

EXPLORING THE LANDSCAPE OF CREATIVE INDUSTRIES: A FINANCIAL PERSPECTIVE

Marina Stanić

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Abstract

Purpose – The creative industries comprise various subsectors distinct in terms of business models, profit orientation and growth prospects. Due to the heterogeneous nature of the industries, measuring and analysing the sub-sectors is difficult. To understand the specific subsectors and highlight their specific characteristics within each of the creative industries, this paper explores differences among small and medium-sized enterprises (SMEs) in terms of asset, capital and liquidity structures.

Methodology and design – The study is based on a data set from financial statements sourced from 8,088 SMEs within the creative industries in Croatia for year 2014. For research purposes, creative industries are clustered into eight subsectors: advertising, architecture, design, electronic media, film and video, music, publishing and press, software and video games. Based on a set of predominantly financial indicators selected from financial statements, the paper provides a comparative analysis of subsectors from creative industries in terms of their balance sheet structure.

Findings – An analysis of the financial statements reveals more similarities than differences among subsectors of creative industries. The software and video games subsector appears to perform better and have the highest growth potential relative to all other subsectors.

Originality of the research – The paper provides insights into the landscape of cultural and creative industries and explores the degree to which balance sheet structures are linked to the characteristics of each subsector within the creative industries.

Keywords small and medium enterprises (SMEs), financial ratios, balance sheet

INTRODUCTION

Over the last couple of decades, creative and cultural industries (CCIs) have been recognized as an important leverage in boosting economic welfare through generation of jobs, revenues and cultural engagement. In the EU, CCIs contribute to 4.2% of GDP and account for 3.3% of the EU's working population (EY, 2014). Furthermore, evidence suggests that creative industries tend to grow at a faster rate than the overall goods and services economy; in some countries, the growth rate is double the growth rate of the aggregate economy (Potts and Cunningham, 2008). Due to these and many other benefits of the CCI sector, a number of governments around the world have begun to introduce policies to support and promote the development of the sector. However, a solid understanding of the economic potential of CCIs is still lacking. To gain profound insights, efforts should be aimed at 1) exploring the distinctiveness of CCIs that differentiates them from the rest of the economy and 2) gaining a better understanding of the idiosyncrasies of each subsector within the CCIs.

By analysing financial statements, this paper focuses on the latter and attempts to identify similarities and differences among SMEs operating within the subsectors of creative industries. The study poses two research questions: 1) Do the balance sheets and income statements of SMEs across creative industries follow the same pattern? and 2) Do SMEs within creative industries differ in terms of liquidity, leverage (capital structure), asset structure and profitability? The empirical analysis includes the entire number of privately-owned SMEs operating within one of the eight subsectors of the creative industries in Croatia.

The paper has a specific structure. The first section briefly define and classifies creative industries and pinpoints to the distinct features of SMEs operating in this sector. The second section provides the results from an analysis of financial statements from SMEs operating in the subsectors of creative industries. Finally, the last section discusses the implication and limitations of the study, and provides recommendations for the further research.

1. THE CREATIVE INDUSTRIES: CONCEPT, FEATURES AND PROSPECTIVES

The term “creative industries” first appeared in documents and reports written by the UK’s Department of Culture, Media and Sport (DCMS) in the late 1990s. The aim was to moderate the perception of cultural industries as predominantly artistic (lumped with “the Arts” segment), and to present them as a legitimate object of national cultural and economic strategies and policies (O’Connor, 2010; Garnham, 2005; Cunningham, 2002). The exploitation of intellectual property rights was set as a common denominator of the preselected subsectors and merged under the umbrella of the creative industries. In line with that regard, the most widely accepted definition of the creative industries delineates this sector as “those industries which have their origin in individual creativity, skill and talent and which have a potential for wealth and job creation through the generation and exploitation of intellectual property” (DCMS, 1998:3). In particular, creative industries refer to a range of industrial activities including advertising, architecture, the art and antiques market, crafts, design, designer fashion, film, interactive leisure software, music, the performing arts, publishing, software, and television and radio (DCMS, 2001:5). Though the concept of the creative industries has proven to capture the underlying economic reality specific for this sector (Lazzeretti and Capone, 2015), the classification of creative industries remains moderately inconsistent across countries hindering international comparability and research prospects.

Knowledge and information are perceived as pillars of the creative industries and represent a point of distinction between the creative industries and all other industries. A common feature of all subsectors that constitute the creative industries is the translation of creativity into economic value. In that sense, the creative industries, relative to other industry sectors, are more innovative (Birch, 2008), focused on or use technological advancements and attract higher educated and highly specialized employees (Oakley, 2006), face demand uncertainty (Caves, 2000) and derive their competitive advantages directly from exploitation of knowledge, creativity and other

intangible assets. Many subsectors of the creative industries are characterized by a high degree of self-employment and business activities that are on a project-by-project basis and often coupled with precarious financial prospects (Barrowclough & Kozul-Wright, 2008). On the other hand, similar to many other industries, the structure of the sector tends to include a large number of small and often micro-sized firms accompanied by a small number of very large firms.

However, companies under the umbrella of the creative industries differ in many ways making generalizations about the creative industries difficult to reach. Subsectors that are rooted in the arts and heritage, such as music for instance, vary in terms of their business models, market approach, funding sources and many other criteria relative to subsectors such as architecture and advertising. Tangible resources used in the creation process can have greater importance, for instance in publishing, film and video production, or their value may have minimum importance in providing a service, such as in some cases of web design or even software development. Additionally, the profile and spatial dimension of creative activities varies across national economies implying the need for specific design and implementation of policy strategies (Boix et al, 2016).

Still, the creative sector has the potential to contribute to economic, social, cultural and sustainable progress in both developed and developing countries through promoting economic diversification, innovation, employment of women and youth, social inclusion of minority groups and positive influence on quality of life in general. Moreover, the creative sector is strongly linked to and sometimes overlaps with other economic activities creating synergies that represent a strong foundation for developing a national economy. The tourism industry should be singled out and noted as one such industry with a high potential for a substantial level of engagement with the creative sector. For instance, software and digitalization has had revolutionary impact on many aspects of the tourism industry and in turn creating innovative business models (Sandell and Skarveli, 2016). Furthermore, advertising and broadcasting play important role in expanding to new markets, while architecture, arts and crafts shape the perception of a place and add to its uniqueness. Strengthening the innovation capacity of tourism sector through cooperation with creative sectors can positively its performance in both new product development and enhancement of current products (Rogerson, 2016).

The need to better understand the creative sector and provide policy recommendations is evident as markets themselves are not always good at providing an optimal environment for creating a competitive advantage for entities existing in such spaces (Bae and Yoo, 2015). Barrowclough and Kozul-Wright, 2008). The notion of a creative sector in Croatia is quite new. The first mapping of the creative and cultural industries in the Republic of Croatia was published in 2015 which marked a certain starting point and a call for further research into this field (Bakarić et al., 2015).

An analysis of financial statements, the main method used in this study, provides a comparison of creative subsectors based on preselected criteria. It considers historical and present data and reflects both the internal factors (strategy decisions and business model characteristics) and external factors (economic conditions and market changes) that influence an enterprise's performance. So far, researchers have paid very little

attention to the financial analysis of SMEs operating within the creative industries. Hence, this paper serves as a guide for similar future studies.

2. METHODOLOGY

2.1. Characterising the Creative Industries and its Variables

This study includes financial data from 2014 of the entire population of Croatian SMEs (totalling 8,088) operating within the creative industries. The data was provided by the Croatian Financial Agency (FINA) in the form of annual financial statements which were then used to extract 16 financial ratios and measures depicting various business strategies and models such as decisions on leveraging and financing, liquidity, asset management and profitability. The indicators were chosen based on the most common practices in analysing financial statements and adapted to the specific characteristics of SMEs operating within the creative industries. Furthermore, the ratios were grouped into four categories relating to liquidity, leverage, turnover and profitability (see Appendix for a full list of ratios and formulas).

For the purpose of this study, SMEs within the creative industries were segmented into eight subsectors according to HKU (2010). Two subsectors, books and press including software and video games, account for almost half of the sector (Table 1). It should be noted that only 4 out of 1926 enterprises in the software and video games subsector are registered for the video games business, all others belong to software development and programming. In addition to being the largest one, the software and video games subsector is most export orientated relative to the other subsectors and has recorded the highest share of intangibles in its structure of total assets. In the context of software development, intangible assets refer to licenses and patents (46%), intangible assets under development (42%), investments in R&D (11%) and other intangible assets (1%). Furthermore, what is noticeable is that the creative sector is dominated by micro-sized enterprises. In only two subsectors, the average number of employees exceeds ten and they are the electronic media subsector (television, radio and web portals) and the books and press subsector. In addition, the electronic media subsector leads in average total sales revenues relative to other subsectors.

Table 1: Population of SMEs within the creative industries (a total of 8,088 enterprises)

Subsector	No. of SMEs (% of sector)	Ø no. of employees	Ø sales (HRK)	% of revenue coming from int. markets	Intangible assets as a % of total assets
Advertising	1483 (18%)	2.64	2,223,438	17.88%	1.22%
Architecture	977 (12%)	2.36	718,321	10.46%	0.77%
Publishing and press	1915 (24%)	12.71	4,457,307	6.38%	1.62%
Design	796 (10%)	1.44	414,927	12.40%	1.02%
Electronic media	395 (5%)	13.41	6,430,123	2.31%	7.55%
Film and video	360 (4%)	2.54	2,671,014	18.81%	4.38%
Music	236 (3%)	2.38	1,340,861	16.48%	5.32%
Software and video games	1926 (24%)	4.61	2,312,518	27.84%	10.26%

Source: Financial Agency (FINA)

As previously mentioned, the definition of the creative industries highlights intellectual property as a fundamental component of the enterprises in the sector. However, this fact is not clearly evident in their financials. Only 14.7% of all SMEs in the creative industries (or 1,190 enterprises) have reported possessing some form of intellectual property in their financial statements. Most of those SMEs are from the following subsectors: software (28%), books and press (26%), advertising (14%) and architecture (14%).

2.2. Financial statement analysis of creative industries sub-sectors

The financial statements of an enterprise represent a standardized and comparable basis for analysis and are considered a valuable source of information. Key performance indicators (KPIs) are calculated based on the financial statements of SMEs in the creative industries and are presented in Table 2, whereas formulas used for calculating the ratios are given in the appendix.

Though analysing financial statements is one of the most common forms of business analysis, rarely is it conducted at an industry subsector level. Given that SMEs are more vulnerable to the changes occurring in internal and external environments relative to large enterprises, more data variance and a stronger influence of outliers in measuring the central tendency is expected. This is also true for the results of financial analyses in this paper. Standard deviation, as a measure of dispersion, is quite high for a majority of the ratios calculated in the paper. While a simple comparison of mean values may be misleading, the results of the analyses can be used to draw conclusions at the more general level by comparing subsectors, rather evaluating the absolute values of financial indicators.

The first group of KPIs indicates levels of liquidity for the selected subsectors. Liquidity represents the ability of an enterprise to meet its financial obligations with its current available (or liquid) assets. As such, liquidity is a prerequisite for business continuity and is one of the most sensitive areas of business for many small and micro enterprises. Lower median values in comparison to mean values for the indicators, coupled with high standard deviation values, points to the presence of outliers. None of the subsectors seem to show extremely high or extremely low liquidity levels relative to other subsectors. In terms of asset structures, the portion of current assets in total assets remains similar across all subsectors. However, software and video games seem to experience less liquidity problems relative to other subsectors as measured by the main liquidity indicators such as current ratio, quick ratio and working capital. Following in their footsteps is the publishing and press subsector with slightly lower values of quick ratio, which points to higher values of inventory in their balance sheets. With the exception of the publishing and press subsector, all other subsectors have a relatively small portion of inventory in their balance sheets given that the current ratio values and the quick ratio values do not differ significantly.

Leverage indicators indicate the capital structure of an enterprise and specify the portion of total assets financed through debt and equity. Key performance indicators in this group are also strongly influence by outliers. In addition, another distinguishing characteristic of SMEs in the creative industries is that 2,135 of them (26.4%) reported

negative values of equity in their balance sheets. There are several possible explanations for this but the most probable one is accumulated losses from prior years. It is possible for an enterprise to continue operations regardless of reporting ongoing negative values in its balance sheet given that they primarily reflect the accounting method. The software and video games subsectors seem to be the least leveraged of all subsectors. All other subsectors display a deceptively similar capital structure.

An analysis of turnover ratios reveals several nuances among the subsectors. The software and video games subsector appears to be the most efficient subsector in terms of utilizing its total assets and long-term assets to generate revenues. If an enterprise is characterized by low asset intensity (which is often the case in software development, advertising and architecture), the values for total asset turnover and long-term asset turnover are higher.

Table 2: Key performance indicators (KPIs) of SMEs in the creative industries in 2014

		Liquidity KPIs			
		Current ratio	Quick ratio	ST asset/ total asset	Working capital
Advertising	mean	11.45	11.27	0.78	74,427.62
	median	1.18	1.12	0.93	13,172.00
	stdev	116.66	116.63	0.29	3,680,230.44
Architecture	mean	8.41	6.35	0.76	139,182.87
	median	1.45	1.37	0.89	18,275.00
	stdev	90.95	70.40	0.29	1,326,611.33
Publishing and press	mean	11.94	6.51	0.76	477,261.71
	median	1.32	1.03	0.91	27,221.00
	stdev	204.88	50.75	0.29	7,908,294.66
Design	mean	9.74	9.46	0.73	- 23,225.98
	median	1.00	0.84	0.87	23.00
	stdev	90.44	90.42	0.32	1,243,689.65
Electronic media	mean	34.43	34.20	0.74	504,075.23
	median	0.98	0.95	0.86	- 537.00
	stdev	631.08	631.08	0.29	15,864,860.14
Film and video	mean	4.93	4.71	0.72	395,343.26
	median	1.23	1.16	0.84	16,407.00
	stdev	19.24	19.18	0.30	6,394,527.48
Music	mean	2.82	2.45	0.73	311,856.39
	median	1.13	0.86	0.86	10,396.00
	stdev	6.10	6.04	0.31	2,450,669.26
Software and video games	mean	12.10	11.96	0.79	583,466.07
	median	1.91	1.80	0.91	35,220.50
	stdev	149.00	148.99	0.27	6,301,297.70

Table 2: Key performance indicators (KPIs) of SMEs in the creative industries in 2014 (continued)

		Leverage KPIs			
		Debt ratio	Equity ratio	Debt-to-equity	LT bank loans / total asset
Advertising	mean	459.11	-458.13	5.93	0.04
	median	0.77	0.20	0.39	0.00
	stdev	11,783.26	11,783.28	184.64	0.18
Architecture	mean	59.68	- 58.70	1.00	0.03
	median	0.60	0.37	0.47	0.00
	stdev	987.69	987.69	26.29	0.13
Publishing and press	mean	675.03	- 674.10	5.03	0.08
	median	0.66	0.31	0.56	0.00
	stdev	18,093.47	18,093.47	145.57	0.68
Design	mean	28.93	- 27.95	36.38	0.05
	median	0.81	0.17	0.28	0.00
	stdev	385.01	385.01	801.34	0.47
Electronic media	mean	207.43	- 206.47	15.22	0.09
	median	0.84	0.14	0.26	0.00
	stdev	3,133.98	3,133.98	209.38	0.59
Film and video	mean	347.87	- 346.92	0.45	0.05
	median	0.65	0.28	0.45	0.00
	stdev	6,350.44	6,350.44	62.60	0.21
Music	mean	2.23	- 1.25	1.05	0.03
	median	0.77	0.20	0.31	0.00
	stdev	5.48	5.47	33.16	0.13
Software and video games	mean	86.11	- 85.22	2.61	0.09
	median	0.46	0.52	0.36	0.00
	stdev	2,299.33	2,299.34	85.13	2.35

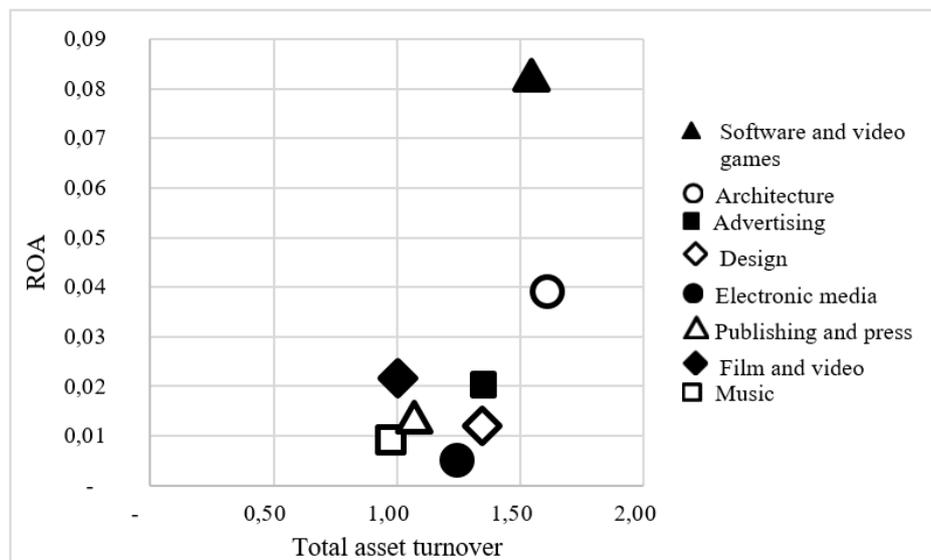
		Turnover KPIs			
		Total asset turnover	Long-term asset turnover	Current asset turnover	Inventory turnover
Advertising	mean	21.26	61.09	24.35	227.59
	median	1.35	9.03	1.77	12.16
	stdev	478.03	226.43	480.51	1,058.68
Architecture	mean	37.07	345.06	40.01	628.59
	median	1.61	9.80	2.27	18.50
	stdev	1,061.08	8,044.28	1,064.18	4,153.74
Publishing and press	mean	34.07	379.51	33.82	129.65
	median	1.06	5.53	1.45	5.93
	stdev	976.65	10,631.78	959.50	1,963.04
Design	mean	22.24	79.30	26.02	106.00
	median	1.35	5.82	1.89	7.82
	stdev	532.28	535.92	535.51	801.19
Electronic media	mean	3.05	34.00	4.16	128.93
	median	1.27	7.32	1.93	20.05
	stdev	12.83	92.89	13.38	261.00

		Turnover KPIs			
		Total asset turnover	Long-term asset turnover	Current asset turnover	Inventory turnover
Film and video	mean	2.47	83.92	5.16	157.36
	median	1.00	4.78	1.46	15.36
	stdev	7.63	480.80	26.64	568.70
Music	mean	1.76	36.55	2.77	252.20
	median	0.97	3.95	1.39	3.49
	stdev	3.85	110.34	5.21	1,815.87
Software and video games	mean	175.17	59.36	53.44	2,395.65
	median	1.56	12.06	2.06	21.54
	stdev	6,331.54	375.60	1,475.08	32,676.80
		Profitability KPIs			
		ROA	ROE	ROS	Net profit margin
Advertising	mean	- 85.83	8.36	1.45	- 197.56
	median	0.02	0.23	0.03	0.02
	stdev	6,825.20	340.90	88.29	2,927.29
Architecture	mean	3.68	26.83	- 0.15	- 861.50
	median	0.04	0.20	0.04	0.03
	stdev	957.93	834.94	3.66	23,450.55
Publishing and press	mean	- 716.30	- 14.92	- 1.56	- 212.90
	median	0.01	0.12	0.02	0.02
	stdev	27,182.56	663.13	45.18	3,507.33
Design	mean	0.51	- 0.17	- 1.27	- 207.25
	median	0.01	0.21	0.02	0.01
	stdev	165.65	10.24	13.58	2,615.83
Electronic media	mean	- 156.25	0.37	- 0.61	- 76.10
	median	0.01	0.13	0.01	0.01
	stdev	2,180.44	3.28	4.25	742.08
Film and video	mean	- 13.53	- 10.81	- 1.31	- 391.01
	median	0.02	0.20	0.04	0.02
	stdev	212.93	210.49	8.43	5,503.69
Music	mean	- 0.09	- 0.21	- 0.18	- 970.91
	median	0.01	0.04	0.02	0.02
	stdev	0.60	4.20	1.29	6,515.02
Software and video games	mean	- 114.20	0.99	- 32.03	- 57.95
	median	0.08	0.31	0.06	0.05
	stdev	4,495.91	16.23	1,271.18	626.93

On the other hand, the film and video subsector as well as the music subsector have a higher asset intensity and therefore lower turnover ratios. Furthermore, the inventory turnover ratio reflects the proportion of inventory in the current asset structure. Subsectors with a higher portion of inventory record lower turnover values which is a sign of lower efficiency in asset management.

Profitability analysis points to more similarities than differences among subsectors. Low median values and negative mean values indicate the presence of exceptionally low net profits and even annual losses are evident in all subsectors. However, the measure profitability together with turnover ratio provides an additional insight into the overall performance of the subsectors (Figure 1).

Figure 1: **Profitability and efficiency indicators of the creative industries subsectors**



According to the Figure 1, the software and video games subsector appears to have superior performance relative to all other subsectors. Its ability to generate profits coupled with efficient asset management indicates the highest growth potential. Furthermore, SMEs in the architecture subsector also seem to stand out in regard to growth prospects, whereas all other subsectors tend to cluster around similar low values for profitability and asset efficiency.

3. IMPLICATIONS AND FURTHER RESEARCH

The aim of this study is to compare SMEs within the creative industries based on information provided in annual financial statements. The novelty behind this approach is that it applies a standard business analysis method – analysis of financial statements – to the industry subsector as a unit of analysis. The focus was not on exploring absolute values of financial indicators derived from the financial statements, but on comparing the subsector performance in four areas of business: liquidity, capital structure, assets structure and profitability. Furthermore, the creative industries in Croatia has only recently captured the interest of scholars and policy makers. Therefore, this study provides preliminary empirical evidence for future studies. Finally, our analysis has

included the entire population of SMEs in the creative industries which provides a comprehensive perspective.

The results show mixed support for initial expectation in terms of diversity of balance sheets and structure of income statements. The financial statements across all subsectors seem to follow a similar pattern. This is the case also in asset structures and capital structures which may be a result of the fact that the creative industries are a human-driven, not an asset-driven sector. It may also be a reflection of influences from external environments on micro and small enterprises within the creative industries. Even in our more detailed approach that focused on specific areas of business, the differences among subsectors are relatively small. However, despite all this, the software and video games subsector shows superior performance relative to the other subsectors, and therefore has been singled out as the propulsive and most promising sector of the creative industries in Croatia in terms of financial performance.

The study has certain limitations that should be noted. The first limitation relates to the quality of data. The methodology covered the entire population of SMEs, including all outliers. Divergence between two measures of central tendency (mean and median) as well as high standard deviation values hinder the analysis. Removing some enterprises from the population in order to obtain more evenly distributed data would certainly improve the interpretability of the results, but it would also reduce the amount of available information. Furthermore, justifying the exclusion of some enterprises is difficult given the number of anomalies in the data: a high portion of enterprises with negative equity, extremely small values of long-term assets and even unbalanced balance sheets. The second limitation relates to classifying SMEs within a subsector. It is a valid assumption that some enterprises have changed or modified the focus of their core business but that change has not been reflected in the NKD code (the Croatian equivalent to NACE) in the official register. For instance, an enterprise can be registered primarily for web advertising and design (the advertising or design subsector) but eventually move into programming (the software and video games subsector) without changing its primary NKD industrial class.

Based on the theory and empirical results of this study, we provide certain recommendations on the focus of future studies. First, a possible aim of future studies is to identify the best practices of a particular subsector by focusing only on selected subsectors. The creative industries is a popular concept, but may not be useful for research purposes given that observing the entire sector will detect some differences, but outliers will be collapsed. Perhaps, it is these outliers that should attract scholars when searching for best practices among SMEs in the creative industries. The second recommendation is to focus on exploring the role of contingency factors and market conditions in determining the performance of the creative industries. A comparative analysis of privately-owned large and small or micro enterprises in this sector may yield useful insights leading to a better understanding of the sector. Finally, creative industries represent a source of innovation that many other sectors can benefit from. Creation of stronger relationship between SMEs in creative industries and tourism sector has a potential to positively influence the growth prospective of both sectors.

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APPENDIX

Ratio	Formula
<i>Liquidity KPIs</i>	
Current ratio	current asset/current liabilities
Quick ratio	(current asset – inventory)/current liabilities
ST assets/total assets	current asset/total assets
Working capital	current asset – current liabilities
<i>Leverage KPIs</i>	
Debt ratio	total liabilities/total asset
Equity ratio	equity/total asset
Debt-to-equity ratio	total liabilities/equity
LT bank loans/total asset	long-term bank loans/total asset
<i>Turnover KPIs</i>	
Total asset turnover	total revenues/total asset
Long-term asset turnover	total revenues/long-term asset
Current asset turnover	sales/current asset
Inventory turnover	sales/inventory
<i>Profitability KPIs</i>	
ROA	net profit/total asset
ROE	net profit/equity
ROS	net profit/sales
Net profit margin	net profit/total revenues

Marina Stanić, PhD, Assistant Professor
J. J. Strossmayer University of Osijek
Faculty of Economics in Osijek
Trg Lj. Gaja 7, Osijek, Croatia
Phone: +385-31-224400
E-mail: marina@efos.hr