# Creative Content Online: an Investor Perspective

Keynote presentation: Ljubljana, Slovenia, June 5th 2008

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**INGENIOUS**
ASSET MANAGEMENT, CONSULTING NETWORK,
CORPORATE FINANCE, INVESTMENTS, VENTURES

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# The future for creative content businesses?

*"Imagine a thousand buckets on the floor all catching little raindrops of revenue.  That's what Time Warner will look like (in the future)."*

Dick Parsons
Formerly CEO, Time Warner

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# About Ingenious

- Ingenious Media is the UK's leading media investment and advisory company
- Founded in 1998, the company now employs over 150 people across five businesses
- The company has raised a total of more than £5 billion to invest in film, TV, games, music, live events and other media and entertainment assets
- It is the largest independent investor in the UK media market with over 5,000 clients spanning:
  - media companies;
  - institutional investors;
  - corporate investors;
  - high net worth individuals;
  - retail investors.

# Selected Ingenious film production credentials

**STUDIOS**


Shaun of the Dead


X-Men: The Last Stand


Children of Men


Night at The Museum

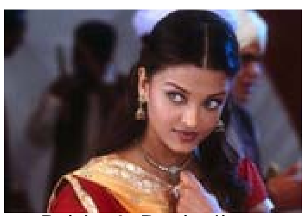

Alien vs Predator


Eragon


Hot Fuzz


Die Hard 4.0

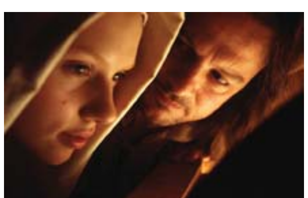
**INDEPENDENT**


Bride & Prejudice


Enduring Love


Hotel Rwanda


Vera Drake


Girl with a Pearl Earring


Brick Lane


Happy Go Lucky


Hallam Foe

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# Main sector risk characteristics of creative content businesses

"*Nobody knows anything*" [maxim of screenwriter William Goldman]

- All investment is risky, but some sectors are riskier than others
- The creative and cultural "industries" constitute the *most* risky sector due to extreme uncertainty of demand (nobody can predict "box-office" outcomes)
- General "hit-driven" characteristics/hits have to pay for the misses
- Risk not uniform across all creative industry business models however:
  - Creative *content* businesses
  - Creative *process* businesses
  - Creative *distribution* businesses
- Rapid collapse of "old" media business models (profits largely earned from distribution and physical product)
- Most content businesses are small, under-capitalised and not commercially driven or commercially sustainable

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# Some typical investor perceptions in the UK and Europe generally

- Success in the creative economy is more a matter of “luck” than judgement
- Creative people are unhealthily dependent on state subsidies, grants and tax credits
- Most creative economy businesses are “life-style” businesses not seriously interested in acquiring business disciplines or in scaling up to be globally, or even nationally, competitive
- Difficult to build business capacity in this sector – particularly in film, theatre and music – due to single project focus of most businesses and shortage of business skills
- Strong perception that the sector is therefore *too risky* for private investors

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# Impact of the digital revolution

- Dramatically changing the way content is consumed and paid for (or not paid for!)
- Destroying value in traditional media companies with potentially significant consequences for future investment
- “Old” media companies struggling to transform themselves away from reliance on outdated delivery systems (selling units of physical product)
- New delivery mechanisms, e.g. mobile phone downloads, are generating a multiplicity of pricing models which, however, are rarely profitable in the short to medium term
- Digital delivery, primarily via broadband and 3G mobile, has enabled consumers to access content, particularly music, by file-sharing, without paying for it
- Digital delivery has facilitated consumer “piracy” on a mass scale and, though a very different phenomenon, also facilitates criminal counterfeiting
- Fostered a cultural attitude that content is “free” (see eg “The Pirate Bay”)
- Greatly increased premium on the value of quality content, *but*
- Exceptionally difficult to monetise value in content creation and ownership of rights

# Consequences of digitalisation for investors

## Downside

- "Re-intermediation" of the value chain in all media businesses/unfamiliar territory
- Increasing market fragmentation
- Greatly reduced profitability
- Diminishing advertising spend on traditional media platforms, eg newspapers, TV/radio
- Reduced spending on content creation/content commissioning, especially on the part of TV broadcasters
- A crescendo of "noise" in an increasingly converged market-place
- Lack of clarity about value propositions in new media markets

*All adds up to investor uncertainty and a serious threat to aggregate levels of investment in content creation*

## Upside

- Proliferation of new delivery mechanisms fuels demand for quality content
- Unlimited opportunities for developing new revenues at low marginal cost
- Opportunities for rights owners to exploit new "rights windows" on multiple platforms
- Multiplication of "long tail" opportunities, especially for specialist niche-businesses (eg historic recordings of classical music)
- Emergence of new commercial opportunities in inter-active online environments, eg gaming and other cyber-worlds

*But very few of these businesses are making any money yet!*

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# State of the digital market: snapshot I

Global digital revenues by industry in 2007:

| Industry | Digital % |
|---|---|
| Recorded music | 15% |
| Newspapers | 7%* |
| Films | 3% |
| Books | 2% |

Source IFPI, PWC Global Entertainment and Media Outlook
*US only

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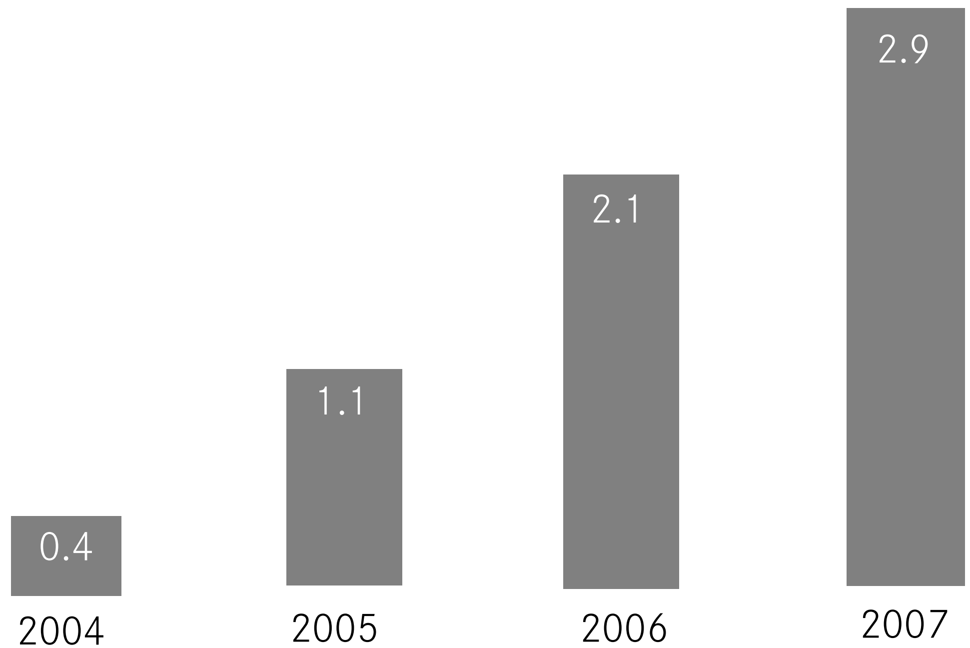
# State of the digital market: snapshot II; music

## Digital music revenues $US billions:




% of the total industry:

2004: 2%

2005: 5%

2006: 11%

2007: 15%

Source IFPI, includes online and mobile sales and record companies revenues.

2007 figure is an estimate

# State of the digital market: good news and bad news in the music industry

- In 2007 for the first time UK songwriters and music publishers earned more income from copyright in broadcasts and legal downloads than from sales of CDs
- Such income (UK only) increased by 54% in 2007, but still accounted for only £9.7m, a fraction of the amount lost through illegal downloading
- There are now (2008) more than 500 digital music services around the world (including two in Slovenia!)
- South Korea became the first market in which digital sales overtook physical sales

*...and then the bad news!*

- For every legal sale of a track of music there are 20 illegal downloads globally according to the trade associations
- Research in Italy and Australia shows that P2P activity largely substitutes for legitimate sales, rather than stimulating new and legitimate business
- In total, 17.6% of all internet users in Europe regularly file-shared in 2007 – a figure that in percentage terms is roughly the same as in 2003
- In 2007 over a third (34%) of internet users aged 15-24 illegally file-shared music. This is 3 times the rate of legal service usage among this age group
- Online piracy in China is estimated at more than 99% of the market for music downloads!

# State of the digital market: audiovisual sector/interactive new media

- Music and audiovisual sectors completely different in terms of consumption patterns
- Fastest growing area of P2P piracy is TV content, but film piracy is also growing rapidly
- All new business models for online and mobile distribution of audiovisual content are embryonic and experimental: the analytics are largely untested
- None of these models are generating sustained revenues or significant profits
- Interactive and converged new media platforms offer advantages of much lower sunk costs than “old” models intermediated by industry “majors”
- New distribution channels such as social networking sites are attractive to advertisers, but little meaningful data or experience to draw from
- Internet advertising spend is the critical factor - in Europe expected to rise by 11-14% in 2008-2009: new content media all fighting for a share of that cake
- Most likely sources of significant revenue in new interactive media are sponsorship deals and product placement by advertisers, not consumer payments

# What the market should decide

- Pricing, availability, distribution and formatting of content
- Advertising-funded/subscription/PPV/sale/rental and other alternative models
- Structure and form of multi-platform agreements
- The development of new rights “windows”
- Revenue sharing agreements between different players in the value chain
- Which market participants are allowed to develop one, ten or a hundred buckets collecting revenue!
- Which buckets collect small drops of revenue, and which buckets collect larger drops of revenue!
- *In other words, which new business models succeed and which fail*

NB Winners and losers in this commercial free-for-all should not be determined by regulation, except where regulation is helpful in stimulating the development of the market, eg by instituting quotas or correcting assymetries in market structure

- Absence of unifying narrative or economic context
  - Growing importance of the creative economy as a subset of the knowledge economy measured in terms of GVA
  - Economic and investment consequences of the transition from “old” media business models to “new” media business models?
  - Consequences for investment flows and availability of risk capital?
  - Consequences for European competitiveness in the global knowledge economy?
- First order questions: essential drivers of growth
  - ISPs and copyrightable creative content: the haemorrhaging of value!
  - Bandwidth capacity
  - Is there a market?
- Second order questions: the market will provide solutions
  - Interoperability of DRMs
  - Multi-territory licensing

# What the European Commission should do

- Reappraise the role and significance of the European creative economy within the framework of the Lisbon 2010 objectives
- Work with partners to build or commission an up-to-date and comprehensive EU creative economy information database to include data on investment flows
- Commission a pan-European study of the availability of risk capital in the creative economy in the 27 member states: is there market failure?
- Commission a feasibility study on the case for establishing a European Creative Investment Bank designed to promote co-production and co-investment finance for European creative industries
- Commission a feasibility study on the case for establishing/funding one or more European Creative Business Schools

# A concluding provocation!

- We have a rich cultural heritage in Europe, and creative talent in abundance, but we lag behind global competitors in Asia and North America in developing creative economy business capacity
- European global leadership in creative talent – eg in fashion design, the art market, games development and music – does not necessarily correspond with, or deliver, commercial success
- Creative talent is highly mobile, and is attractive to global corporations around the world
- The main policy goal must be to build creative content business capacity for the medium and long term: this should be a key policy objective in all EU member states
- If we fail to invest sufficiently, the commercial upside that flows from our rich talent base will go increasingly to the USA (or China, India, Japan or Korea?): we will be left to supply commoditised services to non-European global corporations
- Sustainable investment is the key to success in the global creative economy: there is some evidence that Europe is *not well placed to meet this challenge (*see eg large slate funding numbers now coming out of the Indian film industry*)*

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