STRATEGIC INSIGHTS

This article makes the case for the use of strategically invested private capital as an enabler of socio-economic activity in the cultural sector

Investing in a cultural portfolio to achieve economic development goals

By Ricardo Benn

During much of the last century, tourism and culture were largely viewed as separate components of a country's socio-economic development strategy. Culture was defined in terms of a non-profit ethos with significant links to the educational aspects of the indigenous population and support for national cultural identities. Tourism was viewed as primarily focused on commercial businesses related to leisure activities. However, within recent years, the idea that cultural tourism—utilizing cultural assets for the purpose of increasing tourism—can be a fundamental enabler for sustainable development has been recently touted by a number of leading international institutions including UNESCO, the World Bank and the OECD. There is little question that the creative industries, along with strategic development of tangible and intangible cultural assets can be major contributors to a country's economic development and tourism aspirations. However, the exact mechanisms by which these aspirations can balance profit vs. non-profit motivations and public vs. private sector interests in developing and emerging markets remains unclear.

For countries in emerging markets, the funding model for both programs in the cultural and tourism sectors has traditionally heavily relied on public sector sources with only minimal funds being provided via the private sector. However, public sector funding suffers from inherent limitations. Because programs and investments are fully dependent on the public sector budget cycle and the prevailing political climate, this can often create uncertainty about multi-year funding levels and historically has tended to support smaller scale programs. A notable exception—funded by huge petrodollar surpluses—are the large scale programs announced in recent years by governments in the Middle East including Qatar, Dubai and Abu Dhabi. These major cultural investments ranging from regional film festivals and new museums to dedicated cultural districts represent the aspirations of these governments to create a cultural context and boost the tourism sector along with enabling broader economic development goals. However, these planned investments remain quite vulnerable to the capricious nature of political will, short-term thinking and stable economic factors. In addition, fundamental challenges remain in striking the appropriate balance between the preservation and conservation of indigenous culture against successful promotion and marketing activities.

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At the very core of the issue is the fact that properly quantifying culture, values and heritage is a complicated and multi-dimensional challenge. First, there are the cultural values and norms of a society—the relationships that exist between individuals, families and the broader society. In many Middle East governments in particular, religious and moral behaviors and cultural traditions are often inseparable. Then there are the core aspects of public and private institutions and their collective interactions in maintaining and driving cultural norms. Secondly, there are challenges related to the tangible and intangible cultural heritage of a society. While tangible heritage, which includes archaeological sites, buildings and landscapes are often the easiest to leverage from a cultural tourism perspective, governments often find it hard to counterbalance the encroachment of developers eager to exploit endangered locations. Intangible heritage, which includes traditional handicrafts, performing arts, poetry, music, theatre, and film, can showcase previously unknown aspects of a society. However, in our increasingly globally connected world where information overload is pervasive, the challenge is to present these cultural forms on equal footing with more dominant external cultural forms of expression. Yet, intangible assets are increasingly becoming important in the competition between regions. Where formerly countries competed on getting their national assets listed in the UNESCO World Heritage List, they now seem to be keen to be listed on the UNESCO Intangible Heritage register. This is pointing to the fact that competition has evolved from just culture to creativity.

The primary reason that governments invest in the cultural and tourism sectors is ostensibly to increase employment and economic regeneration to facilitate a highly productive and sustainable economy. In working towards this goal, governments aspire to a series of outcomes for the country and its residents. These will evolve over time as the strategic context changes, however the overall goal is to improve the economic and social status of the country. The typical areas of investment have tended to focus on economic development, leisure infrastructure and tourism facility improvements, heritage preservation and branding and identity. However, governments across the world have proved that even in the best-case scenarios, funded projects can be hijacked by political agendas and in the worst-case, result in the inefficient deployment of capital without little to show for investments.

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Fruitful collaboration is compounded by the fact that the cultural sector often finds it hard to identify direct benefits from developing tourism. Furthermore, there is a general misperception that investment in culture and heritage is a luxury that most emerging market countries cannot afford and instead would better serve their interests by focusing on traditional areas for development: infrastructure, education, and health. This is supported by the general belief that private capital with its focus on shareholder return and maximization of profits is largely disinterested in investments in the cultural arena. This article argues that there is an alternative approach that up until has been aggressively pursued, but is likely to gain much more momentum in the coming years. The fundamental premise of that argument is that strategically invested private capital is much more likely to be successful in deploying funding to develop and promote a country's cultural assets as responsibly managed tourist destinations than the public sector. In addition, because private capital is focused on maximizing return on investment for their stakeholders, it is much more likely to transform cultural site locations to become assets that are socially and culturally beneficial while stimulating demand for employment, training, skills and improved infrastructure.

The case for private capital

The economic underpinnings for cultural tourism programs are fairly straightforward. On one side of the equation, there are a number of supporting demand factors including:

- *Use of culture as a market differentiator*—An increased desire by countries to use culture as a source of national identity and differentiation in an era of hyper competition for available tourists. In addition, greater attention is being paid to intangible culture and its associated components
- *Change in consumption patterns*—A shift towards lifestyles which emphasize 'experiential' travel where personal development and is emphasized over sightseeing
- *Rise of technology meritocracy*—Increased levels of globalization and mobility are facilitating easier dissemination and access to cultural information
- *Development of creative cities and cultural hubs*—Local and national authorities are willing to develop creative activities that have spill over positive effects on the economy

On the supply side, there are also a number of compelling indicators:

- *Focus on 'high quality' tourism*—The increasing perception by a number of governments that cultural tourism can be targeted at high quality tourists who are willing to significantly higher amounts than budget consumers
- *Impact of the economic downturn*—With the lingering effects of the economic crisis, governments and sponsors have cut grants to cultural institutions, forcing them to find new sources of income
- *Projection of Cultural Identity*—Emerging market countries are eager to establish a 'distinct' cultural identity to project power and brand themselves on the world stage
- *Rise of business philosophy* —The increasing competition among cultural institutions, and from other leisure activities, has created a need for the cultural sector to be more aligned with for-profit organizations
- *A trend toward privatization* —The last decades have seen the creation among cultural institutions of mixed forms of governance incorporating both public and private governing authorities. At the same time, a large number of private museums have opened their doors

Given the strategic importance of both the tourism and cultural sectors for countries around the world, cultural tourism strategies that effectively exploit the synergies between these two sectors is therefore a powerful economic multiplier. For example, the United Nations (UN) estimates that more than 50% of European tourism is driven by cultural heritage. Similar surveys performed in the United States estimate that more than 30% of tourists choose their destination based on the availability of a certain type of art, culture or heritage activity.

"..the fundamental premise of the argument is that strategically invested private capital is likely to be much more successful in using funding to achieve development"

At first glance, private equity, which is grouped into the broader category, private capital—used to describe capital supporting any long-term, illiquid investment strategy—seems to be an odd choice for investing in the cultural tourism area. After all private equity—whether in the form of a venture capital firm, or pooled private investor funds—is typically more concerned with obtaining high margin returns for their stakeholders rather than the altruistic benefits of cultural development. However, a further exploration of the full value chain of the transaction is instrumental in understanding the value proposition to each party. More importantly, understanding the downstream benefits that accrue to a private capital investor is critical to the articulation of the business case.

The global growth of private capital has certainly been spectacular. Between 1985 and 2005, private equity funds experienced a compound annual growth of 18.5 per cent and in the last few years, growth has been more marked. According to Private Equity Intelligence, private equity funds raised $401 billion in 2006 or nearly 25 per cent more than the $311 billion solicited in 2005. The technical innovations of private equity can best be understood by noting that the private equity fund turns upside down the assumptions we would make about the public company whose shares are traded on a public market, with most of its capital raised in the form of equity for the benefit of a corporate entity. In contrast, private equity funds are raised from rich individual investors and, increasingly, institutions like pension or mutual funds, which cannot exit by selling their stake on a public market. In a typical private capital transaction, the investing company has its own set of goals, preferences and investment strategies. The focus is on providing working capital to nurture expansion, develop products, or restructure operations, management, or ownership. Fundamentally, the principals of private capital can be leveraged to scrutinize the viability of a given project and strategically invest in the components that promise the highest levels of return. This is best illustrated by highlighting looking at several areas that seem the most promising reasons why private capital would be interested in cultural tourism investments:

- *For better local market exposure*—In many countries, the 'creative industries' have been identified as having an important relationship with tourism. Some countries are beginning to link creativity and tourism explicitly. For example, Singapore has branded itself as a 'Global City for the Arts' and Australia was the first to market itself as the "Creative Nation". The creative arts are often symbiotic with the implementation of innovative application of new technologies in emerging markets. This type of investment exposure can provide private capital investors invaluable insight into the local market players. This is particularly true of any downstream technology investments that might also be under consideration in the target country. Because the introduction of technology and the use of various software products is highly correlated with the cultural profile of a given country, this type of insight can be invaluable when estimating the likely market penetration of new products. In this way, private capital investors can have first hand experience insights into a wide portion of their likely portfolio investments.
- *To support real estate investments*—In many urban areas, cultural institutions have been used to ignite the regeneration of neglected areas, boosting local economies and increasing property values. There is a long history of private capital investments in real estate both through direct ownership of property and through pooled investment funds. Recent market conditions have led to the emergence of opportunistic funds, which aim to take advantage of falling property prices to acquire assets at significant discounts. Therefore by supporting cultural projects which stimulate demand for urban renewal, private capital is likely to realize significant improvement in their overall real estate portfolio as well.
- *To catalyze infrastructure investments*—Michael Porter on his pivotal study on competitiveness famously stated, "Almost everything matters for competitiveness. The schools matter, the roads matter, the financial markets matter, customer sophistication matters, among many other aspects of a nation's circumstances, many of which are deeply rooted in a nation's institution, people and culture." The obvious conclusion is that regional attractiveness and competitiveness are linked. Increasingly, countries have to compete to with equal vigor to attract residents, visitors and inward investment. Every country is increasingly faced with answering whether or not they are interesting places to live, invest and expand businesses in. In other words, what does this district have that offers a strategic competitive advantage over other districts? In this context, investments in various public works (e.g., bridges, tunnels, toll roads, airports, public transportation and other public works), which are core asset class investments for private capital, take on a new meaning. What differentiates one location from another depends more than just on economic factors—standards of living, accessibility—but on more intangible factors such as the 'quality of life' of a location. Therefore, by investing in and more importantly understanding the cultural dimension, there are opportunities to strategic influence these factors in the right direction. In addition, because cultural tourism is increasingly dependent on both inherited assets—beaches, climate—and created factors—cultural attractions, events, etc—there exist opportunities to appropriately tailor the investment portfolio.

The missing link

It is clear that a fundamental understanding of the inner workings of culture is important to successfully deploy cultural tourism and for a country's attractiveness and competitiveness. The most successful national cultural tourism strategies will be those than can create a positive ecosystem that equally supports culture and tourism. But this connection does not happen simply by thinking about it. In the preceding paragraphs we have argued that strategic use of public rather than private capital can be a powerful enabler for cultural tourism strategies. Yet, no matter how well intentioned these strategic investments are, they are likely to fail with out a fundamental understanding of the challenges involved. Therefore, there are number of reasons why institutions contemplating private capital injections in the cultural tourism area should consider cultural development planning and management consulting services?

- Small and medium sized districts generally lack the financial and strategic resources to implement good urban governance for sustainable cultural tourism efforts
- Private capital is generally missing the cohesive guidance on how to practically manage assets in the sector that can create positive impacts in the economy while creating a strong return on invested capital
- Due the lingering impacts of the financial crisis, many financial outlook for many institution's has significantly changed and they require practical advice to adapt to new market conditions
- In many emerging market countries, institution lack the skills and experience required to properly administer programs and required structured capacity development programs
- In many regions, freedom to implement programs will be limited by strong governmental control. Leveraging the right domain expertise and developing the right strategies to navigate these obstacles requires expert, independent support
- Because many relationships will require effective public private partnerships in order to be effective, proper stakeholder assessment from individuals knowledgeable about the nuances of cultural programs will be required in advance of an investment of capital
- Integrated management of cultural tourism efforts requires the introduction of governance styles and systems that involve local authorities the tourism sector and local authorities. Practical, programmatic solutions from experts with years of emerging market experience will be required
- Significant levels of strategic advice will be required to support the business needs of an increasing number of private individuals considering the move into the museum sector

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