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The Road Ahead: A Financial Platform for the Audiovisual Industry

► **Abstract:** *The audiovisual industry, in particular the European market, lies behind in terms of evolution of financial dynamics, as well as organization and management of the firms operating in the business. National and EU institutions are currently engaged in an effort to reform the whole audiovisual industry focusing their attention mainly on market dynamics, although they are also seeking to develop a regulatory framework for public measures to support the industry. Financial markets can play a significant role in fostering the audiovisual industry. The chapter proposes a financial platform specifically dedicated to the audiovisual industry, able to combine the needs of the operators and financial intermediaries alike; the chapter describes goals, players, financial instruments and services to be provided by the financial platform.*

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9.1 The background

The financial dynamics of the audiovisual business are strongly affected by the nature of the products and the production process. Given the cultural nature of audiovisual products, public institutions have traditionally been the major funders of the industry. In Europe, the cultural exception has been, and still is, the principle applied by EU member countries to grant public funds to audiovisual firms.

Audiovisual products are prototype assets by definition; such an intrinsic characteristic makes it very difficult to predict their commercial success and, therefore, estimate the revenues they are able to generate. Moreover, the production of prototype products exposes producers to specific business and process risks. External funders, therefore, are faced with critical issues when assessing the profitability of their investments and risks.

All this explains how, to this day, financing for the audiovisual industry revolves around a model that identifies the actors of the production chain as the industry's funders and public institutions as support parties covering an important part of production budgets.

Yet, opening to capital markets has become an unavoidable necessity for the industry. On one hand, the reduced availability of public funds results in an increasingly marginal role played by national and super-national forms of support to cover production budgets; on the other hand, the decline in advertising revenues – due both to the economic crisis and increasing competition between traditional and new media – has weakened the role of TV broadcasters as important financial backers of the production chain.

A greater involvement of financial intermediaries, and increased use of capital markets, combined with a revised supporting role played by public institutions, are mandatory for the creation of a new and much-needed financial model for the audiovisual industry; one that should be urgently implemented. It is, therefore, necessary to determine the correct conditions to start this innovation process in a harmonious way and establish the direction it should take.

9.2 The great expectations of audiovisual firms

From an economic point of view, each market should be analysed considering both the demand and supply side. Hence, it seems reasonable to start from a fundamental question: what are the expectations of

the audiovisual industry from the financial system? As a matter of fact, should such expectations not be met, the union between the audiovisual sector and finance would not go very far. Access to capital markets means access to credit and equity sources of funds, yet this condition is not enough to meet the financial requirements of the audiovisual industry. In fact, the funds provided through financial channels must possess some indispensable characteristics for the harmonious development of the firms in the sector. This need translates mainly in the necessity of finding resources in a timely manner and with volumes consistent with production budgets and their financial gaps; moreover, financial costs must reflect the risks related to the rating of the firms or the single projects financed. With regard to the loans and debt instruments, then, the mitigation forms required by lenders must be physiological with the nature of the production process, as well as the specific features of audiovisual firms; the latter, in fact, usually do not own traditional collaterals but intangible assets represented by the exploitation rights on their products. Finally, equity must ensure the financial support needed within governance models that take into account the specific nature of the sector; in this perspective, it is essential, for financial investors, to find a balance between direct involvement in the companies' operations and interferences that could affect the technical-artistic production process.

9.3 The great expectations of financial intermediaries and investors

For financial intermediaries, and banks in particular, financing audiovisual firms presents two critical points: the first one is related to the restrictions established by their internal regulations aimed at ensuring sound and prudent management; the second can be referred to the need of operating following prudential regulatory provisions. In particular, the supervisory regulations under the Basel agreements determine a cost-opportunity of lending that increases the higher the risk of the single credit exposure.

These considerations let us foresee two extreme and alternative scenarios: the first one is characterized by the exclusion of the audiovisual firms from the group of clients deemed to be reliable and creditworthy by lenders; the second scenario envisages a collaboration between

financial intermediaries and audiovisual firms to create specific financial engineering and models for credit risk assessment aimed at avoiding a penalizing treatment of the loans granted to the subjects operating in this business.

The need for financial engineering able to provide credit mitigation tools is evident not just on the credit market but also in regard to access to capital markets.

9.4 Homework

Financial intermediaries and audiovisual firms should collaborate to define a possible model for the evaluation of the firms operating in the business and their single projects. Both parties have specific interests in doing so; audiovisual firms in seeking alternative financing instruments; financial intermediaries and investors in entering a new market. In spite of the afore-mentioned risks and criticalities, in fact, the audiovisual represents an appealing market for institutional or retail investors. The prototype nature of audiovisual products, and the link between their commercial potential and the response from the public, translate in their capacity to generate revenues regardless of traditional market trends and economic cycles. Following a traditional portfolio logic, this element facilitates the diversification of the investments. Moreover, in spite of a greater volatility of returns, the audiovisual industry may produce very interesting profits, sometimes far higher than the market average.

A convergence process between the audiovisual industry and financial markets must necessarily rely on a pro-active and strong collaboration between financial intermediaries and firms operating in the business. The former, in compliance with their supervisory regulations, should implement new rating models specifically dedicated to audiovisual firms and examine new financial instruments able to reduce exposure to risk.

On the other hand, audiovisual firms should introduce efficient administrative and management criteria in their operations, providing transparent information in order to allow for an accurate evaluation of their products and balance sheets by the financial intermediaries and the market, and also a correct estimate of the risk-return trade off. This is the only way for them to gain the trust of markets and establish long-term and profitable relationships with investors.

9.5 A financial platform for the audiovisual industry

However, the path outlined cannot be left only to the initiative of the single operators. It is necessary to envisage a systemic effort able to promote measures for the creation of a specific financial market dedicated to the audiovisual industry; such action can be supported and promoted by sector institutions and government policies dedicated to culture.

The financial system is made of different markets; each one of them is characterized by the presence of specialized operators and intermediaries, has its own regulations and specific infrastructures and uses tailor-made financial instruments. The union between finance and audiovisual industry, therefore, cannot dispense from adopting a specialized financial platform.

The urgency to overcome a clear financial crisis of the audiovisual industry has prompted operators to set short-term policies and seek solutions that, being out of the economic context, are likely to result in isolated and ineffective efforts. This is the case of all the actions aimed at raising significant amount of funds from capital markets. Two kinds of problems arise here, though. First of all, the history of finance has taught us that the evolution of financial models always involves a migration from bank-oriented to market-oriented credit systems. It would seem unusual to reverse this pattern for the audiovisual industry, as financial markets cannot be built without first developing credit markets. Banks, in fact, have always played a strategic role in the relationships with the industry: the direct relationships established with firms allow banks to develop skills and know-how needed to assess their clients, production processes and reference markets. The consolidation of the relationships with the clientele in different moments of the production chain allows selecting with accuracy the financial and economic variables to be monitored over time and facilitates the preparation of data bases that can help build and estimate important benchmarks for the sector. Also following such parameters, institutional investors could develop accurate and effective asset management models. A market such as the audiovisual, devoid of specific credit risk evaluation models, could hardly support, with continuity and profit, in an early development stage, initiatives relying on capital markets. Secondly, the investment fund model generally implies involving private investors, besides institutional backers. In this case, any negative performance could soon drive away an important pool of investors, as well as raise

issues related to the disclosure of risks inherent to the financial instruments placed with the retail customers, which were already experimented by the financial system during the last financial crisis.

A specific financial platform dedicated to the audiovisual industry, able to combine the needs of the operators and financial intermediaries alike, would allow for a gradual passage from a form of indirect intermediation to a more developed direct assisted intermediation.

However, this passage requires a strategic and systemic vision, as well as a number of coordinated actions. Audiovisual production is characterized by a decomposed, yet integrated chain: from pre-production to marketing, each phase features specific economic-financial dimensions that partially interact with other stages.

It is necessary, in the first place, to imagine a platform built on a network system composed of various financial intermediaries, each specialized and able to act on one or more phases of the production process (Figure 9.1).

Assessment of the single projects and the forms of their financial coverage, analysis of mitigation tools and the most suitable covenants for single credit lines, provision of guarantees and insurance coverage, evaluation of the firms' assets and libraries of exploitation rights, rating

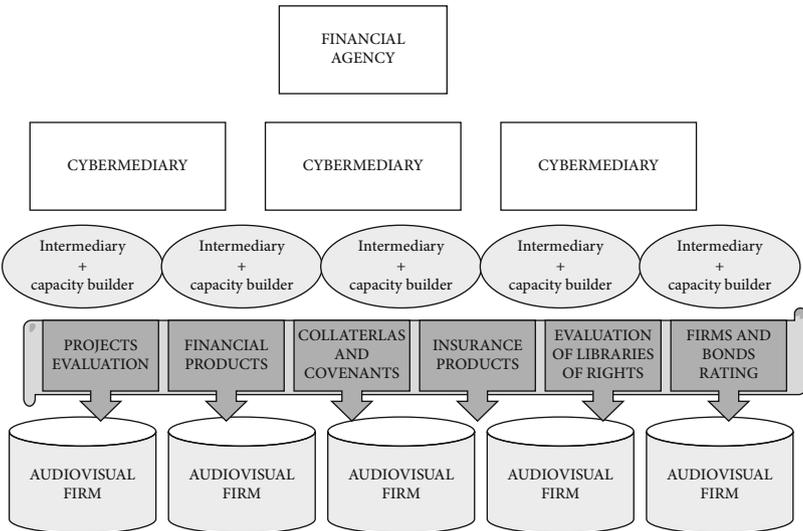


FIGURE 9.1 A financial platform for the audiovisual industry

assignment, support and assistance services provided to firms to access the capital markets, are just some of the specialized functions that should be offered by a financial platform dedicated to the audiovisual industry. On the other hand, the financial dynamics of the audiovisual production process involve multiple and intense interactions all along the production chain. Just think about the relationships between production, distribution and retail. Financial support, therefore, should follow this double nature of the production process: specialization and integration. If, on one hand, the different financial intermediaries need to develop specific expertise, justified by the different operational skills that they must provide and fair risk allocation; on the other hand, the financial system should meet the demand of the single operators without losing track of the unity of the production process.

For such reason, a dedicated platform must ensure to the single financial intermediaries the possibility of evaluating their support within the entire production chain, as well as other dynamics of the single projects or firms. Financial intermediaries must, therefore, be supported in their activity by institutions able to integrate decomposed production processes.

In this regard, it must be noted that some of the most innovative financial markets are experimenting the birth of new intermediaries able to integrate unrelated production processes and operate through the use of multimedia platforms. Such intermediaries have been named “cyber-mediaries”, acting as intelligent service providers for the whole production chain. Audiovisual cyber-mediaries should offer their services – also through multimedia channels – by acting as connectors between the industry and specialized financial intermediaries for each project or firm assisted. A similar network, though, can only work efficiently and effectively if able to ensure a transparent and competitive environment. For this purpose, a specific financial agency should be entrusted with the task of ensuring that the network complies with the above characteristics. The following three conditions are required: a neutral role played by the financial agency, which should act as an intelligent coordinator of the network; cyber-mediaries limiting their activity to networking; presence of several specialized financial intermediaries able to provide services to the different actors operating in an environment ensuring fair and competitive prices. In this scenario, a key role is played by capacity-building providers, i.e. those specialized subjects operating at national and pan-European levels, that can assist banks

and financial intermediaries in entering the market and developing the appropriate skill to manage the business efficiently.

9.6 Policy recommendations

The audiovisual industry, in particular the European market, lies behind in terms of evolution of financial dynamics, as well as organization and management of the firms operating in the business. National and EU institutions are currently engaged in an effort to reform the whole audiovisual and cultural sector. EU Institutions and national public bodies have focussed their attention mainly on strategic and market dynamics, although they are also seeking to develop a regulatory framework for public measures to support the industry. In Europe, the new *Cinema Communication* and the cultural support programme *Creative Europe* share a common objective: to facilitate the transition of the audiovisual industry from artisanal to industrial market, while protecting the authorship and cultural diversity. This is the direction taken by a number of measures aimed at facilitating access to finance for the audiovisual firms – such as the creation of the Guarantee Fund under the programme *Creative Europe*.

In this perspective, a financial platform specifically dedicated to the audiovisual industry would allow conferring to the single, even praiseworthy initiatives, an organic and systemic character. Institutions, therefore, should stimulate the creation of more developed financial infrastructure in order to avoid limiting the single initiatives to an area restricted to a few players. This is a hard but mandatory way to be pursued by the whole audiovisual and cultural industry.



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