OFFICIAL REPORT
AITHISG OIFIGEIL

Economy and Fair Work Committee

Wednesday 25 September 2024

Session 6

The Scottish Parliament
Pàrlamaid na h-Alba

Wednesday 25 September 2024

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ECONOMY AND FAIR WORK COMMITTEE
24th Meeting 2024, Session 6

CONVENER

*Claire Baker (Mid Scotland and Fife) (Lab)

DEPUTY CONVENER

Michelle Thomson (Falkirk East) (SNP)

COMMITTEE MEMBERS

*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Murdo Fraser (Mid Scotland and Fife) (Con)
*Gordon MacDonald (Edinburgh Pentlands) (SNP)
*Lorna Slater (Lothian) (Green)
*Colin Smyth (South Scotland) (Lab)
*Kevin Stewart (Aberdeen Central) (SNP)
*Brian Whittle (South Scotland) (Con)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Douglas Colquhoun (Scottish Enterprise)
Al Denholm (Scottish National Investment Bank)
Bob Doris (Glasgow Maryhill and Springburn) (SNP) (Committee Substitute)
Adrian Gillespie (Scottish Enterprise)
Michael Robertson (Scottish National Investment Bank)

CLERK TO THE COMMITTEE

Anne Peat

LOCATION

The James Clerk Maxwell Room (CR4)

Scottish Parliament

Economy and Fair Work Committee

Wednesday 25 September 2024

[The Convener opened the meeting at 09:04]

Decision on Taking Business in Private

The Convener (Claire Baker): Good morning and welcome to the 24th meeting of the Economy and Fair Work Committee in 2024. I have received apologies from Michelle Thomson, and Bob Doris is attending as a committee substitute. Colin Smyth will attend today's meeting online.

Our first item of business is a decision to take agenda item 4 in private. Are members content to do so?

Members *indicated agreement.*

Pre-budget Scrutiny 2025-26

09:04

The Convener: Our next item is an evidence session with the Scottish National Investment Bank and Scottish Enterprise. The main purpose of the session is to inform the committee's pre-budget consideration. I welcome Al Denholm, chief executive officer, and Michael Robertson, chief financial officer, from the Scottish National Investment Bank; and Adrian Gillespie, chief executive, and Douglas Colquhoun, chief financial officer, from Scottish Enterprise.

It would be helpful if members and witnesses could keep their questions and answers as precise and concise as possible.

I come to my opening question. We are looking at the budget for the upcoming year. We have also had in-budget adjustments made this year, so we are facing a difficult financial situation. I ask the witnesses to briefly say what the priorities are, but to focus more on the challenges and the risks to the delivery of those priorities, given the financial situation that we face. I ask the Scottish National Investment Bank to go first.

Al Denholm (Scottish National Investment Bank): Good morning, convener and committee. Thank you for the opportunity to speak to you.

The budget challenges are something that we are all facing. I will give some context for why this is an important topic. As an institution, we are three and a half years old and we are moving from what I would call the start-up phase to becoming an established player in the Scottish financial ecosystem, delivering real impact in line with our business plans and the missions that were set by the Parliament.

As you will recall, we make investments in businesses and projects that benefit Scotland and that are aligned to the three missions that were set for us when we were established: Scotland's journey to net zero; harnessing and encouraging innovation; and improving places and communities.

In the three and a half years since SNIB was established, we have committed £650 million of the £2 billion that was committed to us when we were first set up—that is roughly £200 million per annum—to support 37 businesses and projects the length and breadth of Scotland. Critically, in doing so, we have also crowded in more than £1.4 billion of private sector support at the same time. One of the key things that we do when we are making an investment is to seek a good crowding-in ratio as part of our process.

Those short-term performance indicators are encouraging and moving in the right direction. They are aligned with the bank's vision when it was set up. We need to continue on that path, and that is why this budget discussion is very important.

We are also making investments on behalf of the people of Scotland that are delivering good-quality long-term investments, creating jobs, reducing emissions and so on, in line with our missions. We have a full pipeline at this stage of the financial year, we are making strong investments in new businesses and projects, and we are supporting existing investees. However, as the committee will be aware, a reduced budget settlement for this year has restricted our ability to invest as much as we would like. We have had to be more selective in what we are doing.

I am sure that we will discuss some of those investments this morning, but I would like to draw the committee's attention to one deal that demonstrates what we can do. Earlier this year, we committed £50 million to the Ardersier port, just outside Inverness. The investment will help to re-energise a decommissioned oil and gas fabrication yard and, with new life breathed into the site, it is estimated that at full capacity it will enable around 3,000 jobs in the local area.

The Convener: I am sorry to interrupt, but will the budget that we are facing slow down the pace that you have said the Scottish National Investment Bank is working at?

Al Denholm: It will absolutely slow it down. That is the point that I am trying to make, as you can hear from my comments. The point about the Ardersier port investment is that it will also act as a catalyst for other investments, so we will start to see additional employers coming into the area because that investment de-risks their investment decisions. We will also start to see more housing being developed in the area to support those workers. If you bring in 3,000 workers, you will have a shortage of housing. The investment has a ripple effect; it is not just the one headline number of £50 million.

In making that investment, we crowded in £350 million of third-party or other capital, and that deal would not have happened without our convening and our work. I give that as an example of the kind of things that we can do and the kind of things that might be threatened if budgets are threatened. Clearly, I could provide other examples across all our missions, but—

The Convener: I am sorry to interrupt, but we are a bit pressed for time. Before I move on to Scottish Enterprise, looking a bit further forward, you will know that the ScotWind revenue of £450 million may be used to support resource spending in the coming year. As a body, you have previously commented on the importance of ScotWind and the opportunities that it presents for renewables investment. Do you have any comment on the Government's announcement of the use of the remaining £450 million that came from ScotWind?

Al Denholm: ScotWind as a whole is a very important strategic initiative, and through the work that we have been doing—we have an investment team in our area that is focused on ScotWind—we are seeing significant opportunities worth close to multiple billions of pounds in funding requests that will ultimately come our way. We are working with the offshore wind investment pipeline work group to support that.

We are making the point that investing commercially first, with our commercial mindset, will generate the best value for the Scottish taxpayer. However, we have noticed that, in many of those deals, there is a need for some grant funding and some concessionary funding. We also think that, if we structure the deals as commercial opportunities that appeal to the private sector, we will get the private sector coming alongside, too, so it is very important to get the structure right.

The Convener: I have two similar questions for Scottish Enterprise. There is a challenging budget settlement this year and looking to next year, so what are the risks to delivery? What is the impact of the announcement that the ScotWind revenue is likely to be used for resource funding rather than investment?

Adrian Gillespie (Scottish Enterprise): Good morning. It is important to break that challenge down into the various budgets, given the different uses of the capital budget, the resource budget and the financial transactions budget, which is under real pressure. Last year, I talked about having to refocus and to focus on transformative opportunities. We have taken that a stage further this year by focusing on three missions, like the Scottish National Investment Bank. Those missions are delivering the energy transition, scaling up the fantastic innovation that exists around the country and facing into the productivity challenge and the potential to leverage in far more significant levels of capital investment to address that.

That approach is showing success in the results. We reached even greater levels of achievement in terms of our impact last year, with record levels of job creation and, significantly, record levels of capital investment. Therefore, the impact of that approach is starting to show through, but there are challenges in the budget situation. The challenges have driven us to focus on more transformative opportunities, which is reflected in our results. Over the past five years, we have delivered 80,000 jobs and we can look at the wider impact on the economy. That is a return of £25 of gross value added for every £1 that we have invested. It shows that we are delivering really good results with our resources, but it shows that we could go further if we had even more resources at our disposal.

Given the situation that we were in with the capital budget this year, we were actually quite pleased with the results. That reflects the strong pipeline of investments that we have built up, particularly in the area of energy transition. One of the challenges is the uncertain timing of when the investments will be required. We would like that to be quicker, and I can talk more about that.

The resource budget has been very challenging, with a 30 per cent reduction over the past two years. Again, we have managed to navigate through that by raising greater levels of income and through some in-year budget transfers from the Scottish Government to support, for example, international trade activity. However, the challenge is that we do not know what that settlement looks like for next year. What I know is that, with the resource budget, we are on the limit of our fixed costs, so if we have a further reduction—even a slight reduction—we will only just be able to cover our fixed costs, resource salaries and do some of the diligence that we are required to perform on investments and that kind of thing.

The financial transactions budget is very challenging. Again, we—

The Convener: Other members will ask about those areas, so there will be an opportunity to say a bit more about them then. I am about to hand over to Lorna Slater, who will pick up on some of those themes, but, before I do, do you have any comment on the decision to move ScotWind's revenues to resource funding?

09:15

Adrian Gillespie: I do not have a specific view on the sources of income; the Government will take those decisions. I suppose that it reflects the situation that we have been in, which is that we are having to use all the assets that are at our disposal to fund some of the near-term opportunities.

The Convener: The ScotWind money was supposed to have been raised for investment in the offshore and renewables sector. The proposal to spend it on funding a shortfall this year means that that opportunity has been lost. Do you have any concerns about that, or does it present challenges for how we develop our renewables sector?

Adrian Gillespie: It is hard for me to comment on that, because I do not know how it will play out for the resources that will be at our disposal. I can tell you that we have an extremely strong inward investment pipeline for the energy transition, which includes 26,000 jobs—that is at a record level. Currently, I do not have any demands on the capital budget that we cannot resource, but that could change significantly next year, depending on the pace at which some of the large inward investments are made available. Those projects are big and involve thousands of jobs, and will also require large amounts of public sector funding; however, the timing of them is uncertain. We have to be ready for that whenever it happens. I think that that is the challenge, rather than the quantum.

Lorna Slater (Lothian) (Green): I have three questions. My first is for both organisations. Both of your business models depend very heavily—at the moment, anyway—on Government decisions year by year. Every time I speak to an organisation, there is frustration about not having foresight, as there is no multiyear funding, which means that they do not know what is coming. I am interested in your view of the current system, which means that your organisations are dependent on the capital budget that comes from the UK Government. How does it affect you that you do not know year to year how much money you will have? I am interested to hear from both of you, but particularly from SNIB, on how plans to make the bank stand alone commercially—as in, that future profits would not be rolled back into the Scottish Government budget—would help to delink the current process? Scottish Enterprise may not have the same options.

Michael Robertson (Scottish National Investment Bank): On the certainty of funding, we are income generative. Last year, for the first time, we generated income in excess of our operating costs. At the point that we are at in our evolution, the pressure on future-year settlements poses a challenge. From an investment pipeline and planning perspective, certainty on what we have to invest from a financial transactions or a capital perspective would be helpful. As Al Denholm mentioned in his answer about the challenges, our pipeline is full. Having some sense of what funding would be available through something like a multiyear settlement would allow us to better line up opportunities with the funding that is available. That is the primary area in which it would aid us to have more certainty.

To address the question about the bank operating on a stand-alone basis, we are moving away from being a resource consumer in what I hope will be the not-too-distant future to being a net income generator. We would like to have line of sight on what would happen with that excess and would like the full ability to make decisions and reinvest our income on behalf of the people of Scotland. In time, we would like there to be some element of recycling for the capital returns from our portfolio.

Al Denholm: I will add just a couple of things. We are making multiyear investments. Very often, you make a commitment that will draw over one, two or three years, but it generally does not draw further. In addition, there are often conditions—good risk management conditions—to those drawings. Rather than saying, “Here’s a cheque for £10 million—good luck,” we have put gates and thresholds on the drawings. Having that multiyear commitment is useful but—importantly—it is also useful for ScotWind, because many such projects draw over multiple years. I make that point for both the topics that we have discussed.

In 2025-26, we expect to be at the point in our evolution of no longer requiring resource budgets because we are earning income over and above our resources. I hope that that will take away some pressure from the Government having to continue to support us on resource.

On the capital side and the return on capital, there is an opportunity to take the proceeds that we receive in the course of business and put them to work again. If you were to model that out over the coming years, you could imagine a position in which the Scottish National Investment Bank would not require a resource budget or a capital budget—at the point at which it gets to a critical size to operate and reinvest. That is why reinvestment—we call it “perpetual”—is so important. By doing that, you create a win-win, in my opinion. It is a win for the economy, because you continue to create the economic benefit, the jobs, the growth, the carbon emissions reduction, et cetera, and you decouple the bank from that funding challenge, which will not likely go away—I read the newspapers like everyone else. I think that we can be part of the solution to that by continuing to provide the benefit if that perpetual recycling is allowed. I give that as a strategic view.

Adrian Gillespie: Sight over future years’ budgets is almost as important as the quantum of those budgets. I am sure that it will be the same for the bank. We are different from a lot of budgets across the Scottish Government in that we invest and get a return, rather than being a cost that delivers a resource.

That does not happen within the boundaries of a financial year. For the people alongside whom we invest—like the bank, all our investment is alongside private sector partners—the process cannot be stopped and started depending on the budget that year. The navigating that we have to do is to try to keep in alignment with an annual budget the cadence of the investments that we source and make happen.

We have highlighted that to the Government, and Douglas Colquhoun and colleagues spend a lot of time with our sponsor department and colleagues across Scottish Government finance to understand the implications of how our model works, because it is different. I ask Douglas Colquhoun to comment further.

Douglas Colquhoun (Scottish Enterprise): I agree with Adrian Gillespie. Having certainty over the budget allows the planning. We walk a fine line internally and with partners about the availability of the budget, to give them the confidence that we will work alongside them. That is the downside risk. We have navigated that well, internally. We are keeping up pressure on staff, as Adrian said, to develop project pipelines, so that we have good, transformative projects.

That also helps with the discussion with the Government, because we demonstrate the kinds of returns that we can make. To refer back, for every £10 million of Scottish Enterprise spend, we deliver 725 jobs, about £250 million of cumulative gross value added and about £17 million of cumulative tax over a five-year period. After about year 4, therefore, that £10 million has been repaid and has gone back into the Scottish exchequer. Those are the kinds of statistics that we use in discussions with the Government.

Lorna Slater: That highlights clearly the frustration in relation to how, even if we are not arguing about quantums, communication—especially between the two Governments—about what might come years down the line could be improved.

For my second question, I will pick up on what Douglas Colquhoun said about evidencing the impact. A couple of weeks ago, I put this question to South of Scotland Enterprise and Highlands and Island Enterprise. You give out direct support in loans, grants and so on, but how do you measure the impact of your indirect support? How do you evidence teaching someone to fish versus giving someone fish?

I got different answers from the two enterprise agencies: South of Scotland Enterprise said that it was in the process of delivering those metrics, and Highlands and Islands Enterprise was less clear on how it showed the most effective intervention on the economy. As great as it feels to give out money, is that the most effective intervention, or are those other things equally effective? I am interested to hear your views.

Adrian Gillespie: I will go back to the bit about giving out money, because we invest alongside other private sector investments. Sometimes that investment is in the form of a grant, but we get a clear return.

To answer your question on advice, it is hard to measure. The other enterprise agencies talked about the difficulty in measuring, because often our advice is to not do something, and we cannot really measure the impact of not taking a particular course of action.

I hear about how critical our advice is from companies that we work with. That is captured in our impacts and evidence, because we not only measure the impact of the money that we co-invest; we measure the impact of the involvement that we have had in a project, which can be giving money or advice—normally, it is a mix.

I will give you the example of Simon Howie, the Scottish butcher in Perthshire. I met him when the company launched its project to generate and store power in order to take its electricity off-grid. He said that our advice was more important than the financial commitment that we made to the project. The impact of that is it taking the entire production facility off-grid and making it completely green powered, and with battery storage.

I hear very strongly from our customers that our advice is critical. Measuring a course of action that is not taken is hard, but we capture the value of that in our outputs, because they reflect the scope of all the financial and non-financial support that we give.

Lorna Slater: Can I ask a very quick question, convener?

The Convener: If it is very brief.

Lorna Slater: It will be super quick. The next question is for the investment bank. My understanding is that the bank can loan a minimum of £1 million. What progress is there towards developing financial instruments that could be used to support smaller businesses and projects that do not need as much as £1 million?

Al Denholm: When we consider what the need of the ecosystem is and what the role that we play is, we believe that, on the equity investment side—which tends to involve smaller investments—there is a clear need in the £2 million to £10 million range, which is called the scale-up range.

According to various studies that have been done on that part of the market, there is available finance for good businesses at that level, either from Scottish Enterprise, the angels or other venture capitalists. However, there is a structural gap in the scale-up phase, and it is measured by a lot of commentators. Therefore, we think that we can have more impact by focusing on the scale-up phase with loans of £1 million-plus. In fact, we were moving towards setting the limit at £2 million, but we set it at £1 million. In rural communities, we will consider going below that because some of the projects are a little bit smaller.

The infrastructure side is where we tend to make bigger investments—£20 million to £50 million—so that is slightly different. Investing in that way provides a derisking function to allow other investors to come alongside, which is more of a development bank function.

The Convener: At the start of the meeting, you said that you have committed £650 million of the £2 billion capitalisation. The capitalisation of £2 billion was announced in 2020. Given our financial situation, are you still confident that the whole £2 billion investment will be delivered during the timescale that was set?

Al Denholm: The commitment was made, and we certainly believe that it will be delivered. That is our working assumption. In fact, in our business plan, we have smooth-lined the balance over the remaining years, and I think it works out that there is £230 million per annum in our business plan. Therefore, it is the assumption that the commitment will be delivered.

Brian Whittle (South Scotland) (Con): I will tie off some of the questions that my colleague Lorna Slater asked. Michael Robertson talked about financial planning and the one-year planning system that we have at the moment. The Scottish Government’s medium-term financial strategy assumes no financial transactions beyond 2024-25, but some of the funding in financial transactions generally extends beyond a year. How does that uncertainty impact investment decisions?

09:30

Michael Robertson: As Al Denholm mentioned, there is a mismatch between the annual settlements that we receive and the drawdown profiles of the commitments that we make to businesses. We have to ensure that we can fund the bank’s future commitments beyond any one financial year-end. The additional FTs or capital budget that flow in are assessed on the basis of what we have in our pipeline after those commitments have been accounted for. That makes it challenging to match up that pipeline and what we are going to commit to the settlement.

Adrian Gillespie: The financial transactions budget is critical for us. We were concerned that, going into this financial year, we would not be able to meet our usual cadence of early-stage investments, and about the impact that that would have on the pipeline that finds its way to the bank and other scale-up investors.

We were able to keep the income that we generate from past investments through financial transactions this year, which has allowed us to keep that function going. We have also topped it up from our regular capital budget by about £10 million. Even with that, we are not able to meet the same level of early-stage investments that we have been able to meet in the past, so that is a concern for us and an uncertainty for next year.

We are trying to bring more international capital into the early-stage investment market to scale up the activity in that market or to compensate for any lack of funding from us, but it is a really big issue. Our investment function is critical for us, which is why we transferred that £10 million from capital into our investment budget this year. It is co-investment and, if we do not keep that pipeline going, that will have an immediate impact on the economy.

Brian Whittle: Mr Denholm, you indicated that you see SNIB's investments sitting at between £2 million and £10 million—that sort of scale—and that Scottish Enterprise perhaps sets the stage before that. The market is becoming more cluttered—GB energy will be entering it, apparently. Have the agencies managed to collaborate? Is there a demarcation between them? How do we make the most effective use of the money that is available, especially public money?

Al Denholm: The good news from your perspective is that the various agencies collaborate and work together congenially and supportively within their boundaries and remits.

I understand Adrian Gillespie's role and work with him, and we have meetings with the senior management of Scottish Enterprise periodically, for example. The investment teams are also aware of each other. Indeed, they know each other and can pick up the phone to each other. Sometimes we refer things that are too small for us to SE, and sometimes SE will refer things to us. Day to day, that works well.

We also work with other agencies in the ecosystem. We now have a memorandum of understanding with the UK Infrastructure Bank. We also see that as a collaborative way of working. Its minimum ticket size is conveniently about our maximum, so UKIB also refers to us. There is an overlap.

I mentioned Ardersier port. UKIB and SNIB both put £50 million into Ardersier. In that example, it is fair to say that we picked up the phone to UKIB and told it about the idea and then it came on board. We have another one or two deals that we have not yet announced where we are working with the bank. Again, it is collaborative. UKIB has its mandate and we have ours.

I look at GB energy as being a body that will provide capital to support the economy, which is a good thing, so I see that as a tick. The key thing is that we work collaboratively. We are already working with and reaching out to GB energy leaders and Scottish Government leaders. The UK Government and the Scottish Government are talking about the matter as well. If we can all work collaboratively to work out how to make the most of GB energy, then, from my perspective on the economic situation in Scotland, that would be beneficial.

Adrian Gillespie: We have developed a strong partnership with SNIB and other investors in the private and public sectors. If we were to look at the companies that we have supported, we would see that, on average, we have invested six years earlier than the bank has. We have been involved in more than half of the published deals that the bank has done, but in the earlier stages. I think that we have managed that interface really well. Some of those companies have been at that point of demarcation, and we have both invested at that stage, and then there will be a natural hand-off to the bank after that. There is sharing of not only deal flow but market conditions.

A critical aspect is that our partnership has grown much stronger in the context of how we support inward investments. We see a package of support that involves some grant funding and some funding for large infrastructure playing through strongly now. We have made that approach work very well. There is demarcation but, as Al Denholm said, the teamwork and the spirit of collaboration that exist are more important.

Brian Whittle: I have a follow-on question from that. It is good to hear that there is collaboration among the various funding and business agencies. However, if there is partnership co-investment, how do you measure its success, both together and separately?

Adrian Gillespie: There would not be that many instances in which we would do so. There has been some interface where we have had a historical investment and the bank has come in, but there would not be that many of those. The success would lie in getting the deal done, because it would not have happened otherwise, or in enabling the company to go further faster as a result of that joint investment. The return would be gauged in the way that we monitor all our investment returns, which is through the amount of private sector funding that has been leveraged in. For us, the ratio is about 1:3.

However, success is also about how investment allows a company not to have to focus so much on where it will raise the next piece of funding from but to achieve the certainty on scale-up funding that will allow its management to focus on its products and markets and to go faster. That is quite hard to measure, but, again, feedback will tend to come from the company and its success. All too often in the past, we have seen companies focus on fundraising, fundraising and fundraising, to the detriment of their customers and their markets.

Brian Whittle: Mr Denholm, you look as though you have more to say.

Al Denholm: I will build on what Adrian Gillespie has just said. One thing that is important to consider is that, whenever we consider an investment, regardless of its source, we will always look at it as a stand-alone investment. We are operationally independent, which is an important premise for us, and we will look at good investments.

So far, we have had 12 investments in our equity portfolio that have had Scottish Enterprise in the stack, but there are others that are not. We are not just a funnel, if you like, where businesses pass through and pass the baton to us. We have to look at each as a stand-alone case. There have been occasions when we have said that investment opportunities are not for us. We look at each one on its own.

As Adrian Gillespie picked up on, when we look at the ecosystem and how companies grow within it, how a company develops in its early years is important. That involves factors such as the skills training and support that it gets, and its decisions on how to structure itself, how to tell its story and how it ensures that it has a good board.

Many great ideas never make it to commercial success. We play an important role in a business's scale-up phase; it is fair to say that Adrian Gillespie's team, HIE and SOSE play a similar role in the earlier stages. However, I do not want to give the impression that there is an automatic passing of the baton. We still look at each case as a commercial investment, through an impact lens, and in the context of our own budget and our other priorities.

Adrian Gillespie: We continue to support the company through our international trade and business growth support as well. There is an investment hand-off, but our involvement with the company as we support it to develop remains.

Brian Whittle: Can I finish with a really quick question, convener?

The Convener: If it is brief, then I will bring in Gordon MacDonald.

Brian Whittle: I just want a point to be clarified. Do you still invest under the enterprise investment scheme, and is there still no capital gains tax after three years? Is such investment still available?

Adrian Gillespie: We do not invest under that scheme, but some of our partners do. It does not impact on us, but it impacts on our co-investors.

Brian Whittle: There no capital gains after three years—is that the way that it works?

Adrian Gillespie: I believe so. I could check that for you.

Brian Whittle: Okay. Thank you.

Gordon MacDonald (Edinburgh Pentlands) (SNP): Before I ask my questions, I thank the Scottish National Investment Bank for the investment in Lost Shore, Scotland's only surf resort, which will open in my constituency in a few weeks, I hope—not that I will be on the water. [*Laughter*.]

I want to ask about financial transactions funding. The Scottish Government's overall financial transaction funding has been cut by 62 per cent, or around £350 million, compared to 2002-23. We know that the Scottish Government has virtually no borrowing powers, so it is in a bit of a straitjacket. We have seen financial transactions funding being cut year on year to its current low level. If it continues to be cut, what impact will that have on your organisations?

Al Denholm: If it continues to be cut, it will obviously have a negative impact on our ability to deliver on our mission. It is very important, and I would say—I am speaking on behalf of everyone on the panel—that we are creating a good economic and social benefit from that money.

At the end of the day, it is up to others to decide how to deploy the budget, but we think that we are making a very strong case for it being deployed in our direction because of the benefits that we can bring.

Michael Robertson: I just want to add a point about income generation and our ability to invest in projects that will make a return to cover our operating costs. That is a consequential of what is almost a compounding effect of lower budgets year on year. At the stage that we are at in our evolution, sustained financial self-sustainability is at a critical point.

Gordon MacDonald: Absolutely.

Al Denholm: I would add one final point that goes back to Ms Slater's point. The ability to recycle moneys to become perpetual will help to remove some of that challenge over time. It will not remove it today, but it will remove it in a few years. We believe that we are about to start getting some returns. We can forecast that, and getting those returns would be beneficial and add to the economic impact that we can have. It is a critical and well-asked question.

Gordon MacDonald: Al Denholm, you have spoken a lot about many of the projects being multiyear. If you are to honour the commitments that you have given to those companies for their investment profile, what impact will that have on new projects and on the leverage that you have to get private capital to invest in a project?

Al Denholm: That is a great question. I will give you an example to bring that to life. Coming into this year, we were budgeting £250 million in our management accounts and our business planning process, and we ended up with £173 million. What that means in practice is that, because we had some existing plans and commitments, we effectively had £80 million less to spend on new investments. The gap means that we do less and we have to be more selective.

We made that point in our annual report. We have had to change and tighten up some of our criteria a wee bit, which means that we have had to decline a number of things that we might have looked at in prior years. That is a key element of the impact it would have, and also of the impact that it would have on planning.

Adrian Gillespie: The impact depends on what Governments choose to do about it. If the Scottish Government replaced financial transactions funding with additional capital funding, we could reinvest it and get a return from it further down the line.

I hope that the United Kingdom Government will continue financial transactions. I cannot emphasise enough what an important source of funding they are for us. On the radio just this morning, there was a story about a company called MiAlgae getting through to the final of the Earthshot prize. It is a brilliant young company and we have supported it all the way from its inception in 2016. I am sure that it has a very bright future. The bit that was not told in that story this morning was that, through our ownership, the people of Scotland own a significant stake in that company and have a stake in its success. Further down the line, when we exit from that company, we can reinvest that in the economy. Last year, we made just over £30 million of investment income from our previous investments.

The exit market has been quite deflated in the past couple of years. Two years ago, we made more than £100 million, and we made £560 million in the past five years. That reduces our dependency on Government funding.

However, we have also put it to Government that we would like to be able to retain more of that income, some of which goes back centrally, because that will affect our behaviour and how commercial we are towards investments. The ability to do so, and also to carry some funding over from year to year, would really help with predictability and smoothing. We have made quite a strong case to allow us to do those things and to commercially behave probably more like SNIB does, from the point of view of investments.

I do not know whether Douglas Colquhoun wants to add anything to that.

09:45

Douglas Colquhoun: The market is really focused on follow-on investment, so one of the consequences of not being able to do so is that it effectively dilutes the returns that you get downstream—I am sure that it is the same for SNIB.

Over the 21 years that we have been running investment, we have secured £2.5 billion of leveraged private sector investment and realised £500 million from that portfolio already, which is worth £478 million at the moment. If we cannot follow on the investment—we have stressed that point to the Scottish Government—it has an impact not just on the early-stage investment market but on our ability to recycle and generate income that will support economic development in Scotland.

Gordon MacDonald: Adrian, you mentioned that the cuts change your attitude towards investment and so on. What is the change in your appetite to risk? If your budget continues to be cut, because of cuts in financial transactions funding, what impact will that have in relation to losses, since there will be the occasional loss from investment from time to time? Do the cuts affect your attitude to risk and does your knowing that your budget is being cut mean that you then have to reassess a lot of potential investments?

Adrian Gillespie: That is a great question. On whether it would affect our attitude to risk, continued cuts would take us to the much higher impact and we would have to draw the line higher—it is the same thing as we have done with all our grant funding—which would probably then take us to a higher level of risk, too. We would be in a risk return scenario, so we would probably take more risk.

Interestingly, when losses are written off, that does not come from the financial transactions budget but from a resource budget. Sometimes, those write-offs are from investments that we made 15 years ago, so it is extremely hard to predict. More cuts would probably make us look for more risk and more return at the same time.

I stress that the model of the early-stage co-investment fund is 21 years old. It is very mature and, as Doug Colquhoun has said, it has leveraged in more than £2 billion of other income.

We are heavily reliant on it as a source of income. If the pipeline is cut off, that will play out further down the line. We will take any steps to keep that funding going, whether through our own means or through raising it from international private markets. It is really important to us.

Gordon MacDonald: I will ask a similar question of Al Denholm. You said earlier that your investment income exceeded operational expenses by roughly £3 million. You had a big loss from Circularity Scotland, however, and we know the reasons for that. How would you be able to cope with losses such as that in the future and has your risk appetite changed in any way?

Al Denholm: There are two elements to that. Michael Robertson might want to add to this. First, as I mentioned, we are a young bank and still maturing, so those early losses will have a more consequential impact on our profit and loss in the early years than they might have in future years.

Secondly, as we model out—assuming the target rate of return, which we have published, and the reinvestment rate—we think that we will be able to absorb those losses from the income statement, if we do good underwriting and make good investment decisions.

Obviously, as you said, every investment has a risk, otherwise it would not be called investment—you would not get a return on it if it were risk free. We think that we can smooth out and absorb loss in the future; it is more consequential in the early days but, as you move into year 6, 7, 8 or 9, it is absorbable.

The same goes for recyclability. Because of that absorbability, pressure is not put on the exchequer for more resource budget. Just now, in the early years, because of the way in which we have been set up, all of it falls back on to the exchequer. The same works for capital; if that can be recycled and built up over time, that reduces pressure.

Because we are investing commercially and getting a commercial return—and because we are, I hope, doing solid, quality underwriting—we can at a point in time get to a position where we will be what I would call off the books, both from a capital and an income perspective. We have not yet reached that point, but it is out there, and it is not that far away, if we can keep this going. If we can keep getting the FT funding—that £200 million, £250 million or whatever the number is—that allows us to build a critical mass. At that point, it will just keep going, like a flywheel, and turn into a national wealth fund for Scotland that will create both financial and societal benefits.

You also asked me about third parties, and I think that this would be a good point to come in on that question, given that I did not answer it the first time. As I said earlier, our crowding-in ratio is about 2:1 with regard to investment—that is, our £650 million plus the £1.4 billion from the private sector—and if what we are talking about were to be put at risk, you would put at risk that crowding-in element, too. It is important to note that we are now getting to the stage that we are being noticed by other asset owners, by which I mean some of the larger asset owners. We have been crowding in some of the smaller asset owners, but we are now getting noticed by some of the household-name asset owners as the kind of people who might partner with us. We have no announcements that we want to make at this point, but we are getting to the point where we think that we can be a solution to what those asset owners would like to do in Scotland, too.

I do not want to give any names, but a number of asset owners have said that it is difficult to invest in Scotland, but they see the benefit of our working with them to help them do that. That is why our Financial Conduct Authority authorisation is so important. If that opportunity were to disappear, that would have a negative impact on the opportunity that we could create for Scotland. It is therefore very important, and we are just at that point where we are getting very positive vibes from big asset owners to invest money in Scotland.

Gordon MacDonald: Thanks very much.

The Convener: Bob Doris, do you wish to ask a supplementary?

Bob Doris (Glasgow Maryhill and Springburn) (SNP): Please, convener.

The Convener: In that case, I will let you in before I bring in Kevin Stewart.

Bob Doris: I will seek to be brief, convener. I want to follow up Gordon MacDonald's line of questioning to Al Denholm on how the removal of financial transactions and capital revenues might have changed the Scottish National Investment Bank's investment decisions. Mr Denholm, you talked about the target rate of return and the reinvestment rate, but a thread running through this whole thing is the need to support Scotland's moving to net zero by 2045. Might the investment decisions that are being made lead the bank to make certain decisions that prioritise investment return and sustainability instead of maximising the pursuit of net zero by 2045?

I have a horse in this race—well, we all have a horse in this race, but I am a member of the Scottish Parliament's Net Zero, Energy and Transport Committee, which is looking at five-year carbon budgets and the next plan in relation to all of this, and we know that we need to leverage in more major private investment than public investment if we are to get to net zero. Are investment decisions being changed and altered in a way that might compromise that private investment, because of the removal of UK financial transactions revenues?

Al Denholm: Clearly, the magnitude of the financial transactions issue will have a compromising effect on the ability to deliver that, and I think that I have answered the question on that topic. I would just like to stress that, whenever we make an investment decision, we look at it through both lenses—that is, both its impact and its commercial return. Both are equally important to us; we will not make an investment that does not have an impact benefit, and we will not make an investment that does not have a commercial return. It has to do both.

We have noticed a specific issue with net zero. We have been up and running for three and a half years now, and we have had something like 1,200 inquiries come into the bank; of those 1,200, about half—in terms of pounds and pence as well as numbers—have had a specific net zero focus. We see lots of demand for our capital. I do not know whether you have had the opportunity to read them, but in our annual report as well as our impact report, we have publicly stated that we will seek to invest roughly half—50 per cent—of that £2 billion capital on net zero, with roughly 25 per cent going on place and roughly 25 per cent going on innovation.

Bob Doris: What I am trying to establish is whether that will shift because of the need to get to sustainability on a quicker timescale as a result of the loss of revenues elsewhere, or whether the investment pattern will remain the same.

Al Denholm: No, the investment pattern and investment process will remain the same—it is the amount of money that we are doing it with that will differ. I hope that I am not missing your point, but that is how I view it. We are committed to net zero, to place and to innovation with the money that we are given, and the two lenses that we will look through with regard to any investment decision are its impact and its commercial return. That will not change.

Bob Doris: Is that exactly the same for Scottish Enterprise?

Adrian Gillespie: It is exactly the same with regard to impact, and to the prioritisation that we give. Indeed, the investment market is sophisticated, and I think that that is demanded. It is a requirement, not an option that we have. However, I can tell you that, as a result of the pressure on financial transactions this year, we were not able to take forward a specific net zero early-stage technology fund that we wanted to put in place. We have had to put it on hold in the current environment.

Bob Doris: That is concerning. I will not come back in after this, convener, but just following on from Mr MacDonald's line of questioning, I appreciate that, obviously, you have to look at investment not just through the lens of the greatest impact that it will make, including on our net zero ambitions, but through the lens of the greatest return that will allow Scottish Enterprise and SNIB to get to sustainability as quickly as possible. This particular situation has not compromised net zero investment in any way, has it?

Adrian Gillespie: I cannot think of any examples where it has compromised net zero investment, other than our not being able to pursue certain opportunities at the moment. We saw a gap in the market for early-stage investment in net zero and having a focused fund for the many investors who are in that specific market, but we cannot take that fund forward at the moment. I am not saying that we will never take it forward—we just cannot take it forward at the moment. The implication, then, is that the situation is slowing things down.

Bob Doris: Okay. Thank you.

Kevin Stewart (Aberdeen Central) (SNP): Good morning. My questions are for Scottish Enterprise in the main.

Mr Gillespie, you have mentioned the three missions in your new strategy. In light of the budget impacts that you have talked about, particularly from the cuts to financial transactions, I am interested in hearing about what you will not be doing in the future that you would want to do, as a result of that hit, particularly to FT funding. Have you looked at the economic impact of all of that?

Moreover, as far as the strategy is concerned, I sometimes hear critical voices both in my constituency and beyond that your concentration is far too much on inward investment instead of growing our own. What would you say to those critics?

Adrian Gillespie: I have just referenced a fund that we are not taking forward at the moment, given the pressure on financial transactions, and the last time that we were here, I talked about some of the savings that we have been making in office premises to make up for the lack of resource funding that we have, for example.

It can be a bit more difficult to talk about what we have stopped doing. We have not taken away lines of business; we have not stopped trade support; and we have not taken away support for innovation. However, what we have done is raise the bar with regard to what we expect to come out the other side for those projects that we support and through our focus on transformational projects in each of those missions. By "transformational", we mean that a project has to make a fundamental difference to the company's future; it cannot just be about supporting a bit of incremental growth.

The support that we have delivered in the past for growth delivered a good economic return, so I am not saying that we should not have been doing that. However, although it delivered a good return, the fact is that we just cannot afford to do it any more, and we have had to raise the bar with regard to what we expect. In fact, some of the figures that I gave you up front on job numbers bear out the fact that the strategy is starting to work.

The impact of what we are not doing is very hard to establish. However, given that we already provide £25 GVA for every £1 invested, you can see that that figure could be taken back quite significantly and we would still be delivering a very good return.

Kevin Stewart: Okay. What about the critics?

Adrian Gillespie: We are pleased with our strong track record on inward investment. It delivers an awful lot of economic return as well as great jobs and brilliant outputs in terms of exports and research and development, and it gets a high profile, because such investments are quite lumpy. However, the comments that you have referred to are not borne out by our evidence on the number of companies that we support and where our support ends up. The fact is that the people whom we employ to deliver inward investment are in the minority compared with those whom we employ to deliver trade support for companies from Scotland or innovation support. There is a bit of a misconception in that respect, which has probably arisen as a result of the amount of media attention that large inward investments bring.

10:00

Kevin Stewart: Maybe you have to deal with those media commentaries, but I also think that you need to do more in letting folk know what you are up to.

You said that you would not invest so much in incremental growth in the future. However, what if that growth includes innovation? How will you invest in innovation in companies that already exist in Scotland?

Beyond the company aspect, there has been a lot of talk this morning about co-operation. What is your co-operation with the research sector in our universities, so that the knowledge and innovation that we come up with here leads to manufacturing and jobs here?

Adrian Gillespie: On the first point, about doing more, I would love to get more coverage in the media of some of the great work that is done in early-stage investment in innovation. It is really hard, and we try really hard. Our social media channels are more successful. Please connect with me on LinkedIn. We do an awful lot of direct communication on LinkedIn about what we are doing with companies.

Innovation is really important to us and tends to underpin some of the transformational growth opportunities that we see. One of our missions is about scaling up innovation. We have a brilliant track record in innovation in Scotland. We have innovative life sciences companies, space companies and quantum technologies—the list goes on. We have set ourselves the challenge of getting those to a scale at which they significantly impact on the economy. That is difficult at both company and sector level, but it is the kind of thing that a national economic development agency should be doing.

From that point of view, innovation underpins not just our scaling mission but the other missions that we have set ourselves. It is therefore critically important, and partnerships with universities are a fundamental part of that. Some of the investments that we have made are critical—for example, those include the National Manufacturing Institute Scotland; the medicines manufacturing innovation centre, which has just leveraged funding of £25 million; Edinburgh BioQuarter; and the life sciences innovation hub, in which we have just co-invested with the University of Dundee. Our role is in helping the university to scale up its innovation potential and make sure that its brilliant research transfers at scale into the economy.

Kevin Stewart: The strategy is long term, and everything is about delivery. How are you monitoring whether that strategy and the missions that you have set yourself are delivering for companies and for the people of Scotland?

Adrian Gillespie: We do that in a couple of ways. The first is in our headline measures on the jobs that are created, the capital investment that is leveraged and the levels of innovation that are delivered through our missions. Information on those is sourced from the companies that we work with.

In addition, we monitor annually the longer-term targets that we have set for our missions—for example, the 675 scale-ups and the 40,000 jobs in energy transition. We are six months into delivering that mission focus now. At the end of each year, we will publish information about our progress on delivering each mission within the framework of our overall headline measures, on which we report to you each year.

Kevin Stewart: You will publish a report on how you think you have done. How do you gather information from folks out there on how they think you have done?

Adrian Gillespie: In the main, we do that through some of our focus groups with customers. I do it personally just through visiting as many companies as I can during the year. Our people do that, too. I note your comments about some of the critics. From key partners in both the private and the public sectors, I have had great encouragement and support about the direction that we are taking.

It is right for a national economic development agency to be focused on the prize of the renewables transition and the prize of making sure that our brilliant innovation is felt at scale throughout the economy, because that pushes up wages and prosperity. Productivity does the same. We should invest more in the future of our economy and should do that at scale. The result of that productivity means better jobs.

I have had a great level of support. In my role, there will always be people who are unhappy and, the more that you raise the bar, the more you leave yourself open to that. That is the situation that we are in. However, I stress that the strategy seems to be playing out.

We successfully launched the energy transition mission earlier, given the pressing nature of it. More than half of our inward investment pipeline, in terms of new inward investors, is now in energy transition. We are seeing a huge increase in exports from the work that we are doing in energy transition. We have resourced that much better. There is an increase of around 23 per cent in our exports in energy transition.

The early signs are positive. We will monitor that closely but, so far, I am pleased with what I see.

Kevin Stewart: In answer to colleagues, you highlighted the impact of the 62 per cent cut to the financial transactions budget. Obviously, we have a budget coming up on 30 October. If the Treasury does not reinstate those financial transactions moneys that were previously available to the Scottish Government and Scottish Enterprise, what will the impact be on your ability to deliver your strategy?

Adrian Gillespie: What the Scottish Government chose to do about that situation would determine the extent to which we would repurpose capital. It is in very short supply, so I imagine that it would be a difficult situation. I imagine that we would not get the levels of financial transaction type of funding that we have had in the past, which would have a significant impact on what we are able to do in the early-stage investment market.

Kevin Stewart: Would it be fair to say that, if financial transactions budgets do not change and do not increase again, and if capital investment from the Treasury does not increase, that would make all of your jobs much more difficult and it would be much more difficult to grow the Scottish economy sustainably?

Adrian Gillespie: Yes, it would be more challenging—there is no doubt about that. We take on ourselves some of the responsibility for fixing that situation by finding other sources of private sector income. For example, we work with other partners, such as Innovate UK, with which we deliver a joint service in Scotland and which funds 16 of our people. We are taking steps to address the issue but it makes our job much harder and that is a critical part of what we do.

Kevin Stewart: It would also be much more difficult to lever in private investment if we do not have that kick-start money from the UK Treasury.

Adrian Gillespie: Yes, we get that 1:3 ratio of leverage.

Colin Smyth (South Scotland) (Lab): I apologise for not being in the room but I did not want to spread my cold to everyone. I hope that you can hear me okay.

Mr Gillespie, you commented earlier that the 30 per cent cut in the Scottish Enterprise resource budget by the Scottish Government over the past two years means that you are now in danger of not being able to cover your fixed costs. Will you elaborate on what it would mean if you had a further funding reduction in the forthcoming budget? Would that mean redundancies or recurring commitments not being delivered, for example? What is the implication of more cuts to your budget?

Adrian Gillespie: I stress that that is a real-terms cut rather than a quantum cut, so that reduction is with inflation taken into account. However, it shows that we have had significant challenges.

I mentioned that we have taken steps such as office closures, making efficiencies where we can and digital delivery. We feel that we have exhausted some of those efficiencies and that any further efficiencies would be really tough. We are on the margins of having to make some even more difficult decisions should the resource funding shrink further.

As part of the savings that we are making, we are reducing the level of staff resource over time: that has reduced by 20 over the past year. We do that through retirements and the natural turnover of people, so I do not envisage us making redundancies. We are watching the outcome closely.

I will let Douglas Colquhoun elaborate on some of the implications. We would have to consider stopping doing some things that we are legally obliged to do, so we obviously do not want to be in that situation.

Douglas Colquhoun: As Adrian Gillespie said, the resource departmental expenditure limit budget covers fixed costs, which are fixed in the short to medium term, so that is the kind of outlook we are looking at. We would probably need to look at the further rationalisation of offices, for example. We have successfully secured a lot of savings from rationalising our overseas footprint and co-locating with the Foreign, Commonwealth and Development Office, as well as closing a few offices in Scotland.

The implication is that, against a fixed cost and a declining budget, operational economic development activities could suffer as a consequence, because those are the things that we can adjust in the short term. Obviously, that is not a great position to be in. Specifically, those activities would be trade and inward investment type activities, such as innovation support and skills support that would be provided to companies through our training plus programme. Those are the kinds of things we are looking at.

As Adrian Gillespie also said, we are looking through our financial strategy to see whether we can leverage in additional income and generate more income. There is also asymmetrical treatment of our investment income, where upside gains are limited to 5 per cent, whereas, if we suffer a 100 per cent loss, that goes against the RDEL budget. We are raising those issues with the Scottish Government, which is, in turn, raising with the UK Government how we could address some of them.

Colin Smyth: To follow up on that, the point was made that you would not be able to meet your legal obligations if there were more cuts. What legal obligations are you referring to?

Douglas Colquhoun: We are at the cusp of roughly £120 million of fixed costs in the short to medium term. We have office accommodation leases and so on, so if we suffer a cut that takes us below the level at which we could sustain those costs through our income, we could be in danger of breaching some of those obligations.

We take tax advice and legal advice, so we just need to make sure that we remain regular and above board.

Adrian Gillespie: The diligence that we undertake on investments is also funded from the same budget.

Colin Smyth: The committee is looking towards the future budget and, to be optimistic, should there be even a partial reversal of the cuts that you face from the Scottish Government, what would the priority be for any additional resources and what would the impact be of that additionality on delivering the crucial economic growth that we want to see?

Douglas Colquhoun: I suppose that it depends on which budget we are talking about. If it is the resource budget, the impact would probably be increased trade activity. Our export support had a very successful second-highest year; it has been on an upward trajectory for the past five years, and we would want to do more on that.

We have talked about the FTs budget at some length. If we are talking about the capital budget, we have a large inward investment pipeline that will address some of the challenges in net zero.

We are also working with the Scottish Government because it has the offshore wind fund, and we are looking to access that. We would be looking at those areas and at scaling up.

As Adrian Gillespie has said, a lot of the activity that we are doing at the moment has slowed down as a consequence of cuts. If they were reversed, we would accelerate those activities, particularly the opportunity in offshore wind. That is where we see the greatest benefit for Scotland's economic development outcomes.

Colin Smyth: Thanks for that. I turn to the Scottish National Investment Bank. In June, it announced a target rate of return of 3 per cent to 4 per cent for the bank, up to and including 2025-26. How does that target rate of return compare with those of similar institutions such as other development banks?

Michael Robertson: When we were setting that initial target rate of return at 3 per cent to 4 per cent, we looked at other development banks across the UK, Europe and further afield. As a comparison with other UK investment banks, UKIB's target is 2.5 per cent to 3.5 per cent return on equity, so we are slightly above that measure. The British Business Bank has a target of 1.5 per cent to 2.5 per cent.

There are slight nuances, such as portfolio make-up and target markets, but we think that ours is a comparable measure to those of other organisations.

Colin Smyth: How do you anticipate that target evolving post 2025-26?

Michael Robertson: We set 31 March 2026 as the measurement date in order to allow our portfolio to have matured and our initial equity investments to have been embedded for a reasonable period of time. We will use that date with a view to informing us on a longer-term measure.

10:15

Colin Smyth: Do you have a view on whether the target is likely to reduce, or are you looking to further scale it up beyond 2025-26? I am not asking you to have a crystal ball, but what is your longer-term strategy for the target rate of return?

Michael Robertson: We value our portfolio regularly, with a view to informing where we think we will land. We are still fairly early in our evolution, at three and a half years old. By the time that we get to March 2026, it will be another 18 months on. The maturity of the portfolio is heading in the right direction, but there are another 18 months to go. As you say, the crystal ball is not so strong today, so I would not like to hazard a guess as to what the longer-term picture might be, but I think that, by March 2026, we will be in a better place to be informed on how we have performed to that date and what a longer-term target might be.

Murdo Fraser (Mid Scotland and Fife) (Con): Thank you, convener, and good morning, gentlemen. I will ask about financial performance. My first question is for SNIB, following Lorna Slater's earlier questions. SNIB was established to be a perpetual institution with its profits reinvested. Last year, when SNIB chair Willie Watt gave evidence to the committee, our colleague Michelle Thomson asked Mr Watt about that. At that point, he said:

"Government accounting rules are not helpful in that regard, but we are talking to the Scottish Government about those issues."—[*Official Report, Economy and Fair Work Committee*, 21 June 2023; c 23.]

Could you give us any update on that challenge and on whether it is proving to be easier to reinvest profits or whether there is still a barrier to that?

Al Denholm: I can answer that from a strategic perspective and Michael Robertson can come in with more details.

We are talking to the Scottish Government about that. Adrian Gillespie made the point that we are an investment body and, therefore, we are unusual in that we are different from many other cost or spending centres. We have been working on getting that very important message across and landing that with stakeholders. I will be honest that we have had challenges with the turnover of some of the key stakeholders, while the UK general election has also created some barriers to our ability to engage. We are now at the point at which our message is being heard, which is important. We are trying to work through the mechanics of how to solve the challenge, and there is good intent to seek to do that from the people who we are talking to. However, we are still on a journey and we still have a long way to go.

Michael Robertson is across the detail and I look at the strategic picture, but I think that the principal reason for the challenge is because we are different—we are an investment institution that is seeking to reinvest to create a perpetual status; we are looking for multiyear funding; and we are looking for flex at year end—and the system does not quite know how to deal with something that is different in that regard. Last year, we got to 31 March and we did not know whether were going to be able to complete a £50 million deal according to the rules. We got it done, and we did not compromise our underwriting in doing so, but that is the kind of real live challenge that we face. We do not want to have a situation in which the people who we are negotiating with know that that is a live challenge for us and for them to try to play that against us. That would not be to the Scottish taxpayers' benefit.

There are lots of reasons why it would be beneficial for us to be able to reinvest our profits. As Adrian Gillespie mentioned, flex would be the first aspect, and then reinvesting, and so on. A large part of the challenge is because we are different.

Murdo Fraser: Mr Robertson can come in on that on a moment, but first, just so that I am clear, I ask whether those are Treasury accounting rules or Scottish Government rules. Where is the blockage?

Michael Robertson: In terms of the perpetual status, it is the UK budgeting manual, with its various pots and permissions. As Douglas Colquhoun mentioned, the system is hugely complicated, even on the gains that are received on particular assets and where those flows are directed to. Earlier, we talked about early-stage losses going against the resource budget, for example, but it does not follow that gains will also go against that budget, therefore there are inconsistencies in the treatment of losses and gains.

The UK budgeting rules affect not only us but some of our counterparts in the rest of the UK, so other organisations are dealing with the same challenges in that space. Where we see potential for advancement within the Scottish rules is on flexibility, and potentially on multiyear investments as well.

Murdo Fraser: Thank you. I have a couple of other questions on financial performance, the first of which is for SNIB. You will be aware that the issue of bankers' bonuses is politically contentious. I am aware that the SNIB pays such bonuses. There is a long-term incentive plan that sets out the performance conditions that relate to them. What are the performance measures that determine whether bonuses are paid?

Al Denholm: I will set a bit of context before answering your question. When we were set up, the Scottish Government looked across the financial ecosystem to work out what the right pay and reward package should be for staff in the sector that we operate in. In doing so, it looked at the public, financial and private sectors and at other development banks, and it came up with a package that contains a bit of all of those elements. Ours is not a purely private sector or public sector package but something in between that seeks to achieve a compromise that would work.

One of the biggest elements of what we do involves competing with the private sector for our talent. Very few people in the public sector have the skill set to do the type of investing that we do, which involves structuring and so on, so we really have to try to attract talent from the private sector, which tends to pay a base salary plus a performance-related bonus.

As for magnitude, as I said, we are not at one end of the scale or the other but somewhere in between—I stress that point. However, the very fact that we have a strong mission impact statement helps us to bridge part of that gap with the people whom we hire. Our staff retention and engagement come from that as much as from any other factor.

The long-term incentive programme performance conditions are set annually, on a forward-looking basis. Our annual report and accounts note what the conditions are. From memory, this year, we have 10 or 12 conditions that span the spectrum of what we do—investment performance, financial performance, mission delivery, third-party crowding in, and so on—so a number of those elements are publicly available.

The process for getting conditions agreed is that, within the bank, we will come up with a recommendation to our remuneration committee and we will go back and forth on that with, I think, pretty robust challenge on the thresholds. In my experience, it is a very robust process. We then go to our shareholder team to seek their support to take the agreement to ministers for their sign-off. That is the process.

Murdo Fraser: Ultimately, do the Scottish ministers sign this off?

Al Denholm: Ultimately.

Murdo Fraser: I will come to Scottish Enterprise in a minute, but first I have one more question for SNIB. I noticed that, according to the accounts, in 2023-24, which was the most recent financial year, you spent £96,000 on contracting with a public relations firm. What was that for?

Al Denholm: As a fairly new business, which is in a complicated financial ecosystem, we feel that we need to get our message and communications out to all elements of the financial ecosystem, to remove confusion and tell our story. When I was going through my interview process, the bank was young and, if you googled it, you could see lots of online commentary from people who were guessing what the bank did or did not do, and what its mission should or should not be. We have to get out there and tell our story about who we are, what we are not, what we are doing and what our focus areas are.

That is beneficial for a number of reasons. It makes clear to potential investee companies what we do, so, if we get an inquiry, it is an inquiry that makes sense and is reasonable. It also makes it clear to stakeholders in all spheres of life—whether that be parliamentary, business or media—who we are.

In my opinion, given that we have a third-party capital strategy, it is also important that the message is out there that what we do is consistent. In addition, we want the message to reflect the reality of what we do and to be informed.

We are also doing social media, such as the work that Adrian Gillespie is doing. We have something like 13,000 followers on LinkedIn now, and we use multiple platforms. It is important that we get the message—about who the bank is—out in a consistent way, because there is sometimes a bit of confusion.

Murdo Fraser: I have one question for Scottish Enterprise. Your accounts for 2023-2024 show a significant change in emphasis in spending priorities, with a shift away from business growth and towards innovation and investment.

Scaling up businesses is one of the key objectives of the national strategy for economic transformation—NSET—so why has there been that shift in priorities? Is it simply driven by the reduction in your budget?

Adrian Gillespie: That might just be about language. I was talking earlier about incremental growth rather than transformative growth. Transformation is the “T” in NSET, and that is what we are focused on, because that is where a national agency should be focused.

Business growth is our purpose. Our purpose is defined as helping companies to innovate and scale up, with the outcome of transforming the economy, so business growth is fundamentally important to us, but we should be getting involved at the transformative stages of that growth. That includes capital investments and supporting innovation where there are risks that the project would not happen without our support.

Export support is transformative, and Douglas Colquhoun talked about our support for export programmes. For example, last year, the companies that we took to the Biotechnology Innovation Organization convention in Boston reported £40 million of additional sales as a result of that trip.

Quite a few of the things that we have traditionally done, such as export and innovation support, are fundamentally important to us. What has changed fundamentally is where we set the bar for the kinds of projects that we should be supporting.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): Good morning to everybody. My first question is for Scottish Enterprise colleagues, and it is about performance and targets that you have included in your annual report.

Adrian Gillespie, if you were to replicate your performance or outturn on a number of indicators, you would already have met the targets that you have set for yourselves for the current year. Could you have been a little more ambitious? This is a good story and there is really good performance, but in achieving that good performance did you consider stretching the targets for the following year a little?

Adrian Gillespie: That is what we achieved in the most recent financial year, and there were some record achievements. I cast my mind back to the discussion that we had with our board at the beginning of that year, and our board's challenge back to the executive team was that we might be being too ambitious, given the increases. The figure of 16,500 jobs is a record performance.

To put the capital investment in context, I note that over the past five years we have supported £3.8 billion of capital investment projects. Last year, the figure was £1.9 billion, so, in one year, we did what we tend to do over three or four years. I do not think that we could have foreseen that.

10:30

It is important to say that there are some very lumpy capital projects there. Energy transition projects tend to be very capital intensive, so it is really important that they are realised. However, I do not think that we should have set ourselves a target that was any more ambitious because we could not have foreseen the level of performance that came through.

I am bound to say that, but that is straight up: that was the conversation—our board was concerned that we might not be able to hit some of the targets. There were, in fact, times in the year when we were concerned that we might not be fixed on the targets, which focused our minds. Therefore, they fulfilled the purpose of being stretch objectives.

Willie Coffey: Do you want to add a wee bit, Douglas?

Douglas Colquhoun: We did, in fact, stretch five out of the six targets up a range in the current year. We kept the growth investment target static simply because of the difficulties of the budget, which we have talked about, and the market. However, in doing that, we recognised that—as Adrian Gillespie said—there were some significant contributors that cannot always be replicated. We recognised that, and we took the decision to set that ambition partly because we want to maintain momentum in building a pipeline of good-quality transformative projects, and because—as Adrian has said—we think that with the budget we can constantly raise the bar in relation to what we will support, which should feed through in the results. However, that comes with challenges.

Willie Coffey: Adrian—do you want to add something?

Adrian Gillespie: Yes. I will make just a quick but really important point.

Many of our customers and our staff across the world will listen in to this discussion, and they will hear a lot about the challenges around budgets. It is really important that we keep sending the message that we are looking for transformative projects, and that challenges do not lower our ambition. I just want to say, for the sake of our people across the world who are looking for projects, that the message from us is very clear: keep delivering projects and we will find a way to navigate through the budgetary challenges. We are raising our ambition, not lowering it.

Willie Coffey: That is brilliant. I have a few more questions that I would like to ask both of you.

We noted at committee previously that Highlands and Islands Enterprise seems to be scaling back a wee bit on its assessment and evaluation activity. There has been a little bit of discussion of that around the table this morning. Can you confirm that you do not have any intention of doing that, and that you will thoroughly report on, evaluate and assess the impact of your achievements and so on?

Al Denholm: I am not aware of what HIE said, so please excuse me. I hope that I interpret the question correctly.

We measure our impact on a company-by-company basis or investment-by-investment basis. We make it a condition of our investment that the company reports back to us. We have a central database that gathers all that information and we are committed to doing that.

As I mentioned in response to an earlier question, we see impact as being critical to what we do. It is about both impact and commercial success, and we have no intention of ever cutting back on that. We are also very transparent in reporting on that; in fact, we are very transparent on what our objectives for impact are, which is quite unusual for an investor.

Willie Coffey: Is it the same for Scottish Enterprise, Adrian?

Adrian Gillespie: Yes.

Willie Coffey: I will wear my parochial hat. You both mentioned some impressive figures at the outset. Al Denholm spoke about £650 million being invested in 37 businesses. Adrian spoke about 80,000 jobs being delivered, and 26,000 jobs in the investment pipeline coming along. If I ask you about this as an Ayrshire member of the Scottish Parliament, can I—or any of my colleagues—see where the benefit of all of that is going in relation to our particular parts of Scotland? Do you do that? I am not asking you for it now, but could we, as members of Parliament, see how that impact and those benefits are being spread around Scotland, so that all the communities in Scotland benefit from the activity?

Adrian Gillespie: Yes. We have information on impact by region.

In Ayrshire, for example, XLCC at Hunterston was a big contributor, with 800 jobs and almost a £1 billion in capital investment. There are some very chunky projects. I could go round Ayrshire and tell you more. There is DSM Nutritional Products, for example, and we have supported many other projects. There are also many more in the pipeline.

We can give the committee the regional picture. Frankly, I think that we could tell the regional story a bit better, and we are working on that.

Willie Coffey: That is excellent.

Is there any kind of regional dimension to SNIB's reporting?

Al Denholm: Yes. We were set up to make sure that we focus on all the regions of Scotland: that is our mantra. We are still young, so we have got to only 24 of the 32 councils so far, but our ambition is to get to all 32 in due course. I do not yet have any in Ayrshire, but that is not because of lack of trying.

Willie Coffey: My last question for you is about artificial intelligence and the ability to understand and engage with developments in that area. Neither of you has made a clear strategic mention of AI—for example, of its risks and opportunities—not only as that relates to what happens within your organisation but in relation to possible developments externally. Will you talk just a little about whether you are aware of the risks and opportunities that might be provided by AI, and about what you might plan to do in the years to come?

Adrian Gillespie: Yes—and you will see more about that in what we produce in the future.

We had a good discussion with our board just after the summer. Some aspects of that were to do with how we deliver our services, which HIE and SOSE mentioned a couple of weeks ago. When it comes to how we deliver, we are all involved in a pilot—if you like—of Microsoft Copilot. Through use of artificial intelligence we can also take away some things that our staff see as getting in the way of our working with our customers. We have just developed a digital and data strategy, which went to our board, and we will publish it very shortly and will have much more to say on how we will utilise AI.

AI is also an opportunity for the economy. Through our innovation advisers, we are working with companies on specific opportunities for utilising AI—in particular, some of the AI that is embedded in Microsoft Office and other products that companies already use.

It is also an opportunity for inward investment. There is a strong pipeline of AI companies, mainly from the US, that are very interested in Scotland. They see the skill set that we have here—the capabilities in engineering and software—as being really strong. For example, a company called Launchpad manufactures an AI box—the term does not do it justice—that can manufacture pretty much anything, including large structures for the offshore wind sector, for example. That involves significant amounts of private sector funding.

Actually, there is an interesting story around that. The company was not considering Scotland, but a referral came through a personal contact of one of our trade envoys in California, which put Scotland on the map. As soon as we were in, we were able to convince the company that Scotland was the optimal location. I make the point that our extended network across the world is very tuned in to the AI opportunity and is bringing opportunities our way.

AI is really important, and there is more to come from us on it, both as a sector in itself and how it cuts right across the economy.

Willie Coffey: That is excellent. Does SNIB have engagement with elements of AI?

Al Denholm: Yes. I will pick up on some of Adrian Gillespie's points—both on what happens within SNIB and in what we are doing in investment.

We in SNIB recognise AI as a potential productivity tool to help us to do our job a bit better. We are considering how we might do some of our due diligence better through linking into Companies House and other data sources to help to speed up that process. That does not mean that AI will make the decisions, but it will help to make gathering of the information that we need a bit more efficient. We are considering that.

However—putting on my risk hat—I want to make sure that we place boundaries when it comes to data going out, to make sure that we cannot be hacked. We will do all the things that you would expect, from a risk perspective. We are working our way through that.

We also note that all the people whom I call youngsters—I say that with grey hair—are aware of and use such tools to help them in their studies and their jobs, so that they know the language. We need to facilitate that safely. We are actively looking at that, and Copilot is one of the tools that we are looking at.

Because AI is a relatively new area, we are not seeing a lot of investment. We have to guard against an element of what I call AI-washing: people saying, “Oh well, we’re AI, therefore we deserve a higher valuation.”

Putting that to one side as something to be aware of when making an investment, we yesterday announced our first AI-related investment—in Leap AI, which is based in Aberdeen. Interestingly, it is focused on the food and beverages sector, which is an area in which there are skills shortages. It will help companies to do a bit more of their picking and sorting and putting vegetables in the right place, using a computer that can recognise whether something is an avocado, a potato or whatever. I am simplifying it for effect. We have made a £3.5 million investment in that Aberdeen company to support it, and we crowded in about £4 million of third-party capital at the same time.

Willie Coffey: That is interesting. That reminds me of the AI development in the national health service that dispenses medicines, which is also done very much in that fashion. Thank you for your example.

The Convener: I have a couple of questions before we finish. We have had wide discussion of financial transactions. My understanding of financial transactions is that they are consequences of UK Government spending. The former First Minister initially described them as a con before they were seen as a solution to funding the Scottish National Investment Bank. The Scottish Government has said that it assumes that there will be no further financial transactions. I come back to the Scottish National Investment Bank. The £2 billion funding is dependent on financial transactions, and the Scottish Government assumes that there will be no further financial transactions. What discussions are you having with it about alternatives, and how confident are you about the £2 billion, given that assumption?

Al Denholm: There are two elements to those conversations. One is about making sure that our case is made by the SG to the United Kingdom Government, to make sure that it thinks about how, in the next budget, it can help to facilitate this. We also make the point about the benefits that we bring. That is one conversation.

The other element is that it is up to ministers to decide how to allocate their budgets generally. We are making the point that we get a multiplier effect on the money that we spend, and that that benefit should be considered alongside other spending decisions. That very important case needs to be made.

The Convener: I have the same question for Scottish Enterprise about the assumption that there will be no further financial transactions, which play a significant part in your funding. There are options for the Scottish Government to transfer funds from resource to capital budgets. Would you ask it to do that, and what discussions are you having about alternative funding?

Adrian Gillespie: Our investment activities existed before financial transactions existed, and they were funded out of our regular capital budget. I mentioned that we have transferred £10 million, but we have not transferred £10 million; we have utilised £10 million of our capital funding to fund investments. The advantage is that, rather than financial transactions being paid back to the source of the financial transactions—the UK Government—if we do it from our regular capital budget, we keep all the returns from that, which we can reinvest. There are options open to us to use the regular capital budget to fund our investments and keep all the returns.

We strongly make the case that it is not a budget line or a spend line. It is an investment line, and it pays back down the line. We have a lot of evidence to show that the financial returns are significant. We have generated more than £500 million of income from those funds. There have been losses of £170 million, but they are a small part of the returns, but they have also created more than 4,500 jobs.

One thing about being patient and changing the economy over time is that it is easy to forget that, 20 years ago, the early-stage investment market looked very different in Scotland. The existence of those funds has brought a lot of new investors to the country. That is the case that we put forward.

Ultimately, the decisions will be with ministers, but we are doing our bit in looking for other sources of funding in Scotland and internationally, now that we have a very established and successful model that we believe compares extremely well with private sector investment models. There might well be the opportunity for us to leverage in other funds at the fund level to allow us to continue that.

We are trying to keep all options open, but the points that have been made this morning about the importance to the economy have been very well made. We need to find a way to keep those investments going; we need to find a way to make that happen, and those discussions are happening at the moment.

The Convener: Finally, I have a question for the Scottish National Investment Bank. When you were here in June last year, we had a discussion about the finance that was provided to Circularity Scotland. As part of that, you said that you were reviewing the decision-making process. Is that process complete, and have you learned any lessons from it?

Al Denholm: As I said at the time, I had looked through all the investment decision papers and the full audit trail of all the factors that were taken into account in that process. I did that through the lens of a new person coming in with experience in the investment industry as a chief investment officer at some of the largest institutions in the country. I did it on the basis of personal experience.

I looked through all those investment decision papers and contented myself that all the right steps had been taken, and that ultimately they were taken with the full operational independence of the investment committees of the bank, which was one of the challenges that we faced.

The actual underwriting process, as I said, was absolutely market standard: it included financial due diligence, operational due diligence, management due diligence, management opportunity and the political environment at the time. It included all those elements. Various Governments globally at the time were talking about circular deposit schemes, and we had support from various Governments in this country for that direction of travel. My conclusion was that, at the time when the decision was taken, it was a sound decision.

The Convener: Thank you. That is helpful.

That brings us to the end of today’s meeting. I thank witnesses for attending.

10:45

Meeting continued in private until 11:50.

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