

## ENTERPRISE & SKILLS AGENCIES REVIEW: PHASE TWO SUBMISSION

### Summary

- The Royal Society of Edinburgh (RSE) wholeheartedly supports the underlying aim of the Scottish Government to enhance Scotland's economic performance and to improve its standing in international comparisons of performance indicators.
- To help achieve this objective the RSE believes that there is a strong case for the development of an overall Industrial & Innovation Strategy. This will need to be tailored specifically to the Scottish environment and circumstances. It should complement and augment the initiatives being taken by the UK Government, which published in January 2017 its Green Paper "Building our Industrial Strategy" and initiatives of the European Union.
- As well as addressing the opportunities, challenges and priorities specific to Scotland, such a Strategy should take full account of important current developments – for example, the likely effects of the decision of the UK to leave the European Union and the role that the constituent bodies within UK Research & Innovation will play in supporting research & innovation in Scotland.
- We believe that significant changes to the structure and governance of the public sector infrastructure supporting enterprise and skills in Scotland should not precede, but should rather be informed by, a new Scottish Industry & Innovation Strategy.
- The RSE does not however believe that the Scottish Government has made an adequate and persuasive case for the abolition of the independent Boards of the four agencies under review – Scottish Enterprise, Highlands & Islands Enterprise, Skills Development Scotland and the Scottish Funding Council.
- It is not clear that the proposed structural and governance changes will of themselves achieve better alignment and co-ordination across the enterprise & skills agencies.
- Structural and governance changes of the type and significance of those which have been proposed by Ministers should be the subject of primary legislation.
- The proposals of the Crerar report do not fundamentally address the concerns of the RSE, and the proposed arrangements are only for the establishment of "Delivery Boards" accountable to the Strategic Board.
- The Crerar Report was predicated on the establishment of the Strategic Board, but far from "decluttering the landscape" the structures set out in the Crerar Report add to the complexity.
- In the meantime while there is continued uncertainty, the Scottish Government should allow the Agencies to replace key staff and the appointments of board members due to retire should be extended, to maintain good governance and operational effectiveness.

### Introduction

- 1 The Royal Society of Edinburgh (RSE) notes the publication of the Scottish Government Phase One Review of Enterprise & Skills Agencies<sup>i</sup>. The RSE made a submission as part of the Review<sup>ii</sup> and also provided a briefing<sup>iii</sup> to members of the Scottish Parliament Education & Skills Committee in advance of an evidence session with the Cabinet Secretary Keith Brown MSP.
- 2 The RSE also notes the recent Publication of the report by Lorne Crerar on Proposals on Governance and the Creation of a Strategic Board.

- 3 We welcome the opportunity to provide a further submission to the Scottish Government as part of Phase Two of the Review. In this Advice Paper we will respond to issues raised in the Phase One recommendations, comment on developments since the publication and address the issue of the need for a comprehensive renewed Industrial & Innovation Strategy for Scotland.
- 4 The RSE would wish to record the fact that it is difficult for external bodies to engage with Phase Two of the Review due to a lack of transparency of the internal work of the process and the lack of clarity on whether the recommendations of the Crerar Report are now accepted as Government policy.
- 5 We further believe that due to the extended nature of the Review process it is essential that the Government allows the Agencies to replace key staff who have left and extend the terms of board members whose term of office is coming to an end. This is essential to maintain the operational effectiveness of the Agencies.
- 6 This Advice Paper was prepared by a working group of the RSE chaired by our Vice President Professor Iain Gray and approved by the Council of the RSE.
- 7 The RSE receives circa £2.5 million grant in aid from the SFC to deliver an outcome agreement. The RSE also delivers Enterprise Fellowship programmes with support from Scottish Enterprise and the UK Research Councils. In 2016/16 the income for these programmes totalled just over £1 million.

## Enterprise & Skills Review: Phase 1 Report

- 8 The RSE supports the aspirations of the Scottish Government to improve Scotland's ranking to the top quartile of OECD countries in terms of productivity, equality, wellbeing and sustainability. We note that the Government also sets out a principle that the review should be "driven by evidence, to listen to the views of users and put forward proposals that respond to their needs."
- 9 The Phase One Report recommended the establishment of a new "Scotland-wide statutory board to co-ordinate the activities of HIE and SE,

including SDI, SDS and the SFC." The Report itself did not explicitly indicate that this would involve the abolition of the Boards of the existing agencies, nor was this implied, although statements subsequently by Ministers clearly indicate that this is their intention.<sup>iv</sup>

- 10 The RSE has grave reservations about the intention to abolish the existing Boards. Amongst other factors, we note the serious concerns raised in the Highlands and Islands over the proposal to abolish the HIE Board, as expressed by the vote passed in the Scottish Parliament on the 18th January in support of a motion urging the Scottish Government to retain the Board of HIE. We also believe that the removal of an arms-length, independent Board for Further and Higher Education would inevitably undermine the independence of the university sector from Government, and would introduce new uncertainties for Scotland's Colleges, which have already experienced a recent period of significant change.
- 11 We are concerned that, rather than furthering the aim of the Government to improve Scotland's economic performance, abolition of the Boards could have the opposite outcome by undermining one of the most important engines driving innovation in the Scottish economy – our higher education & publicly funded research system. The role of SFC in engaging with funding bodies such as the UK Research Councils, major research charities and European bodies is a crucial one. We do not believe that the evidence base underpinning the case for the Scottish Government's proposals to abolish the Boards is adequate.
- 12 Greater integration and better alignment of agendas and priorities across economic development, tertiary education and skills development would clearly benefit the Scottish economy. Efforts in this direction are important, and worthy of encouragement and support. However, the creation of a highly centralised body with a vastly complex and diverse remit is not considered likely to be helpful in meeting this objective – indeed, it might well be counter-productive. The following points are put forward for consideration:

- Most Boards (whether of companies, public sector bodies or other entities) find that the responsibilities of setting a clear strategic direction, balancing the interests and priorities of different sets of stakeholders, allocating resources accordingly and maintaining high standards in other important areas of corporate governance amount collectively to a very significant challenge even in the context of a single organisation. The proposition that a single Board could discharge these responsibilities effectively across a group of up to six complex organisations, functioning in diverse operating environments and seeking to achieve very different categories of objectives and outcomes, seems lacking in credibility.
  - It must be assumed that a single over-arching Board of the type which has been suggested by Ministers would be responsible for making decisions on allocation of resources across all of the areas of its responsibility – otherwise it would be a Board in name only, without the authority to pursue fundamental strategic objectives as it saw fit. This opens up the prospect of such a Board making decisions on allocation of resources between (for example) university teaching in scientific and technical disciplines, the infrastructure to support growth of businesses in the Western Isles and the maintenance of overseas trade offices in selected foreign locations. This would seem to have the effect of transferring significant areas of decision making from the purview of elected politicians to that of an executive body.
  - The scope, diversity and complexity of the issues which would fall within the ambit of the responsibilities of a Board of the type proposed would be enormous. It is very difficult to conceive of a reasonably-sized group of people who could collectively bring to bear the range of experience, insight and understanding necessary to inform properly the strategic thinking and decision-making processes which would be required of it.
  - There seems to be little information available on the thinking regarding the structure and composition of the proposed Board (for example, the intended balance between executive and non-executive members) or on definition of the stakeholders in whose interests it would have a statutory duty to act. It would seem reasonable to expect that there would be an imperative to act according to some definition of overall high-level national priorities. That being the case, it bears pointing out that should, for example, the Chief Executives of the various bodies overseen become members of the Board, they might find themselves in conflicted positions on a fairly regular basis. Even if an entirely non-executive board were established, there would be a significant risk that its functioning would become preoccupied with vying for resources and priorities between the bodies it was supposed to be directing. To some extent, tensions of this type between these bodies are probably inevitable (and up to a point may indeed be healthy). The intention should be to ensure that as far as possible these tensions are harnessed and managed constructively to improve co-ordination of overall objectives and alignment of operational activities. It is not clear that the creation of a single over-arching Board would achieve this, and there are reasons to believe that it could lead to a considerable risk of damage to the Scottish economy.
  - To date the Scottish Government has not clarified whether the proposed new Board would be chaired by a Government Minister, or an independent chair. If it were to be chaired by a Government Minister this would further undermine the independence of the agencies involved.
- 13** It is suggested that a more deeply considered and imaginative approach would yield more effective outcomes. The starting point should not be a rearrangement of organisational structures, but the consideration at a fundamental level of issues including:
- What a modern society should expect of its tertiary education sector – in a holistic sense, including its economic, technical, cultural, philosophical and other roles.
  - How government and the public sector can interact most appropriately and effectively with private sector business in the interests of creating a more dynamic and prosperous economy.

- 14** There would appear to be scope for new thinking in these and related areas. The most appropriate and effective responses to current economic, social and other challenges, and the optimum design of the organisations and structures to deliver these responses, need to be rooted in common understanding and clarity of purpose on these issues.
- 15** Whatever structure is eventually implemented after Phase Two of the Review, the RSE is clear that there must be adequate protection for the independence of the Higher Education system and that this is best achieved by the retention on an independent SFC Board. It is our understanding that Universities Scotland have indicated to the Government the need for there to be a statutory non-Ministerial body for higher education.<sup>v</sup>
- 16** If the Scottish Government does intend to proceed with a model similar to that proposed in the Phase One Review Report, the RSE believes that this should only be done through the thorough scrutiny that would take place through a Parliamentary Bill. We do not believe that it would be appropriate to make such fundamental changes without primary legislation.
- 17** The recently released Crerar Report on “Proposals on Governance and the Creation of a Strategic Board” was clearly predicated on the establishment of the new Strategic Board (SB). It didn’t seek to provide an analysis of the ability of the new SB to achieve the step change in economic policy that the Scottish Government along with most people and organisations in Scotland also desire. The RSE contends that the answer to reversing Scotland’s economic underperformance will be found in harnessing the innovation and creativity that exists in our universities and businesses through their engagement in creating an inclusive Industrial and Innovation Strategy; rather than enforced structural and governance changes. Scotland remains a place of great creativity and the role of Government is to encourage and nurture that to convert more of the innovation into new and emerging businesses. There is little evidence to date as to how structural changes in publicly funded agencies will dramatically improve our economic performance.
- 18** In fact the complex series of sub-groups proposed to operate between the SB and the Enterprise and Skills agencies could even harm the performance of the agencies. In addition there is already one new NDPB proposed (the SB), with perhaps two more, so rather than decluttering the landscape for business to engage with the Enterprise Agencies these proposals could in fact make it a more complex system for the private sector to engage with.
- 19** The cost of running this new overarching structure has not been stated but it could become significant and will inevitably require funding. What is not clear is how such funds will be provided. It is also not yet clear whether the Agencies will have their budgets set by the Parliament through the annual Budget Bill, or whether the SB will have the power to vire funds between the Agencies.
- 20** The lack of clarity in the Crerar Report as to who should Chair the SB remains a concern and the RSE strongly recommend that if the Government continues with its plans to create the SB, its Chair should not be a Government Minister, but independent.
- 21** The RSE would also urge the Government to take cognisance of the two recent debates in Parliament on HIE and SFC. While Crerar recommends retaining Boards of the Agencies, these are described as “Delivery Boards”. To maintain the independence of the university sector in particular the Agency Boards need to be strong and independent of direct Government control.

## A Renewed Industrial & Innovation Strategy

- 22** In supporting the aspiration of the Scottish Government to improve Scotland’s economic performance, the RSE urge that a renewed Industrial & Innovation Strategy for Scotland is created. This would be far more helpful in supporting the aspiration than the organisational structural changes that the Review proposes.

- 23** Such a review should take full account of the potential impact of the UK leaving the European Union, considering what different models of future engagement may mean for the economy in Scotland. It should also take full account of the Higher Education and Innovation infrastructure changes within the United Kingdom, such as the proposed establishment of UK Research & Innovation (UKRI), which is currently going through its Parliamentary scrutiny at Westminster.
- 24** The availability of resources to support innovation in Scotland through UKRI should also be factored into consideration. The RSE notes the recently published Scottish Government Innovation Plan for Scotland<sup>vi</sup>. We are surprised that this Action Plan makes no explicit reference to the role of UKRI in supporting innovation, through the resources available to Innovate UK and the seven Research Councils. It is hoped that the proposed Industrial & Innovation Strategy will address this issue.
- 25** The RSE believes that the Scottish Government should commission a body of advisers to consider the full range of economic and policy levers that are available to promote innovation and economic development. This is far broader than the services provided by the Enterprise and Skills Agencies and should also consider issues including: infrastructure (utilities, transport & digital); education & skills; enterprise services; resources to support innovation, including UK & European; incentives to support private sector research & innovation; the availability of growth capital for emerging companies; high growth potential sectors; and the role of entrepreneurial education.
- 26** The RSE would be very willing to lead the work of a group established to provide advice on a new Industrial & Innovation Strategy for Scotland. In some of these areas we have already contributed ideas through reports on growth capital<sup>vii</sup> and entrepreneurial education<sup>viii</sup>. A background note on the evolution of industrial policy and strategy in the UK and in Scotland is included as an Annex to this paper.

## Annex

### *Development of Industrial Strategy in the UK and Scotland*

There has never been a consistent, coherent long-term strategy guiding overall policy relating to government interaction with industry in the UK. Where government intervention in industry has occurred to any significant degree over the last half century or more, it has largely been driven by short-term political pressures or expediency, or in some cases (eg. in areas of defence procurement) by other considerations such as national security. It has not been driven by any thought-through strategic approach to enhancing the relevance, performance or competitiveness of British industry even in its domestic market, far less internationally.

The late 19th and 20th centuries saw the rise and subsequent decline of UK companies as pre-eminent global players in manufacturing industries including railway engineering, shipbuilding, automotive and aeronautical engineering. The 1970s and 1980s saw the decline and in some cases the virtual demise of entire sectors of British manufacturing industry. The philosophy that seemed to dominate the political response to this appeared to consist partly of complacency or simply resignation (“we can’t compete in manufacturing with lower cost base economies”; “sunset industries”; “rust-belt industries”; etc.) and partly of a perception that it didn’t matter anyway (“our future lies in a service economy”).

This philosophy failed to recognise or foresee a number of factors, for example:

- The so-called “low cost-base economies” would not remain low cost-base for ever.
- Automation would change the economics of manufacturing significantly, reducing dependence on relatively unskilled labour and requiring increasingly sophisticated design, process and management capabilities.
- While the services demanded in a modern economy have undoubtedly grown in variety, complexity and value, people were not going to stop needing or wanting material artefacts. Global demand for physical products (including those of the “sunset industries”) has grown dramatically as living standards and disposable income have increased, and consumer expectations in terms of performance, reliability and value are now of a different order from those of thirty or forty years ago.

During the latter part of the 20th century a transformation of global manufacturing industry was taking place, while Britain to a large extent simply retired from the fray. Investment in new infrastructure and technical and managerial capabilities was woefully inadequate, and existing skills and experience were lost rather than being built on and updated. Successive governments over decades appeared to have no understanding of or even interest in the formulation of a coherent strategy to attempt to slow or reverse this decline of British industry.

There is a long history of political focus in the UK on scientific and technical innovation. In 1963, the then Labour Party leader Harold Wilson referred to the “white heat” of a scientific and technological revolution that he saw as shaping the British economy of the future. This and much subsequent policy thinking may have been something of a two-edged sword, in engendering a rather narrow view on the part of policymakers and others of the mechanisms by which science and technology generate economic impact. On the route to commercial and economic success, scientific research and technical proof of concept are of themselves, to borrow Churchill’s famous turn of phrase, not the end, nor even the beginning of the end. In fact, they are probably not even the end of the beginning.

Britain’s failure to derive the economic benefits that might have been expected from its outstanding scientific and technological achievements has now been the subject of debate for many years. References are regularly made to examples of British scientific or technical breakthroughs that have ultimately been exploited with significant commercial success and economic benefit – but not in Britain. Britain certainly has a distinguished record at the leading edge of many areas of science and technology, but there has perhaps not been a sufficiently clear recognition that this of itself does not automatically lead to commercial success.

End user purchasers (whether corporate or individual consumers) very seldom buy “leading edge technology” as such – they buy total products which may in some cases incorporate such technology, but also typically require and depend on a wide range of other capabilities, technologies and elements of infrastructure to bring them to market. These can range from product design and manufacturing process technologies and expertise through global distribution and logistics capabilities to international service and support infrastructures. All of this needs to be underpinned and driven by deep and detailed understanding of the characteristics and

behaviours of the markets involved, which may vary significantly in different regions of the world.

There has been a good deal of discussion over many years of the advisability of basing a national economic or industrial strategy on trying to “pick winners”, by which most commentators seem to have meant picking winning technologies, or possibly emerging industry sectors likely to experience significant growth. In either case, as long as these discussions are preoccupied with the technology involved rather than the capacity to deliver value into global markets in the form of total products as outlined above, they quite seriously miss the point. This is a recipe for repeatedly developing new technologies and then failing to exploit them by participating fully in the value chain from development to market.

There are also dangers in an over-preoccupation in industrial policy thinking with breakthrough or emerging technologies. In many industries and over long periods, maintaining a competitive market position calls more for sustained incremental improvements in product functionality, reliability and value than for the introduction of fundamentally new or disruptive technology. This again highlights the importance of encouraging and supporting existing established companies to keep developing their expertise and capability throughout the entire value chain and, where relevant, across geographies.

Any notion of trying to regenerate British industry along the lines on which it functioned half a century ago would be misguided. For example, the structure of the global automotive industry is now such that the concept of recreating an indigenous British volume car maker looks far-fetched. The global industrial landscape of today is vastly more complex, and in many ways fragmented and specialised, than that of fifty years ago. While this presents challenges, it also offers opportunities. Rather than thinking in terms of monolithic industry sectors, it is now more realistic to think in much more specialised and niche terms. For example, rather than considering the competitiveness of UK companies in car manufacture, it is now more relevant to consider competitiveness in, say, the market for lightweight composite engine components or software for driver information displays or leather for car seats. A focus on building companies that are amongst the very few players capable of competing globally in very specialised niche markets would seem to be one realistic and viable element of an industrial regeneration strategy.

This is perhaps even more relevant to Scotland than to other parts of the UK. The thinning of the population of large indigenously-controlled Scottish companies has been a concern for many years. During the 1970s and 1980s the policy response focused largely on attracting inward investment by multinational companies. The hard lesson from this era was that it is difficult to anchor such operations locally over the long term. Subsequently, economic development policy has placed greater emphasis on the creation of new businesses, particularly where these have a strong technology dimension. This has yielded some significant successes, but few that have led to the emergence of truly substantial international companies whose locus of overall control has remained in Scotland. The environment which has evolved in Scotland has proved reasonably effective at creating new companies and supporting their early growth, but less so at scaling them up.

One part of the Scottish business base which has been the subject of relatively little policy focus has been the population of indigenous medium-sized businesses. There may have been a perception that these businesses form a fairly small proportion of the Scottish corporate base. It may also have proved relatively difficult for the economic development infrastructure in Scotland to interact productively with them. Nonetheless, there are significant numbers of successful businesses with established market positions and trading histories (albeit in many cases towards the smaller end “medium-sized” by most definitions). Some of them offer excellent examples of imaginative growth strategies, and collectively they represent an important body of entrepreneurialism and experience. It would seem worth considering carefully how this might be stimulated and encouraged to even greater effect. This is not to underestimate the challenges involved – stimulating new strategic thinking and encouraging change and development in mid-sized companies may require more complex and demanding interventions than supporting early-stage companies. However, given the right circumstances, the potential for economic impact may be greater and the risk of failure lower.

The publication in January 2017 of the UK Government’s Green Paper “Building our Industrial Strategy” sets the scene for a new approach to the relationship between industry and government. This will call for a carefully considered and co-ordinated response from Scotland, involving the development of a complementary strategy designed to address the specific characteristics of the Scottish industrial base and its particular challenges and opportunities.

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