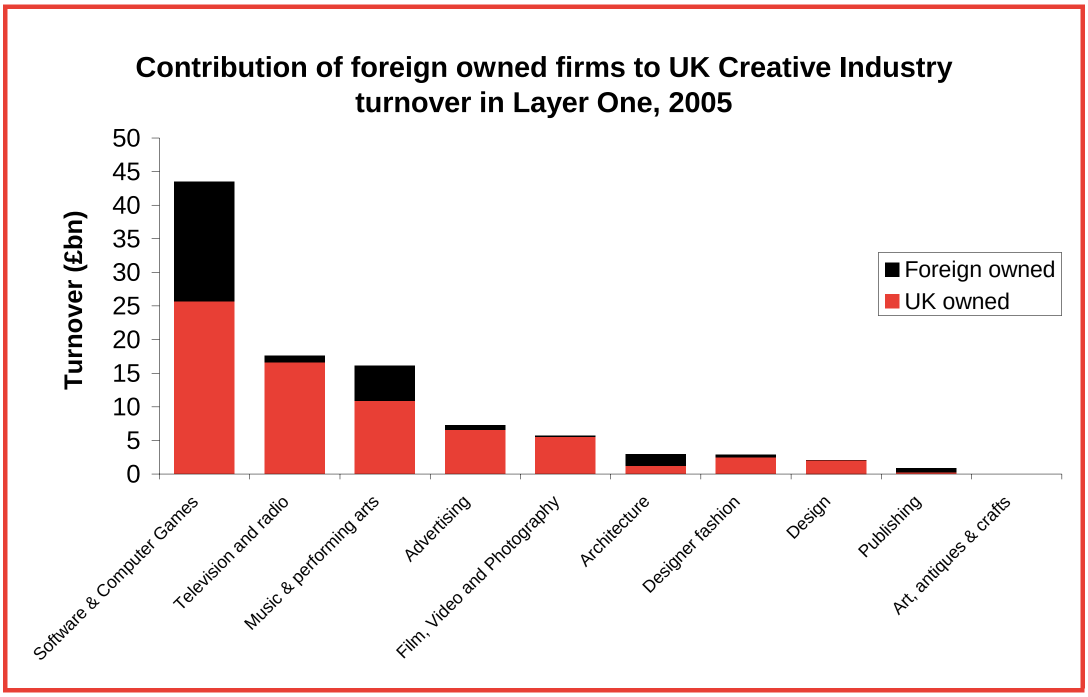

Figure 8: Contribution of foreign owned firms to UK Creative Industry turnover in layer one, 2005

Source: IDBR and Frontier analysis

This analysis shows that foreign owned firms in layer one of the Software and Computer Games industry made the largest contribution to Creative Industry turnover with a turnover of £18bn in 2005. The next largest contribution is made by layer one foreign owned Music and Performing Arts firms which had a turnover of £5.3bn. Foreign owned firms' contribution in the Architecture industry layer one is also relatively high, with a turnover of £1.7bn in 2005.

We have also explored the average turnover size of foreign owned firms in layer one. This is shown below in Figure 9.

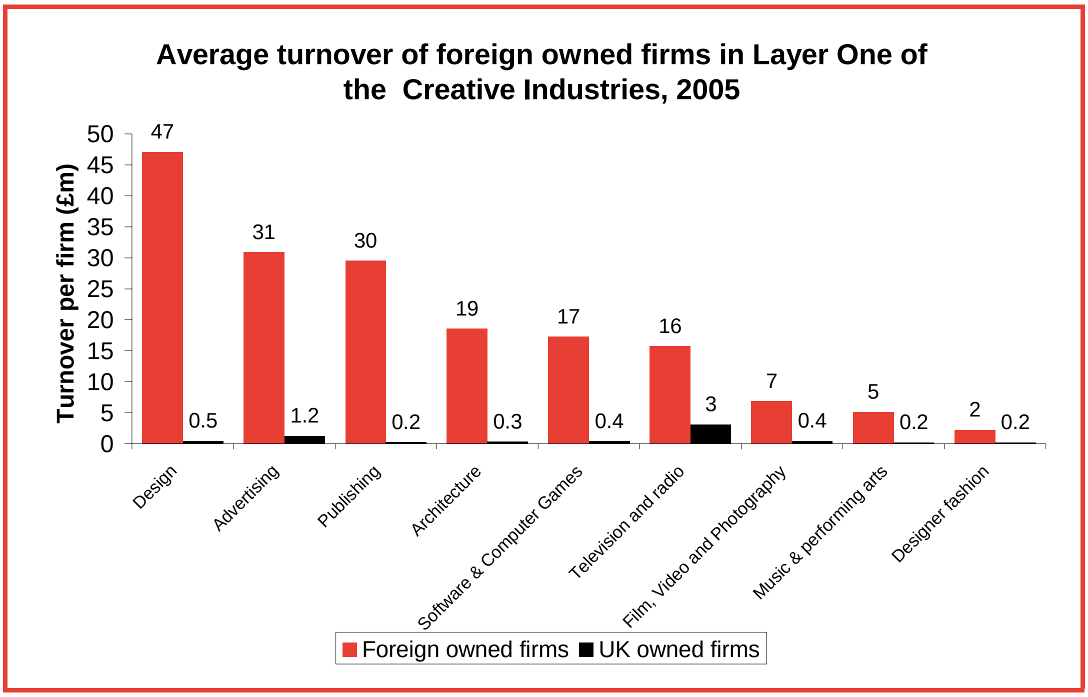

Figure 9: Average turnover of foreign owned layer one Creative industry firms, 2005

Source: IDBR and Frontier analysis

This analysis shows similar results to those obtained above for employment size. Layer one Design firms, Advertising and Publishing firms are significantly larger than other firms in the Creative Industries.

- *Design:* the 40 layer one foreign owned firms we identified have an average annual turnover of £47m. This compares with an average of £0.5m for the 2,600 layer one UK owned Design firms that we identified.
- *Advertising:* The 171 foreign owned firms we identified in layer one have an average annual turnover of £31m. This compares with an average of £1.2m for the 9,000 UK owned firms.
- *Publishing:* The 20 publishing firms we identified have an average turnover of £29m. The 1,100 UK owned firms we identified have an average turnover of £0.2m.

Foreign owned firms in the wider definition of the Creative Industries

If we widen our definition of the Creative Industries to take into account all of the outer layers, the data suggests that, relatively speaking, foreign owned firms are less important to the Creative Industries:

- layer one and outer layer foreign owned firms turned over £103bn - or 23% of total layer one and outer layer turnover; whereas
- layer one foreign owned firms turned over £28bn - or 28% of total layer one turnover in the Creative Industries.

Again, this overall result does not apply to all the Creative Industries and is largely driven by the Software and Computer Games industry:

- foreign owned firms in, for example, the Software and Computer Games and Advertising industries make a relatively large contribution to layer one in comparison to their contribution to all layers; whereas
- foreign owned firms in, for example, the Film, Video and Photography and Architecture industries make a larger contribution to all layers in comparison to their contribution to layer one.

In terms of which industries contribute most in aggregate terms to turnover when all layers of the Creative Industries are taken into account, Figure 10 below shows this again to be led by the Software and Computer Games industry. Total turnover of Software and Computer Games firms in layer one and all the outer layers was £34bn. The turnover of foreign owned firms in the Publishing industry also becomes significant when the outer layers are taken into account. Foreign owned publishing firms had a total turnover of £18bn. Similarly, foreign owned firms in the Architecture industry made a significant turnover contribution of £10bn in 2005.

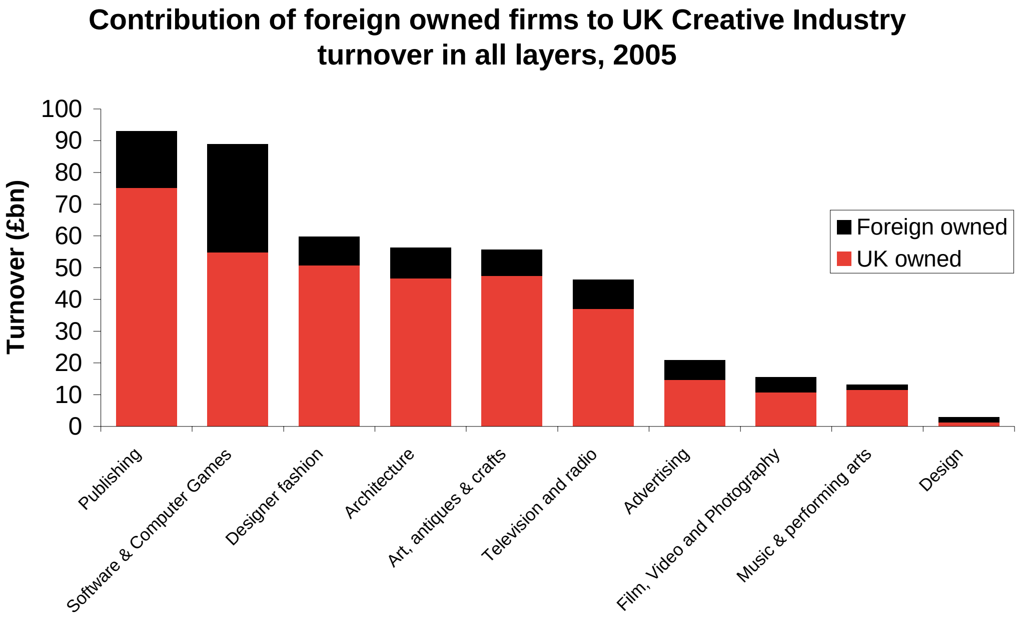

Figure 10: Contribution of foreign owned firms to UK Creative Industry turnover in all layers, 2005

Source: IDBR and Frontier analysis

3.2 THE INDIRECT CONTRIBUTION OF FOREIGN OWNED FIRMS

The case studies analysis informs this part of the study. In particular, firms in the Advertising, Design, Music, Performing Arts, Television, Video, Film, Computer Games and Software sectors were consulted.

All of these firms carry out a range of activities. These include layer one as well as outer layer activities including sales and distribution activities. The indirect benefits that are identified below therefore relate to a wider set of creative industry activities than just layer one.

Our discussions with creative firms suggest that there are two key ways in which foreign owned firms can indirectly contribute to the economy:

- supporting the UK supplier base; and
- growing small UK firms.

3.2.1 Supporting the UK supplier base

In the majority of cases it appears that UK firms that supply foreign owned firms are drawn to locate around foreign owned firms rather than the other way around. There are a few exceptions – notably in the software and computer games sector. These are discussed in the next chapter when we consider the factors which attract multinationals to locate in the UK.

Many of the multinational firms we spoke to had developed close working relationships with a local supply base. For example, London based advertising firms work closely with London based television production firms to produce television advertisements. Similarly the design firm we spoke to contracts with local resin and prototype manufacturers.

However - apart from those in the software and computer games sector - none of the firms we spoke to had been influenced to locate where they did because of the presence of a supply base. These firms felt that wherever they had located, a supply base would have formed around them. Some firms also expressed the view that in the future, geographical proximity may cease to advantage local suppliers to the same degree. This appears to be driven by pressure from either their parent firm or from their customers to cut costs by outsourcing to overseas firms. This was particularly the case for firms currently outsourcing for digital media services such as television production for the advertising industry.

3.2.2 Growing small UK firms

The evidence suggests that acquisition of small UK firms by foreign owned creative firms may be beneficial to the UK economy. Our case studies with multinationals suggest that acquisition appears to be prevalent in the advertising, music and computer games industries.

- Small UK advertising agencies are often asked by their clients to team up with or be bought by a large multinational agency to provide the capacity and reach its client requires.
- Foreign owned computer games firms have recently acquired several small UK computer games developers to improve their level of in-house expertise. These UK firms remain in the UK and tend to retain their management team.
- Many UK music labels have been acquired by multinational music recording firms to improve their ability to attract a wider scope of talent. Again it appears that these remain in the UK and retain their management structure.

More research would be required to assess whether acquisition has an adverse impact on employment. Issues that could be addressed include assessing the extent to which acquired UK firms:

- retain their management team;
- benefit from increased or more stable sales revenues; and
- acquire new skills.

We have been able to explore the relative performance of UK firms that are acquired by foreign owned firms over time using the IDBR database. To do this we have focused on all firms in layer one which were small (i.e., employed less than 10 individuals) and UK owned in 1995 and which were still operating in 2005. We have examined the performance of those firms which remained UK owned over the period with those that became foreign owned.

This analysis suggests that foreign ownership has a positive impact on performance for firms in layer one of the Creative Industries. The results of this analysis are shown below for advertising, software and computer games and the music industry (i.e., those industries which were identified via the case studies).

	Small firms that remained UK owned	Small firms that were acquired by a foreign firm
Software and Computer Games	11%	30%
Advertising	11%	22%
Music	5%	40%

Table 2: Average annual growth rate for turnover of small firms which were established before 1995 and still existed in 2005

Source: IDBR and Frontier analysis

This analysis shows that for all three industries, small firms which were acquired by foreign owned firms outperformed those which had not been acquired (in terms of turnover growth) in layer one.

We see a similar pattern for the employment growth of firms which were small and UK owned in 1995. This is shown below in Table 3.

	Small firms that remained UK owned	Small firms that were acquired by a foreign firm
Software and Computer Games	6%	23%
Advertising	5%	17%
Music	2%	9%

Table 3: Average annual growth rate for employment of small firms which were established before 1995 and still existed in 2005

Source: IDBR and Frontier analysis

- This analysis shows that for all three industries, small firms which were acquired by foreign owned firms outperformed those which had not been acquired (in terms of employment growth).

There are two potential explanations for the relatively strong performance of UK firms that are acquired:

- UK firms benefit from being acquired; or
- foreign owned firms are acquiring strong performing UK firms.

We have conducted further statistical analysis to assess which of these explanations applies to acquisition in the Creative Industries. The results from this were inconclusive. Further analysis, potentially in the form of further in-depth cases studies - is therefore required to assess whether acquired UK firms' relatively strong performance is a cause or a result of acquisition[14].

14 There is a body of economic research literature exploring the relationship between firm productivity and foreign ownership in the UK. For example, Griffith, R., Redding, S. & Simpson, H. (2004). Foreign Ownership and Productivity: New Evidence from the Service Sector and the R&D Lab, CEP Discussion Paper no. 649, Centre for Economic Performance, LSE.; and Criscuolo, C. & Martin, R. (2005). Multinationals and US Productivity Leadership: Evidence from Great Britain. CEP Discussion Paper no. 672, Centre for Economic Performance, LSE. These papers find evidence for foreign owned firms in the UK being more productive than UK owned firms. Both papers suggest (but do not provide evidence) that foreign firms' productivity performance could be attributable to foreign firms cherry picking the highest performance UK owned firms.

4 Why multinational firms locate in the UK

The previous section suggests that foreign owned Creative Industry firms make a significant contribution to the Creative Industries:

- in terms of their direct contribution, foreign owned firms contributed 20% of total layer one employment and 28% of total layer one turnover in 2005; and
- in terms of their indirect contribution, these firms appear to make a valuable contribution by supporting UK suppliers and providing growth for small firms.

It is important therefore to understand what attracts them to invest in the UK. This section explores these issues.

Each firm was asked to comment on the drivers of investment from their firm's perspective as well as to discuss opinions as to the potential drivers from the industry's perspective. Where firms were foreign owned we asked them to focus on the reasons why they chose to invest in the UK (and to remain located in the UK). In the case of UK owned multinational firms, we focused on the reasons why the UK was the best place to remain based and why they thought other non-UK firms in their industry were attracted to the UK. In addition, we asked firms what factors would cause them to leave the UK.

Broadly, the factors which drive Creative Industry multinationals to locate in the UK can be categorised in terms of:

- supply side factors;
- demand side factors; and
- other factors.

These and the factors which would cause UK multinationals to leave the UK are discussed in turn below.

4.1 SUPPLY SIDE FACTORS

Our discussions with Creative Industry firms identified the following supply side aspects as being important to their decision to locate in the UK (or remain located in the UK):

- UK labour force;
- UK supplier base; and
- ability to acquire UK firms.

4.1.1 UK labour force

Our case studies with Creative Industry firms highlighted the importance of a skilled labour force and also the UK's ability to attract and retain key skills. In particular the UK was described by all of the firms we interviewed as having a key advantage in terms of at least one of the following aspects:

- the quality of its graduates;
- the UK's ability to attract and retain highly skilled labour (including overseas graduates); and
- the UK's general appeal to visiting company executives.

The results of this analysis are illustrated below in Figure 11.

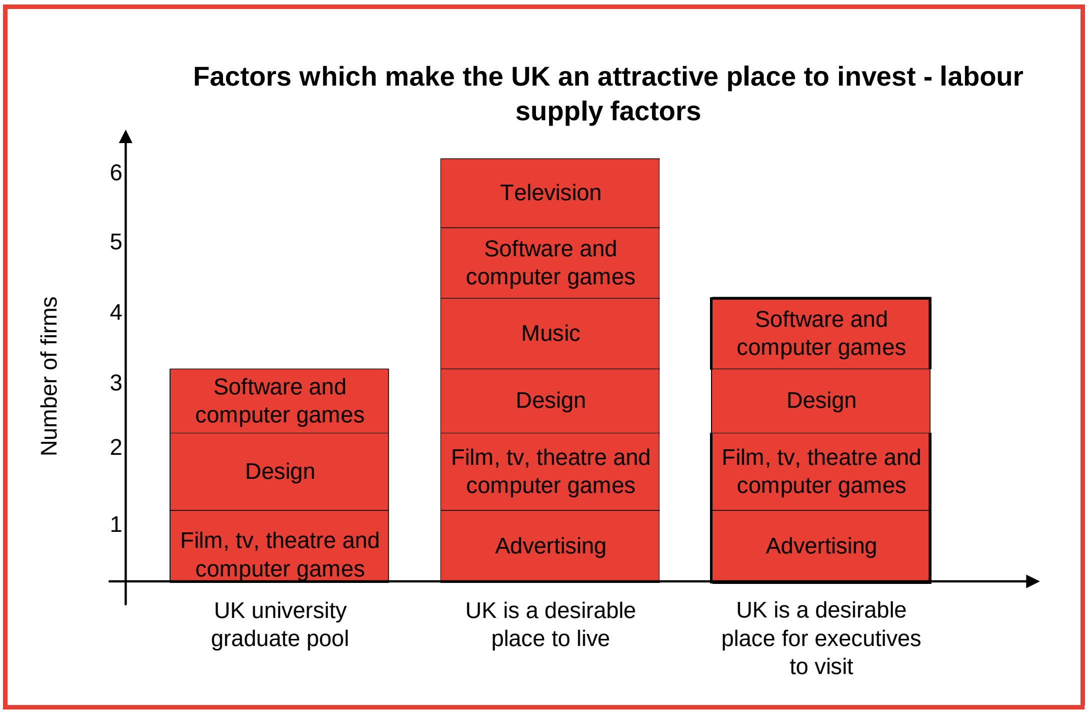

Figure 11: Labour supply factors which make the UK an attractive place to locate

Source: Frontier analysis

This figure indicates which firms' decision to invest in the UK had been significantly influenced by labour supply factors.

UK university graduate pool

Three of the firms we spoke to referred to the UK's graduate pool as a key factor for locating in the UK. Each example that was provided by firms highlighted niche technical skills as being of particular importance. Some of these skills are academic in nature (e.g., mathematics and physics for the Software industry) whereas others are vocational (e.g., stage crafts and dance for the performing arts industry).

- The *Software and Computer Games* firm had chosen to open a second research facility in the UK to maximise its chance of recruiting UK graduates, and to maximise collaboration opportunities with researchers within one of the Universities.

- The *Design* firm stated that the presence of six top design colleges in the UK (e.g., Royal College of Art and Coventry University) was among the key reasons for choosing to invest in the UK. Other potential (European) sites typically only offered one college of the same calibre. The size and quality of the graduate pool in the UK is such that the firm can receive 300 applicants for one position with many highly skilled applicants offering to work for nothing for their initial period of employment.
- The *film, tv, theatre and computer games* firm referred to the UK's drama, dance and stage craft schools as a particular reason for focusing its theatre activities in the UK.

The UK is a desirable place to live

All six of the firms we spoke to referred to the attractiveness of the UK as a place to live as a subtle but key factor in their location decision. The fact that this was identified, without prompting, by all the firms we spoke to suggests this is a significant driver. In particular, the UK was said to be able to attract and retain skilled workers and key managers. In many cases the UK's attractiveness appeared to be partly due to its cultural facilities. Firms described both private leisure facilities (for example, restaurants, and galleries) as well as facilities provided by the subsidised sector, such as public museums and galleries. In addition, the U.S firms we spoke to suggested that the English language was also an important driver in their decision to locate in the UK.

- The *Software, Computer Games and Design* firms stated that the UK's ability to retain foreign graduates was particularly important. The Software firm opened a second research office in the UK because it thought there was a significant portion of UK graduates who would not want to relocate from the UK to the US.
- The *Advertising* firm stated that Advertising Executives would be unlikely to relocate to another country because they valued the opportunities that London provided to network. Because these effects are reinforced by the presence of other advertising executives it is unlikely that layer one advertising operations will ever leave the UK, despite pressures from overseas head offices to reduce costs.
- *The Software, Computer Games and Film and Television* firms said that their decision to locate in the UK was to some degree aided by the fact that their executives liked living in or visiting the UK. In some cases this was attributed to London's cultural facilities.

The responses we received from the six firms suggests that whilst the attractiveness of the UK does appear to be a driver, it requires the presence of other drivers (e.g., skills) to have a significant impact. In addition, more research is required to understand which particular aspects of the UK's cultural facilities are most attractive to foreign owned firms.

The UK is a desirable place for its executives to visit

All of the foreign owned firms we spoke to said that overseas executives liked to visit London. Although this is unlikely to be a causal factor in the firm's initial decision to locate, the firms felt that this advantaged the UK in providing it with a relatively high profile within the global organisation. When prompted, the foreign-owned firms agreed that the UK's cultural facilities played an important role in making the UK attractive. In terms of the nature of these cultural facilities this includes both the leisure industry as well as the subsidised sector.

- The firm in the *film, tv, theatre and computer games* industry went a little further in describing the UK as having a close cultural relationship with its U.S (the site of its head office), meaning that its executives felt more comfortable visiting and also dealing with people in the UK.

4.1.2 The UK supplier network

The previous section discussed the impact of the UK skills base on firms' decisions to locate in the UK. In addition, there is evidence that, for some sectors, UK firms may also attract multinational investment. The characteristics of these firms are described below in Figure 12.

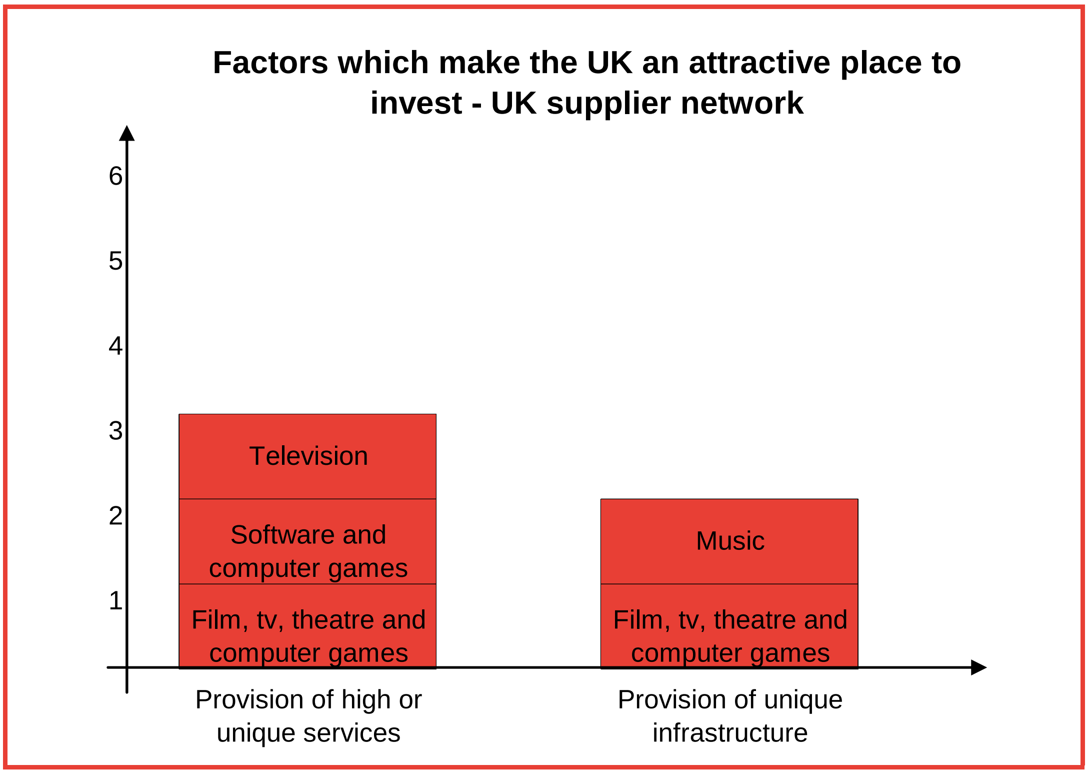

Figure 12: UK supply base characteristics which make the UK an attractive place for Creative Industry firms to locate

Source: Frontier analysis

Figure 12 identifies two characteristics of the UK Creative Industry supplier base as particular draws for multinational firms:

- provision of highly skilled or unique services; and
- provision of a unique capital infrastructure.

In general, UK firms that attract multinational investment appear to offer unique, valuable services which complement the in-house expertise of the multinationals. Therefore, rather than seeking to poach individuals from UK firms, multinationals establish supply contracts with the firm.

Provision of highly skilled or unique services

- The firm in the *Computer Games* industry recognised the UK as a leader in particular types of computer games design technology – for example driving simulators. The presence of these highly specialised firms meant that the firm invested more in the UK than they otherwise would have done. For example, rather than a one-off blockbuster driving simulator game being developed by the US office, the project would be developed by the UK office.
- *Firms in the television industry* identified the UK's special effects, stage and costume design expertise as a potential draw for television production firms.

Both of these examples led to multinational firms increasing their presence in the UK in terms of their layer one, development activities. As a result, employment and expenditure by these firms in the UK increased.

Provision of unique infrastructure

- Firms in the *performing arts or theatre* industry identified London's West End theatres as a critical factor in deciding to invest in the UK. Aside from New York's Broadway, London is unique in being able to offer a permanent theatre facility to firms. As a result the firm would always invest heavily in bringing stage shows to the UK before touring them around the rest of Europe.
- The *music firm* we spoke to identified the UK's weekly music press and national radio stations (such as Radio 1) as features which benefited UK record labels and which were unique to the UK. Gaining a review in a key music magazine or getting onto the play list of a national radio station, is seen as one of the most effective ways of marketing a band, both in the UK and internationally.

4.1.3 Ability to acquire UK firms

Acquisition of UK firms by foreign owned firms can form an important part of a multinational firm's strategy to enter and/or expand in the UK. Figure 13 below illustrates the extent to which this may apply to the Creative Industries.

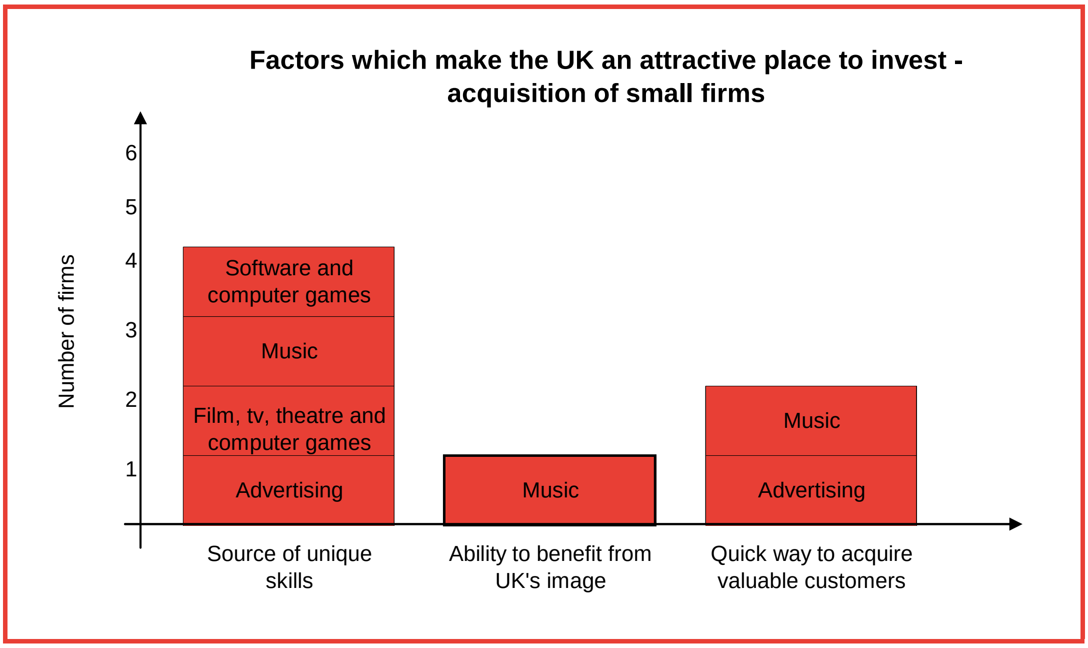

Figure 13: UK Creative Industry firm characteristics which make them an attractive acquisition prospect

Source: Frontier analysis

As Figure 13 illustrates, there may be three key ways in which acquisition of UK firms benefits multinational Creative Industry firms:

- bringing new or unique skills in-house;
- improving or diversifying the firms brand image; or
- rapid expansion of the firm's customer base.

Bringing new or unique skills in-house

Our analysis of the supplier infrastructure has highlighted the UK's expertise in particular types of computer games development. Where these skills overlap with (rather than complement) the key activities of multinational firms, multinationals may choose to bring these skills in-house, through acquisition.

- The *Software and Computer Games* firm we spoke to had acquired a number of the UK's leading software developers. We understand that these firms operate relatively autonomously with the parent management structure. The firm believed these acquisitions enabled them to improve their skills base and so keep abreast of the competition from other games platforms.
- The *Advertising* firm we spoke to described situations where large multinational agencies had been asked to bring in expertise from other firms by their clients. This usually happened when a large client was happy with the expertise of the small firm handling its account, but less happy with the small firm's capacity or global coverage. In these cases the small UK firm may approach another multinational advertising firm to provide the desired combination of expertise and global reach.

Improving or diversifying the firm's brand image

Brand image is important for most firms. Firms can improve their brand by investing in their corporate image. In one particular Creative Industry – music – however, being UK owned and located appears to be particularly important aspect of developing a strong brand.

- The *music firm* we spoke to referred to a recent trend of the major (mainly overseas) record labels purchasing UK labels. It appears that UK record labels are more likely to be able to attract particular genres of band. By signing to a UK label, these bands believe they will be marketed more effectively. This could be because of contacts within the industry or because they can be cross promoted on the back of existing successful acts on the label (e.g., through live tours, websites or consumers listening to new acts that are signed to the same label as other bands that they like).

Rapid expansion of the firm's customer base

A key factor that will be discussed in more detail below is the role of demand in attracting multinationals to the UK. One way that multinational firms may tap into this demand is by acquiring UK firms.

- The *Advertising* firm we spoke to described acquisition of UK firms as a common way for the larger firms to grow. Small agencies are then formed by successful artistic directors of larger agencies. Their reputations are such that they quickly accumulate accounts and so become an attractive proposition for large multinational firms looking to expand in the UK.
- As described above, large firms in the *music industry* have recently started to acquire UK record labels. As a result larger, overseas labels can benefit from a ready made customer base.

4.2 DEMAND SIDE FACTORS

For many of the firms we spoke to, the size or characteristics of the UK consumer base appear to have been a factor in attracting investment to the UK.

Figure 14 below illustrates our findings on the importance of the UK consumer base on firms' decision to invest in the UK.

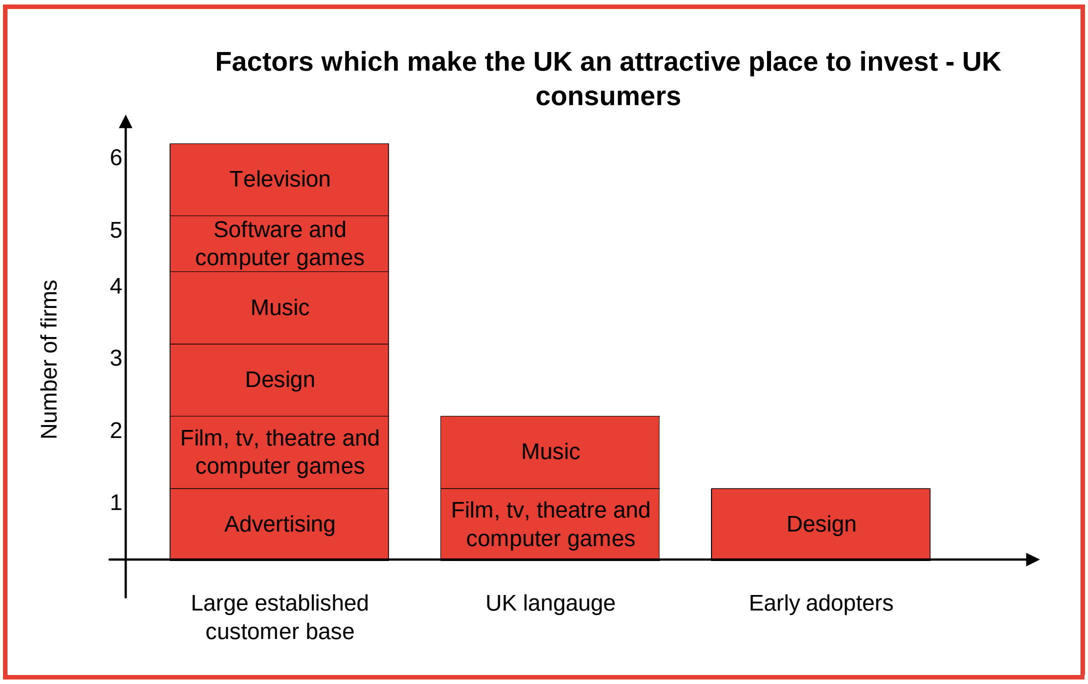

Figure 14: Characteristics of the UK Creative Industry consumer base which make the UK an attractive place to locate

Source: Frontier analysis

This figure shows that three key areas were identified as potential significant attractors to the UK:

- a large established UK customer base;
- the English language; and
- early adapters (for the Design industry only).

Large established UK customer base

Every firm we spoke to explicitly stated that being close to the UK consumer base was one of the key reasons for locating in the UK. As a result, many multinational firms had established a sales, marketing and distribution capability in the UK. In some cases these firms operated a dedicated UK sales and marketing base from the UK, in other cases, multinationals were basing their entire European sales, marketing and distribution operation in the UK.

- The *film, tv, theatre, and computer games* firm had established a UK base to market and distribute its products to UK customers. Most products were supplied by its head office to be sold on to UK consumers. In a minority of cases, the UK office would have responsibility for developing products specifically for the UK consumer base.
- *The advertising* firm we spoke to said that in general advertising agencies set up offices wherever their clients' major consumer markets are. For example, a large agency, LINTAS opened offices in all of Unilever's major markets, including Africa and Asia. Multinational firms therefore tend to open offices

in the UK. These offices may simply act as distributors, or they may play a more significant, creative role such as 'transcreation' (i.e., modifiying adverts to account for cultural and language differences) or production of a complete campaign, if a client wants to run a large, UK specific project.

- The *software and computer games* firm had opened a UK office that was dedicated to marketing and distributing its products. A particular reason for wanting to locate in the UK was to be close to its customers so it could provide ongoing, high quality customer support.

Our case studies suggest that whilst the UK customer base may be important in driving their initial decision to locate in the UK, customer demand may only drive their decision to investment in non-layer one sales and distribution activities.

In terms of firms' decision to locate layer one activities in the UK, consumer demand appears to make this decision more likely (because the firm already has a presence and some infrastructure in the UK). Consumer demand does not however appear to determine the scale of investment in layer one activities.

This suggests that whilst UK consumer demand may be a necessary pre-requisite for multinational investment, it is not sufficient in itself to attract the high value added layer one activities.

The English language

The fact that the UK customer base has English as its first language was seen as a particularly significant advantage for the American firms we spoke to. These firms tended to be more confident investing in the UK market than other European countries.

In terms of specific industries, we found the following.

- The *film, tv, theatre and computer games* firm said that the UK was particularly attractive for importing its television and film products as these needed relatively few modifications to bring them to market.
- The *music* firm stated that English speaking bands had a significant advantage in the global music industry. US and UK record labels had a natural advantage in being able to attract and effectively promote these bands. The UK may be further advantaged outside of the US because US labels may choose to promote bands in new US states rather than new countries, because the return on investment from doing so was higher.

Early adopters

UK consumers and UK based firms that are further down the supply chain can also be characterised in terms of the types of product they demand. Evidence from one firm in the Design industry suggests that, at least in the Design industry, UK firms and consumers are among the first to adopt new ideas.

- The *design* firm we spoke to said the fact that UK consumers were perceived as being early adapters of technology was a key factor in deciding to locate its design base in the UK. This characteristic was attributed to UK consumers' relatively high education levels and wealth. The firm felt that locating its creative operations close to the UK consumer base enabled them to stay on top of consumer trends and, hopefully, one step ahead of the competition in terms of new ideas. A second *design* firm we spoke to suggested that the fact its UK clients (e.g., BT) were investing in new technologies ahead of its European counterparts was giving it an edge in the wider European market when pitching for new work[15].

4.3 OTHER FACTORS

This final section highlights other factors which the case study firms identified as being key factors in their decision to locate in the UK. These are illustrated below in Figure 15.

15 We spoke to a second Design firm after completing the first round of cases studies. We did this because we were concerned the first firm operated in a specialised part of the industry and so its responses may be specific only to this area of design.

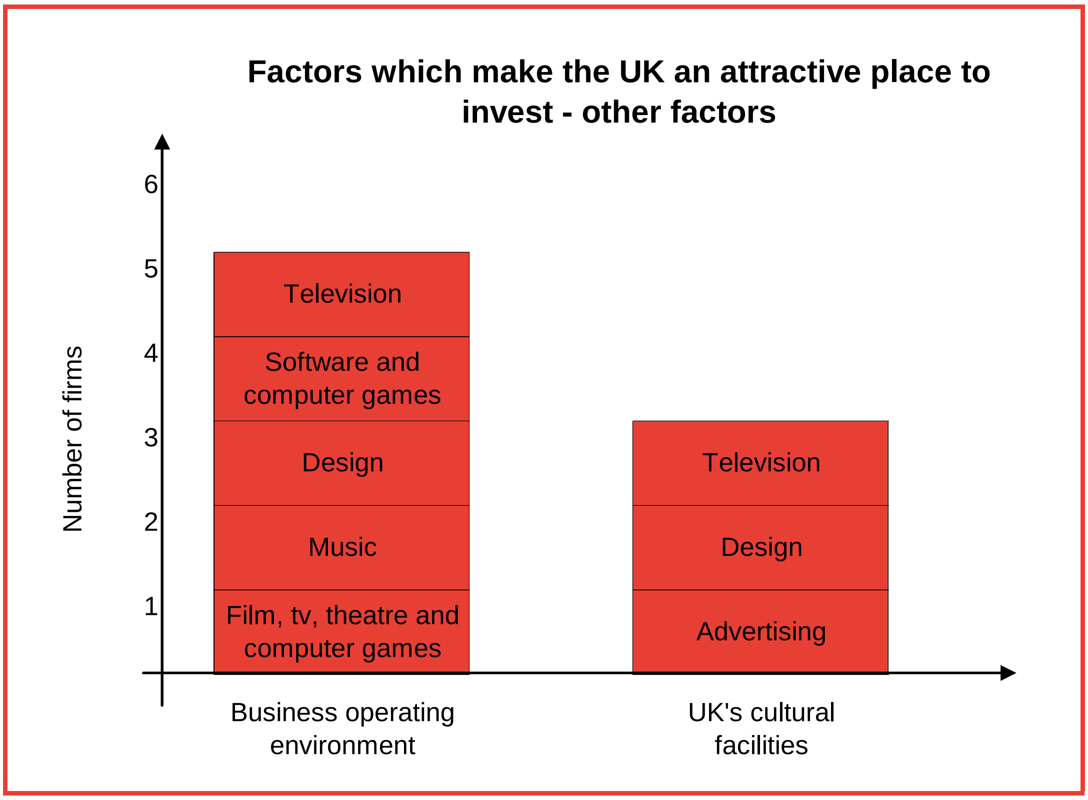

Figure 15: : Other UK specific factors which make the UK an attract place to locate for the Creative Industries

Source: Frontier analysis

In particular the following factors were identified by at least one of the firms:

- UK business operating environment; and
- the UK's cultural facilities.

UK business operating environment

Many firms referred to the UK as offering a favourable business operating environment. In particular, three issues were cited as key reasons for locating, or remaining located in the UK – fiscal factors, the ability of firms to protect their intellectual property rights, and liberal labour laws.

- The *film, tv, theatre and computer games* firm we spoke to referred to the importance of a low tax environment for its film production activities. This view was also voiced by the *television* firm. This was the case because all inputs to the film production process were mobile and so the final decision rested on profitability and so tax.
- The *design* firm faced constant pressures to relocate because of relatively high labour and rent costs. One way it had been able to counter this was by gaining tax credits through the UK Government's R&D tax credits system. This had been a significant breakthrough for the firm and would be critical in ensuring it remained located in the UK.

- Intellectual property rights protection was seen as crucial by *music, software and computer games* firms we spoke to. Without the protection afforded by the UK Government, they would not have invested to the same extent in the UK.
- The two *US* firms we spoke to explicitly mentioned the UK's favourable labour laws as a key reason for choosing to invest in the UK. In particular, the UK's legislation on flexible working hours and hiring arrangements were highlighted.

UK's cultural facilities

We have discussed the role of culture in attracting and retaining talent to the UK and in raising the profile and reputation of the UK as an attractive place for international business executives to visit and do business. In addition, our case studies with creative firms suggest that the UK's cultural facilities might play an important role as a key input to the production process.

- Designers in *Advertising* firms draw on a wide range of influences from the visual arts to produce new work. This includes art, design, fashion and photography exhibitions and cinema, as well as more specific establishments such as the London Design museum.
- The *Design* firm we spoke to spoke of the London's art and design museums as a significant input to its production process. It actively encourages its employees to consume as much culture as possible and often purchases tickets to exhibitions and cultural events.

It is important to note that all of the firms we spoke to required prompting to mention culture as a potential driver of their investment decision in the UK. This contrasts with the other drivers that we have referred to in this study which were identified unprompted by firms.

4.4 FACTORS WHICH WOULD CAUSE MULTINATIONALS TO LEAVE THE UK

We also asked firms whether they were considering leaving the UK, or alternatively which factors would cause them to consider leaving or reducing their investment in the UK.

None of the firms we spoke to said they were considering leaving the UK and most found this question difficult to answer. In general, the factors which attracted these firms to the UK tend also to be those that could make them leave the UK. Three factors in particular appear relevant – the UK customer base, labour skills and costs, and IP protection.

- The *Advertising* firm we spoke to is to some extent reliant on its clients having a significant customer base in the UK. If these firms' customer base was to reduce significantly this implies that Advertising firms may reduce their level of UK investment.
- *Software and Computer* firms require highly skilled computer science graduates. One of the firms we spoke to expressed a concern at the lack of suitably skilled graduates in the UK labour market and suggested more should be

done to attract students to study for these skills. Although the firm itself was not experiencing recruitment issues, it was aware of other firms in the industry who were.

- The *Music* and *Software and Computer Games* firms suggested that a deterioration in IP protection rules could significantly alter their decision to continue operating in the UK.

In addition the Design firm we spoke to referred to negative experiences during and at the start of its investment in the UK which could reduce the likelihood that other creative firms invest in the UK.

- The first issue is a lack of specific, local advice for multinationals wanting to locate in the UK. The firm suggested that access to advice from multinationals from the same country and/or sector would significantly improve firms' experiences trying to invest in the UK.
- Another issue which relates to the attractiveness of the UK to visiting executive (a point raised earlier in this report) was lack of awareness of the UK Government's fast track passport control facility which allows non-EU executive to by-pass the long queues at Heathrow airport. Until the firm was made aware of this service, it ranked the fact that its executives has to wait for up to an hour to clear immigration as one of the key disadvantages of doing business in the UK.

4.5 CONCLUSIONS

This section has explored the factors which drive Creative Industry multinationals to locate in the UK. We have done this using evidence from six in-depth case studies with Creative Industry firms. Our key findings can be categorised in terms of supply side, demand side and other factors.

- In terms of supply side factors, access to skills from UK graduates or existing firms was particularly important for firms in the Software and Computer Games sector and in the Design sector. Connected to this was the view, expressed by all the firms we spoke to, that skilled graduates and experienced executives were attracted to live in the UK. Part of this attraction may be due to the UK's cultural facilities, but more research is required to understand more fully the role that culture may play. High-tech UK firms in the computer games and television industries also provide valuable services to multinationals (for example computer programming of cutting edge driving simulation games and special effects).
- In terms of demand side factors, all the firms we spoke to said the UK customer base, and to as lesser extent, the English language had been a factor in their location decision. In the majority of cases, this had influenced firms to invest in distribution and marketing activities. In a few cases, consumer demand appeared to have caused firms to invest in layer one creative activities such as product creation or adaptation. Again more research could be done to understand the link between demand and supply side factors and

the degree to which demand side factors alone would be sufficient to attract investment in the creative activities of firms.

- The final set of other factors which attracted firms to the UK can be summarised as the business operating environment – for example IPR protection, liberal labour laws and fiscal factors; and the UK's cultural facilities, this time in their contribution to firms' production processes.

Our findings in this and the previous section on the benefits that multinationals bring to the UK economy, leave us with several questions that could be answered through further study. These questions and our recommendations for how they could be explored are detailed in the next section.

5 Recommendations for next steps

The analysis we present in this report provides an introduction to an issue which is important, but also complex to understand. Our statistical and qualitative analysis has allowed us to draw some initial findings as to the benefits that Creative Industry multinationals may bring to the UK economy and what it is that may attract these firms to invest.

Our findings raise a number of interesting issues which could be addressed through further research and analysis. These are discussed below.

- *The benefits of UK firms being acquired:* Our analysis suggests that small UK owned firms that are acquired by foreign owned firms are more successful (in terms of employment and turnover growth) than those that are not acquired. More research, potentially through further in-depth case studies with UK small firms that have been acquired and foreign owned multinationals, would allow us to explore the extent to which these small firms' success is attributable to being acquired, or whether multinationals are selecting only successful firms for acquisition. If small firms are successful because of acquisition we would also want to explore what multinationals are providing to these firms that makes them successful. This research should be conducted alongside a wider review of the existing economic evidence on the impact on UK firms of foreign multinational investment (including those outside of the Creative Industries).
- *The skills requirements of Creative Industry multinationals:* Skilled labour was expressed as a key attractor during the case studies. Our limited sample of firms suggests that there may be a skills gap for some industries. The extent to which this applies to each of the Creative Industries and exact nature of this gap should be explored through a study which sought to engage with sector skills councils, key UK universities and senior managers in Creative Industry firms.
- *The role of consumer demand:* Although consumer demand was expressed by all the firms we spoke to as a key driver of their decision to locate in the UK, we need to explore in more depth exactly why this is a key factor and whether this leads to a particular type of investment – for example, sales and distribution – which earlier analysis has suggested may not fall under the definition of a Creative Industry activity. In addition, it would be important to explore the interplay between this and the supply side factors identified above. For example whether are combination of these factors are required for a firm to invest or whether demand or supply factors on their own are sufficient. This should be explored through further in-depth case studies with Creative Industry firms.
- *The role of culture in attracting multinationals:* An interesting finding from the case studies was the potential for the UK's cultural resources in both the leisure industry and the subsidised sector to attract firms to the UK. It is important to note that most of the case study firms required prompting to mention the culture as a potential attractor. This suggests that culture may be less

important than the factors identified above. The case studies suggest that culture may for example encourage talented graduates from our universities to search for jobs within the UK, it may also play a similar role attracting and retaining executives of international Creative Industry firms. More could be done to understand the relative importance of culture and which aspects of culture are most important. These issues could be explored through a combination of a large scale survey of UK university graduates and in-depth interviews with executives and HR departments of large foreign owned firms with a UK base.

Annexe 1: Our approach to defining the Creative Industries

The current approach to defining the Creative Industries is based on Standard Industrial Classification (SIC) code data defined at the 4-digit level[16]. This data is quite aggregated and does not permit much detailed analysis to be carried out. For example, some Creative Industries such as Design, cannot be defined at all using 4-digit SIC code data.

More dis-aggregated 5-digit data is now available which should allow a more in-depth analysis to be carried out. The Creative Industries are not currently defined at this dis-aggregated level, we must start our analysis by developing a robust definition of the Creative Industries at the 5-digit level.

It is important that this 5-digit definition is robust, representative and is consistent with the current 4-digit definition. The remainder of this annexe deals with these issues. In particular it discusses:

- the current approach to defining the Creative Industries;
- alternative approaches to defining the Creative Industries in light of improved data; and
- the implications of these alternative approaches in terms of Creative Industry performance.

THE CURRENT APPROACH TO DEFINING THE CREATIVE INDUSTRIES

The current DCMS approach to defining the Creative Industries is based on 4-digit Standard Industrial Classification (SIC) code data. To define each industry, DMCS has selected where possible, one or more 4-digit SIC codes that correspond closely to the activities of that industries. In some cases, the 4-digit code includes activities which lie outside of the Creative Industry definition. Where this is the case, only a percentage of the 4-digit code is taken as being part of that Creative Industry.

The Creative Industry SIC codes and any percentages which are applied to the codes are shown below in Table 4.

16 The Standard Industrial Classification system allows firms to be classified according to their principal activities so that firms can be grouped into industries. There are many levels at which this can be done. Two-digit SIC codes define industries at a the broadest level. For example, SIC code 74 covers all firms which carry out 'Other Business Activities. Three, four and five-digit SIC codes define industries in more detail. For example the 3-digit code 74.2 refers to 'Architectural and engineering activities and related technical consultancy', whereas the 5-digit code, 74.20/1 is more specific, referring only to 'Architectural activities'. In practice firms allocate themselves to a SIC code. This means that in some cases some firms may be mis-classified. This is a particular problem when the SIC code definitions change (or more are added), as firms may take time to adjust their definition.

Creative Industry	SIC code	Proportion of code included
Advertising	Advertising (74.40)	100%
Architecture	Architecture and engineering activities and related technical consultancy (74.20)	25%
Art & Antiques	Other retail sale in specialised stores (52.48); Retail sale of second-hand goods in stores (52.50)	5%
Crafts	None	None
Design	None	None
Designer fashion	Clothing manufacture (9 codes)	0.5%
Video, film and photography	Reproduction of video recording (22.32); Photographic activities (74.81); Motion picture and video production, distribution and projection (92.11 to 92.13).	25%
Music and the visual and performing arts	Publishing of sound recordings (22.14); Reproduction of sound recording (22.31); Artistic and literary creation and interpretation (92.31); Operation of arts facilities (92.32); Other entertainment (92.34).	25% - 50%
Publishing	Publishing of books, newspapers, journals & periodicals (22.12 & 22.13); other publishing (22.15); news agency activities (92.40)	0% - 50%
Software and computer games	Reproduction of computer media (22.33)	25%
Radio and TV	Radio and television activities (92.20)	100%

Table 4: The current approach to defining the Creative Industries

Source: DCMS

The current approach clearly defines some industries such as advertising and radio and television. In these cases a 4-digit code can be used to represent the Creative Industry without the need to apply a percentage to the code.

Annexe 1: Our approach to defining the Creative Industries

In contrast, some industries are much harder to define:

- for some industries a small percentage of the 4-digit SIC codes are taken to represent that part of each code which refers to the Creative Industries – e.g., for Designer Fashion 0.5% of nine clothing manufacturing codes are taken to represent the industry;
- for other industries, the current approach does not allow some industries to be defined separately – this is a particular problem for the Software and Computer Games industries who collectively account for over one-third of total Creative Industry GVA; and
- in some cases, a Creative Industry cannot be defined at all - this is the case for the Crafts and the Design industries.

These findings suggest that more detailed, 5 digit SIC code data could enable a more accurate definition of the Creative Industries to be established. Also, the current approach which applies percentages to SIC codes, means that detailed structural statistical analysis cannot be undertaken.

A FRAMEWORK FOR DEFINING THE CREATIVE INDUSTRIES

Our analysis started by considering:

- whether a greater level of detail allows some industries to be defined more accurately; and
- where to draw the line when defining each industry - for example, for the music industry, do we include only activities such as composition and live performance, or do we extend our definition to include activities such as the manufacture and sale of CDs?

To address these issues we have analysed each Creative Industry's supply chain. This sets out, for each industry, all of its activities (as defined at the 5-digit SIC code level). In addition, it classifies these activities in terms of their position within the industry supply chain.

The framework

Our framework describes each industry in terms of a series of five layers – layer one and four outer layers – layer two to layer five. Each one of these layers corresponds to a distinct stage in an industry's supply chain:

- Layer one broadly represents those activities which lie at the top of each supply chain. These include activities such as composition for the Music industry, programming for the Computer Games industry and writing for the publishing industry. Layer one arguably describes the creative element of each Creative Industry. We have therefore adopted layer one as our key definition of the Creative Industries.
- Layer two of any Creative Industry broadly represents those activities which directly support layer one activities in the supply chain. In many cases these

are the activities which translate the creative activity into a marketable product. This includes activities such as publishing for the Publishing industry, casting for the Performing Arts and computer related work for the Software and Computer Games industries.

- Layer three of a Creative Industry is one stage further removed from layer one and includes those activities which support layer one and layer Two activities described above. In many cases this includes the manufacture of the hardware which directly supports the creative process – for example, the manufacture of television cameras and other hardware directly used in creating television programmes. In addition it includes the next stage in the production process from layer two activities - for example, this would include book binding for the Publishing industry and the reproduction of software for the Software and Computer Games industry.
- Layer four of a Creative Industry represents those activities which support the layers described above. In general this includes the manufacture and wholesale of raw materials such as printing ink and pulp for the publishing industry and also the manufacture of hardware that is used in the consumption of Creative Industry products such as televisions for the television industry and arcade machines for the Computer Games industry.
- Layer five represents the least Creative activities of any Creative Industry. In many cases layer five activities include the retail to the final consumer such as the sale of DVD players for the music industry, and games consoles for the Computer Games industry.

A generic supply chain for the Creative Industries with the corresponding layer definitions is shown below in Figure 16.

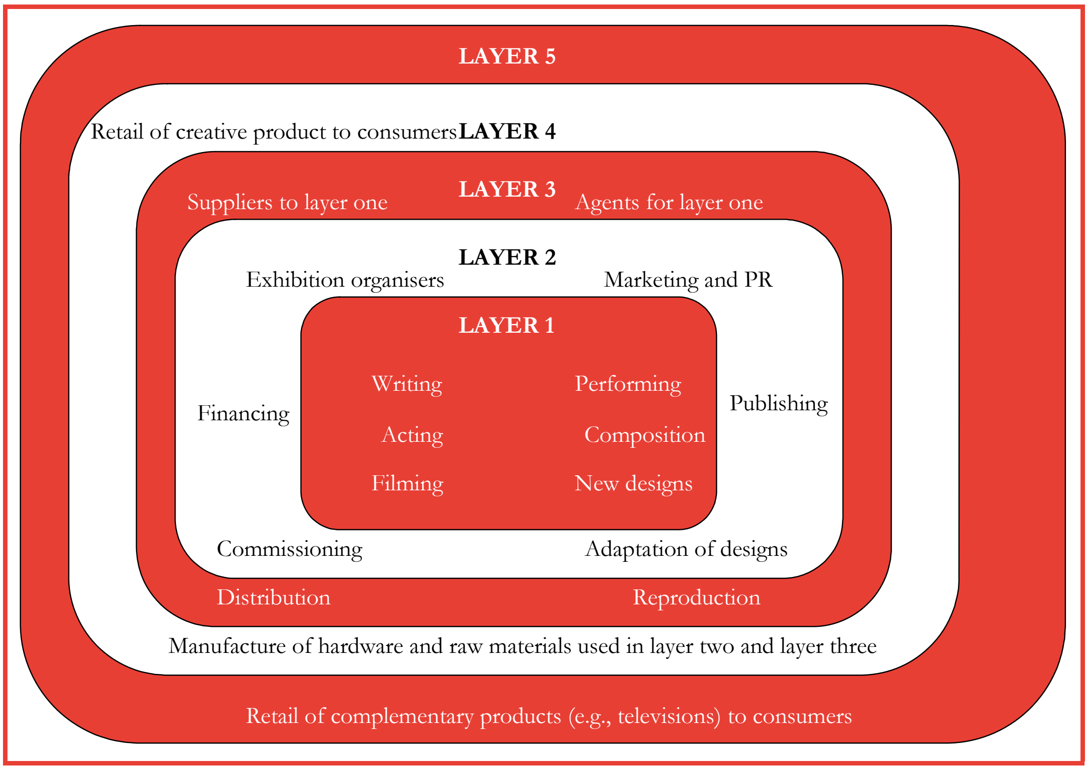

Figure 16: A generic supply chain for the Creative Industries

Source: Frontier

One of the key issues for defining the Creative Industries is where to draw the line in terms of the activities that are included in any definition. Our supply chain framework has helped us to analyse this by ordering the activities of each Creative Industry in terms of its supply chain.

This approach has revealed a distinct set of layer one activities. These appear to represent the creative processes which drive each Creative Industry. We have therefore adopted layer one as our working definition for each Creative Industry.

Annexe 2 sets out, for each Creative Industry, the activities included in each layer.

Key advantages with this approach are as follows:

- most of the Creative Industries can be defined more accurately, without the need for applying proportions to the data; and
- in some cases we have been able to define a layer one for an individual industry - this is the case for Architecture, Advertising, Design, Designer Fashion, Publishing and TV & Radio.

In other cases it has been necessary to combine layer one of two Creative Industries - this is the case for Film, Video and Photography, Music and the Performing Arts, Art, Antiques and Crafts and Software and Computer Games.

IMPLICATIONS OF DEFINING THE CREATIVE INDUSTRIES USING 5-DIGIT DATA

This section considers the implications of using the 5-digit SIC code definitions in our analysis of the Creative Industries. To do this we compare the size of the Creative Industries using the 5-digit definition with the size of the Creative Industries using the 4-digit definition currently employed by DCMS. We do this in terms of employment and turnover.

Under the new 5-digit definition we estimate that the Creative Industries employed 728,000 and had a turnover of £99bn in 2005. The estimates are lower than those under the existing definition of 982,000 employees and £129bn.

This is shown below in Figure 17 for employment.

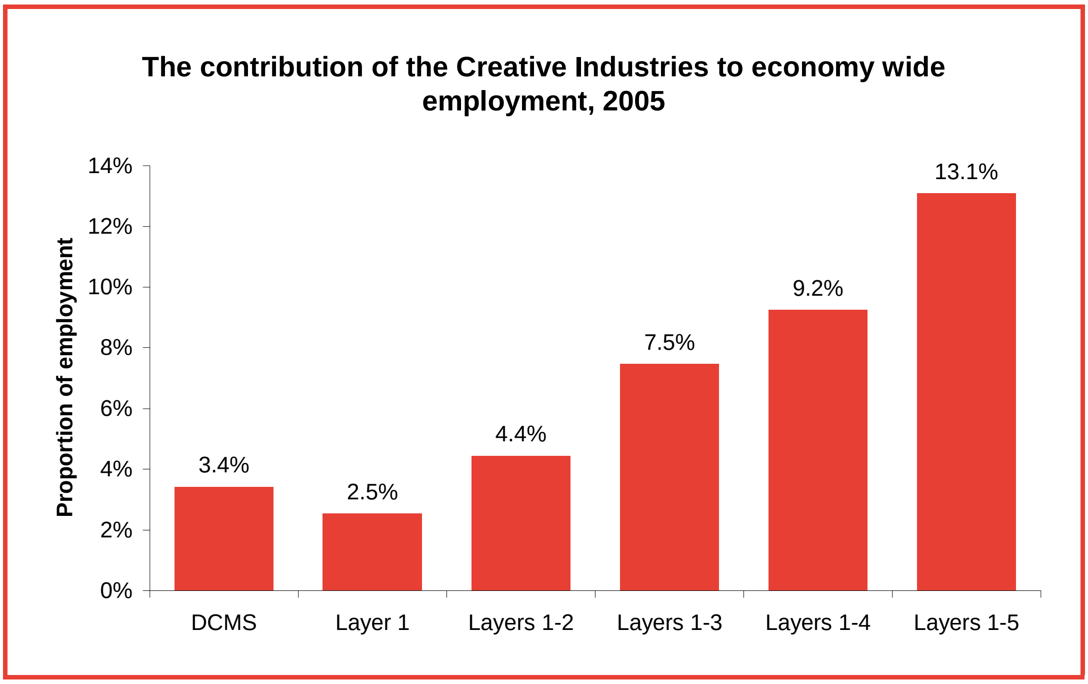

Figure 17: Comparing Creative Industry employment under the current 4-digit SIC code definition with the recent 5-digit SIC code definition

Source: DCMS, IDBR and Frontier analysis

The analysis above shows that the new definition is narrower than the existing definition in terms of employment. For example, under the existing definition the Creative Industries account for 3.4% of UK employment. Under the 5-digit definition of layer one, the contribution falls to 2.5%.

The result is similar for turnover. This is shown in Figure 18 below.

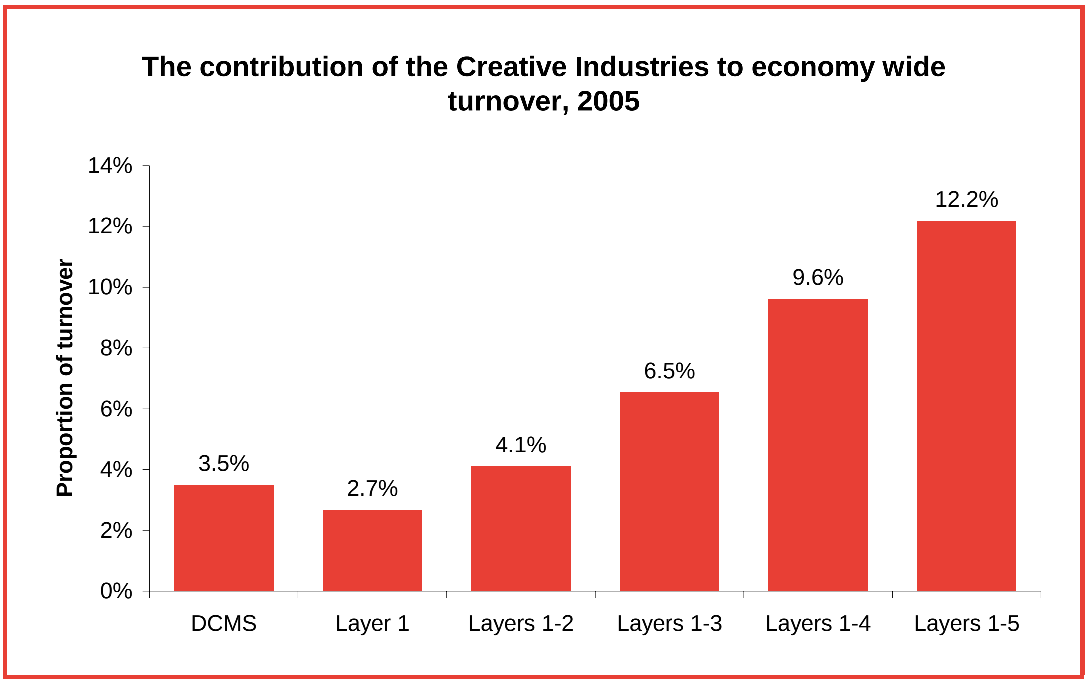

Figure 18: Comparing Creative Industry employment under the current 4-digit SIC code definition with the recent 5-digit SIC code definition

Source: DCMS, IDBR and Frontier analysis

The analysis above shows that the new definition is narrower than the existing definition in terms of turnover. For example, under the existing 4-digit definition, the Creative Industries account for 3.5% of UK turnover. Under the 5-digit definition of layer one, the contribution falls to 2.7%.

For more detail on the activities which define each Creative Industry see Annexe 2.

Annexe 2: Creative Industry definitions

This annexe sets out the definition of each Creative Industry in terms of its key activities and the corresponding 5-digit SIC codes.

ADVERTISING

Layer	SIC Code	Description
Layer one	74.40/2	Planning, creating and putting in place advertising campaigns
Layer Five	74.40/9	A "catch all" code for advertising, including handing out free samples and aerial advertising
	74.40/1	Selling or leasing advertising space or time

Table 5: 5-digit SIC code definition of the Advertising industry

Source: National Statistics and Frontier

ARCHITECTURE

Layer	SIC Code	Description
Layer one	74.20/1	Architectural design and construction supervision
	74.20/2	Urban planning and landscape architecture
Layer Two	74.20/4	Engineering advice and design for construction projects
Layer Three	74.20/6	Scientific consultancy like weather and geological surveying
	74.15/3	Construction holding companies and head offices
	70.11	Real estate developers
	45.21/1, 45.21/2, 45.21/3, 45.22, 45.23, 45.24, 45.25	All types of construction work, like residential buildings, bridges, roads, sports facilities, dams and related work like laying foundations and putting up scaffolding.
Layer Four	74.20/3	Quantity surveying
	51.54	Wholesale of hardware, plumbing and heating equipment and supplies
	51.53	Wholesale of construction materials and sanitary equipment (e.g. toilets and sinks)
	51.13	Agents who sell timber and building materials
	45.41, 45.42, 45.43, 45.44, 45.45	All types of building completion like plastering, painting and glazing, Floor and wall covering and installing swimming pools
	45.31, 45.32, 45.33, 45.34	All types of building installation like electrical work, insulation work and plumbing

Table 6: 5-digit SIC code definition of the Architecture industry

Source: National Statistics and Frontier

ARTS, ANTIQUES AND CRAFTS

Layer	SIC code	Description
Layer Two	74.87/3	Exhibition and fair organisation
	52.50/1, 52.48/6	Retail sale of antiques and retail sale in commercial art galleries
Layer Three	36.63/9	Catch all SIC code for "other manufacturing" (potentially some craft firms, if they are large enough to be covered by the IDBR)
	36.22, 36.61	Manufacture of jewellery and dinnerware made of precious metals and imitation jewellery
	36.30, 33.50	Making musical instruments and watch & clock making
	28.75, 28.61	Making various metal products like swords but also ship propellers etc. and making cutlery
	27.54, 27.41, 26.82/9	Casting and production of heavy and precious metals and manufacture of mineral products
	26.30, 26.25, 26.21, 26.70	Making ceramic tiles, pots, jars, tableware, statuettes etc. and cutting stone for building and ornamental use
	17.51/9, 17.51/2, 17.51/1	Carpet and rug making
Layer Four	51.47/9	A catch all SIC code that includes the wholesale of floor coverings but also stationary and sportswear etc.
	51.44, 51.47/8	Wholesale of china and of travel and fancy goods
	51.47/3, 51.47/4	Wholesale of jewellery and imitation jewellery

Table 7: 5-digit SIC code definition of the Art, Antiques and Crafts industry

Source: National Statistics and Frontier

DESIGN

Layer	SIC code	Description
Layer one	74.20/5	Engineering design for industry

Table 8: 5-digit SIC code definition of the Design industry

Source: National Statistics and Frontier

DESIGNER FASHION

Layer	SIC Code	Description
Layer One	74.87/2	Fashion design but also interior design and graphic design
Layer Two	17.53, 17.71, 17.72, 18.10, 18.22/1, 18.22/2, 18.23/1, 18.23/2, 18.24/1, 18.24/3, 18.24/9, 18.30, 19.20, 19.30	Manufacture of clothing items like hats, shoes, outerwear and underwear or accessories like bags and luggage.
Layer Three	17.11, 17.12, 17.13, 17.14, 17.15, 17.16, 17.17, 17.21, 17.22, 17.23, 17.24, 17.25, 17.30, 17.54/1, 17.54/2, 17.54/9, 17.60, 19.10	Manufacture of fibres, textiles, prepared fur and prepared leather
	51.16, 51.24/1, 51.24/9, 51.41, 51.42/1, 51.42/2, 51.42/3, 51.42/9	Wholesale of, and activates of agents involved in the sale of, fabrics, fur and clothing,
Layer Four	52.42/1, 52.42/2, 52.42/3, 52.42/4, 52.43/1	Retail sale of cloths, accessories and footwear

Table 9: 5-digit SIC code definition of the Creative Industries

Source: National Statistics and Frontier

FILM, VIDEO AND PHOTOGRAPHY

Layer	SIC code	Description
Layer One	74.81/3	Specialist photography (e.g. underwater)
	74.81/9	Photos for commercials, fashion, tourism etc.
	92.11/1	Producing films, cartoons and documentaries
	92.11/9	Dubbing, editing, post production etc.
Layer Two	74.81/2	Portrait photos (mainly passport photo companies, although doesn't include photo machines)
Layer Three	92.12	Motion picture distribution
	74.81/4	Film processing
	52.48/2	Retail sale of cameras but also office equipment
	51.47/6	Wholesale of photographic goods
	33.40/3	Manufacture of cameras, projectors etc.
	24.65	Manufacture of unrecorded media (also includes unrecorded media for computers)
	24.64	Manufacture of photographic chemicals
	22.32	Reproduction of DVD's and tapes
Layer Five	92.13	Cinemas

Table 10: 5-digit SIC code definition of the Film, Video and Photography industry

Source: National Statistics and Frontier

MUSIC AND THE PERFORMING ARTS

Layer	SIC code	Description
Layer one	92.31/1	Live theatrical presentation
	92.31/9	Artistic and literary creation and interpretation
Layer Two	92.72/1	Casting for theatres, motion pictures or television
	92.32	Theatres, concert halls, arts facilities and ticket agencies
	22.14	Music publishing
Layer Three	92.34/9	"Other entertainment activities" code that includes VUE and Tussauds
	51.47/5	Wholesale of musical instruments
	22.31	Reproduction of sound recording
Layer Four	51.43/1	Wholesale of records, CD's etc. and players
Layer Five	92.72/9	"Other recreational activities" code

Table 11: 5-digit SIC code definition of the Music and Performing Arts industry

Source: National Statistics and Frontier

PUBLISHING

Layer	SIC Code	Description
Layer one	92.40	Journalists, press photographers and news syndicates
Layer Two	22.13	Publishing journals
	22.12	Publishing newspapers
	22.11	Publishing books
Layer Three	74.87/9	Business activities note covered by other SIC codes, including author's agents but also consultants etc.
	22.25	Activities like embossing and laminating
	22.24	Pre-press work, like composition and typesetting
	22.23	Bookbinding
	22.22	Printing maps, magazines, music manuscripts, diaries and similar items
	22.21	Printing newspapers
	22.15	Publishing photos, posters, timetables etc.
Layer Four	24.30/2	Manufacture of printing ink
	21.12	Manufacture of paper and paperboard
	21.11	Manufacture of pulp
Layer Five	52.47	Retail sale of books, newspapers and stationery
	52.11/1	Retail sale by newsagents, confectioners etc.

Table 12: 5-digit SIC code definition of the Publishing industry

Source: National Statistics and Frontier

SOFTWARE AND COMPUTER GAMES

Layer	SIC code	Description
Layer one	36.50/9	Manufacture of video game machines but also chess sets, dolls, playing cards etc.
	72.21	Development and supply of ready made software "off the shelf"
	72.22	Development of made to order software, software consultancy and web page design
Layer Two	72.60	Computer related work not covered under other SIC codes
Layer Three	72.10	Hardware consultancy
	22.33	Reproduction of software
Layer Four	51.84	Wholesale of computers, peripherals and software
	51.47/7	Wholesale of toys, including video games
	36.50/1	Manufacture of arcade games, including billiards etc.
Layer Five	52.48/5	Retail sale of toys (including video games), spots goods, stamps and coins

Table 13: 5-digit SIC code definition of the Software and Computer Games industry

Source: National statistics and Frontier

TELEVISION AND RADIO

Layer	SIC code	Description
Layer one	92.20/1	Radio production and broadcast
	92.20/2	Television production and broadcast
Layer Three	32.20/2	Transmitters and television cameras
Layer Four	51.43/9	Wholesale of radios, TV's, lighting equipment and some other appliances
	32.30	Manufacture of TV's, video recorders, camcorders, record decks, microphones and similar goods
Layer Five	52.45	Retail sale of radios, TV's, DVD's, musical instruments and musical scores

Table 14: 5-digit SIC code definition of the Television and Radio industry

Source: National Statistics and Frontier

Annexe 3: Case study questionnaire

The case study questionnaire is designed to investigate the reasons why foreign owned multinational firms decided to invest in the UK. It also explores the activities of the firms outside of the UK in terms of key non-UK markets and potential growth in these markets.

KEY ISSUES FOR MULTINATIONALS

Understanding your business

- Please describe your global business function and key final services/ products.
- What part of your overall global business function is located in the UK?
- How does this relate to your global business?
- What proportion of your total global business activity does your UK office represent (in terms of turnover and employment)?

Your decision to invest in the UK

- When did the firm establish a UK presence?
- How did it do this – through new acquisition or establishing a new office?

[if acquisition was used]

- Why did it decide to use this approach to growth?
- Going forward will acquisition be used as a means of growth? (this could be categorised in terms of highly likely/highly unlikely etc.)
- Does the UK have an advantage in terms of the number of firms which international firms can use to grow?

[if yes]

- What characteristics are most important for these firms?
- Does the UK have more firms with these characteristics than other countries?
- Why do you think this is the case?
- How has performance changed since the acquisition?
- Why is this?

[for all firms]

- Why did you choose to locate in the UK?
  - Explore supply side factors and their relative importance

        - the presence of other multinational firms –lowered perceived risk of investment, cluster advantages, easier to use their contacts to set up own supply chain
        - fiscal, skills, suppliers, competition in the UK, IP issues
    - Explore demand side factors and their relative importance:
        - Size of the UK market for the product
        - Is local presence a factor?
- [if not already discussed] What role do UK CI firms play in this relative to all the factors discussed above?
- Has UK investment grown/ declined/ stayed still over time?
    - explore why, using supply and demand factors mentioned above.
- Looking forward, is investment likely to increase/decrease over time?
    - explore why, using supply and demand factors mentioned above.
- Are you thinking of leaving the UK?
    - explore why, using supply and demand factors mentioned above.
- Where else in the world are you investing?
    - are your activities different in these countries?
    - why did you decide to invest there rather than increase UK investment?

Role of culture and creativity

- Where in the UK are you located?
- Are there any creative or cultural facilities close to your office?
- Do your employees value their presence (or wider UK cultural facilities)?
- Do you think this is a significant factor in enabling you to attract or retain your employees?
- Do you use the UK in any way to brand your firm?

[if yes]

- Which aspects do you highlight?

Wider benefits to the UK economy

- Do you provide training for your employees? What sort?
- Who are your key customers and suppliers?
- Are these UK based firms?
- Do these tend to be small or large firms?
- Do you engage with other firms, organisations or individuals outside of your day to day business transactions.

- Who do you engage with most – e.g., are small/ UK firms part of your network?
- How does this happen – e.g., trade association, sector skills groups, networking overseas trade missions etc.
- What is your role and level of contribution? (e.g., training, information sharing, contacts, lease or hire of equipment, facilities etc. at cost to small firms/individuals just starting out)

KEY ISSUES FOR DEMAND

5.1.1 Firm's global business

- Does your firm sell its output globally?
- What is its approximate (global) market share?
- What are the key (country) markets for all of these products?
- Which markets are you in?
- What is your share of these markets?
- What determines the extent to which you sell into a market?
- What are your key strengths and weaknesses?
  - is local culture or language a factor?
  - are there high sunk costs for that market?
  - IP issues?
  - uncertainty over future of market?
- Does this vary by country/ product (discuss)?
- What would enable you to overcome these barriers?

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