1. What are the advantages or otherwise in establishing the Bank as a public limited company?

The advantages of this model can be summarised as follows:

- There are potentially more avenues available to raise capital, through share issuance.
- It possesses a more effective decision-making structure, through a single Board, with a Chairman and clear investment criteria.
- It is not impacted by State Aid rules.

Nonetheless, we at BfS believe that setting up the SNIB as a PLC is a somewhat controversial decision. This is mainly because the advantages set out above, and as presented in page 8, section 46 and 47 in the Policy Memorandum of the Scottish Investment Bank Bill, may also be seen as its disadvantages.

To make this clearer, having the ability to issue shares means that everyone can buy them and the amount of capital that can be raised is higher than in the case of the Private Limited Company. This can also share the risk, by spreading ownership to more shareholders, which can be advantageous. However, if anyone can buy shares it is possible, after a period of time, that the initial owners, in this case the Scottish ministers, lose control of the direction of the Bank or at least it may become much more difficult to control it.

For example, there is the possibility that an institutional shareholder, such as another bank that has higher purchasing power than other investors, becomes very influential or even reaches a point where the SNIB is under institutional ownership. In other words a PLC, as a company whose shares are freely transferable, has the advantage of attracting investment but is also more susceptible to takeovers. In the case of the SNIB that would result in the loss of control over the direction of the institution. This is potentially an issue of all PLCs but the very purpose of the SNIB makes this possibility a more serious issue that should not be disregarded.

There is then problems associated with issuing bonds. While it can be a stable and longterm source of finance, raising capital in this way could, nonetheless, place the bank in a situation where it is under the informal governance of financial markets. Were the risk in taking on such debt obligations to go wrong, that is it did not result in an effective income stream to service the debt, the Bank would have to take on new debts to repay old ones – i.e. issue new bonds or take out loans. The Bank’s ability to take on new debt to pay old debt would depend on the confidence of financial markets and not simply on the basis of being guaranteed by the Scottish Government.
To gain confidence, the Bank would need to make the investment attractive, and to do this it may need to sacrifice some control to private investors. One example of such a sacrifice would be to allow investors to purchase shares in the Bank, its subsidiaries, or shares it owns in other private enterprises at a future date. Another option may be to sell investors securities in the form of a collection of income streams flowing in from the Bank’s own investments, such as dividends or loan repayments to SNIB. Again, this would risk an encroachment of private interests in SNIB’s operations.

The ability to maintain the confidence of financial markets would again rest on the risk premium attached to the Bank by ratings agencies. But ratings agencies can also be steered by private interests that may wish to capture influence in the Bank.

Further disadvantages of the PLC model can be summarised as follows:

- A strict profit and risk criteria for investment and shorter-term profit aspirations may limit investment in start-ups and new sectors.
- PLCs may not be inclined to carry on supporting struggling investments for the greater good and are more likely to withdraw support.
- Free-market economics do not allow infant companies time to develop and gain strength to cope with competition.
- Contractual requirements for profit and return by a PLC may be unaffordable for smaller, higher risk ventures.

Given these dangers, the clause in page 8, article 47, that ‘share ownership remains with the Scottish Ministers, and that the Bank’s borrowing is zero unless the Scottish Ministers or the Scottish Parliament approve a different arrangement in future’ should have an extra clause. In addition, to better facilitate the public’s ability to have an input into the Bank’s activities, and precisely because of the purpose and main objectives of the SNIB, as they are presented in the Scottish National Investment Bank Bill, we at BfS believe that a cooperative ownership model and legal structure could be a better choice.

This is because co-operatives are based on values that are shared by the Scottish people such as: self-help, self-responsibility, democracy, equality, equity, and solidarity. A co-operative, as defined by the International Co-operative Alliance, is: “an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through jointly owned and democratically controlled enterprise”.

In relation to that, we propose the SNIB to have the legal structure of either that of the community interest company (CIC) or the community benefit society. Our reasoning is that in this case the ownership stakes (shares) cannot be sold, much like in co-operative banks operating around Europe, but can only be redeemed or sold back to the bank. This seems more appropriate considering that the shares will belong to Scottish ministers and thus ownership may unavoidably change over time. This eliminates the risk of a takeover and thus of the potential of change in the Bank’s direction.
The fact that it is not possible to issue new shares or to sell shares to an open market arguably minimises the funding sources. However, this can be turned into an advantage as it may put some constructive pressure on the directors because the absence of the option to finance the Bank through other routes will make necessary the seeking of investments that will be more likely to be profitable in the short term and then upping the investment risk profile once the banks success has been fully established.

This will also necessitate sustainable and long-term strategic thinking about the Bank’s objectives and operations. It must emphasised that the absence of clearly defined long-term strategy by the UK government combined with the possibility of selling shares to private investors arguably led to the privatisation of the UK’s Green Investment Bank; an institution with similar aims and objectives as well as legal structure (PLC) to the one proposed for the SNIB. We think the SNIB should be in the business of addressing market failure and realising unmet opportunity as opposed to creating another private investment vehicle with public money.

Using a cooperative model would allow the Scottish Government to pioneer new ways of raising capital. One of these could be to raise finance from local communities. Already communities in Scotland contribute money to fund their own development projects, where members of the community will make small donations (and become shareholders) in a project – spreading the risk throughout the community. If such projects fail, however, the community loses significant amounts. In many cases, these failures are due to inexperience in enterprise management. The investment bank could raise money from local communities and then coordinate investments, supervise them and provide expertise to ensure that projects succeed. These projects could subsequently be incorporated into the cooperative structure of the Bank – with the income stream split between the community and SNIB. The income stream to communities could be used for further SNIB-associated projects, while the SNIB’s dividends can be used to finance its other activities.

Using the network of cooperatives in this way can also reduce the risk of projects failing by easily moving capital around the company. An example is the Mondragon Conglomerate in Spain, the 10th largest business group in Spain. It has proved remarkably resilient even during economic depression: instead of closing less successful enterprises and/or making staff unemployed, it either moves capital from thriving enterprises to struggling ones, and/or labour from struggling enterprises to thriving ones. This way, jobs are protected and the risk of a fault in one part of the firm’s chain of activities spreading to the whole network is reduced.

Furthermore, our proposed legal structure does not eliminate the possibility of paying out dividends to members. This is one of the possible ways in which profits may be utilised. However, we believe that due to the nature of the SNIB, the primary objective should be to use profits either for reserves or for reinvesting them in other projects - as a way of self-financing the Bank’s operations. Meanwhile, a co-operative such as a CIC can be formed
as a limited liability company making the delegation of authority to directors possible to manage the company’s business and exercise all the company’s powers on a day to day basis.

The ‘asset lock’ issue that is referred to in page 8, section 46 in the Policy Memorandum of the Scottish National Investment Bank Bill as a reason for not choosing the CIC legal structure does not seem to be really a problem considering the nature and purpose of the SIB. It does not eliminate the possibility of selling assets to meet the obligations of the bank. Meanwhile, it is possible to set the Scottish Parliament as the asset lock body to which the assets are going to return to. For the SIB’s case in particular the asset lock restriction may be beneficial as it could act as a guarantee that the assets will not be transferred to anyone other than the specified asset-locked body.

Finally, ‘the regulator’ issue does not seem to be reason enough to reject the CIC. The role of ‘the regulator’ is arguably a bit unclear in the relevant publication by the UK government. However, it is clear that the purpose of it is to make sure the company, in this case the SNIB, is going to actually operate for the common good, which is certainly something that needs to be clear and not an issue considering the aims and objectives of the SNIB. In addition, it is also clarified that ‘the regulator’ will not make the process more lengthy with unnecessary bureaucratic formalities, which arguably means its role is that of the guarantor rather than of the decision-maker.

Nonetheless, there are potential disadvantages of the cooperative model too, as the very socialised nature of its governance (and thus number of parties involved in its management) may lead to inefficient decision making. This presents a risk to small and startup businesses who need to innovate and move quickly in order to succeed.

In any case, it is our view that the SNIB should not be a PLC. The disadvantages of establishing a bank as a public limited company relate to UK legislation (Companies Act 2006) which obliges companies to give primacy to shareholder returns. This coupled with ‘light touch’ regulation drives aggressive short-termism which further drivers the UK’s equity gap.

In 1945 the Industrial and Commercial Finance Corporation (ICFC – later Investors in Industry) was founded to close the equity gap and provide finance for SMEs from the level where commercial banks stopped lending. When Investors in Industry was privatised as 3i in 1994 this invaluable service to SMEs ended.

A study from David Merlin-Jones suggests that there are five lessons from the experience of the ICFC:

- The ICFC established local branches and got to know local businesses. Staff, with expertise in specific industrial sectors, took account of these relationships and did not make sweeping decisions about entire sectors.
• It invested for the long-term in companies that were well-run firms with good management teams.

• It would be unwise to establish a new industry bank as a limited company where the drive for profits leads to short-term investment strategies. If funds are to be raised from private investors, it should be in the form of bonds and other instruments to insulate the bank from short-term pressures.

• The ICFC was established by the Bank of England and relief heavily on the existing banking sector which used this dependency to undermine the competitive threat imposed by the ICFC. An industry bank should be established as a rival the main banks, not as a dependent offshoot.

• Unlike the Green Investment Bank, the ICFC was not focused on a narrow sector to deliver political ends, rather it supported any business with a sound business plan.

Thus, the SNIB needs to occupy the space that a PLC, for good reasons, cannot or will not occupy. Aside from the cooperative structure, there are also other models that could deliver success.

The first would be to establish SNIB as a semi-autonomous branch of the government, with no shareholder structure. Doing so would offer the following advantages:

• It would keep the cost of borrowing lower as it can raise money at state bond rates.

• A public body can take the higher risk for the common good.

• It would deliver a more stable patient capital, as state ownership can permit a much longer-term view to be taken and allow time for ventures to become profitable and succeed.

• State owned bodies are less likely to allow ventures in key sectors to fold.

• State investment can deter the acquisition of successful ventures, allowing value to remain within Scotland. Indeed, it may be possible, for key ventures at least, to rule out private sector acquisition, at least for a period.

• State lending is more likely to have social outcomes attached to its terms (such as investment in local economies) than private investment, which is more likely to be purely profit focused.

Yet there are disadvantages with this model that must be taken into consideration:

• State bodies may be more susceptible to political interference – what wins votes rather than what investments make the most sense.

• The decision-making process can be more bureaucratic, with a broader range of stakeholders and views to consider.
• A state-owned entity cannot issue shares to raise more capital, although it may have
greater access to grant funding than a PLC, subject to State Aid rules.

Given the weaknesses of the state-owned model, it is pertinent to consider a third model,
that strives to deliver the best of both. This is the so-called B Corporation model or ‘B
Corps’. A B Corps is privately owned, but operates on a long-term model, with a strong
social and ethical influence over its operations since its articles of association oblige it to act
in the common good. Toridos Bank is an example of a B Corps bank and it is proposed that
a B Corps model for the SNIB should be seriously examined. If a B Corps is found to be
inappropriate, the state-owned model or cooperative model is likely to be the best fit for the
SNIB.

2. What in your view are the fundamental characteristics of a national investment
bank?

In our view, which is based mainly on the role of existing national investment banks around
Europe, the SNIB’s primary responsibility should be to provide aid in the form of investment
opportunities in those areas that are underdeveloped – and to protect underdeveloped
enterprises from the pressures of international competition. These are usually areas in
which investment is considered, by private investors, to be of higher risk or of less
profitability in the short-term. For instance, areas that require further research or innovative
approaches within existing sectors, with an emphasis on projects that have the potential to
improve productivity in particular; considering Scotland’s productivity issues. It is these
short-term motives that produce an equity gap for SMEs, typically between £20,000 and
£2million, which is a barrier to productive growth. An investment bank should aim to plug
the equity gap.

It is logical for a private investor operating within an environment that is not rewarding
sustainable and innovative approaches, driven by short-term profits, to avoid investments
that go beyond the norm. The role of the SNIB should be to enable these types of
investments and create the environment that encourages them as it is proven that they lead
to technological breakthroughs and advances as well as economic growth.

This is why it should be supported and mandated by the Scottish state. There are many
examples around the world, in which state-backed institutions were able to support
investment in underdeveloped sectors and underfunded groups and areas. For example,
we think it is of the utmost importance for the Scottish economy to provide finance to SMEs
that play a fundamental role in driving the Scottish economy. In addition, we think that
groups that underrepresented such as female and BME entrepreneurs should be
particularly supported as they represent a large and dynamic part of the Scottish population.
Supporting them could provide an instant boost to the Scottish economy.
However, to do so it is important to be able to provide more than financial assistance. The Bank’s personnel should be able to provide guidance through its expertise. Having personnel that possesses financial as well as scientific expertise could be beneficial in identifying the best investment opportunities for the bank as well as help those interested in being financed by the bank. In general, it should be concerned with tasks and activities that promote the common good of the people of Scotland focusing on sustainable prosperity.

We believe, in line with Mazzucato and Macfarlane, that the SNIB should have a wide range of instruments at its disposal, including both debt and equity, suited to different areas of the risk landscape. However, we believe that issuing bonds should be the main way through which the bank should be financed. This will enable it to be independently financed, while it will provide the SNIB with the freedom it requires to operate as bonds, unlike shares, do not come with an ownership right. In addition, it provides the Bank with many choices of bonds to work with. It is expected that a Bank backed by the Scottish state would be appealing to potential bond buyers.

3. **Is the level of capitalisation proposed sufficient for the Bank to deliver its desired impact? Please expand.**

The level of initial capitalisation should be sufficient to make an impact on the Scottish economy in the initial years. While we welcome the fact that the Scottish Government does not intend to borrow to increase its capital base for now, we would urge against any move to do so in the future – something the policy memorandum does not rule out.

The borrow to lend model of investment banking – as the 2008 financial crisis revealed – can be a risky model. Some of the problems of borrowing have been outlined in the response to question 1. There are other problems too. For instance, in the event of a financial crisis, were one to happen, if SNIB required borrowing to keep its capital levels up to a sufficient level to avoid insolvency, interbank lending could seize up – as it did in 2008 – leaving the Bank without necessary funds. As the credit system consists of a concentrated market of global banks, borrowing will likely increase the exposure of SNIB to international financial markets and the threats that come along with that, such as the consequences of financial speculation from elsewhere in the world economy.

4. **What is your view on the proposed costs in the set up and day-to-day running of the Bank?**

N/A

5. **What governance arrangements ought to be in place?**

With regards to the members of the co-operative that would form the ultimate decision-making body, we propose a pluralistic model of governance consisting of three main bodies. To clarify, in line with the First Minister’s recent announcements, we suggest that one of the bodies should be the Citizens’ Assembly. This would enable the participation of people from the wider Scottish society and the representation of the diverse ideas and views that make
up Scotland. The process of choosing the members of the Scottish Citizens’ Assembly has not been set yet, but if it follows the Irish model then this will take place in a random way. It follows that the membership/ownership rights are going to be transferable.

The Scottish Ministers should be the second body, as the democratically elected representatives, and they should have the same membership/ownership rights as the members of the Citizens’ Assembly. The third body should consist of a Panel of academic and industry experts that will be able to provide expertise and guidance. This body should be selected by the Scottish government and it should have the same membership/ownership rights with the other two bodies. These three bodies should form the ‘community’ of the co-operative looking to direct the operations of the SNIB towards the common good of the people of Scotland.

6. **How can we ensure the market is ready for the investment opportunities the Bank can offer?**

We agree that the Bank should be a lender of first resort and not just of last resort, generating innovations to shape and create markets as opposed to only addressing market failures. However, due to specific circumstances in Scotland, the initial question for SNIB is not just how it can make the market ready, but rather, how it can first preserve markets in vulnerable parts of the country. This can be done through a combination of lending to encourage innovation but in areas of market failure.

One example is the exit of many commercial banks from rural Scotland. In 2018 BfS issued a survey on local bank closures in Scotland. 97% of the respondents to this survey managed micro- or small-businesses. 80% of respondents knew of one or more banks that had closed in their area since 2010. 52% of respondents already experienced the impact of these bank closures. 96% of respondents answered that it would impact negatively on their business. Problems cited are increased travel times to bank branches and a lack of places to deposit cash, raising cash-flow problems.

As our survey revealed, market failures such as this affect actors across the entire market. This can have especially negative consequences in more rural parts of Scotland, which account for the majority of its landmass. Respondents answered that one of the functions of SNIB should be to fill the gap left by commercial banks that exit vulnerable areas of the country. One of the activities of SNIB could therefore be to pioneer innovative models of community banking that are able to overcome geographic barriers but are also resilient to the economic situation in vulnerable areas: a combination of lender of first and last resort.

7. **What ethical and equalities considerations do you think should inform the Bank’s ethos and decision making?**

We believe that the Bank should hold to the following principles: equality; transparency; diversity; and inclusion. It should be established and run following the spirit and practice of open government. We would like to add, in the same manner, that it should be
characterised by an ethos of honesty, openness, social responsibility and caring for others. Following our proposal that the Bank should be a co-operative it should, subscribe to the following set of co-operative principles as they are set by the International Co-operative Alliance: voluntary and open membership, democratic member control, member economic participation, autonomy and independence, provision of education, training and information, co-operation among co-operatives, and concern for community.

In accordance with the Ethical Standards in Public Life (Scotland) Act 2000, we suggest that its code of conduct should be defined by the above principles, while we believe that the Bank should operate in prefigurative way. This is to say, its code of conduct should act as the paradigm of what the outcomes of the investment projects it finances should follow. In other words, the projects it supports and the tasks, be it cooperation with other national investment banks or international organisations, it undertakes should be those that are in line with these ethical principles. Therefore, the ethical considerations of the operation of the Bank should not end with it but they should be the basis upon which it chooses its investment projects.

As with our proposal about what the legal structure of the Bank should have, we agree that it should make information about its operations public in accordance with the Freedom of Information (Scotland) Act 2002. With regards to the Gender Representation on Public Boards (Scotland) Act 2018, we totally agree that steps should be taken in order to achieve the 50% of the directors being women target. In addition, we would like to propose that when it is possible preference should be given to people of different ethnic backgrounds to have a more balanced and proportionally accurate representation of the population of Scotland.

If the Bank is to be one instrument supporting the Scottish Government's mission to tackle inequality in Scotland, the Bank itself should introduce an income cap for its employees. The Mondragon Corporation again sets the example here, with the wage ratio between the highest and lowest earners being 20 to 1 – it is possible to have this kind of income distribution in a large institution.

The Bank should also set an example by working out a framework which rejects investments that generate zero-sum returns. In other words, the Bank should not undertake investments that may benefit the Scottish public but at a cost to other people in the world. An example of such ‘zero-sum’ investments is the Norges Bank’s shareholdings in real estate firms. Particularly in Real Estate Investment Trusts (REITs), real-estate firms that ‘streamline’ taxes and are engaged in financial speculation in real estate. In the UK, looking only at the top five firms in the real estate market, the Norges bank owns significant shares. Norges Bank also owns shares in other financial firms that have investments in REITs.

These are highly profitable activities that would generate income that the Bank could channel into sustainable activities and supporting communities. But such investments as those in real estate, and this is just one example, exacerbate inequalities elsewhere, reduce
affordable public access to housing, and reduce the tax base of governments. The Bank’s model must take into account the wider global society, not just the local society, before investing.

Given this, it is again worthwhile to mention the B Corps bank (such as Toridos Bank), which maintains – bound by its articles of association – an ethical mission to act in the common good.

8. It is proposed that the Scottish Government will set the strategic direction of the Bank but the body itself decide on its investment approach. What is your view on this “mission-led” approach?

We consider the mission-led approach proposed for the Bank to be the one that is most commonly used by other NIBs around the world and thus probably the most appropriate one. According to Mazzucato and Macfarlane Mission-oriented policy is distinct from traditional approaches to economic policy in a number of key ways with the major one being concerned with co-creating and shaping markets to achieve societally agreed missions driven by public purpose, rather than limited to ‘market fixing’.

This is indeed what the Bank should be aiming to do. However, we would like to add that the mission-led approach of the SNIB should be informed by the Scottish values put forward by the Scottish government in its 2015 Economic Strategy as well as in its 2018 National Performance Framework (NPF). In BfS we believe that the powers of the Scottish government should be used for a purpose and this purpose should be informed and driven by the values of the Scottish society.

Consequently, we think that the mission-led approach should be a values-led approach; the mission should be to act upon the Scottish values and reinforce them through investing in projects that promote the following; security and opportunity; wellbeing and development; sustainability and equality; and, internationalisation and inclusivity. We believe that a strong economy needs a strong society and vice versa and we think that this is possible through this value-led approach.

With regards to that, it is fundamental for the Scottish government to utilise the National Performance Framework in conjunction with the values-led approach suggested here, to judge the success of the Bank. It should act proactively to develop and maintain this framework for evaluating performance over time, to inform decisions about future policy. The absence of clarity in the criteria through which the Green Investment Bank was going to be evaluated was one of the main reasons the UK government was unable to judge its performance in relation to the GIB’s aims and objectives. This is something that the Scottish government should be aware of and act in order to avoid.

9. Is there any other aspect of the Bill you wish to address? Please elaborate.
We would like to raise the two following issues:

1) We think that utilising the funds available through the Financial Transactions Capital (FTC), to assist with the capitalisation of the SNIB is certainly a safer way than trying to attract private capital. However, considering that the FTC has to be repaid to the HM Treasury and in line with the FM’s announcement about another referendum for independence, we would like to propose that in case the people of Scotland vote for independence the FTC debt should be transferred to the Scottish Central Bank.

2) The proposed legal structure as well as the justification for choosing it resembles a lot the initial reports and announcements by the UK government about setting up the Green Investment Bank. However, the GIB was being designed specifically with a view to a possible transfer of the company to the private sector in due course:

“The GIB will initially be owned by the Government and will operate as a separate institutional unit at arm’s length and with full operational independence. The GIB’s proposed governance model will be designed to allow for a possible eventual transfer of ownership from Government to the private sector of some or all of its activities”.

With regards to that and since choosing the legal structure of a PLC is mainly for the purposes of attracting private capital, are there similar plans for the future of the SNIB? Is the Scottish government considering the possibility of transferring the Bank to private ownership in the future?