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Digital Central: Key Sector Data

A statistical snapshot of Digital Sector SMEs in the West Midlands

25th May 2007

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Executive Summary

This document presents a 'snapshot' of Digital Sector Small- and Medium-Sized Enterprises (SMEs) in the West Midlands of England.

The analysis aims to bring together key sector data that can be used to engage investors, mentors and public sector funders in an evidence-based dialogue about what the Digital Sector is now in the West Midlands. A complementary report (*Digital Central – Mandate for Action*) has been generated from the same project summarising what the sector needs for the future in terms of common threads of business development, with suggestions for cluster activities that could follow up to address them.

Both reports draw on the statistical findings of a project executed on behalf of Digital Central in the West Midlands of England by Pembridge during Q1 2007. The project applied the *Vital Statistics* benchmarking and diagnostic tool developed by Pembridge Partners LLP and BOP Ltd to 50 'Digital sector' SMEs.

Objectives

The objectives of this project were to:

1. Provide individual diagnostic reports and benchmarking services to 50 SMEs, highlighting how they compare to their peers, what their strengths, weaknesses, opportunities and threats are, and how they might address them.
2. Gather new and valuable data across the sector, disseminating it through this report to empower Digital Central, SMEs themselves, Advantage West Midlands, business clusters, Higher Education Institutions, Investors and Mentors to help the sector grow by devising policy based on evidence
3. To promote the Digital Central brand and create a platform for future engagement of a wider group of SMEs

All these objectives and contractual reporting compliance were achieved on budget in full.

Summary of findings

- On the basis of the data gathered, the Digital Sector in the region consists of around 620 SMEs.
- The scale of operation of the SMEs varies widely, from 1-178 full-time employees, with a median of 3 employees. 75% of firms had 7 staff or fewer.
- Turnover ranged between £10k to £13m per annum, with a median of £160,000.
- The SMEs operate with a mix of business models, suggesting a range of potential for scalability. Some provide creative services on a work for hire basis, while others operate intellectual property (IP) based businesses.

Conclusions

- The Digital Sector in the region has some potential 'stars' but also shows great variability between businesses. 'One Size Fits All' will not work from a policy standpoint.
- This project has begun mapping and made direct phone contact with around 40% of the Digital Sector in the region. The other 60% remain to be contacted.
- This project has made 50% of Digital Sector SMEs in the region aware of Digital Central.
- There is scope to engage the remaining 50% of SMEs with Digital Central, and to improve confidence in the figures reported here from a very small sample base, by repeating this project with the SMEs yet to be contacted.
- If repeated, the exercise could gather data required to assess the GVA due to the sector in the region.

Context

Digital Central

Digital Central is a regional development project that helps the West Midlands of England be nationally and internationally recognised for its digital media and music sectors. That includes Film, Television, Animation, Interactive Media, Computer Games, Digital Imaging, Music and Radio. Its aim is to develop an enterprise culture for cluster businesses that will help accelerate economic growth and increase employment through the promotion of innovative new ideas, the development of new market opportunities and the nurturing of a new generation of cluster entrepreneurs. Digital Central undertakes activity against three key strategic themes: networking, showcasing and innovation.

Digital Central represents a major collaboration between the regional development agency, the private sector and higher education. The project is funded by the regional development agency, Advantage West Midlands as part of their strategy for the development of the Screen, Image and Sound business cluster. Digital Central is managed by the University of Central England in Birmingham.

Pembridge Partners LLP

Pembridge Partners LLP was founded in 2001 to help owner-managers in the Creative Industries build and realise commercial value in their firms. It does that by providing finance and advice focussed on commercial growth for profit. Since start-up, Pembridge has raised or directly invested £25m, engaged with over 1,200 SMEs and typically has 50 current engagements across Creative Industries. Today, Pembridge comprises four partners and a support team of four based in London, but operating with a network of 20 regional associates across the UK, in Singapore and in the Netherlands.

In addition to its work directly with private SMEs, Pembridge operates a Joint Venture with Burns Owens Partnership Limited (BOP) to share its tools and techniques on a consulting basis with public sector organisations that share its mission to achieve growth in the Creative and Digital industries. Clients include the London Development Agency, North West Development Agency, Skillset, Screen Yorkshire, Film London, Northern Film and Media, East Midlands Media, South West Screen, the Singapore Media Development Authority and the University of the Arts, Utrecht. Higher Education partners include University of Central England and the University of Westminster.

Vital Statistics

Vital Statistics is a tool developed by Pembridge Partners LLP and its partners to deliver three outcomes at once:

- It provides a ‘snapshot’ of the current state of commercial development of a SME, giving affirmative insight to the owners of that business in an action-oriented report;
- By providing quantitative, auditable evidence about SMEs it allows a fair, rational allocation of development resources to be made by public sector agencies seeking to engage with the sector.
- In building a ‘fine-grained’ database of data about SMEs that was previously unavailable, it allows policy makers in both public and private-sector agencies to set policy based on real-world evidence and to evaluate the effect of interventions repeatably and quantitatively.

Vital Statistics has been applied to over 1,300 SMEs in the UK, Singapore and Netherlands. The bulk of the SME database on which it operates is focussed on the Creative Industries but this is now expanding to include many other sectors such as manufacturing. See Annexe 1 for a detailed account of the methodology applied using Vital Statistics in this project.

Helicopter view of the sector

In this section we summarise the project's overall findings about the sector in the region.

Size of the sector

Annexe 1 details the methodology used to identify and gather data from Digital Sector SMEs in the region. The approach was selected to include independent micro businesses but to exclude individual freelance staff wherever possible.

On that basis, a total of 573 SMEs were identified using all data sources available to the team. An empirical estimate would be that perhaps another 10% of SMEs may exist which escaped our net, suggesting that the sector comprises a total of around 620 SMEs.

Split of firms by sub-sector

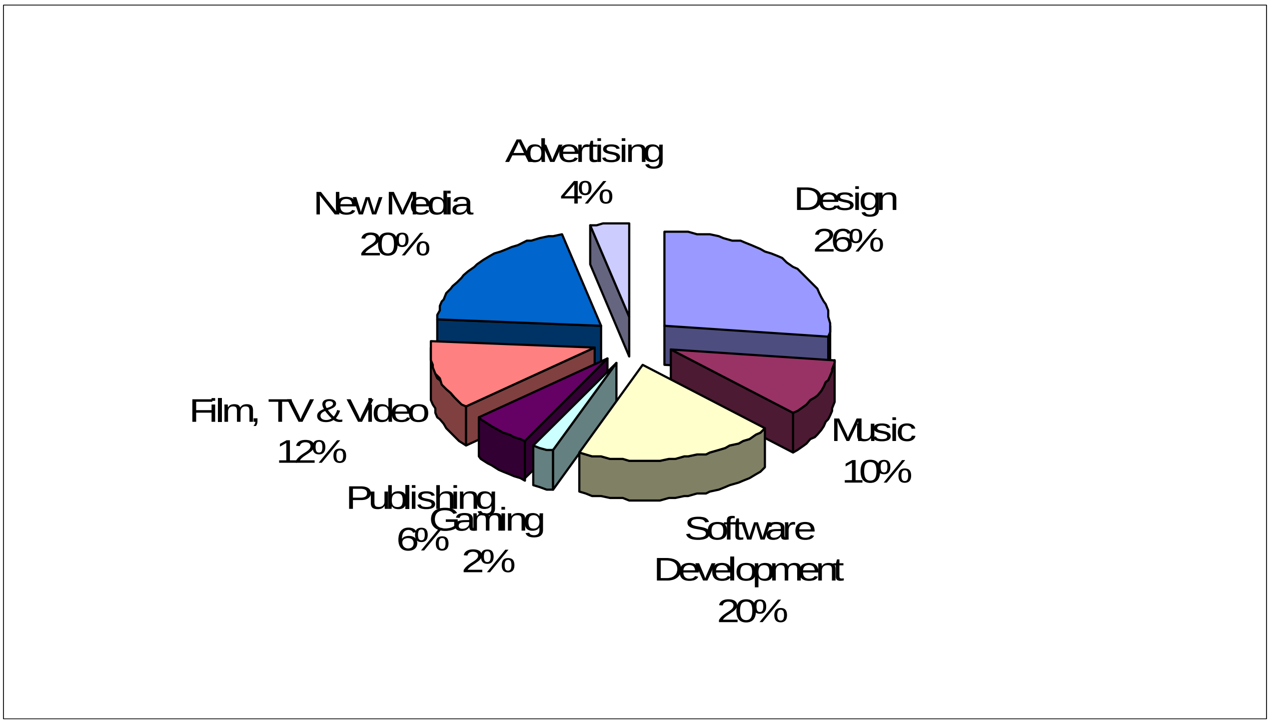

Figure 1 - Split of firms by sub-sector in sample (SMEs' own classification)

We asked SMEs to categorise themselves into one of the above sub-sectors. The results are shown in Figure 1, making clear that Software Development, Design and New Media are the three largest sub-sectors. In practice, several firms operate across a number of these sub-sectors and it seems clear that rigid sub-divisions are unhelpful in a sector where convergence and rapid innovation are defining characteristics.

Estimated number of Digital SMEs by sub-sector in the West Midlands

Despite our reservations regarding a rigid delineation of SMEs, Figure 2 projects the proportions of different sub-sectors identified in our sample to estimate the actual number of firms operating in the region, based on our estimate of the total size of the sector (620 SMEs).

Sub-sector	Estimated total number of SMEs in region
Design	167
Music	62
Software Development	124
Gaming	12
Publishing	37
Film, TV & Video	74
New Media	124
Advertising	25

Figure 2 – Estimated number of Digital Sector SMEs operating in the West Midlands by sub-sector

Range of SME operations

- In terms of trading history, SMEs ranged from 1 year old to 25 years old, skewed towards younger firms (25% were under 3 years old). The median age was 6 years.
- In terms of employees, the SMEs employed between 1 and 178 full-time staff, skewed very strongly towards micro-businesses. The median number of full time employees was 3, with 75% employing less than 7 full time staff.
- 26% of the SMEs were managed by a sole director, 46% by a team of two and the remainder by a larger team, with the largest company having 6 directors.

Range of financial scale

Only 60% of participating SMEs were able to provide financial data. Of those:

- Turnover ranged between £10k to £13m per annum, with a median of £160,000. 25% of firms turned over less than £46k, but the top 25% turned over more than £533k.
- Turnover growth ranged from -40 to +570%, with a median of 22%. A quarter of SMEs were growing turnover more than 73% per annum, while one in five had contracted in the last two years.
- As a percentage of turnover, gross profit ranged from 6%-100% with a median of 69%.
- Gross profit growth ranged from -30 to +550% with a median growth rate of 28%.
- Operating profit expressed as a percentage of turnover ranged from -40 to +80% with a median of 13%. The top quarter of SMEs were generating 35%+ operating profit, while the bottom quarter generated 6% or less.

Compiling all this data together, Figure 3 illustrates the sample in terms of European size classification. It comprised 86% micro businesses, 12% small businesses and only 2% medium sized enterprises.

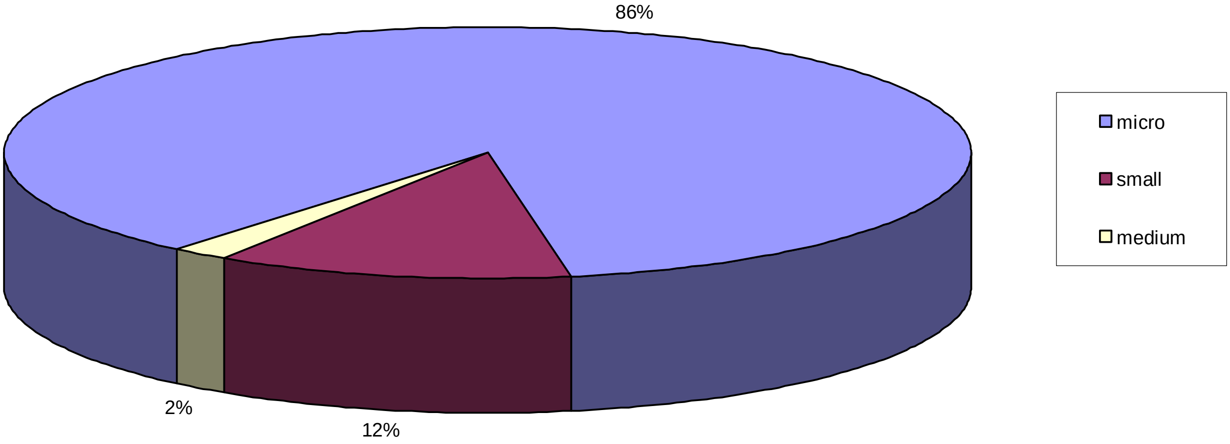

Figure 3 - SMEs in sample by European Size Classification

Potential of the Digital sector in the West Midlands

In this section we interpret data gathered from the project in the light of Pembridge's experience running similar projects internationally.

Inferences from the 'helicopter view'

It seems clear that the digital sector includes a very wide range of businesses. Top quartile performers on all the financial measures are doing very well and appear to have strong growth potential (judging by track record of the last two years' trading). However, there are also many businesses that appear marginal in terms of their sustainability (turnover so low as to barely support one person plus overheads with very low operating profit) and which demonstrate little potential for growth.

The implication is that this is a sector with some great potential 'stars' but also one that shows great variability between businesses. 'One Size Fits All' will not work from a policy standpoint. If the goal of policy is to increase employment and GVA sustainably, the evidence we have found points strongly towards targetting genuine high-growth businesses rather than propping up those that cannot demonstrate real growth potential.

Current leading sub sectors and business models

For indications of which sub-sectors have historically shown potential to grow, we looked to see how the seven SMEs with more than ten employees described their business activities. In no particular order, the descriptions were:

- Developer, publisher and distributor for handheld and mobile games
- Full service digital agency
- Product designers, developers, distributors in mobile IT and auto ID
- Graphic designers
- Logistic Support and software consultants
- Character Animation and Digital Effects, CGi Production Studio
- Brand Strategy Design delivery and Digital Solutions

We note that five of these seven businesses are doing work which is based fundamentally on a creative work-for-hire business model (they are agencies of one kind or another), one has a business model based on generating and brokering Intellectual Property and the remaining firm has a model based on delivering business services. Empirically, we see this pattern.

We suggest that the list above is interesting for what it omits as well as what it includes: there are no music, TV, or film businesses in the list. While this may be a function of the small sample size it echoes a pattern we have observed empirically in other regions: despite the high profile of sub-sectors such as TV and film, and the historic high levels of public support for them, there appears to be potential for future intervention to achieve greater impact if focussed on some of those businesses that have not hitherto been in the spotlight.

Annexe: Methodology

The project with Digital Central followed a pattern of best practice established by Pembridge working with more than twenty public sector agencies around the UK and abroad.

Overview of project key stages

These were as follows:

1. We marketed the project to engage relevant SMEs, by distributing a notice about the project through existing mailing lists of organisations partnered to Digital Central, and by direct e-mail and phone approaches to relevant SMEs. The scheme was promoted as open to SMEs with more than two years' trading history.

2. SMEs wishing to participate signed up online using an e-form provided by Pembridge but appearing as part of Digital Central's website with its branding.

3. Following sign-up, each SME received automatically an acknowledgement e-mail including a fax cover sheet that they printed out and signed, thereby agreeing to the scheme's terms and conditions. They used the cover sheet to fax (or scan/e-mail) their last two years' accounts to Pembridge having been assured that confidentiality about this data would be maintained.

4. The accounts submitted were analysed by Pembridge and entered into a database system that schedules a phone interview with each SME.

5. Each SME was interviewed and data from this interview and the accounts used to generate a report automatically. The report was e-mailed to the SME.

6. At the end of the project, Pembridge collated together all the information gathered to produce several different summary reports as described below and of which this forms one.

Selection of participants

In the absence of a widely-accepted definition of the Digital Industries sector, we adopted a pragmatic approach to identifying potential participants who might wish to engage with Digital Central and specifically this project.

- Digital Central was able to provide contact details for 159 SMEs
- We bought 567 records from Experian using criteria based on geography and a liberal but reasonable interpretation of what the sector might include.
- We had 8 referrals from companies we called

These tactics allowed us to build a database of 736 records. Manual screening then established that 163 of those were judged not to be worth contacting because they were from the wrong sector, had no website, or no e-mail address. Therefore our 'cleaned up' list of positively identified Digital Sector SMEs comprises 573 businesses

Of the 'cleaned' list, we e-mailed 350 and 8 applied online directly as a result of that email (2.2% response rate)

We then made follow up telephone calls to explain what Digital Central was and what was being offered to 250 of the 350 on the e-mail list before we hit our budgeted quota of 50 SMEs willing to participate (a 'hit rate' of 10%).

Setting expectations amongst SMEs

Past experience with Vital Statistics shows that successful sign-up of SMEs, and their ultimate satisfaction levels with the process, are critically dependent on them having had their expectations about what the process can do for them set realistically and clearly up front.

Therefore, a consistent message was established early on and used in all communication, which could be summarised as follows:

- Digital Central is there to help the West Midlands be nationally and internationally recognised for digital media / music businesses.
- It's here to support companies like yours with the aim of making the West Midlands an exceptional place to build a business.
- We need your help and we'd like to offer you ours.
- We identified your company as an entrepreneurial business
- We invite you to take part in our Vital Statistics project. It's free and takes just 20 minutes of your time.
- You will get a totally confidential report showing how your business compares to similar businesses
- You will get an individual action plan that you can use to steer towards commercial success.

Delivery mechanism

The project was delivered on a fully outsourced basis by CCM Limited, the joint venture business operated by Pembridge and BOP to embody their *Vital Statistics* methodology. CCM assumed full responsibility for all aspects of marketing, project co-ordination and interviewing.

Outputs

Four types of output were delivered under this project:

A - Business Support
The key output delivered for Digital Central was Business Support. This was achieved by providing an individual *Vital Statistics* report to each SME participating. The confidential report showed how the SME compares to its peers, where its strengths and weaknesses lie and what it might do to capitalise on opportunities and avoid threats (an anonymised example report is available to interested readers on request to hugh.mason@pembridge.net)

B – Recommendations
A brief, pragmatic, action-oriented report was delivered to Digital Central complementing the document you are reading now. That report summarises the overall state of all the SMEs participating and draws together common threads of business development needs with suggestions for cluster activities that could follow up to address them.

C – Statistics
This report summarises in statistical terms aspects of the sector that will be of interest to investors, mentors and public sector funders as they set their respective policies for work with the Digital Sector in the West Midlands.

D – Presentation
The insight arising from the project was shared informally with an invited audience at the launch of Digital Central's London facility and developed further at a meeting of the Steering Group for Digital Central.

Limitations of the methodology

The methodology used was that judged to be best practice based on Pembridge's experience operating and reviewing similar exercises. However, practical limitations impose a range of restrictions on the inferences that can be drawn from the data gathered:

1. We are not aware of a generally accepted firm and useful definition of the Digital Sector – that used for this project is an empirical approach described above. This limits the capacity to compare data obtained through this project with other projects that may have used a different definition.
2. It is difficult to draw a firm line between enterprises that are micro businesses and those which are really just a freelance individual trading under a business name. The methodology we used attempted to exclude freelancers on the grounds that an enterprise based around one individual is difficult to scale. Our estimate of the size of the sector is affected by our decision to exclude such individuals and the basis on which they are excluded may mean that very small micro businesses are under-represented in our sample.
3. Only 20% of the businesses we contacted were both eligible to participate and willing to do so. Of those that participated, only 60% were able to provide financial data. The sample size is therefore small and not adequate for robust statistical analysis: hence we present this report as a 'snapshot' rather than a full report and recommend that the project is extended.

Timeline

22 JAN 2007: Contract for delivery executed.

29 JAN 2007: Marketing start. Applications for the scheme to be in by end February 2007 with a public cut off date for supplying accounts advertised as 16 FEB 2007.

From 29 JAN 2007: Companies sign up online and send in accounts as soon as they do so. Accounts analysed by Pembridge as soon as they arrive and interviews scheduled/executed as SMEs commit to participate.

From 12 FEB 2007: Main body of interviews start. Individual report generated as soon as practical after interview. Keep chasing for accounts from signed-up SMEs yet to supply them (from experience, expect some dropout at this stage)

5 MAR 2007: Real cut-off date for receiving accounts. SMEs that haven't delivered by this time dropped politely from the scheme

17 MAR 2007: Interviews all completed by now (SMEs that just can't get round to being interviewed politely dropped from the scheme). Final individual reports go out. Optional reports and presentation material generated (if required by Digital Central)

31 MAR 2007: Delivery of all agreed outputs complete.