

RSE RESPONSE TO THE SCOTTISH GOVERNMENT CONSULTATION ON THE PROPOSED GRAND CHALLENGES FOR THE SCOTTISH NATIONAL INVESTMENT BANK

The Royal Society of Edinburgh (RSE) has engaged extensively with the Scottish Government and the Scottish Parliament throughout the development of the Scottish National Investment Bank (the Bank). Through a range of advice papers, briefings roundtables and evidence sessions, the RSE has consistently voiced its support for the Bank and supported the passing of the enabling Act by the Scottish Parliament in January 2020.

The Bank will adopt a mission-oriented approach, and the proposed missions are outlined within the consultation as, Climate Emergency, Place-based Opportunity, and Demographic Challenges. While the mission-oriented approach is supported in principle, the RSE has consistently encouraged a gradual approach to the adoption of missions, starting with one clearly defined mission to avoid the resources of the Bank being spread too thinly.

We are concerned that the proposal that the Bank focus on three valuable but distinct and very challenging, large-scale missions will make it difficult for the Bank to make significant impact in any of these areas, particularly given the proposed level of capitalisation of £2bn over ten years (£200m per year).

We believe it would be preferable that the Bank focus on one mission to begin with. This will provide it with a clear focus in which to frame its objectives and evaluation criteria. This will allow the Bank's Board and staff to gain experience on how best to engage with mission-oriented funding. Of the three missions outlined in the document, the Climate Emergency mission, as the first to be proposed, should be the Bank's immediate priority, before gradually adopting the others.

Whether the Scottish Government decides to start with one mission or all three, it will be vital clarity is provided over where the Bank chooses to invest within each mission area, and how it can add value. Moreover, it will be important vital for the Bank to engage with other government agencies, local government, and the private sector to complement existing investment and minimise the risk of duplication and waste.

The Scottish Investment Bank (SIB) has experienced relative success in investing in companies that have the potential for high growth across all sectors. As the Bank will subsume the SIB, we would expect the SIB to invest in the mission area(s) chosen, alongside investment in companies from all sectors. It will be important to ensure that the organisational setup and networks of the SIB are not destabilised as it is integrated with the Bank.

The growth of the tech sector, and digitalisation, will have a significant impact on the three proposed mission areas. The recent report by Mark Logan presents recommendations on how to grow the sector. As the Scottish Government has committed to implementing these recommendations, and with some focusing on the financing of companies within the sector, they along with the Board of the Bank, must consider what role, if any, the Bank can have in helping to implement the recommendations and achieve success in growing this sector.

Introduction

- 1 The Royal Society of Edinburgh (RSE), Scotland's National Academy, has welcomed and supported the development of the Scottish National Investment Bank (the Bank) since plans were first proposed in 2017. We have outlined our views and recommendations in responses to previous consultations in 2017,¹ 2018,² and 2019.³ This response has, like previous submissions, been led by the RSE's Economy and Enterprise Committee (EEC) through a subgroup of Fellows, members of the EEC, and members of the Young Academy of Scotland.
- 2 With the passing of the Bill for the Bank in January 2020, we welcome the opportunity to provide our views on the 'grand challenges' (missions) which have been proposed for the Bank. We look forward to continuing to engage with the Scottish Government on the development of the Bank and we would like to take the opportunity to discuss our comments further with government and the Bank's Board should this be considered useful.
- 3 The consultation presents three proposed investment areas with questions: Climate Emergency, Place-based Opportunity, and Demographic Change, which assume that these three proposed missions are accepted. The RSE has previously commented on mission-oriented funding, suggesting that the Bank should adopt a gradual approach by choosing – at least initially – one clearly defined mission rather than several broad challenges.

Considerations and Comments

General Comments

- 4 The RSE supports the concept of a mission-oriented Bank. There are examples of other national development banks which operate successfully using a mission approach. In the UK, the British Business Bank and (until its sale) the Green Investment Bank provide valuable experience from which the Bank can draw.
- 5 It is notable that these banks have a single, clearly defined mission, against which their performance can be measured and assessed. The consultation document accepts that there should be a limit to how many missions the Bank should have, and this is set at three. However, even three missions – particularly when they encompass very large, challenging and cross-cutting policy areas – could prove to be unwieldy. Moreover, in addition to the resource challenges of operating across three such wide-ranging missions, there will be opportunity costs in the potential trading off between the gains that can be made by investing in one mission (e.g. climate emergency) against those that would have arisen had investment taken place in another mission (e.g. demographics challenge).
- 6 Given the Bank's proposed capitalisation of £2bn over 10 years – equating to £200m a year – while investment from the Bank can leverage private sector investment there is a clear mismatch between the scale of ambition and the resource available. We know of no similar bank anywhere in the world which has been given such a range of large-scale missions against which it is expected to deliver. This highlights the challenge the Bank faces in investing in three vast missions.
- 7 Therefore, we advise the Bank to start with a narrower focus in its formative years, which could mean choosing one mission. This approach will provide the opportunity for the Bank and its staff to gain invaluable experience on how best to engage with missions while continuing to meet other obligations like financial return.
- 8 We are surprised that the consultation document makes no mention of investing in new and innovative companies with the potential to grow and provide prosperity and employment. While this may be achieved through investment in each mission, it is the explicit role of the Scottish Investment Bank (SIB) to invest in innovative and potentially high growth companies regardless of sector. Since the Bank is to subsume the SIB, we hope that it will continue and expand its work in supporting all potential high growth companies, regardless of whether they are covered by the overarching missions.
- 9 The SIB has been successful in establishing partnerships and networks with private investors and public agencies, while investing in start-ups and spinouts across the country. This activity has been focused on potential high-growth companies in Scotland and it should continue to be a key plank of the Bank's activities, particularly as it aims to make a positive return on investment in its early years. Therefore, it will be important that the successful activity of SIB is not lost within the missions of the Bank. It would be unfortunate if institutional reorganisation destabilised the SIB, which should maintain its current focus within the organisational structures of the Bank.

1 Royal Society of Edinburgh. 2017. 'Scottish National Investment Bank'. URL: <https://www.rse.org.uk/wp-content/uploads/2017/11/RSE-Response-to-Scottish-Government-Scottish-National-Investment-Bank-Consultation-API7-27.pdf>

2 Royal Society of Edinburgh. 2018. 'Scottish National Investment Bank 2018'. URL: https://www.rse.org.uk/wp-content/uploads/2018/11/API18_19-3.pdf

3 Royal Society of Edinburgh. 2019. 'Scottish National Investment Bank 2019'. URL: <https://www.rse.org.uk/wp-content/uploads/2019/05/API19-05-2.pdf>

- 10** A key role where the Bank could provide added value is in market creation and addressing market failures by leading investment in ventures which are not likely to be profitable in the short-term and where private capital is unavailable. These investments will have a longer financial return period and higher risk, a profile which might not align with chapter 58 of the financial memorandum states that the Bank will aim to cover its operational costs from 2023/24. Therefore, ‘quick win’ investments may be needed, and the more mature investment portfolio of the SIB could help towards achieving this target.
- 11** Whatever mission(s) the Bank chooses to focus on, it is clear that it will have an important role to play in supporting Scotland’s recovery from the COVID-19 pandemic. Through its investment in missions, a main objective should be creating new high skill and high value jobs that will improve productivity. This will be important in addressing the increased unemployment that is likely to result from the pandemic. The Bank may also choose to focus on creating new jobs for younger people to reduce the potential damage of generational scarring. While this may be inadvertently achieved through investment in the missions presented, there may be a need to include a specific objective around this within the final mission(s).

Proposed Mission Areas

- 12** We recognise that the missions were chosen because they are the biggest long-term challenges to the Scottish economy and society, and it is likely that the threats they pose will be exacerbated by the pandemic. However, the description of each area is very general and wide-ranging and greater clarity is needed from the outset, not only in terms of what the Bank will invest in, but also what it will not invest in. Key questions relate to how will the Bank provide added value and meet the objectives in these areas compared to other policies? and how will it differentiate itself from the private sector and other government agencies which are already active in these areas and avoid duplication?
- 13** Furthermore, it is not clear how the Bank will invest in the missions and how the missions will be developed at more than a schematic level. When deciding where to invest or setting a narrow focus within each of the proposed missions, the Bank may gain wider support and buy-in if it conducts engagement at a local level with communities and civic society or through citizens assemblies. We recognise, however, that the Bank cannot respond to every demand and must make its own investment choices if it is to avoid dissipating its energies and losing focus.

Climate Emergency

- 14** We have supported the choice of climate emergency as the initial mission of the Bank, with other missions being developed subsequently.
- 15** The decarbonisation and net zero ambitions and commitments, with predetermined timelines and targets, provides the Bank with a clear focus, and COP26 at Glasgow provides an immediate focus for action. However, while investment from the Bank may help drive and crowd-in investment in green technologies and processes, this will require a coordinated approach using a range of different policy levers, many of which are outside the Bank’s control. Financial incentives and taxation policy will be important in driving changes in investment practices towards environmental objectives and promoting more sustainable businesses and livelihoods. The identifiable need for the Bank to invest in this area indicates that as well as market failures, the current government policies are not as effective as one would hope.
- 16** The adoption of digital technologies could contribute to addressing climate change, promoting sustainability and regional inclusion. As the Logan Report suggests this is an area in which there is national capacity for growth as the market is not performing well. Investment in potential high growth companies in this area could help stimulate the market, achieve a faster return than other investments in this mission area, and meet some of the recommendations set out in the Mark Logan Report on technology business sector.⁴

Placed-based Opportunity

- 17** Existing regional inequalities across the UK and within Scotland are likely to get worse due to the impact of the COVID-19 pandemic. However, other government departments, agencies and local authorities already investing in these areas have longer experience, more expertise and greater resources than the Bank will be able to command. Therefore, if this mission is one of those chosen, the Bank should adopt a focus (within a sector or project) within it where it can clearly demonstrate that it will add value.
- 18** The Building Scotland Fund is a precursor to the Bank, and it will be incorporated into its operation. This fund was intended to invest in the housing and commercial market to increase social housing and attract further investment into the market. However, its activities have been criticised.⁵

⁴ Logan, M. 2020. ‘Scottish technology ecosystem: review’. URL: <https://www.gov.scot/publications/scottish-technology-ecosystem-review/>

⁵ Scottish Building News. 2020. ‘Only 700 Affordable Homes Delivered Building Scotland Fund Despite £100m spend’. URL: <https://www.scottishhousingnews.com/article/only-700-affordable-homes-delivered-building-scotland-fund-despite-100m-spend>

- 18** Once incorporated, it is expected that the Bank will continue to invest in housing. However, investment in social housing and private housing works well in Scotland through existing models within housing associations and local government, which have a good understanding of local needs and issues and established access to capital markets. They also have a good record in delivering social inclusion. Therefore, further investment into the housing market should be delivered through the housing associations and local government rather than the Bank.
- 19** Instead, the Bank may be better placed to invest in green projects which reduce residential carbon emissions and link to the climate emergency mission or industrial and community projects that will help provide greater employment opportunities. This could include, for example, investing in high growth companies or in industrial hubs in communities which have high rates of multiple deprivation. This type of support can help to attract further investment into these communities. Investing in regions will present the Bank's Board and Strategic Team with difficult decisions as there will be trade-offs from investing in one region and rather than another. Therefore, it will be important for the Bank to develop a decision-making framework which is transparent and can be used to provide a clear rationale for investing in certain regions.

Demographics

- 20** The demographic challenge of an ageing population and declining working age population is impacting many OECD nations in Europe. In Scotland, the problem is more acute than in many other nations as it is expected that there will be an absolute decline in the working age population, rather than the relative decline which most other countries will experience. In addition, there will be regional imbalances between urban and rural areas in Scotland, in terms of growth and decline in numbers.
- 21** However, this challenge is complex and vast, and while investment from the Bank may help to make a marginal difference, the Bank will have no control over the main policy levers which would more effectively address these issues, such as immigration policy. Therefore, the Bank should focus its investment on areas, initiatives or projects, which would help address the demographic challenge. A specific area the Bank may wish to consider investing in is technology innovation which can improve the provision of health and social care.

Areas Missed: Digital

- 22** The recent review into the Scottish technological ecosystem by Mark Logan provides insight into how important the Scottish tech sector will be to the economic recovery from the pandemic and what is

needed to achieve high growth. Digitisation will drive the new economy and lead to a demand for new skills. While not a mission in itself, digitisation has the capacity to contribute to all three of the proposed missions.

- 23** The Scottish Government has committed to implementing all the recommendations of the Logan Report. The report identifies problems with the flow of investment to firms as they attempt to scale up and presents recommendations on how to address this issue, including the formation of a 'Series A (scale up stage) Fund'. This is a longstanding problem which impacts all sectors and which the RSE has highlighted in previous responses. As the Bank will control almost all the Scottish Government support system for early-stage companies in its operations, the Scottish Government and the Bank's Board should consider how it can help implement the recommendations presented in the Logan Report. If investment in the tech sector/digitalisation becomes another mission, then this must be supported with an increase in the proposed capitalisation.

Conclusion

- 24** While we welcome the creation of the Bank, we believe the three proposed missions are too diverse and not defined enough to enable its Board to plan and budget effectively and for Scottish Government and external stakeholders to be able to measure and evaluate its performance properly.
- We recommend that one of the three missions should be chosen as an initial focus: we suggest the climate emergency.
 - Of the other two suggested missions, place-based opportunity is already covered by several other public bodies, while the Bank will have no control over the main policy levers influencing population.
 - We suggest that the Bank define, more clearly, its role in relation to private investors and other public agencies, to avoid duplication and waste.
 - We fully support the incorporation of the SIB into the Bank and urge that its activities be continued and expanded.
 - The Scottish Government should consider the role of the Bank in the implementation of the recommendations presented in the Logan Report, which may involve providing additional funding if an additional mission is adopted.

Additional Information

Any enquiries about this advice paper should be addressed to Paul Stuart, Policy Advice Officer (pstuart@these.org.uk). Responses are published on the RSE website (www.rse.org.uk)
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