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Risk Perception and Management Methods in the Funding of Cultural Activity Sectors

by

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V. DESCRIPTION OF SOME FINANCING AND RISK MANAGEMENT MECHANISMS

I. QUEBEC'S SOCIETE DE DEVELOPPEMENT DES ENTREPRISES CULTURELLES (SODEC)

1.1 Historical background

Given the strategic role that culture, and more specifically cultural industries, play in affirming the specific characteristics of the province, Quebec very early on decided how it would support cultural action within its borders. Since the early 1960s and over a long period of time, the government acted mainly through the Cultural Affairs Ministry.

In 1978, in order to meet changing requirements and faced with the need to fund cultural enterprises owing in particular, to their under-capitalization, their small size, the small size of the market in Quebec and the small amount of products exported, the government established the Cultural *Société de développement des industries culturelles et des communications* (SODICC), with an initial endowment of CAN $10 million.

As a "specialized bank", SODICC's role was to provide cultural companies with financing facilities to which they had no access at traditional financial institutions that were not prepared to bear the risks inherent in cultural sectors.

To meet the growing needs of cultural companies and in view of the success of the facilities put in place, the government decided to increase the SODICC's capital to CAN $20 million in 1982. Its capital has not since been raised. Following a consultation focusing on both an assessment of action taken to date and the restructuring of the company, SODICC became the *Société de développement des entreprises culturelles* (SODEC) in 1995.

1.2 SODEC's roles

SODEC ensures that the Quebec government's action is consistent in cultural sectors, by performing four complementary roles:

- it offers the services provided by an investment bank, including loans and loan guarantees and, in exceptional cases, it invests in the project and in share capital;
- it administers government aid earmarked for cultural enterprises to support the production, distribution and the export of works; such aid is granted in the form of investment in the project, grants or repayable aid;
- it manages tax credit measures granted by the government to cultural enterprises, which take the form of refundable tax credits on the cost of labour incurred designing and producing works;
- it conducts or participates in research and sector analyses and coordinates the work of various consultative commissions.

SODEC also contributed to the establishment of the *Fonds d'investissement de la culture et des communications* (FICC), in which it holds a one-third stake. The FICC is a venture capital fund that acquires stakes in companies.

SODEC is also a partner of the Entertainment Investment, Limited Partnership (FIDEC), a public private partnership, whose remit is to invest in projects that are international in scope.

1.3 SODEC’s operations as an investment bank

SODEC operates as an investment bank in the various fields of the culture and communications sector. Its funding facilities are designed to meet all financial needs of sector enterprises and include financial tools generally offered by financial institutions, namely loans at notice, revolving credit, loan guarantees and, in exceptional cases, investment in the project and in capital stock.
SODEC prefers loan guarantees for term financing. In exceptional cases, SODEC invests in the project or in capital stock, only for major projects aimed at industrial structuring. In those circumstances SODEC plays a proactive role in the development of the project, but constitutes a funding source of last resort. Rather, it directs projects to the *Fonds d’investissement de la culture et des communications* (FIDEC) and to the Entertainment Investment, Limited Partnership (FICC).

SODEC categorizes each file according to the type of financing required by the client. The types of financing fall into the three categories outlined below and only the last one does not take the form of a loan guarantee:

Conventional operations
This category comprises financing operations such as discounts on ticketing, partnerships, grants, all other contracts and the purchase of fixed assets or stock by the enterprise. Funding in this category gives the enterprise access to credit backed by a form of security that is not generally recognized or that is too specialized for traditional financial institutions.

Development
This type of financing is designed to bolster an enterprise’s working capital and is used to meet all of the needs of a business in good financial health, enabling it to carry out various expansion projects. Examples of acceptable funding include the launch of products on new markets, the development of new concepts or of new products, export initiatives, the opening of new sale outlets and the acquisition of foreign firms (in part or in whole) in order to improve the enterprise’s position on international markets. Such funding can also be offered for the establishment of companies in new competition-free niches, when all project components point to a high likelihood of success.

Recovery
This type of funding cannot take the form of a loan guarantee since, by definition, the applicant has to prove that the financing required is not available elsewhere on terms that would be viable for the enterprise. Such funding is used mainly to keep companies experiencing temporary financial difficulties afloat, if their collapse would adversely affect the sector. Investment in new fixed assets or aimed at expanding the enterprise’s normal operations, that is not essential to its survival, may not be funded under this head. The applicant must, moreover, prove that the enterprise is potentially profitable in the short term.

1.4 SODEC’s role as a complementary to other financial partners

An enterprise’s total funding requirements sometimes exceed the capacity of traditional banks, given the lack of cover by guarantees, resulting from a conservative approach to the liquidation value of the assets put up as collateral. SODEC may in such cases be involved in a complementary capacity and provide the bank with reassurances as to the enterprise’s ability to achieve its financial forecasts, since it has all of the requisite tools. The bank is always the first ranking lender on the assets that it finances (receivables, inventories, property, plant and equipment). SODEC accepts a second rank and can recognize a liquidation value on off-balance sheet assets (rights, master tape) following a valuation.
The presence of SODEC, in partnership with financial institutions, encourages the latter to grant cultural enterprises loans at relatively low interest rates. SODEC also draws financial institutions into investing in an economic activity in which they were insufficiently involved, encouraging activities reputed to be sensitive for financial institutions in new or evolving branches of activity.

1.5 SODEC's relations with other economic stakeholders

SODEC's relations with other economic stakeholders rest on two lines of action – strategic analysis and financial analysis.

By producing studies that enable other players to understand the complex environment of cultural enterprises, SODEC helps to raise awareness of cultural industries and at the same time, determines their contribution to the economy of Quebec. First, once they have read these studies, the sector's stakeholders become aware of the intrinsic value of their field of action, which helps to put problems encountered into perspective. Second, by disseminating such information in cultural, economic and political circles, SODEC contributes to the public debate and to a better understanding of culture and its organizations.

By sharing its financial views and analyses with a wide range of local, regional and national economic stakeholders, SODEC constitutes a forum in which different points of view are expressed and deep insights can be gained into the stakes involved in project funding and business plans. In its exchanges with ministries, other State-run companies, specialized funds, investors and, naturally, banks, SODEC paints a transparent and clear picture of the fields that it finances. Owing to its experience, it can put economic developments into perspective and suggest solutions that reassure all partners.

1.6 Entertainment Investment, Limited Partnership (FICC)

Entertainment Investment, Limited Partnership (FICC) has a share capital of CAN $30 million and its partners are SODEC (one third of the capital owing to a refundable government advance) and the Quebec Solidarity Fund (FTQ). It was established in 1996, in response to the observation that firms' needs for financing tools increased in line with their development and their success. The remit of FICC is to facilitate the capitalization of companies that have reached a certain level of financial maturity and have proven substantial growth in buoyant fields. FICC offers venture capital tools, such as share capital and convertible debentures.

1.7 Fonds d'investissement de la culture et des communications (FIDEC)

In partnership with financial institutions and with companies in the sector, SODEC has also established the *Fonds d'investissement de la culture et des communications* (FIDEC). The purpose of this limited partnership is to meet the needs of cultural enterprises active in the fields of cinema, television production, shows or the promotion of artists, by providing them with new financial tools in order to support the production and the marketing of the products aimed at international markets. It invests in the form of funding such as advance loans, project investment, rights acquisition and equity investment, quasi equity and debt. The remit of FIDEC, in which SODEC has a CAN $20 million stake, is to invest in projects on an international scale. It has a share capital of CAN $45.5 million.

1.8 Main results[7]

Analysts employed by SODEC's investment bank are as rigorous as those working for traditional financial institutions. The difference lies in their unique competencies in the cultural sector and the need, owing to SODEC's role as a public institution, for them to take the same approach to service in processing all loan applications, regardless of the financial amounts involved. Owing to its analysts' rigour, SODEC has less than 4% in bad debts and has kept its initial endowment of CAN $20 million intact, and its investment bank is thus still active 25 years on.

Funding of enterprises

Breakdown of authorizations by financial tool (2008-2009 financial year)			
Financial tool	Number of authorizations	Amounts ($)	%
Revolving credit	21	10,865,000	46.6
Collateral security margin	8	3,645,000	15.6
Loan at notice	20	8,822,000	37.8
TOTAL	**49**	**23,332,000**	**100**

7 SODEC report for the2008-2009 financial year.

Funding of enterprises

Breakdown of authorizations by field (2008-2009 financial year)			
Field	Number of authorisations	Amounts ($)	%
Performing arts	8	4,225,000	18.1
Cinema and television production	23	11,362,000	48.7
Music and variety shows	5	3,700,000	15.9
Books and publishing	10	3,475,000	14.9
Multi-media	3	570,000	2.4
TOTAL	**49**	**23,332,000**	**100**

Breakdown of all of the SODEC's funding by nature of activity and by field (2008-2009 financial year)					
	Aid programme		Funding of enterprises	Tax measures*	
Field	General programme	Export and for cultural influence programme	Funding enterprises	Prior decisions: estimate of tax credit	Intermediary financing
Performing arts			4,225,000		
Visual arts					
Film and television production	33,838,046	1,783,996	11,362,000	97,043,364	6,238,941
Music and variety shows	12,774,926	1,769,137	3,700,000		
Dubbing				2,127,155	
Sound recording				1,347,165	55,574
Books and publishing	4,585,422	706,158	3,475,000	5,883,212	218,828
Software					
Print media					
Art related	3,572,834	229,827			
Multi-media			570,000		
Musical comedy production				9,399,910	224,296
Radio					
Production services					
Film and television				24,631,127	
Multi-sector					
TOTAL	**54,771,228**	**4,515,615**	**23,332,000**	**140,431,933**	**6,737,639**

II. L'INSTITUT DE FINANCEMENT DU CINEMA ET DES INDUSTRIES CULTURELLES (IFCIC)

2.1 Historical background

After the Second World War, film production in France was in complete disarray. As early as 1949, the State authorities set themselves the task of reconstructing this strategic industry, by focusing firstly on the problem of how to finance it. Producers were experiencing great difficulty in finding financiers willing to cover the legal risk and the completion risk of a film, not to mention the risk of a commercial failure. One of the first steps taken by the authorities was thus to put in place government-subsidized loans. Then, in the 1960s, the State authorities simultaneously established a fund in support of the film industry and a system of bank guarantees. Established in 1968, the guarantee system was initially entrusted to a specialized banking pool. The guarantee (80%) was thus managed by bankers themselves and the interest rate was subsidized.

From 1983, for neutrality reasons and in order to encourage the development of competition between banks in this sector, the guarantee fund was entrusted to a specialized body, IFCIC, which is not involved in any other banking activity and in which capital the State was a majority stakeholder. In the same year, its terms of reference were expanded to include all cultural industries – publishing, musical production, live shows and so on.

IFCIC is thus a neutral and independent body. Neutral, as it is open to most of the lending institutions, and independent, as it is financially responsible for all of its decisions.

Its main public shareholders are, after the State are the OSEO group and the Consignments and Loans Fund, which together hold around 49% of the share capital. The remainder is held by 15 private banks and lending institutions. Most of the major banking networks and lending institutions are involved or represented in the capital through their parent companies or through a federative body.

2.2 Scope of work

A private limited company, operating in the public interest, the IFCIC is a lending institution that has mandated by the Ministry of Culture and the Ministry of the Economy and Finance to contribute to the development, in France, of the cultural industries, by facilitating access to bank financing for companies in this sector. It has two specific tasks, namely to:

- give cultural enterprises access to bank funding, by providing guarantees, generally amounting to 50%; loans guaranteed by IFCIC are granted to finance most of the requirements of cultural enterprises, at all stages of their development, but IFCIC does not grant loans (except in the case of repayable advances of funds) nor subventions;
- provide a high level of expertise to bankers and to entrepreneurs; owing to its understanding of the sectors, to its research committees and networks of professional experts, the Institute has access to the requisite information for thorough analysis of the risk posed by enterprises applying for funding and can work with them in compiling their loan applications.

2.3 Operational instruments

Guarantee funds

IFCIC has around €13 million of equity capital and, more importantly, two active guarantee funds that have an overall net worth of more than €66 million:

- the cinema and audiovisual guarantee fund, funded by the National Cinema Centre (CNC);
- the cultural industries guarantee fund.

These funds are used, on the basis of regularly revised risk ratios, to guarantee outstanding risks (IFCIC share) of some €20 million, corresponding to around €540 million in loans, while maintaining adequate capacity to cover new risks taken.

The amount of public funds managed by the IFCIC is determined on the basis of targets for new loans to be guaranteed for each operational sector. In general, funds are granted under a contractual arrangement involving IFCIC, CNC, the Ministry of the Economy and Finance and the Ministry of Culture. If necessary, under that arrangement, certain annual priorities are set for action by the Institute. Owing to public monies paid into the guarantee funds and to the strong leverage effect they permit, IFCIC affirms its role as the preferred partner of cultural enterprises, at a lower cost for the State and for guarantee beneficiaries.

Advance funds

The IFCIC is also authorized by the Bank of France to manage repayable advance funds available for enterprises operating in cultural sectors. To that end, in 2006, IFCIC established the Musical industries Advance Fund (FAIM), endowed with €2.9 million and assigned to it the role of backing investments to help independent music companies develop or adapt to changes in the industry. FAIM's funding is to be increased considerably in the near future, owing to a contribution by the Consignment and Loans Fund.

The following investments are eligible for grants: editorial investments, tangible and intangible investments, financial requirements linked to structural growth, transmission operations and recovery plans. Advances, limited to a maximum outstanding amount of around €150,000 per enterprise or per group of enterprises, bear interest at the rate of 4% per year and are repayable over a period of 12 to 48 months, possibly including a grace period.

2.4 Credit mechanisms

Loan guarantee for the film and audiovisual production and distribution sectors

This activity has historically underlain the establishment of the IFCIC. It gives independent producers and distributors access to credit to obtain the cash flow necessary for producing or distributing their works, although their capital gearing is often very light. The particular risk of such loans, which underlie financing agreements relating to the work, attaches to the quality of such financing and to the completion of the work (budget not to be exceeded, delivery to different partners). Operations eligible for this guarantee are outlined below.

Production loans are granted to finance expenses relating to the acquisition of intangible rights in one or several works or expenses concerning subsequent stages in the development of corresponding projects. They can be guaranteed up to 70%. These loans are also used to finance pre-production costs, when the decision to produce a film has been taken and directing film-making costs have been incurred, and actual film-making costs (filming and post-production) until delivery of the film. These loans are usually guaranteed for up to 55%.

Distribution loans are granted to finance expenses linked to the payment of a minimum guarantee of receipts agreed by the distributor, or promotion and publicity launch expenses, and also reproduction expenses incurred for film screening in cinemas.

Company loans are granted to provide medium-term financing to distribution and production enterprises. They should be backed by a substantial "portfolio" of existing films. The last two types of loan can be guaranteed up to 50%.

Loan guarantee for cultural industries

The historical activity of guaranteeing film and audiovisual production loans has been extended to all cultural industries in order to provide special backing for small- and medium-sized enterprises in a reputedly high-risk economic sector.

Enterprises in the cultural industries sector in European Member States can receive this guarantee. They include books (publishing, distribution, book shops), music (publishing, record production, production of shows), live shows (production, acquisition and fitting out of theatres), fine art (galleries and studios), arts and crafts (production and sale), heritage sites (exploitation and restoration), architecture (architects' firms), multimedia (producers, publishers, technical service providers), the press (political and general press information, cultural press), film exploitation and technical industries for image and sound.

Loans guaranteed are intended to finance most of the requirements of cultural enterprises, at all stages of their development – investments in publishing, real estate, equipment and material, rights acquisition and licences, campaign credits, working capital funds that have become necessary owing to the development of the activity and the purchase or establishment of companies, to list but a few. These could be medium- or long-term loans, leasing products or bank guarantees, or again some short-term loans.

The guarantee generally amounts to 50% of the loan, and risk capping is enforced by IFCIC (€100,000 as at 31 December 2008). The guarantee rate can be as high as 70% of the loan for amounts below €100,000, or up to €140,000 for projects involving the digitization of media archives.

Loan guarantee for cinemas

IFCIC provides financial guarantees and expertise to the banks of cinemas that are independent of the major distribution groups. This guarantee amounts to a maximum of 50% of the loan, capped at €2,150,000. All cinema operators' requirements can be financed with the assistance of IFCIC: establishment, purchase, modernization and fitting out, replacement of operating equipment and working capital increases.

Loan guarantee for the film, audiovisual and multimedia technical industries

IFCIC offers financial guarantees and expertise to banks that finance the film, audiovisual and multimedia technical industries.

Eligible operations are medium-term loans designed to finance:

- external growth;
- investments in real estate (acquisition, construction, works);
- investments in equipment;
- Restructuring and working capital increases.

These operations are generally guaranteed at a rate of 50%, capped at €2,150,000.

Loan guarantee backed by assigned receivables.

The IFCIC provides financial guarantees and expertise to banks and financial institutions that assist in the financing of the assigned receivables of the film, audiovisual and multimedia technical industries.

Lending institutions are rather reticent about making credit lines available on the basis of assigned receivables held by enterprises whose solvency cannot really be assessed by the lending institutions (such as the lack of relevant information and inadequacy of ratios that are generally used).

In order to meet the beneficiaries' working capital funding needs, IFCIC shares the risk with the lending institutions, which consequently limits their risk of loss that could be incurred if the beneficiary cannot repay the receivables assigned and unpaid.
Eligible funding includes factoring, "Dailly law" assignments and discounts. The guarantee rate is generally 50%, capped at an amount determined in line with the funding arrangement made (10% to 20% of the guarantee line).

2.5 Main results[8]

As at 31 December 2008, total outstanding commitments guaranteed by IFCIC amounted to €564.6 million, while IFCIC 's outstanding risk stood at €273 million. Short-term loans for film and audiovisual production accounted for more than 80% of the latter amount.

- Guarantees granted in 2008 for film-making loans (production loans) were used to finance practically all (nearly 90%) of French film production. IFCIC's outstanding risk (excluding disputes) for film production amounted to €172.1 million as at 31 December 2008, corresponding to €325.3 million in loans. As at 31 December 2008, disputed outstanding amounts totalled €3.2 million.

- The outstanding risk (excluding disputes) for audiovisual production amounted to €44.9 million as at 31 December 2008, corresponding to €85.7 million in loans. As at 31 December 2008, disputed outstanding amounts totalled €1.1 million.

- The outstanding risk (excluding disputes) for cultural industries amounted to €15.8 million, corresponding to €40.2 million in loans. As at 31 December 2008, disputed outstanding amounts totalled €1 million.

- The outstanding risk (excluding disputes) for technical industries amounted to €10.3 million as at 31 December 2008, corresponding to €30.3 million in loans. As at 31 December 2008, disputed outstanding amounts totalled €0.6 million.

- The outstanding IFCIF risk (excluding disputes) for cinema operators amounted to €24.2 million, corresponding to €71.6 million in loans. As at 31 December 2008, disputed outstanding amounts totalled €0.4 million.

III. THE FONDS DE GARANTIE POUR LE FINANCEMENT DES INDUSTRIES CULTURELLES (FGIC) / ORGANISATION INTERNATIONALE DE LA FRANCOPHONIE

3.1 Overview

The decision to establish a guarantee fund is the result of the desire of the *Organisation Internationale de la Francophonie* (OIF) to promote the development of cultural enterprises in countries of the South. Cultural activity sectors are perceived by traditional financial players as being particularly risky sectors. Accordingly, the OIF deemed it necessary to work together with lending institutions in funding these sectors, which are today often excluded from traditional bank financing.

The purpose of the guarantee mechanism operated by the *Fonds de Garantie pour le Financement des Industries Culturelles* (FGIC) is to reduce the final risk borne by a lending institution when it provides funding for a project and/or enterprise, in pre-determined conditions.

The OIF has established three distinct guarantee funds (for a total amount of €1,185,000 as at 31 August 2009) that have been operational since 2004 in the following countries:

- Morocco (funds amounting to €290,000);
- Tunisia (funds amounting to €280,000);
- West Africa: Benin, Burkina Faso, Cote d'Ivoire, Mali, Senegal and Togo (funds amounting to €615,000).

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8 IFCIC 2008 annual report.

The OIF has formed partnerships with specialized financial institutions in beneficiary countries for the purposes of delegating the management of the funds and the analysis and assessment of the risk of applications made for the guarantee it provides.
For Morocco, the OIF has formed a partnership with the Central Guarantee Fund (based in Rabat), which is a financial institution specialized in the management of guarantee funds. For Tunisia, the OIF's partner is the Tunisian Ministry of Finance, which delegates the management of the funds to a Tunisian insurance and reinsurance company (Tunis Ré), a state-owned company based in Tunis. For West Africa, the OIF has formed a partnership with the ECOWAS Investment and Development Bank, a regional financial institution based in Lomé, whose shareholders comprise the 15 State Members of the Economic Community of West African States (ECOWAS).

The OIF's guarantee fund is open to all credit institutions in the beneficiary countries. The guarantee applies to short- or medium-term loan operations in the following sectors of activity: film and audiovisual production and distribution; technical industries relating to the cinema, audiovisual and music, radio and television; the print press; music and phonogram production; publishing, production and distribution of books and printing works; publishing and production of cultural or educational multi-media content; theatre and live shows; operating cinemas; theatres and shows; arts and crafts; visual arts and fine art; and fashion, crafts and design that have an artistic or cultural element.

Eligible operations are loans, leasing operations or bank securities that may be granted to eligible enterprises. Credits through bank overdrafts are excluded. Funding is guaranteed for tangible or intangible investment projects, production projects and the acquisition of enterprises. Operations related to working capital increases are eligible when they form part of an investment or development project.

The OIF has helped to set up guarantee funds in target countries, by taking additional action to ensure their success. This mainly includes:

– the organization of training seminars for bank managers on financing and economic and financial analysis of risks inherent in cultural enterprises and projects in order to improve bankers' ability to analyse cultural projects submitted for funding;

– the organization of training seminars for promoters and company managers in cultural sectors on project formulation and on the management of cultural enterprises: one of the main obstacles to accessing financing and to the development of cultural enterprises in the countries in question is the difficulty experienced by company managers in drafting, submitting and defending their projects for consideration by financial institutions;

– the conduct of socio-economic studies on the situation of cultural sector enterprises in the countries in question. The aim of this study is to paint a picture of the various cultural sectors in the countries concerned, that will enable the various economic players (bankers, fund managers, cultural promoters, civil servants and authorities and international organizations) to understand the context in which these activities are being carried out, the potential of the sector, the main advantages and drawbacks and, generally, the situation of enterprises operating in those sectors.

3.2 Main results[9]

FGIC Morocco as at 2 October 2009
Number of credit operations against guarantees: 19
Outstanding risk: €678,791.29 corresponding to around €4,639,325.40 in credit. The operations counter-guaranteed mainly concern, on the one hand, the financing of technical equipment and material and, on the other, real estate financing for fitting out premises. Three activity sectors were involved – printing, radio broadcasting and film production.

[9] Internal activity report of the FGIC produced by the OIF. January 2010.

FGIC Tunisia as at 31 August 2009
Number of credit operations guaranteed: 7
Net outstanding risk: €173,318 corresponding to €350,196.59 in credit. Operations guaranteed are medium-term loans and were for tangible investments (purchase of equipment and fitting out of premises). The outstanding risk is split among four activity sectors: film and audiovisual production, the press, information technology development and theatres.

FGIC West Africa as at 31 August 2009
OIF funds disbursed: €615,000
Number of credit operations guaranteed: 7
Outstanding risk: €485,231.50 corresponding to €880,166.29 in loans. Operations guaranteed are for medium-term loans and were for tangible investments in the following sectors of activity: film/audiovisual, television broadcasting, printing, music and fashion.

Since the three guarantee funds were put in place, 213 bank managers in the countries in question have been trained in risk analysis of cultural projects and companies and their awareness has also been raised on the potential and the specific features of cultural industries.
For cultural entrepreneurs, 516 have been trained to compile a full funding application for submission to financial institutions and to use key management tools (project formulation and monitoring, formalization of financial management, accounting, business plan and formalization of contracts).