Scaling up: AI and creative tech

Creative UK welcomes the opportunity to respond to the Communications and Digital Committee's call for evidence as part of its inquiry into *Scaling up: AI and creative tech*. We acknowledge the Committee's vital role in examining the effectiveness of existing schemes to support scaling, with the aim of better understanding how to maximise the economic potential of the UK's SMEs and help them secure competitive advantage. This inquiry is timely and essential, particularly as 83% of creatives have already adopted AI into their working practices[i].

At Creative UK, we have tried to address many of the challenges referenced in this response through our Creative Growth Finance Fund – a landmark fund providing vital scale-up finance to a portfolio comprising some of the UK's most promising creative businesses. As of October 2023, our Creative Growth Finance investment portfolio has recorded a 108% improvement in average monthly revenues, raised £19 million in third party funding, and created 233 jobs – an average headcount growth of 41% across the whole portfolio[ii]. It is through innovative solutions like this that we can unlock the economic and social potential of the UK's creative tech SMEs, and avoid losing them to regions with environments more conducive to scaling.

We need a suite of mission-focused, purpose-led interventions from government and an ambitious vision led by industry to move us from short-term initiatives to long-term patient investment.

About Creative UK

Creative UK is an investor, connector, supporter and champion of creative businesses working to generate the right conditions for a thriving creative economy.

Our members are based all around the UK and range from freelancers and small and medium-sized enterprises (SMEs) to providers of further and higher education, trade and representative bodies, arts and cultural organisations, heritage sites, international industry powerhouses and local authorities. We also provide expert resources and financial opportunities that are tailor-made for the CCI, offering bespoke investments, access to funding, loans, growth mentoring, policy development, industry insights and analysis through engaging with members, stakeholders and UK Government departments.

Creative UK has actively invested in and supported small, private-sector creative companies in the UK for the last decade, investing more than £50m into these businesses' promising creative ideas, and combating market failures in the sector. In 2019, Creative UK agreed a new creative financing partnership with the sustainable bank Triodos to launch a £20m venture debt fund – Creative Growth Finance. This has now been re-capitalised, resulting in an additional £35m in both debt and equity investment for the CCI.

1. **What is the economic potential for improving the UK's scale-up landscape, and what are the consequences of failing to capitalise on this?**

The cultural and creative industries are a cornerstone of the UK's economy and cultural landscape, contributing £126bn annually in GVA, which accounts for around 6 per cent of the UK economy. As a significant driver of economic growth, regional development and social cohesion; enhancing the capacity of creative businesses to scale would unlock further growth and strengthen the sector's global competitiveness. It would also help ensure that UK-based businesses retain homegrown talent, whilst attracting creatives and tech specialists from abroad.

The cultural and creative industries already employ over 2 million people in the UK and have shown impressive resilience and growth, with jobs across the sector growing at a rate five times faster than the wider economy (DCMS)[iii]. Research has shown that when the procurement expenditures are accounted for, the contribution of the cultural and creative industries is even greater; for every ten jobs that the creative industries directly support, a further seven are supported elsewhere as a result of supply chain multiplier effects. Similarly, for every £1 that the industries directly contribute to the wider economy, a further £0.50 is supported through supply chain effects[iv].

However, whilst creative businesses often combine technological innovation with cultural content, too often they find themselves unable to capitalise on these trends. This is partially due to the large proportion of SMEs, micro-businesses and freelancers across the sector; all of which face structural, financial and operational barriers to scaling up. By improving the scale-up landscape, the UK could significantly increase this figure, particularly if the sector is supported to exploit the rapid advancements in AI that are already having a significant impact.

Failure to support startups in the cultural and creative industries risks driving talent, innovation and investment away from the UK, as creatives seek out regions with more favourable conditions for scaling their businesses. This would result in stifled competition and the concentration of creativity within a small number of dominant companies, limiting opportunities for new entrants and resulting in an over-reliance on imported creative content.

2. **What specific barriers do SMEs face when seeking to scale in AI, and in creative technology? A) To what extent are these challenges unique to their respective sectors? B) What role does access to finance play?**

One of the primary barriers for SMEs in creative technology is limited access to finance. Many creative SMEs struggle to secure traditional bank debt because they often lack tangible assets or predictable revenue streams. This issue is especially acute where businesses are often project-based and reliant on IP. AI and creative tech businesses frequently require significant upfront investment in R&D and content creation, with longer timelines for profitability. This makes it particularly difficult for these businesses to attract venture capital or bank loans. The ScaleUp Institute's 2022 Annual Review identified that scaleups remain much heavier users of finance than other businesses, and while VCs and Angels are key sources of equity provision, 5 in 10 scaleups believe they do not have sufficient capital to meet their growth trajectory[v].

These challenges are compounded by issues with the UK's investment infrastructure and ecosystem.

We believe greater investment is required in regional creative clusters which often lack access to the same level of resources, networks and mentorships available in large cities. The same 2022 report from the ScaleUp Institute identified that these regional disparities continue to inhibit the ability of scaleups in the regions to succeed, with most perceiving that the majority of funding resides in London and the South East. For example, immersive tech companies in the North East need opportunities to collaborate with larger players to avoid creating growth bottlenecks.

There are also regulatory challenges that need to be addressed, particularly in protecting the IP rights of content creators as generative AI continues to push the boundaries of copyright law. For many SMEs in the cultural and creative industries, the unauthorised use of their IP can prove a significant barrier to them scaling their businesses. Ensuring robust IP protection is essential to help SMEs safeguard their creative input, while also fostering an environment where innovation can thrive.

A further regulatory obstacle exists as intangible assets, such as IP and creative output, are treated differently under international accounting standards compared to physical assets, like property or machinery. This difference poses a significant challenge for the cultural and creative industries, as intangible assets are often considered "riskier" by financial institutions, due to how they must be accounted for. Under these standards, banks lending against intangible assets must retain more capital on their balance sheets, making it costlier to lend to creative businesses compared to more traditional sectors, like real estate. This can stifle access to finance for creative SMEs, even though the actual risk of lending to these firms may not be higher.

Despite this, banks such as NatWest have developed innovative products and methodologies to better assess and manage the valuation of intangible assets, helping to bridge this gap. While these initiatives help, larger structural change—such as reforming international accounting standards—is slow and complex. However, it is crucial that the UK Government, particularly the Treasury, remains engaged in these ongoing reviews of accounting standards. For example, the International Accounting Standards Board (IASB) is currently reviewing how intangibles are treated, and Government involvement could help shape a more supportive environment for the creative industries.

Another barrier faced by SMEs when seeking to scale is the difficulty in finding people with the necessary expertise in AI to help develop their knowledge base. This shortage of specialised talent can hinder innovation, as creative businesses struggle to access the technical skills necessary to integrate AI into their operations.

As alluded to previously, businesses in the creative and AI sectors operate at the intersection of content creation and technological innovation. This in turn exacerbates the barriers to scaling as creative SMEs deal with both technological and cultural complexities.

3. **How effectively are existing organisations (such as UKRI), catalyst programmes, industry schemes and other Government initiatives addressing these issues? A) What outcomes are being achieved? B) Are any changes necessary, and how would they work in practice?**

Existing organisations like UKRI and Innovate UK are instrumental in providing grants for early-stage R&D. However, these initiatives tend to favour sectors like biotech or fintech where scale-up timelines and return on investment are more predictable. This is a major challenge for creative tech SMEs who have not benefitted to the same extent due to their perceived higher risk profile and longer R&D cycles.

Currently, R&D tax relief focuses heavily on advancements in science and technology, excluding the arts and humanities. Yet, innovation within the creative industries is equally transformative, often pushing the boundaries of both technological and cultural output. For example, creative companies are at the forefront of developing new digital tools, immersive experiences and AI-driven content creation, which could potentially qualify under broader R&D definitions. This is especially true for small and medium-sized enterprises (SMEs) which, due to their size, struggle to access the same level of support as their larger counterparts.

SMEs in the creative industries drive economic growth and cultural innovation. They invest in R&D to develop new methodologies, processes, and platforms; but many lack the financial resources to take these projects to full maturity. A report from the Creative Industries Policy and Evidence Centre highlighted how R&D investment in creative technology is often overlooked, despite its role in driving competitive advantage for UK companies internationally[vi]. Smaller firms, especially those outside London, have shown that even modest R&D projects can generate significant social and economic value when given the right support.

In October 2023, the Council for Science and Technology published a letter it had shared with 10 Downing Street. The letter, which underlines the Council's support for public investment in R&D in the creative economy, highlights the creative industries' status as an outlier, delivering more economic value than the life sciences, aerospace and automotive sectors combined. It also questions why the creative industries continue to be seen as a lower priority for investment than traditional STEM subjects, despite their economic value.

The Council urges the Government to recognise its role in creating the conditions for the industry to thrive, arguing it has a more "direct responsibility" in the cultural and heritage sector. It even specifically recommends the Chancellor and Culture Secretary commission research from the Creative Industries Policy and Evidence Centre into the requirements and availability of scale-up finance for creative businesses – the precise purpose of this inquiry[vii].

UK startups and SMEs, already facing a restrictive funding and finance landscape, are facing additional barriers in the form of HM Revenues & Customs (HMRC). Earlier this year, UK startups reported being wrongly asked to pay back thousands of pounds in tax credits after HMRC implemented measures to tackle error and fraud[viii]. Many of these startups who claim to have been wrongly targeted have experienced deficits in their finances, stifling further innovation and eliminating their potential to scale. Such approaches, when conducted indiscriminately and without reaching conclusions swiftly, are unhelpful and counterintuitive, particularly in the creative industries. This is largely due to creative startups' higher risk profile and longer R&D cycles. Any disruption to innovation timelines could be the difference between collapse and success.

4. **What further measures (financial and non-financial) are needed to address barriers to scale in AI, and creative technology?**

At Creative UK, we have been developing a wholesale approach to funding the cultural and creative industries to support growth and innovation in the sector by leveraging public interventions to unlock private capital. The idea is to create a wholesale institution that provides the right type of money at the right stage for creative businesses, which uses public interventions to catalyse private investment, while incentivising innovative new financial products and services. This approach draws inspiration from social impact models like Better Society Capital as a model for how targeted investment can drive growth.

Better Society Capital was established with an initial one-off £400 million investment from the UK Government via the Dormant Accounts Fund, leveraging an additional £200 million from four UK high street banks. Since 2011, Better Society Capital has catalysed the social impact market to grow eleven-fold to over £9bn[ix]. We need a similar intervention for the cultural and creative industries so the sector can boost the UK Government's growth agenda.

AI and creative tech businesses frequently require significant upfront investment in R&D and content creation, with longer timelines for profitability. This underlines the need for a patient approach to long-term growth, recognising the interrelationship between investing in culture, project funding, adventurous artistic R&D and commercial success.

We believe there are also opportunities to expand creative-specific investment funds, such as our Creative Growth Finance Fund, to include AI-led creative businesses. This would help mitigate risk and offer tailored financial products for eligible SMEs.

Similarly, establishing public-private partnerships that pool private investment and public funds—through risk-sharing financial products— could have the same effect, whereby large investments in the creative industries are de-risked. Part of this requires changes to the way we view public subsidy. In many other sectors, including advanced manufacturing, green energy and biotech, public subsidy is understood as an investment for the future, a necessary catalyst to stimulate longer-term, patient and dedicated private capital. Investment in arts and culture is too often seen as a cost, not an opportunity.

As previously mentioned, reforming and redefining R&D tax credits to include creative processes and content-driven innovation would incentivise more companies to invest in cutting-edge and often overlooked projects. Additionally, extending tax relief to companies that combine AI with creative outputs could level the playing field for creative tech SMEs.

With regards to non-financial measures, strengthening regional creative clusters by providing a better investment infrastructure, networking opportunities and access to mentorships would help distribute growth beyond London and the South East. The Creative Clusters Programme is a step in the right direction, but initiatives like this require long-term, sustained investment for them to realise their full potential.

A focus on skills development, such as fostering AI and creative tech-specific skills through HE institutions, on-the-job training programmes and access to independent and impartial knowledge about AI tools (particularly if these resources are industry-specific), would also help address barriers to scale. In addition, focusing on accessibility to AI – including building an understanding of the definition, functions and usage of AI – could help provide clarity to those less informed about AI's applications. This would ensure creative SMEs have access to a workforce capable of scaling innovative projects; and we hope the establishment of Skills England will help advance progress in this area.

5. **What role do academic institutions play here, and what can be done to boost commercial links with AI and creative technology?**

Academic institutions play a critical role in supporting the scale-up of AI and creative tech businesses through research, skills development and industry collaboration. The UK is one of the world's leading research centres in AI, with leading institutions like the University of Cambridge, Imperial College London, University of Oxford and University College London (UCL) boasting strong programmes in AI, machine learning and data science.

There are also universities that combine strengths in AI and creative tech, with universities like Goldsmiths, University of London, and the Royal College of Art, which focus on developing interdisciplinary talent that blends technical and artistic skills. These institutions help provide both the technical expertise and creative talent that drives innovation across the sector, particularly though in gaming, digital design, animation and VR/AR. The result is a strong pipeline of graduates with the unique skillsets needed to help these sub-sectors thrive.

Many of these universities are often key partners in early-stage R&D projects, helping creative tech SMEs overcome technical and financial challenges. This is demonstrated to particularly strong effect by government-backed initiatives like Knowledge Transfer Partnerships (KTPs) which facilitate collaboration between academia and industry, creating a pathway for SMEs to access and benefit from cutting-edge research in AI.

To fully support the growth of creative tech SMEs, academic institutions should deepen partnerships with industry through more targeted incubation programmes and by embedding skills crucial to future commercialisation into academic curricula. However, as with the existing definition of R&D, the cultural and creative industries must not be marginalised through narrow definitions which result in them missing out from much-needed support.

While much of the above focuses on the contribution of higher education, there is also a need for many of these skills to be developed at a much earlier stage. As such, a long-term, cross-government strategy is needed to support creative education and skills development, ensuring that creative industries are recognised for their significant economic and cultural contributions. This should include reintegrating arts subjects into the core school curriculum, expanding access to vocational training and internships, and supporting creative career pathways from an early age. Re-embedding creativity into the curriculum is critical to innovative thought, with creative thinkers demonstrating greater flexibility and adaptability in their approach to problem-solving.

Finally, the UK's collections – namely museums, archives and libraries – also have an important role to play as valuable research institutions. There is an opportunity here for the collections to support the scale-up of AI development and R&D through the expansion of large-scale digitisation: this would unlock considerable economic, scientific and social potential in the UK's cultural heritage collections which could in turn bring huge benefits to the UK.

6. What can the UK learn from overseas?

In 2017, the French President Emmanuel Macron formally opened Station F, a business incubator for startups, in Paris. Already the biggest business startup incubator in the world, in the first five years of its existence Station F has supported more than 5,000 French startups with 92.4% still in operation[x]. Station F represents a unique model for nurturing creative tech startups. Through its focus on interdisciplinary innovation and embrace of government support, France has created an environment conducive to scaling creative businesses. We believe there is an opportunity for the UK to replicate this by establishing creative tech-focused incubators and offering specialised financial products tailored to creative tech SMEs.

Elsewhere, the US has successfully leveraged public-private partnerships to de-risk investment in AI and creative tech. For example, the National Endowment for the Arts, an independent agency of the US federal government, provides seed funding for creative projects which is then matched by private investors. This could serve as inspiration for the UK to develop similar co-funding initiatives that incentivise private sector investment in AI-driven creative sectors.

Finally, South Korea has established dedicated districts, such as the Sangam Digital Media City (DMC) in Seoul, which concentrate media, tech and creative industries in one location. The DMC in particular has become a premier hub for digital media companies, including those operating in broadcasting, animation, gaming and music. By grouping these industries together, businesses are provided with access to world-class infrastructure, talent, and funding. The Seoul Metropolitan Government played a critical role in facilitating public and private sector partnerships, through funding the foundational infrastructure, including broadband networks, and offering tax incentives. This drew in international tech giants, lending assurance and confidence to investors. The UK could benefit from similar creative hubs, particularly in underdeveloped regions[xi].

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