ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 2 December 2009

Session 3

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ECONOMY, ENERGY AND TOURISM COMMITTEE
32nd Meeting 2009, Session 3

CONVENER

*Iain Smith (North East Fife) (LD)

DEPUTY CONVENER

*Rob Gibson (Highlands and Islands) (SNP)

COMMITTEE MEMBERS

*Ms Wendy Alexander (Paisley North) (Lab)
*Gavin Brown (Lothians) (Con)
*Christopher Harvie (Mid Scotland and Fife) (SNP)
*Marilyn Livingstone (Kirkcaldy) (Lab)
*Lewis Macdonald (Aberdeen Central) (Lab)
*Stuart McMillan (West of Scotland) (SNP)

COMMITTEE SUBSTITUTES

Nigel Don (North East Scotland) (SNP)
Alex Johnstone (North East Scotland) (Con)
Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)
David Whitton (Strathkelvin and Bearsden) (Lab)

*attended

THE FOLLOWING GAVE EVIDENCE:

Crawford Gillies (Scottish Enterprise)
Archie Kane (Lloyds Banking Group)
Lena Wilson (Scottish Enterprise)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Katy Orr

ASSISTANT CLERK

Gail Grant

LOCATION

Committee Room 1

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 2 December 2009

[THE CONVENER *opened the meeting at 10:34*]

Financial Services Inquiry

The Convener (Iain Smith): I welcome colleagues to the 32nd meeting of the Economy, Energy and Tourism Committee in 2009. We have two items on today's agenda. Later, we will hear from the new chief executive of Scottish Enterprise, Lena Wilson, along with the chairman, Crawford Gillies, on the agency's future proposals, but first we have the continuation of our banking and financial services inquiry. I am pleased to welcome back our adviser, Philip Augar, and I thank him for his helpful advice to the committee throughout the inquiry.

Today, we have one witness: Archie Kane, who is a group executive director with Lloyds Banking Group. I am pleased to welcome him to the committee. I invite him to make some brief opening remarks and then we will open the questioning.

Archie Kane (Lloyds Banking Group): Thank you, convener. I thank the committee for inviting me to speak to it today. Lloyds Banking Group is happy to take part in the inquiry, as it examines how the future shape of financial services affects Scotland.

There is no doubt that Scotland suffered when HBOS and the Royal Bank of Scotland got into difficulties in 2008. The circumstances behind those difficulties have been well documented and clearly articulated. They had a significant impact, but Scotland's fundamental reputation as a strong financial centre remains intact.

It is important to bear in mind that the financial sector in Scotland is not simply banking. The insurance and fund management sectors in Scotland are very robust. They have deep and wide pools of talent and have come through the crisis in remarkably good shape.

I was part of the Treasury's financial services global competitiveness group. One of that group's findings was the strength of financial services throughout the United Kingdom, not only in London and particularly in Edinburgh. I still firmly believe that a strong and growing financial sector is not only important to Scotland but vital to the economy as a whole.

Scotland plays a significant part in Lloyds Banking Group. We are one of the largest private sector employers in the country, with more than 20,000 staff throughout Scotland; our registered office is on the Mound here in Edinburgh; and we hold our annual general meetings in Scotland. A large number of the group brands are based in, and run from, Scotland. The Bank of Scotland, Scottish Widows and Scottish Widows Investment Partnership are some examples of those brands.

As the main board director with responsibility for the group in Scotland, I established the Scottish executive committee, which meets monthly in our office on the Mound and brings together senior executives from throughout the group in Scotland at managing director level to consider matters from the group perspective in Scotland.

Lloyds Banking Group has been in receipt of state support and the Government owns 43 per cent of the company's common equity. The recent announcement about our capital raising, which our shareholders approved last week, gives us a good platform on which to build Lloyds as a stand-alone business eventually. I acknowledge that the level of Government support comes with great responsibility to our customers, colleagues and the community at large. We in the banking world have to learn from what happened recently. I understand that not everybody agreed with the merger of Lloyds TSB and HBOS, but I believe that the new enlarged group will deliver long-term value for our shareholders and am committed to ensuring that Scotland is proud of the company, which has great Scottish brands such as the Bank of Scotland at its core.

I would be happy to take questions.

The Convener: Thank you very much for those opening remarks. I will explore a couple of points with you to clarify where the Scottish operations sit within the Lloyds Banking Group structure. First, will you explain your own position a bit more? What is your current role within the group and where do you sit within the corporate structure?

Archie Kane: I am a main board director of Lloyds Banking Group. I have been in the company for almost 24 years, from the Trustee Savings Bank through Lloyds TSB to Lloyds Banking Group. I have been on the board for almost 10 years and am the longest serving main board director. I am responsible for the insurance group of businesses within the group. There are four operating divisions within the group: retail banking; wholesale banking; wealth and international; and insurance.

Insurance comprises such brand names as Scottish Widows, Clerical Medical and Halifax Life. There is a bunch of general insurance businesses as well. When we aggregate all our insurance businesses, we are the biggest insurance company operating in the UK. The division is headquartered in Edinburgh, where the executives meet monthly. About 70 per cent of the top executives are resident in, or operate from, Edinburgh. The headquarters of the division is therefore in Edinburgh.

I also have responsibility at main board level for Scotland across all lines of business—all the banking, asset finance and so on. To meet that responsibility, I constituted the Scottish executive committee, to which I referred in my preamble, which consists of about 14 or 15 executives at managing director level—they are very senior people. For example, Philip Grant, the chief operating officer of the wholesale bank, who is based in Edinburgh, sits on the committee, as do Susan Rice, whom I appointed as managing director of Lloyds Banking Group in Scotland, and Caroline Booth, the worldwide head of purchasing and procurement for the whole group, who lives in and operates out of Edinburgh. Those are the type of people whom I have on that committee, which meets monthly and operates from the Mound. I therefore have a dual responsibility for the insurance businesses and for all the businesses in Scotland.

The Convener: You mentioned that the registered office for the group would be in Scotland. What functions does the registered office have?

Archie Kane: The registered office has just been moved to the Mound this week, I think. It used to be in Henry Duncan house with the Lloyds TSB group. Certain legal and company secretarial functions reside in the Mound, as well as the insurance businesses and a range of other activities. Perhaps I should just explain a bit about the Mound. We have based our Scottish headquarters, which includes many of the things that I have discussed, on the Mound. However, we are running out of space on the Mound, which is an active and vibrant place. I am told that that is different from how it was prior to the acquisition. In fact, when I arrived on day one of the acquisition of HBOS, the building was fairly empty. I can reassure members that it is now a very active and vibrant place. The biggest problem now is trying to find space for people to fit into it. We have plenty of other offices in Edinburgh, so I am sure that we will be able to deploy people. However, the dynamic on the Mound has changed significantly.

The Convener: Just to clarify, is the building on the Mound the registered office for the whole Lloyds Banking Group or just for the Scottish operations?

Archie Kane: It is for the whole group, so we hold our annual general meetings in Scotland. Over recent years, they have been in Glasgow, and they were in Edinburgh prior to that. That was the case in the Lloyds TSB world as well as in the Lloyds Banking Group world.

The Convener: Was the last AGM not in Birmingham?

Archie Kane: We had a general meeting, not an annual general meeting, in Birmingham, which was for the rights issue that took place last week. As you will probably know, the meeting was held at very short notice because of the discussions with the Government over the asset protection scheme and our decision to have the rights issue. Despite various attempts, we could not find a venue elsewhere at short notice that was big enough to accommodate us, so the meeting was held in Birmingham.

The Convener: But the main corporate headquarters for the group as a whole is in London.

Archie Kane: The Lloyds Banking Group headquarters is in London. They have always been there and we indicated that that will continue to be the case. I spend some time in London and some time in Edinburgh.

The Convener: You mentioned Susan Rice. We read in the papers recently that her role is changing. Is that the case?

Archie Kane: Yes. Susan Rice was for a number of years chief executive of Lloyds TSB Scotland, which was a subsidiary of Lloyds TSB. When we started to pull all the businesses together following the acquisition, I asked her whether she would accept the role of managing director of Lloyds Banking Group in Scotland, which of course has a far greater and wider remit. I am very pleased to say that Susan took up that appointment. She has moved into the Mound building and is now working there with a small team. As part of that appointment, she had to relinquish her position in Lloyds TSB Scotland, which is a fairly small part of our operations in Scotland. You probably read that, as part of our discussions with Brussels and as a result of the state aid negotiations, we will have to dispose of Lloyds TSB Scotland along with a portfolio of other businesses throughout the UK.

10:45

The Convener: I have a final question on the structure and management of the Bank of Scotland operations and the Lloyds TSB branches in Scotland. Where are the key decisions taken on that? Are they taken in Scotland?

Archie Kane: Peter Navin is responsible for Scotland and all the branches in Scotland. He operates in Scotland and covers all those branches. He has a team that focuses on the branch networks in Scotland, which currently are the Lloyds TSB Scotland and Bank of Scotland networks. That is all run within Scotland. He then reports down to London to a colleague of mine, Helen Weir, who is the group executive director in charge of the whole of the retail bank.

Lewis Macdonald (Aberdeen Central) (Lab): Our inquiry remit covers the future of Scottish financial services, but it is important that we get your perspective on how we got to where we are. You mentioned the observable change on the Mound between the time when HBOS was there and the present day. You have already seen some changes worked through. Will you briefly give us your view of what the cardinal failures were at HBOS and what the principal reasons were for its getting into such a position?

Archie Kane: I was not a director or member of the executive of HBOS, so I cannot give you deep or private insight into what happened there. If we consider what happened during the financial crisis, particularly at the end of 2008, we find that banks throughout the world got into difficulties, so that was not peculiar to the UK or Scotland. Clearly, HBOS was one of those banks. Right from the start of our involvement with HBOS, we have applied our risk models and our risk appetite—the areas and types of business with which we will operate. Businesses have to meet certain criteria to meet our risk appetite. It is clear that HBOS's operating model and its approach to risk were different from ours.

Sometimes the inference is drawn that there was a problem in Scotland. It is important to say that my view is that the issues that impacted on the two big Scottish banks were more to do with the operating models that the banks used than with anything intrinsic to or endemic in Scotland and the Scottish economy. Banks in virtually every jurisdiction in the world ended up having problems—we could look at Fortis, Commerzbank and ING. Fundamentally, the issue comes down to the operating model that those institutions used.

Lewis Macdonald: Representatives of UK Financial Investments came to see us a couple of weeks ago. To paraphrase their evidence, they said that the Royal Bank of Scotland suffered from an institutional bias in favour of growth and acquisition rather than value, and that HBOS suffered from a culture of risk taking that had lost touch with the value base on which judgments should have been made. In essence, there were two faulty operating models and it was coincidental that they were both banks with a substantial base in Scotland. Is that in line with your analysis?

Archie Kane: I agree with that.

Lewis Macdonald: What did you find when Lloyds TSB took over HBOS? Clearly, the decision to merge with HBOS must have been a difficult decision because people would have been aware of the problems in HBOS. After the merger, did you find what you expected to find?

Archie Kane: We did a huge amount of due diligence before we acquired HBOS. In fact, we did everything that we could legally do as one public company dealing with another public company. We were aware of the problems, particularly in the commercial and corporate lending markets. What we did not predict—very few people did—was the steep and rapid decline of the economy in quarter 4 last year and into this year. When a bank has big lending books, a rapid decline in the economy has an impact on impairments and bad debt provisions. That is the one thing that we probably underestimated. However, we were not alone in forming that view.

When we took over HBOS, we found that the risk culture and the approach to risk were not the same as we would expect in our own organisation. Perhaps some of the management information was not as strong as we would expect in our own institution. Clearly, some decision making was handled in a fashion that would not have been our way. Those are the types of things that we found. However, from day one, we have applied our own risk modelling and risk reporting. We have investigated all the books on a file-by-file or case-by-case basis, so we now have a pretty good handle on the situation, the level of exposure and what activities fall within our risk appetite. As regards those bits that fall outwith our risk appetite, we are working our way carefully through with those clients to find sustainable long-term solutions as we go forward.

Lewis Macdonald: I assume that you also found low morale, especially when it became clear that HBOS had rapidly lost value. How have you gone about changing the culture among the staff you acquired through the merger, especially among those who were responsible for, or involved in, the faulty decision-making processes? To what extent have they accepted and endorsed the change in direction and culture in the business?

Archie Kane: Clearly, morale is a key issue when dealing with large numbers of colleagues and staff. However, a quite interesting and peculiar phenomenon was that, perhaps because morale had gone down a great deal towards the end of 2008 as the problems of HBOS became manifest, there was a sense of relief when the takeover deal was done. That was the feedback that we kept getting back from the line management in the HBOS companies. Of course, as we went into the difficulties of the economic crisis and had to face up to the issues confronting Lloyds Banking Group, we had to rebuild morale not only on the HBOS side but on the Lloyds TSB side. Morale, communication with staff and motivation of staff are key issues as we go through difficult times.

I have great sympathy for the staff. We are going through a large and complex integration of two very large organisations. That creates uncertainty for staff. Having run the whole merger when Lloyds and TSB got together, I am very aware of the impact that integration has on staff. The issue affects staff from both heritages—both HBOS staff and Lloyds TSB staff—so we want to get through that as quickly as possible. Obviously, communication is key. We need to clarify the future as quickly as possible by working through the various projects, laying out the strategy and explaining to people how things will operate in terms of jobs and so on.

Lewis Macdonald: The merger of Lloyds and the TSB was clearly driven primarily by commercial considerations. Was the merger of Lloyds TSB with HBOS primarily a commercial decision or was it a patriotic act?

Archie Kane: The Lloyds TSB board had to operate on behalf of its shareholders. We had to consider the merger as a commercial decision. The caveat to that answer is that it is evident that we would not have been able to take over HBOS if it had not been in trouble. We would also not have been able to take over HBOS if the Government had not been prepared to waive the normal competition rules. We could not have become trammelled in a long-term competition review because the share price of both banks would have been vulnerable. That is evident and there is no point in trying to hide from the fact, but we had to consider the merger on a commercial basis. When we made the decision, we did it on a commercial basis and we still believe that, in the fullness of time, it will be seen to be a strong commercial case.

It is evident that we have some short-term difficulties to work through. However, I point to the almost unanimous—more than 99 per cent—shareholder vote in favour of the rights issue last week. That would not have happened if we did not have a viable strategy and the investors did not believe in the company's future; otherwise, they simply would not have subscribed to that rights issue.

Lewis Macdonald: How important was the emergency liquidity assistance in that judgment? Was it critical to your decision and the success of the acquisition?

Archie Kane: You refer to central bank liquidity assistance. It is important to remember what was going on at the time. Towards the end of 2008, Lehman Brothers was failing and Northern Rock failed and was completely taken over by the Government. There was serious concern about financial stability throughout capitalist western society. Central banks in all those jurisdictions made special liquidity arrangements available to the banks in their jurisdictions. What happened in the UK was no different from what happened in many other jurisdictions. In fact, we have availed ourselves of some of the central bank liquidity wherever we operate, such as the liquidity in the US and from the European Central Bank. What the Bank of England did in 2008 and has subsequently done is entirely in keeping with a central bank's role as a lender of last resort.

Liquidity was an issue. There was a complete shortage of liquidity. The credit crunch means that banks stop lending to one another. In those cases, central banks have to step into the breach to ensure financial stability. Financial instability was a real worry and a real threat. That was without doubt a backdrop to everything that took place.

Ms Wendy Alexander (Paisley North) (Lab): Mr Kane, in the autumn of 2008, was HBOS in any state to remain as a viable independent entity?

Archie Kane: It is clear now that HBOS could not have survived on its own. It was finished as an entity.

Ms Alexander: I am struck by the extent to which you have dwelt this morning on the concerns about HBOS's operating model, its appetite for risk, and the quality of its management information and decision making. Do I take it from that that you believe that it was brought low by its own strategy, rather than by the reactions of the markets—spivs and speculators, as they were dubbed at the time?

Archie Kane: It is evident that HBOS pursued a particular operating model and had a particular approach to risk that were different from those of other banks. Therefore, when the liquidity crisis hit, it was more vulnerable than other institutions. We look back now from the position of a much more stable regime. The financial sector is much more stable now because what the UK and other Governments did was appropriate and has done the job. As we look back and the dust settles, it is clear that some institutions got through the crisis because they had different operating models and approaches to risk and some did not.

Ms Alexander: Given all that, what are the benefits to Lloyds of the HBOS business?

11:00

Archie Kane: HBOS had a range of businesses. It had a very good retail franchise, particularly the

Bank of Scotland, which is an excellent retail franchise. It had a range of insurance businesses, for which I am now responsible, which we are rapidly developing and integrating. It had a large exposure to the small and medium-sized business sector. It had some issues on the corporate side that have to be worked through—I think that they have been well publicised and are understood now. It also had Halifax, which is the premium mortgage bank in the UK. HBOS therefore had a range of different businesses, not all of which were in trouble and some of which were in very good shape. It was the aggregation of the risk that was the problem. That is why we believe that, once we get through the short-term problems, we will have a very strong financial entity that will help us to move forward.

Ms Alexander: The phrase "short-term problems" is perhaps slightly euphemistic, given the scale of support that has been offered. Will you confirm that you were asked in writing in advance to tell the committee how much taxpayer-funded support the Lloyds Banking Group has received in the past 14 months, and could you explain to us why that information has not been provided?

Archie Kane: I am very happy to give you the numbers, if that cuts through to the issue that you are after. The Government put just over £17 billion of funds into the common equity of the new Lloyds Banking Group. There have been various pluses and minuses in the sense of money back and money out, but the net amount of cash flow, if you like, that the Government has invested in Lloyds Banking Group is about £17 billion.

Ms Alexander: What has been the maximum extent to which, at any point in the past 18 months, you have made use of the credit guarantee scheme, the special liquidity scheme and the asset protection scheme?

Archie Kane: Let me take the last one first. The asset protection scheme was offered in March 2009. At that point, we and RBS intimated that we would participate in the asset protection scheme. There was a clear reason for doing that. Quite frankly, the capital markets were closed at that point. We had no real alternative and no other place to go to get funding. As we worked through the summer and engaged in detail with the asset protection scheme, we came to the conclusion that it simply was not appropriate for us to enter into the scheme. However, we had to have an alternative. The alternative is the rights issue, which is a combination of common equity and a conversion of debt, which amounts to £22 billion-plus—the biggest of its kind in history. We can do that now because the markets are supportive. We believe that the rights issue is a much better solution and that it will accelerate the move of Lloyds Banking Group to being an independent entity, standing on its own two feet. That is our firm intention and objective.

We have therefore never drawn down anything from the asset protection scheme. Having said that, we have paid £2.5 billion to the Government. The reason for that is as follows: the Government and Brussels took the view that the fact that the asset protection scheme was made available to us gave an underpinning to the organisation that was implied insurance or implied state aid. We engaged in negotiations with those two parties, and engaged independent advisers on what the range of the value was. The Government had its range of value, and we met somewhere in the middle on the figure of £2.5 billion.

Ms Alexander: What was the implicit sum assured, which the £2.5 billion covered?

Archie Kane: The figure that we initially spoke about was some £260 billion of assets that we would have potentially put into the asset protection scheme. It is probably unlikely that it would have ended up at that number—it would have moved around. However, that was the initial figure that we used.

Ms Alexander: Could you give us comparable figures for the credit guarantee scheme and the special liquidity scheme?

Archie Kane: As you know, Mervyn King recently mentioned at the Treasury Select Committee that RBS and HBOS had received special liquidity arrangements from the Bank of England towards the end of 2008. For HBOS, that peaked some time in November 2008 and was paid back prior to the acquisition on 19 January—the figure was about £25 billion. Let me be clear that we, along with all other banks, continue to access the liquidity schemes from the central bank. Under the rules of the schemes, we cannot divulge at any point in time the amount that we take through them. The amount varies from time to time, depending on issues such as how the institution is moving, how much debt is paid back and how much lending we put into the economy. However, that is no different from the situation in any other country. In fact, as I said earlier, we access liquidity in a similar manner from the European Central Bank and the Federal Reserve in the US. Similarly, the rules are that we cannot divulge the sums at any particular point in time.

Ms Alexander: What about access to the credit guarantee scheme?

Archie Kane: That happens on a similar basis. I do not have the exact numbers.

Ms Alexander: It would be helpful if you could write to us with a summation. As a banker, you will understand that parliamentarians, as the stewards of the public purse, would like to record the full exposure of the taxpayer in supporting individual institutions in the past 14 months. For the record, those figures would be of interest to the committee.

Archie Kane: I am happy to write to you with information, in so far as I can divulge it.

Ms Alexander: I am happy with that.

I have one final question. Last week, the City minister, Lord Myners, said that the Lloyds Banking Group board was fully aware of the loans that were made under the emergency liquidity assistance scheme. Is that your recollection as a member of the Lloyds board?

Archie Kane: I assume that you are talking about the funds that had been advanced to HBOS prior to the acquisition.

Ms Alexander: I am talking about the emergency liquidity assistance. Lord Myners clarified that the entire board was made aware at the time.

Archie Kane: We were aware that significant funds had been advanced to HBOS. In fact, the prospectus that HBOS put out and the one that we put out specifically drew attention to the fact that funds had been provided and that they would continue to be provided. However, we could not talk about specific numbers, as the rules do not allow that. I guess that the concern at that time was about financial stability. In retrospect, it is understandable that there was concern not to create additional worries and to try to get through the difficulties.

Ms Alexander: In a hypothetical situation, if somebody at the AGM last November or December asked how much use you had made of the scheme, the answer would have been, “We can’t tell you.”

Archie Kane: Yes. We had a general meeting last week and we had similar questions. The chairman and chief executive were clear that we avail ourselves of the liquidity schemes, as does every other bank. That is not peculiar to us or to state aided banks; all banks can avail themselves of such schemes and do so to a greater or lesser extent. They do it in other jurisdictions as well. The rules are that we cannot divulge the extent to which we access the schemes.

Gavin Brown (Lothians) (Con): About 14 months ago, the Office of Fair Trading had concerns about the takeover’s impact on UK-wide competition in relation to personal current accounts and mortgages, and on lending to SMEs, particularly in Scotland. Was the OFT justified in its concerns?

Archie Kane: The OFT and the competition authorities have a duty constantly to monitor to ensure that competition operates appropriately in all markets throughout the UK. Frankly, that is welcome and sensible. We welcome competition, as it is a good thing. From time to time, investigations are mounted.

The banking and financial services market in the UK is highly competitive. Recently, there has been a change in the type of player in it. A number of the entrants—foreign entrants in particular—that came into the market and created a lot of the competition shut up shop and disappeared when the going got tough as a result of the financial crisis. There is nothing that can be done about that. If companies decide to withdraw from a market, they cannot be forced to stay, particularly if they are incapable of staying. Equally, there is still a large number of players in the mortgage market and in excess of 100 different institutions play in the savings and investments markets in the UK. The market is highly competitive. It will wax and wane over time and the backdrop of the economy will play a part in that.

Gavin Brown: Are you aware of any dialogue with, or investigations by, the OFT in relation to personal current accounts, mortgages or SMEs within Scotland?

Archie Kane: You will be aware of the current account charging decision that the Supreme Court handed down recently. The OFT was fully involved in that. That is an example of an area in which it was fully engaged, but I am not aware of other significant OFT investigations that would have a particular impact on Scotland.

Gavin Brown: Are you aware of any specific Scottish work that it is doing?

Archie Kane: I cannot bring to mind anything, although that does not mean to say that it is not doing work in Scotland.

Gavin Brown: Is Lloyds Banking Group taking any steps to try to ensure that the marketplace in Scotland is as competitive as possible?

Archie Kane: Yes. We intend to be a competitive force within Scotland. That means that we will have to have products that are fit for purpose and those products will have to be priced competitively. Our primary brand in Scotland will be the Bank of Scotland. I mentioned earlier the difficulties that HBOS had in surviving on its own. You must realise that it had basically shut down in the corporate and SME market in 2008. It was simply not operating because it had run out of liquidity and funds.

We are now breathing life back into the Bank of Scotland. It is up and running and is open for business. It is competing in the SME market and across the full range of its product set. We intend the Bank of Scotland to be a strong, competitive force within Scotland.

As part of the resolution of the state aid negotiations with Brussels, we have had to come to an agreement whereby we have to dispose of certain parts of our business. I make it clear that that is painful. Nobody likes to dispose of parts of their business. It is hard to gain business and market share—companies compete strongly for it and defend it as best they possibly can—so it is difficult to dispose of parts of the business. However, we have come to an agreement with Brussels and, as part of that, Lloyds TSB Scotland will be divested of, as part of the portfolio of businesses that we will put together. That will take with it a significant chunk of the personal current account market in Scotland and a proportion of the SME market in Scotland. It is unclear how that will eventually land. We do not know who will buy Lloyds TSB Scotland or whether it will be floated off. We have four years to work our way through that. However, one thing is clear: it will be a separate competitive force. That, in and of itself, resolves some of the concerns that might have prevailed.

11:15

Gavin Brown: Let us drill down into the SME market. MSPs get a lot of correspondence from SMEs. Roughly what percentage share of the SME market does Lloyds Banking Group have in Scotland?

Archie Kane: About 30 per cent. It is not the biggest player in Scotland. That is about where we are.

Gavin Brown: Roughly what impact would the divestment of Lloyds TSB have on that percentage?

Archie Kane: The impact would probably be in the region of 10 per cent plus—it would probably be somewhere between 10 and 13 or 14 per cent. Lloyds TSB Scotland's percentage is much smaller.

Gavin Brown: Just so that I have got things right—

Archie Kane: I am talking about start-ups. With respect to the existing book, the total share is around 30 per cent. Lloyds TSB Scotland's percentage would be smaller—it would be 9 to 10 per cent of the existing book.

Gavin Brown: I want to be absolutely clear. Would Lloyds Banking Group's market share of 30 per cent—give or take a percentage point or two—drop down to 27 per cent or to 20 per cent?

Archie Kane: It would drop to about 20 or 21 per cent of the existing book. I am talking about the total market share. I was initially talking about new business, as we tend to focus on new business. Those are the figures for the actual market share.

Gavin Brown: How have your lending policies to SMEs in Scotland changed? Roughly, has the percentage of SMEs that you have been able to say yes to changed over the past couple of years, say? Has net new lending changed?

Archie Kane: I must deal with the question in two halves. Lloyds TSB Scotland has increased its lending over the difficult time. In 2008, it significantly increased its lending to the SME sector by somewhere in the range of 15 to 18 per cent year on year. The Bank of Scotland declined during that period. Earlier, I mentioned that it was basically shut for business because of liquidity and funding problems, but we have opened up again and the bank is now active.

In the period from June this year, we have increased overall lending in the SME sector in Scotland by about 10 per cent. That has been done by bringing the Bank of Scotland back online and building up the pipeline, which takes a while. When I talk about SMEs, I mean businesses with a turnover of up to £15 million. We have started to rebuild the business pipelines.

We continue to have application conversion rates that are slightly in excess of 80 per cent. The figure varies, but it has not dropped below 80 per cent. We have definitely seen a drop in demand—that is, in the applications that we have received. There has probably been a year-on-year drop in demand of around 20 per cent.

We also carefully monitor the commitments that we have out there. The quantum of commitments that have not been drawn down is around 25 per cent. A significant amount of credit has been agreed and is available to the SME sector, but it has not been drawn down. There is an important reason for that. A large number of businesses have been destocking and paying back, or reducing, their debts. The level of repayments is significant.

Gavin Brown: You refer to a drop in demand and funds that have been agreed but not drawn down. How do you think Lloyds Banking Group as a whole will do against Government targets for lending to businesses?

Archie Kane: We have agreed with the Government that we will seek to deploy an additional £28 billion over two years—£14 billion per annum. The split of that is about £3 billion on the mortgage market and about £11 billion across the various sectors of the commercial market. The mortgage market is going fine. The difficulty, which is in the corporate and commercial sector, is in finding the demand, which is not as robust as it was in previous times. That is a challenge for us, but we are intent on trying to be available and to access businesses that are out there.

In the SME market this year, we have written to all our SME customers to indicate the services that we have available and that we are open for business. By the end of this year, we will have physically contacted all our SME customers to say that we are open for business. The reason why we are doing that is that it is quite evident that, given that the Bank of Scotland has gone through that difficult period, a number of customers might have formed the view that it was not really interested in participating in that market. It is very important that we get out there and communicate with customers. That is why we have that big programme.

We are also holding about 200 seminars per annum for small businesses and start-up businesses to try to explain to them what services we have available, how we can help them and how they can access our facilities. That is a new initiative that we have put into the marketplace. There is really quite a lot of activity in and around lending to the corporate and SME sector.

The Convener: Business organisations have told us that they are not applying for loans, not because they do not need the money, but because the conditions that the banks are imposing are such that businesses know that they will not get a loan. There is a view that some of the banks wish to reduce their exposure to property because they have been overexposed to it in the past. The fees that have been applied—either up-front fees or exit fees when the loan comes to an end—mean that businesses are simply not applying for loans. The 20 per cent drop in demand is not a result of there not being a need out there. People are not applying for loans because they know that they will not get them or because they cannot afford them.

Archie Kane: The reason why I mentioned the communication programme, the seminars and communication with customers is that we understand that there might be a perception out there that the banks—and our bank in particular—may not be interested or "open for business". That is not the case. Our application conversion rate has not changed. We still convert more than 80 per cent of the applications that we get into loans. That has been relatively consistent for a period of time.

Let me be clear: there are sectors, and businesses within sectors, that might not meet the appropriate credit criteria, so there will be cases that we turn down. At the end of the day, banks want their clients to succeed and survive. Banks lend money with the full intention of getting it back one day. There will be businesses that do not meet the criteria because of their operating model or risk structure. It is important to understand that and to be realistic about it. The intention of Lloyds Banking Group, particularly through the Bank of Scotland, which we are trying to breathe life back into, is to make it clear that we are open for business and that, in the corporate and SME market in particular, we are keen to do business with our existing customers and with new customers.

Rob Gibson (Highlands and Islands) (SNP): Good morning, Mr Kane. I want to move on to areas that you consider to be strong—insurance and asset management. You said in your submission:

> "Scotland remains a strong player in global finance. Firms in the insurance and asset management area have largely come through the recent crisis in good shape".

Indeed, you said in your opening remarks that they had come through in remarkably good shape. Will you say a bit more about the insurance division as based in Scotland?

Archie Kane: The Lloyds Banking Group insurance division consists of Scottish Widows, Clerical Medical, Halifax Life and a range of other smaller brands, and Lloyds TSB General Insurance and Halifax General Insurance. The headquarters of those businesses are on the Mound, as I articulated earlier, but they operate throughout the UK. Some businesses are based elsewhere. For example, our general insurance businesses are based in south Wales and Yorkshire, so we run those general insurance businesses from two hubs. Our life and pensions businesses are based in Edinburgh and Bristol. Those are the two primary hubs that we operate.

Our life and pensions businesses are number one in market share for the UK and are particularly strong in the insurance bond markets and mutual funds. We are also very strong in the pensions market and, to a lesser extent, in the annuities market. We therefore operate across the key, core, long-term savings markets throughout the UK.

Our general insurance businesses are about number three in distribution across the UK. We operate mainly in the home insurance and creditor insurance markets, although we also distribute motor insurance and so on. We are therefore a significant player in the life insurance and general insurance markets. Our headquarters for those businesses is on the Mound, so the finance director, I, the risk director and the human resources director operate from the Mound to run those businesses. I am also one of the managing directors of the biggest bit of Scottish Widows, which is clearly based in Edinburgh.

Rob Gibson: How much of the insurance division is Scottish Widows?

Archie Kane: Scottish Widows is the primary life and pensions business. In fact, we have announced the decision that that will be the predominant brand of our life and pensions business in future. We have combined the sales forces of the bank insurance sector and the independent financial adviser portion of the market, and rebranded at Scottish Widows.

Rob Gibson: How many of the 20,000 employees in Scotland are in the insurance business, and how many of those are in Scottish Widows?

Archie Kane: Of the 20,000, about 3,500 are in the Scottish Widows life and pensions business, which is virtually all Scottish Widows.

Rob Gibson: It is important to see how that might be a future player. Do you envisage it expanding its role to a greater extent than any other element or division?

Archie Kane: I fully intend the insurance businesses to grow. The insurance market is quite fragmented. Although we are number one, market share varies between 10 per cent and 16 or 17 per cent in the various individual product markets. There are therefore no restrictions on trying to grow those businesses, and we fully intend to grow them. If we think about it from the point of view of Scotland, having the headquarters of the biggest life company in Britain in Edinburgh is quite a new thing.

Rob Gibson: Indeed. Turning to asset management, and thinking about it as a strong, Scotland-based business, you are collating part of your business into the SWIP brand. Can you tell me a bit more about the size of SWIP and how it is organised in Scotland?

Archie Kane: Yes. When we took over HBOS, it had its own fund manager called Insight Investment Management. You have probably read that Insight has been disposed of and sold to the Bank of New York Mellon Corporation. Insight handled a large proportion of the internal funds, that is, the funds coming from the insurance and savings activities in HBOS. As part of that disposal, we are transferring all those funds from Insight, which was based in London, to SWIP, which is in Edinburgh. SWIP will therefore end up with some £120 billion to £125 billion of funds, which will make it one of the biggest fund managers in the UK. It is based in Edinburgh and run from Edinburgh—it is a Scottish institution.

Rob Gibson: SWIP's role in your group is clear. In the context of the company's potential, how many people are employed in SWIP?

11:30

Archie Kane: I used to run SWIP—I used to be chairman, but I have not been chairman for a little time. I think that SWIP has about 400 people based in Edinburgh. Fund managers are small in terms of the number of people, but SWIP is a big fund manager and will probably expand. I am not up to date on the exact numbers that SWIP has, but the figure is of that order.

Rob Gibson: Small but specialised as SWIP is, do you expect it to grow?

Archie Kane: Yes—

Rob Gibson: Will there be more jobs in Edinburgh?

Archie Kane: I expect SWIP to grow. We are talking about sophisticated, high-end jobs. The fund management sector is a deeply skilled environment. I expect it to grow because, among other things, I intend to grow the insurance businesses, which are a significant feed of funds into the fund management business.

Rob Gibson: Are you in asset servicing on SWIP?

Archie Kane: We outsource our back office to, for example, State Street, which is also based in Scotland. We have a big outsourcing deal with State Street.

Rob Gibson: Why?

Archie Kane: Because we have decided to focus our activities on the areas in which we think that we can add value and we think that the back office is best done by someone else. We make those decisions across all our businesses and across the value chain in all our businesses, on the basis of whether we think that we can create value. For example, in the general insurance businesses we think that we have real competitive advantage, so we do claims handling ourselves; in other businesses we pass functions to people whom we think can do them better and more economically than we can do them.

The Convener: Before we move on, do you have an interest in buying any of the RBS insurance businesses that have to be divested? Would you be allowed to bid for those businesses under European Union rules?

Archie Kane: I am not entirely sure whether the EU rules would allow that, but I must say that we have no particular interest in or intentions in relation to the RBS insurance businesses.

Stuart McMillan (West of Scotland) (SNP): May I take you back to your earlier comments? Do you feel that you are running a Scottish business or a business that is part of a larger group?

Archie Kane: It is quite evident that we are part of a larger group, so it would be foolhardy to pretend otherwise. I run the insurance businesses, but they are part of a larger group, and I am responsible for Scotland, as part of the Lloyds Banking Group. The business is part of a larger group, but the group takes Scotland very seriously—it is a significant part of the group's business. I personally take that seriously. I am Scottish and I have lived and worked abroad and travelled extensively; now I am back home.

I regard the role that Lloyds Banking Group plays in re-establishing its business and in helping the Scottish financial sector to recover from the difficult period as an important role on which to focus. The two objectives are goal congruent. The return of the financial sector in Scotland and the prosperity of Lloyds Banking Group are part of the same agenda. I am very interested in the development of the financial sector in Scotland and of Lloyds Banking Group as it operates in Scotland. If the Scottish economy does not do well, there must be an impact on Lloyds Banking Group in Scotland. If it recovers and does well, Lloyds Banking Group will do well, if it competes properly, as we intend it to do.

Stuart McMillan: You said that the Bank of Scotland is a primary brand in the group, which you want to be more open for business in the SME sector. Could the Bank of Scotland run as a separate entity at some point?

Archie Kane: That is a hypothetical question. We are focused on trying to revive the Bank of Scotland brand and believe that we have taken some pretty good steps forward, but we have a lot of work to do. Our intention is that the Bank of Scotland will be a key brand within the Lloyds Banking Group portfolio. That is our focus; we do not think about anything outside of that.

Stuart McMillan: Do you envisage the Bank of Scotland being focused solely on Scotland or will it be a UK-wide institution?

Archie Kane: Our primary focus is for the Bank of Scotland to be a Scottish brand that operates within Scotland. The other brands that will operate throughout the UK in the retail and commercial banking space will be Lloyds TSB and Halifax. They will be deployed in other areas throughout the UK. That is our focus and intent at this time.

Stuart McMillan: In your original submission to the committee, and in some of your earlier comments, you mentioned that around one fifth of the top 500 Lloyds Banking Group executives work in Scotland. I assume that those people are focused within Edinburgh and the Edinburgh area.

Archie Kane: Yes, and Glasgow.

Stuart McMillan: You said that AGMs would still take place in Scotland. Will other senior meetings primarily take place within Scotland or will they be elsewhere as well? I am thinking about the amount of travel throughout the UK that executives will need to do.

Archie Kane: The first thing to say is that we travel quite a bit, as Lloyds Banking Group is a large institution. I spend far too much of my time in the air, to be frank. I would rather not, but I have to do that. That said, a range of meetings take place in Scotland. There are the AGMs, which you mentioned, and the Scottish executive committee, which meets monthly in our offices on the Mound. The Scottish Widows board meetings take place in Scotland all the time. Black Horse asset finance is another brand that is run from Scotland; its board and executive committee meet and operate in Scotland. SWIP management and its board meet and operate in Scotland. Indeed, I used to be the chairman of SWIP, and we always met in Edinburgh; that will continue. There will also be a Scottish retail banking organisation, which will be run and will operate from here.

A considerable number of high-level committees will meet and operate within Scotland. However, the executives who are involved in those will, from time to time, have to commute to meetings that take place elsewhere. I am a member of the Lloyds Banking Group main board and have to attend that board when it meets. In recent times, it has met more often than not because of the problems that we have had, although I hope that that will calm down. No matter what sector they are in, any executive who runs a significantly sized business in Scotland and has business outside Scotland will travel quite a bit.

Stuart McMillan: What percentage or ratio of senior-level meetings and business operations takes place within Scotland compared with the rest of the UK?

Archie Kane: I would struggle to give you a fact-based answer on the percentage of meetings that are held in Scotland versus the percentage of meetings that are held elsewhere. I have never focused on that, but I go back to the fact that 20 per cent of the top 500 executives in the group are based in Scotland. That is an extremely healthy representation.

I also go back to the fact that our office on the Mound is now extremely busy with constant meetings. I do not know whether you know it, but the Bryce hall—the big hall at the centre of the Mound—is constantly booked for conferences and get-togethers. A number of those are senior HR conferences held by people based in London. A group operations conference was held recently on the Mound, and people came to Edinburgh for it. Those conferences are held on the premises, with a view to the current economic circumstances. A number of events that would previously have been held elsewhere, such as Birmingham or London, are taking place on the Mound in Edinburgh. That is a good thing.

Marilyn Livingstone (Kirkcaldy) (Lab): I have questions about employment. You said that 20,000 staff are employed in Scotland, and that 20 per cent of the top senior executives are based in Scotland. I know that you will be unable to give us exact numbers, but what kind of functions are the others involved in?

Archie Kane: Do you mean other executives or just the general population?

Marilyn Livingstone: Just give us an idea of the general trends in Scotland.

Archie Kane: The primary employer is the retail banking operation and the network. We have 480-plus branches, which employ large numbers of people throughout Scotland. We also have a large corporate banking operation, and I have mentioned the insurance operation, which employs 3,500 people. We have fund management businesses, information technology support services, administration services and so on. The retail bank is the predominant employer, followed by the wholesale bank, then the insurance division, and so on into group functions.

Marilyn Livingstone: In your submission, you talk about the restructuring, and you say that it will take two to three years to complete. So far, you have saved £100 million, which has had an impact on staffing levels throughout the group, including in Scotland, of course. Where have the job losses taken place within the group? Where might future job losses occur?

Archie Kane: Up until October, we had announced that 1,000 jobs would go in Scotland. They have come primarily from the retail bank, group operations and the insurance division. Those areas have been the three primary drivers, with some losses in the wholesale bank as well—the corporate and commercial bank. The jobs have come out of different parts of the group.

We are just short of a year into an integration that will take two to three years, so although we are quite advanced in what we are doing, we still have quite a long way to go. In November, we tried to look forward to the end of 2010 for the projects that we felt were sufficiently advanced. We announced further job losses through to the end of 2010 in group operations—insurance in particular, in Scotland—which will be another 500-plus jobs, but that will be all the way through to the end of 2010. We have tried to give as much notice as possible, but that does not mean that that will be the end of it. There will be projects in other parts of the business as we go forward.

Marilyn Livingstone: You also say in your submission that you have good relations with the trade unions, so I take it that there are on-going discussions with them.

Archie Kane: Yes. We have three extremely active trade unions: Accord, Unite and LTU—the Lloyds TSB Group Union. We have regular and on-going discussions with the unions on all issues to do with staff and staff conditions. There is weekly communication—in fact, probably more often than weekly—and there is a formal monthly meeting. However, the key functions, such as human resources and the industrial relations part of HR, are constantly in discussion and negotiations with all the trade unions. We have an open and adult dialogue with them.

The unions are important in what we are doing. We are trying to integrate the businesses, so it is important that we discuss with them anything that impacts on staff, whether that is in relation to jobs or to staff terms and conditions. It is important that we have that constant dialogue and subsequent dialogue with the staff.

11:45

Marilyn Livingstone: On a more positive note, what are your expansion and relocation plans?

Archie Kane: As I mentioned before, I hope that we will be able to expand the insurance division. We are definitely intending to expand other parts of the group—our wealth and international operation has a clear expansionist strategy. The retail bank will seek to cross-sell more products to its customers, as will the wholesale bank. We will try to expand all those businesses.

As we go through the rationalisation of the businesses we tend to focus on what I described earlier as hubs. In other words, Edinburgh is a significant hub for our insurance businesses. We will coalesce around the hub in Edinburgh. We will also have a hub in Bristol for our insurance businesses.

For things such as business continuity planning, we have to try to split our key activities—for obvious reasons, we cannot have them all in one place in this risky world. We have to have back-up and support and we have to be able to move in real time from one hub to the other. We will do that with our life businesses in Edinburgh and with our insurance businesses in Bristol, Newport in south Wales and Leeds because that is where those businesses were based historically. In Scotland we will base significant hubs in Edinburgh and Glasgow and one or two others in other parts of Scotland, where there will be telephone centre activities, for example. That is the type of logic that goes into how we will arrange and morph our business into the future.

Christopher Harvie (Mid Scotland and Fife) (SNP): I have a question about the historical situation. You give the impression that what happened in autumn last year was part of a general worldwide recession and had come somewhat out of the blue. However, if you look back at the *Financial Times's* coverage of things such as the growth of instrumentalised work gauges and the like, it reports that from about the middle of 2007, when Moody's reassessed its super-standard investments, a general freeze started in France and set into international financial markets. When Sir Victor Blank went to HBOS in autumn 2008 and a deal was rapidly done, as you said at the beginning of your remarks, were people then fully apprised of the nature of the debt problem in HBOS, to which you alluded in relation to the corporate investment area? Even the *Financial Times* was backing the stand-alone survival of HBOS for about a fortnight after that. When did the real problems of HBOS become apparent to Sir Victor Blank and the Prime Minister?

Archie Kane: I will not speak for Victor Blank or for the Prime Minister; it would not be appropriate for me to put words in their mouths. However, if you cast your mind back to autumn 2008, you will remember that things were extremely tense and there is no doubt that there was a global situation. One of the key moments in the UK was the failure of Northern Rock. The other big event in the global environment was the failure of Lehman Brothers. Subsequently, a whole series of banks got into trouble—UBS was a classic. We have since ended up with a raft of different banks including Fortis, Dexia and ING getting into trouble.

The big issue that impacted on all banks at the time was the possibility, along with the withdrawal of credit and funding in the interbank market, of panic in the retail banking market. We all remember the photographs of the queues outside Northern Rock branches. I believe that the authorities were right to be concerned about that possibility, and I believe that they took the necessary steps to prevent the spread of that contagion. Had it continued and developed, it would have had a considerable impact on us all and, to be frank, I think that our discussion this morning would have been very different. The widespread impact of a severe failure in the banking system, which leads to a lack of confidence among the population at large, is dire for an economy such as ours—or, indeed, for any developed western capitalist economy—and the steps that the various Governments have taken have proved to be absolutely right.

By the time we, as a board, reached the decisions on HBOS, we knew that the bank was having real funding difficulties, as Mervyn King made clear in his comments to the Treasury Committee last week. These things are all well understood.

Christopher Harvie: Can you put a figure, to the nearest billion, on the bad-debt problems in HBOS's corporate division? I have heard that it is north of £70 billion.

Archie Kane: I can refer you only to what is in the public domain and our published accounts—I am not allowed to go any further than that. We have articulated the provisions that we have made and have indicated the rough percentages of those provisions, with HBOS accounting for about 80 per cent of impairments. As for the £260 billion of potential impaired assets that we would have put into the asset protection scheme back in March if we had proceeded with it, the percentages are very similar. That gives you a rough idea of the situation but, as I say, I cannot really talk about anything that is not published or in the public domain.

Christopher Harvie: Would a so-called bad-bank facility into which these assets could have been placed have assisted you by simply taking them right out of your hands?

Archie Kane: I think that that is what the Government had in mind when it devised the asset protection scheme, which was more of an insurance scheme. The point is that if there is going to be a bad bank, someone has to fund it; the insurance element of an asset protection scheme has the same impact. As a result, the two concepts are kind of related.

Christopher Harvie: Do you not think in some sense that the major problem of the companies into which HBOS bought at the height of the housing boom—even then, it was evident that nemesis was on its way—has retarded the prospect of offering bank services to local businesses and small and medium-sized enterprises? If you have on one side Crest Nicholson, McCarthy & Stone and Kenmore with their billions of pounds of debt and, on the other, relatively small concerns simply wanting some cash to tide them through, surely you are faced with a rather difficult juggling act.

Archie Kane: It certainly was a difficult juggling act for HBOS. Because of issues such as that to which Christopher Harvie refers, HBOS was basically running out of funds. That would have impacted right across all the HBOS businesses. The lack of funds—lack of liquidity—eventually impacts on a bank's capital and on its ability to raise and access capital. That was definitely the case for HBOS, but we are not in that situation now. Our rights issue has received huge support, which puts our capital in a very strong position, and we have improved our access to liquidity every month this year as we have gone on. So, we are improving. I am not saying that we are yet in the position that we would like to be in; however, the Lloyds Banking Group is going from strength to strength.

The rights issue demonstrates the public investor view of the organisation. It means that we are able to provide banking and financial services to all our clients, be they retail businesses, small businesses or start-up businesses. We intend to finance some 300,000 start-up businesses over the next two or three years throughout the UK. We have serious intentions in the start-up and SME space, and we are focused on that. We realise its importance for the UK as a whole and for Scotland—the percentage of gross domestic product that is generated by small to medium-sized enterprises in this country is now significant. It is in all our interests, including our group's interests, to be actively engaged in fostering and promoting that sector of our economy.

Christopher Harvie: I have spent 30 years teaching—partly economics—in Germany, where the local banking system is to a great extent mutualised. You have a tradition of mutualisation within Lloyds HBOS, through the TSB and the Halifax Building Society.

Let us say that there is a double-dip recession, meaning that a lot of our more optimistic ideas might be scattered. Would not it be precautionary to explore the notion of having a more mutualised structure in keeping with the practical mutualisation of a lot of the activities that are being spun off from new communications techniques—the Google revolution? Would not it be better, as far as your local banking and investment networks are concerned, to revert to something that is closer to the Kreissparkasse model or the old-fashioned mutual building society model for some of your activities?

Archie Kane: There is no doubt that mutuality has a role to play. There are some very fine mutual organisations operating within the UK. I am also aware of the German banking model. We have a good and healthy insurance company in Germany and I was there for two days last week, so I am aware of how the financial system operates in Germany. The only thing that I would say is that any period of financial difficulty impacts on mutual organisations as well as on private organisations, and in the UK a number of mutuals have been in difficulty and have had to be rescued and taken over. I would counsel that mutuality, in and of itself, is not a solution to the sort of crisis that we have been through. Nevertheless, I believe that mutuality has a useful and vibrant role to play.

Ms Alexander: In your written submission, you state:

> "We believe that we have a social as well as an economic role in Scotland and we take it very seriously."

In the light of that, can you tell us why Lloyds Banking Group is refusing to consider proposals by the Lloyds TSB Foundation for Scotland regarding its future?

12:00

Archie Kane: We take our social responsibility seriously. We are part of the community wherever we operate and must be cognisant of that.

I will explain briefly how the foundations operate. We have four foundations: a Scotland foundation, an England and Wales foundation, a Channel Islands foundation and an Ireland foundation. All those foundations have exactly the same covenant and the same memorandum and articles—they have the same arrangements with the group. They are funded by the group, and the funding is 1 per cent of the average of the past three years' profits. However, we are no longer making profits. If we continue as we are, there will be no money available to any of the foundations—not just the Scotland foundation, because the position is exactly the same for all of them.

We must recognise the difficult economic reality of the situation that we are in; nevertheless, we want to support the foundations. We have had negotiations with the foundations in order to come up with a solution to the problem. Those discussions have been led at very senior level within the group by Lord Sandy Leitch, who is a Scot and understands the Scottish situation extremely well. He has led the negotiations with the foundations. Unfortunately, only three of the foundations have engaged in the discussions—the Scottish foundation has not. We have yet to come to a final resolution with the other three, but the negotiations are well advanced and we are hopeful that we can come up with a solution to the short-term problems in financing the foundations.

I will explain what happens if we do not come up with a solution. For the period during which we are in a loss-making situation, we will pay £200,000 to the four foundations, which will be split in different proportions across the foundations. That is how the covenant currently works. We are trying to find a way to fund the foundations through the difficult period. In order to do that, we must take all our stakeholder groups into consideration—we cannot give advantage to one stakeholder group over another. We have customers, employees, investors, the foundations and the charities. Sandy Leitch is trying to find a way to fund the foundations through a difficult period while rebalancing the whole way forward for the foundations, which is why we are having the discussions.

Ms Alexander: Let me try to unpick some of that. Can you confirm that the covenant was set up in perpetuity and has been in place since 1985? Can you also confirm that, unless it is broken by the group, it will run for at least the next 25 years?

Archie Kane: No—that is not correct. The covenant was set up in 1985 or 1986, at the time of the TSB's demutualisation. However, the covenant can be dissolved when one of three conditions is met. If the Lloyds Banking Group was taken over, or was to become insolvent, the covenant would continue to run for one year, and if the Lloyds Banking Group gave notice to the foundations, the covenant would continue to run for a nine-year period. The position is the same for all the foundations.

Ms Alexander: My point is that the first two of those three conditions do not apply. The third condition requires the covenant to be broken by the group. If that does not happen, the covenant will continue to run for 25 years.

Archie Kane: Wendy Alexander is right, unless we can find a resolution that is consistent for all the foundations—we must treat them all exactly the same.

Ms Alexander: Let us come to the question whether you are obliged to treat all the foundations comparably. Am I right that the essence of the group's proposal is to reduce the foundations' funding from 1 per cent to 0.5 per cent of the group's pre-tax profits?

Archie Kane: A package of proposals has been put to the foundations, part of which is a reduction in their funding from 1 per cent of the group's profits. When the foundation was set up, it was the TSB Foundation and, up to now, some £85 million has been disbursed through the Scottish foundation. However, since Lloyds got together with the TSB Foundation the cake has got bigger, so the proposal is for the foundations to get a smaller slice of what is now a much larger cake.

Over time, the amount of funding that the foundations get should increase, but we must balance all our stakeholder groups. We must take into consideration our investors, our employees, our customers and all our stakeholder groups. We cannot consider one stakeholder group—in this case, the foundations—in isolation. We must take into consideration the economic reality of where we are. At the moment, we are not making profits. If we continue with the covenant as it stands, the foundations will not have any money.

Ms Alexander: As you know, provision is made for what happens when the group is not making profits. No one doubts the need for short-term transitional arrangements, but I am pressing you on why the essence of your proposal is to halve the amount of money that goes to the foundations when the group is profitable. Why is that the right thing to do?

Archie Kane: Because we have to balance all our stakeholder groups. We cannot look at the position of the foundations in isolation.

Ms Alexander: Which stakeholders have you consulted on the proposal to halve the amount of money that goes to your charitable foundations?

Archie Kane: The board considers all its stakeholder groups consistently. That is part of its remit.

Ms Alexander: The obvious stakeholder to ask about is UK Financial Investments. Have you consulted UKFI or the Treasury on the proposal? Given that UKFI owns 43 per cent of Lloyds, it would seem the obvious stakeholder to start with. Has it sought the proposed reduction? Has it been consulted in any way?

Archie Kane: Clearly, UKFI has not sought any reduction. I am not involved in the discussions that take place, which are led by the deputy chairman of the group—you can take it from the fact that the issue is dealt with at such a senior level that a great deal of importance is attached to it.

The fact of the matter is that we are in an economic situation in which we are not making profits. If we continue with the covenant as it stands, the foundations will not get any money—or rather, they will get £200,000, as opposed to the millions of pounds that they got in the past. If we do nothing and just carry on, as you suggest, the four foundations will end up with £200,000, which will be split among them in different proportions. In an effort to solve that problem, we have come up with a proposal for funding the foundations through the difficult period, which involves rebalancing our stakeholder interests.

Ms Alexander: No one disputes the need for transitional arrangements for when you are not making profits. We have dwelt on the scale of public support that has been made available to you. I am asking you to justify why it is right to halve the share of profits that you make available to the foundations when you are profitable. Has any stakeholder prevailed on you to do that?

Archie Kane: It was not originally envisaged that the covenant would apply to a group as large as Lloyds Banking Group, which comprises HBOS and Lloyds TSB. There is no doubt that the foundations will get a smaller slice, but the cake will be much larger, so the quantum that they will eventually be paid will be larger—they will get more pounds. We have had highly productive discussions with three of the foundations; one foundation has chosen to take a different stance.

Ms Alexander: I put it to you that you cannot provide evidence that the total amount of money that will go to Scottish charities will increase, given that, for example, the HBOS Foundation has been closed. Can you provide any evidence that the total amount of money that will be available to Scottish charities will increase as a result of halving the share of profits to which they are entitled?

Archie Kane: Clearly, we cannot give profit forecasts, which is what you are asking me to do. You know that, legally, I am not allowed to give a profit forecast, so I cannot do that.

Ms Alexander: You have said that the basis of your decision is that more money will be available to Scottish charities, but I simply do not see how you can sustain that with evidence because, as you say, to do so would involve forecasting profits. I am asking you to provide a justification for halving the amount of pre-tax profits that will go to Scottish charities when the group is profitable; we have not had such a justification. I am asking you to name any stakeholder that has urged that action on you.

Archie Kane: As I said, we have engaged in negotiations with the four foundations. Three sets of negotiations are progressing actively, but one is not. The door is still open. We would still like to fund all the foundations through the difficult times, and I would like us to fund the Scottish foundation through difficult times. However, our approach to all the foundations must be consistent—treating one foundation differently from another would be totally inappropriate.

Ms Alexander: I will pursue that in the context of Lloyds TSB Scotland's different history. The Government has a 43 per cent shareholding in Lloyds Banking Group. We in the United Kingdom have recently had active discussions about the financing of the devolved Administrations. It would be extraordinary for Jim Murphy to walk into a Cabinet meeting and say, "I'm prepared to consider only exactly equitable arrangements for Northern Ireland, Wales and Scotland," so I am slightly puzzled as to why you—the Scottish member of Lloyds Banking Group's board—do not seek to facilitate a solution to the problem in Scotland. I presume that that is in your power to achieve, should you choose to do so.

Archie Kane: I ask you to take a step back and think about where the money is coming from—Lloyds Banking Group. The Lloyds TSB Foundation for Scotland receives a disproportionately large amount in comparison with the size of the communities in which it operates. That was agreed when the covenant was drawn up, and we are not talking about changing any of that. However, it would be inappropriate for us to treat the foundation in Scotland differently from those elsewhere, given the number of people whom we employ, our large number of customers and our involvement in society in those other areas. I admit that I disagree with you—it would be inappropriate to treat one foundation differently from another. If the situation were reversed, I would make the same argument in relation to the other foundations.

Ms Alexander: You are prepared to carry the reputational risk to Lloyds Banking Group in all parts of the UK—although the organisation has benefited in the past 12 to 14 months from more than £20 billion of Government support—of not being prepared to consider maintaining the arrangements for supporting charitable organisations throughout the UK that support some of our most vulnerable groups. Is that not a reputational risk that requires revisiting?

Archie Kane: We are absolutely keen to support the foundations through difficult times, and we have made a proposal to help to do that.

Ms Alexander: Will you give an undertaking today that you will consider the proposal that the Lloyds TSB Foundation for Scotland has put on the table? We simply ask for that to be considered.

Archie Kane: Through Lord Leitch's good offices, we are actively engaged in negotiations with all the foundations. We will continue to negotiate—the door is open and we will continue to have dialogue. I would love to see a solution that includes all the foundations, and I undertake that we will continue to discuss the situation with them and to negotiate. We seek a solution whereby we can support the foundations with significant sums through difficult times.

The Convener: We need to check your views on a couple of matters for the record. What are Lloyds Banking Group's views on the divestments that the European Commission proposes?

Archie Kane: Deep and significant negotiations took place with Brussels about the businesses that we must dispose of. As I said, we have ended up with a portfolio of businesses to divest that consists of the Cheltenham & Gloucester, Intelligent Finance, Lloyds TSB Scotland and a range of branches throughout England and Wales.

It is painful to have to divest those businesses, but, given what has happened to a range of banks that have gone through the same process with Brussels, we regard that as probably a reasonable and fair outcome. We do not see that process as having a significant negative impact on the development and implementation of our strategy in future.

12:15

The Convener: Let me move on from that. Is there a timescale for the selling off of the Government's shares in Lloyds Banking Group? Do you have any particular views on how that process should take place?

Archie Kane: We do not decide when the Government sells its shares. That is entirely within the hands of the Government, which has appointed UKFI to hold those shares. Our understanding—I think that this is public—is that UKFI will seek to get money back for the taxpayer and that it hopes to make a profit in the process. The decision is within the hands of UKFI as the agent for the Government.

The Convener: If there were further pressures on Lloyds Banking Group to raise more cash, would it consider selling off some of its existing businesses, such as the Bank of Scotland, as a means of raising cash?

Archie Kane: Sorry, can you say that again?

The Convener: If Lloyds Banking Group needed to raise further cash after the current rights issue, would it consider the option of selling off parts of its existing business?

Archie Kane: We have absolutely no intention of doing that. We have embarked on a rights issue, which will create an extremely strong capital base and has been well supported. It is not our intention to dispose of any parts of the group. Of course, all groups are living organisms that acquire and dispose of different parts as time goes by, but we have no plans to do such a thing.

The Convener: My final question is on the various proposals that have been made about regulation and corporate governance. What is Lloyds Banking Group's view on regulatory change and corporate governance? How well placed are the group's existing corporate governance arrangements to meet the potential requirements of, for example, the Walker review?

Archie Kane: We fully intend to comply with the Walker review, and we have signed up to the Financial Services Authority's recommendations on remuneration as well as to the G20 recommendations. We are very comfortable about complying with all those recommendations.

We are a strong supporter of a firm and robust regulatory environment, and we hope that regulation will change for the good. We would like to see consistent and robust regulation—not constantly changing regulation—and we are a firm supporter of strong regulation. We intend to play a role within the regulatory framework.

The Convener: Will any of the proposed changes to regulation threaten the group's ability to carry out business in the international market?

Archie Kane: The big issue is consistency of regulation from jurisdiction to jurisdiction. If there is inconsistency of regulation from one geography to another, that can create disequilibrium and advantage one territory over another. That is a significant worry. For example, if country A has an extremely draconian regulatory environment by comparison with country B, capital might flow from country A to country B. Capital can flow in minutes, as it is unbelievably liquid. If the regulatory environment becomes too draconian, the second thing that will flow is skills, which are the next most liquid resource. Therefore, the regulatory issue is about having not just a strong and robust regulatory environment but consistency in the global environment. Moving ahead such that we get out of equilibrium with other jurisdictions could create problems.

The Convener: I thank Archie Kane for coming along today to give us his very robust answers to our questions. That has been very helpful indeed. Our next session on the banking inquiry will be next week, when we will hear from HSBC's chief executive for Scotland and from the Financial Services Authority.

I suspend the meeting for a few minutes while we change witness panels.

12:19

Meeting suspended.

12:26

On resuming—

Scottish Enterprise

The Convener: Item 2 is an update from Scottish Enterprise. It is primarily to welcome to the committee the two new postholders: Crawford Gillies, chair of Scottish Enterprise, and Lena Wilson, who has recently taken over as chief executive. I welcome you both to your first appearance at the committee in your current posts and invite you to make opening comments before we go to questions.

Crawford Gillies (Scottish Enterprise): Let me say at the outset how pleased we are to be here this afternoon. It was unfortunate that, when you met in October, Lena Wilson and I had other long-standing engagements and were not able to attend. We are delighted to be here today.

I will start by setting the scene. Looking back, my appointment as chairman in February came at an interesting time for the economy and for Scottish Enterprise. The turbulence in the financial markets that you have just been discussing and the resulting recession undoubtedly posed significant challenges for Scotland, to which we have all had to respond. Looking forward, even if growth comes in the near future, we all expect that it will be somewhat sluggish for some time to come and that unemployment is likely to continue to rise.

As far as Scottish Enterprise is concerned, we are at a point where we have a new focus, remit and chief executive, a smaller budget and a reduced head count, but a big task on our hands, which is to help Scotland recover from one of the deepest recessions since the last war.

Along with other members of the board, I see my role as very much to provide guidance and support to our chief executive and her team and to challenge them to ensure that we deliver on short and long-term objectives.

The board that I inherited includes a good cross-section of businesspeople from large companies and small companies, leading academics and the leader of the Scottish Trades Union Council. Since I joined, I have been impressed by the commitment of Scottish Enterprise board members and the quality of and engagement in the debate that we have.

Our budget settlements in the next few years, like those of other public sector partners, will undoubtedly be a challenge. In responding to that and doing the most we can for Scotland, the watchwords have to be prioritisation and partnership. There has to be prioritisation of the areas where we believe that we can deliver the strongest opportunities for the economy—we are committed to maximising the impact of every pound that we spend. As for partnership, I believe strongly that, by working closely with others who have an important role to play in economic development, we can all be more effective than we otherwise would be. Since taking up post earlier this year, I have spent a considerable time with our other public sector partners. I sense a renewed commitment to partnership and to partnership working for Scotland.

I am happy to discuss any of those issues, but I will first pass over to Lena Wilson.

12:30

Lena Wilson (Scottish Enterprise): Good afternoon convener, committee members and clerks. Like Crawford Gillies, I am absolutely delighted to have the opportunity to be here today so early in my post—it is week 4—and to begin what I hope will be a productive relationship with the committee. I regret that I was unable to be here the previous time that the committee took evidence from Scottish Enterprise, but I had a long-standing commitment to a meeting with some inward investors and the First Minister in Ayrshire.

As I said, I have been in post for just a month. I am currently spending all my time meeting customers, our staff and, as Crawford Gillies said, our partners, to give a preliminary overview of my priorities and to listen to their views on how we can deliver even more for Scotland. As the new chief executive, I am committed to Scottish Enterprise playing a strong role alongside our sister agencies in helping to deliver and develop globally competitive sectors for Scotland, globally competitive companies and a deep customer focus.

I know that members feel that they did not get the information that they were looking for when Scottish Enterprise last appeared before the committee and I regret that. In the intervening period, we have made every effort to rectify that and provide you with all the information that you wanted. I hope that you have that now. We had concluded that, with so many changes to Scottish Enterprise, it might have been far too complex to make comparisons, but I feel that we have made every effort to make reasonable comparisons and explain them fully to you. As chief executive, I assure you of my absolute commitment to be transparent and open and to give you timely flows of information in the future. I stress that and want to ensure that that is what we do. I believe that you now have all the information that you required.

As Crawford Gillies said, the budget is tight and we must continue to make tough decisions now and in the future, so prioritisation is definitely a watchword. In running Scottish Enterprise, my priority will be to ensure that we deliver actions that support companies through the current challenging economic environment in the short to medium term. For example, we will focus on our manufacturing advisory service and our approach to internationalisation and innovation. We will also ensure that we continue to invest in Scotland's longer-term priorities. For example, we will make sure that we commercialise our fantastic intellectual asset base and grow sustainable high-scale companies out of it. We will continue to exploit Scotland's competitive advantage—we have some globally competitive advantages in key sectors. We have to ensure that while we deliver in the short term we keep a long-term focus.

I want Scottish Enterprise to deepen our customer engagement by being even more relevant to our customers; to support and motivate our staff, who have been through a great deal of change in the past few years, because they are key to this delivery; and to be an excellent public-sector partner. Given that resources will be so tight, more and more it will be a question of what we can lever through the rest of the public sector.

We are happy to take questions.

The Convener: Thank you. I will start with questions about the overall budget available to Scottish Enterprise. You said in your third submission to the committee that the real-terms decrease in Scottish Enterprise's budget is slightly less than that previously quoted but still amounts to 16 per cent of your budget after taking account of various changes and stripping out the things that you no longer deal with. Given that we are currently in recession and likely to remain in recession or slow growth over the next year or so, do you really think that Scottish Enterprise has done enough to protect its resources to help protect Scotland's economy?

Crawford Gillies: There is no doubt that anyone in our position would like a bigger budget than we have—there is no surprise there. That said, our big challenge is to get the maximum that we can from the budget that we have. Lena Wilson, our board and I are absolutely determined to do that. We believe that with the budget we have we can continue to deliver a significant amount, particularly when we work in partnership with others.

The Convener: Have you made representations to the Minister for Enterprise, Energy and Tourism that you could do more with a bigger budget? If so, what form has any such representation taken and what additional things have you suggested you could do if you had more money?

Crawford Gillies: Perhaps I should take the committee through our budget plan, which I think of as having four stages. Stage 1 is our business plan, which was published in March and laid out a proposed three-year spending plan. Over the subsequent seven or eight months, we have been engaged in dialogue with Government ministers and officials; for example, every month Scottish Enterprise's chief executive and I meet the economy director-general to discuss budget issues, priorities and so on. That is the second stage.

Stage 3 is the publication of the Government's proposed budget and, for us, stage 4 is to consider how best to spend the allocated money. That process is still on-going; indeed, as we have said in our submission, the numbers that the committee has received have not yet been finalised. Our own board is reviewing them this coming Friday, and they will be firmed up over the next couple of months.

Lena Wilson: We also have a track record of being able to utilise additional moneys that become available through the year, and we always have a list of longer-term projects on the stocks that can be accelerated if such funding or any other opportunities for Scotland come up. For example, we have always been able to bring other inward investment opportunities to Government and other partners throughout the year.

The Convener: With regard to the four stages of your budget process, is Scottish Enterprise happy or unhappy with what happens between stages 2 and 3?

Crawford Gillies: I do not want to repeat myself, but as I have said—and as anyone who runs an organisation such as ours will tell you—we would always like more money because we feel that we could do more with it. At the same time, however, we recognise the budget pressures that the Government and the whole public sector are under and after having this dialogue with the Government we are focusing very much on maximising the impact of what we have been allocated.

Rob Gibson: I am interested in your comment that innovation and commercialisation are important for growing the economy, given that those are the very budgets that have taken the biggest hits. How can you justify such a move at this stage in Scotland's economic development?

Lena Wilson: We have been very much concentrating on company-to-company interventions. Indeed, many such interventions this year have taken place through our Scottish manufacturing advisory service, which has helped companies with issues such as liquidity, customer retention and simply staying afloat and has allowed organisations to become much more efficient.

We have also continued to invest in the company side of innovation and have not cut any of those budgets. However, as our business plan shows, we have cut back a bit on some of the longer-term sectoral innovation projects for which, in this current economic climate, funding might well not be available anyway. It is perhaps only a matter of pushing out the timing for those larger sectoral projects but, as I have said, we have not cut any company-to-company interventions. In fact, one of the biggest calls on our budget is for help almost to innovate out of recession. We have had many requests for that from companies and we have great examples of companies that have introduced product and service innovations to find new customers and get into overseas markets.

With regard to commercialisation, we have spent a great deal of money on developing intellectual assets and are now moving towards commercialising those assets into companies. The bulk of our interventions in commercialisation will be in the company space, helping Scotland's great intellectual assets to grow into companies.

In summary, we focused strongly on keeping the company side alive and we have maybe traded that off against some of the longer-term sectoral initiatives, which will come back on board as the economy picks up.

Rob Gibson: To take an example that affects the whole of Scotland, where do companies and longer-term projects that are involved in renewable energy fit into that picture?

Lena Wilson: Renewable energy comes into one of three areas. First, it may come into the internationalisation side. For example, when Skykon acquired the Vestas facility in Campbeltown, it received money not only from the Scottish Enterprise budget but from the local authority budget as well as a large chunk of regional selective assistance. Secondly, it may come into our infrastructure development. I am thinking of, for example, Fife energy park and the work that is being done around Dundee. Much of our accelerated capital expenditure has been devoted to renewable energy. Thirdly, you may find some of it in the commercialisation work that is bringing the intermediary technology institutes into Scottish Enterprise. One of the ITIs is focused wholly on energy, with a big focus on renewable energy. We are also working closely with the academic base on that. Renewable energy cuts through our budget.

Renewable energy is a sector that the board very much wants us to focus on. The opportunities in making Scotland a low-carbon economy are phenomenal. Of the earlier set of projects that I have on the stocks—I think that there are some 10 or 11—about 70 per cent relate to renewable energy infrastructure.

Rob Gibson: Renewable energy must be a sector of the economy that can help us out of the recession if it is invested in now. The development of companies that can handle that work is both a short-term and medium-term project. Are you able to give that as big a shot as you would like, or is that limited in any way by the constraints within which you are working just now?

Crawford Gillies: I refer back to a board strategy session that we had about four weeks ago, just a couple of days before Lena Wilson took over. That was the first step in what I described as stage 4 of our budget process. It was a high-level discussion over 24 hours with our entire board, not to get into the nitty-gritty of the numbers—as we say, we will do that in the future—but to talk directionally about where we should be focusing more resources and where we see the biggest opportunity for Scotland. The number 1 take-away from that session was the big opportunity that we have in renewables, which we need to get behind rapidly. Lena Wilson and her team have been asked to ensure that the budget, which we will review, absolutely reflects that priority.

Rob Gibson: Okay. Thanks for that.

The Convener: Marilyn Livingstone has another committee commitment at 1 o'clock, so I invite her to ask her questions now.

Marilyn Livingstone: You have talked about how partnership working will help you to get best value for your pound. Especially in the regions, are enough staff being deployed to take forward that partnership working?

Crawford Gillies: I have not come across any evidence that we do not have enough people on the ground to develop the right sort of partnerships, which will often be with local authorities. I have talked to local authorities—I was down in Inverclyde yesterday—and I have not heard that. The local authorities are saying that they have a high regard for the expertise that exists in Scottish Enterprise. In the past, they may have looked to Scottish Enterprise for both expertise and cash. Although there is less cash available now, they still want the expertise on the property and infrastructure side to work with their officials.

12:45

Marilyn Livingstone: That has not been my experience in Fife. When we lost Scottish Enterprise Fife, we lost a lot of that expertise. I have attended meetings that would previously have been attended by a representative of Scottish Enterprise Fife but at which no such representative has been present. In some areas, you will find that what you describe is not the case. That is a concern, as I agree with you that partnership working, especially with other public sector bodies, is important. What you have described has certainly not been my experience.

Lena Wilson: You make a good point. We have nominated a senior member of Scottish Enterprise staff to partner, befriend or buddy—whatever you would like to call it—every local authority. The difference that you are seeing is that that person is no longer a member of Scottish Enterprise Fife staff; they are a member of Scottish Enterprise staff.

We are matching the most appropriate expertise, as we are doing with the customer base. We used to have invisible boundaries. For example, one of our specialists based in Edinburgh would concentrate on the Lothians and would not cross the Forth road bridge to help a company in Fife. Now, many companies in Fife are accessing greater expertise than they did before. I have a meeting in the coming weeks with Ronnie Hines, the chief executive of Fife Council. We have excellent working relationships with Fife Council on a number of projects, particularly in infrastructure.

Marilyn Livingstone: Okay. I make my point. It is okay at that level but, across the board, in areas where it was working before there has definitely been a diminution. That is how it feels on the ground.

Where does the co-operative development agency show in the budget? Could you tell me a bit about Scottish Enterprise's commitment to the co-operative development agency? How do you see it being funded and continuing in the future?

Lena Wilson: The co-operative development agency comes under the enterprise part of our budget, as it is about helping businesses to start up and grow. We see the co-operative development agency as supporting another useful model—it is a business model, like many other models. The agency has an excellent chief executive in Sarah Dees. She has a small team, but she leverages many other parts of Scottish Enterprise. The budget that you might see for the agency—I do not have the exact budget to hand right now—is the budget that we will use to run that service, but the agency will also bring in all the other experts in Scottish Enterprise. For example, if a co-operative business wanted to focus on innovation or internationalisation, it would have exactly the same access to those services that any other business would.

I was pleased to speak at the co-operative development agency conference last year. We are committed to the co-operative model as another business model, to be used where appropriate.

Marilyn Livingstone: Could we have a note of the budget for the co-operative development agency and the comparisons with previous years? That would be really helpful.

Lena Wilson: Of course. I am happy to provide that information.

Marilyn Livingstone: I have one final question. The reduction in spending on innovation has been presented as a tactical response. What conclusion has Scottish Enterprise reached about its most appropriate and effective role in supporting technology development and exploitation? What does that imply for the future strategy? That is quite a concern.

Lena Wilson: We now work with a number of industry advisory boards. The technology advisory board, which is a group of Scotland's leading technology entrepreneurs and senior business leaders, launched its strategy document about three weeks ago. The board has guided us on technology. Technology applies to many of our sectors and we have an important role in enabling technologies, not only to attract talent and inward investment but to encourage company growth.

We are currently running a strong campaign on technology and innovation, encouraging people to strengthen their business through innovation. About 1,000 companies have responded to that campaign and 179 companies have downloaded our new innovation guide, which talks them through the process. We are also running a series of winning through innovation events for companies throughout Scotland. About 440 companies have reserved places on that. It is a very strong part of the offering.

Lewis Macdonald: I will start with a point that was made in response to Rob Gibson's question about renewable energy. I think that Crawford Gillies said that the renewable energy sector is recognised as presenting the biggest opportunity. Do you recognise that the oil and gas sector is of exceptional significance to the Scottish economy at present? Where does it fit into your view of the energy sector going forward?

Crawford Gillies: I will start to answer that and Lena Wilson will give some examples. I absolutely recognise the importance of the oil and gas sector. Just two weeks ago, I met representatives of the sector in Aberdeen and looked at some of the innovations that are happening on the subsea side with the new research institute and so on. There is a significant opportunity there. Leaving aside ensuring that we get the maximum from exploiting the North Sea, the opportunity that is presented is much more on the international side; it relates to how we develop the supply chain such that the industry in Scotland operates around the globe. That is different from the challenge on the renewables side.

Lena Wilson: One of our biggest investments in oil and gas is in the offshore technology conference in Houston. We take hundreds of companies out to Houston every year and run a series of events on the development of the supply chain. We help a number of oil and gas companies with their internationalisation. The oil sands in Calgary in Canada are a market, as is Perth in Western Australia. We have been intensifying our support in that area and in the energy industry more widely—it is not just about renewables but about oil and gas, power systems, smart grid and the technology that supports that. The oil and gas sector is very important. Many hundreds of oil and gas companies are account managed.

Lewis Macdonald: Do you recognise that there is concern when you say that you want to park long-term innovation projects, because some of those potential projects are in the energy industries and are the key to the recovery from economic recession that the whole economy looks to those industries to help to achieve?

Lena Wilson: Perhaps I should clarify the point about parking projects. We are aiming to carry on with every project for which all the funding could be in place. Remember that Scottish Enterprise funding is about leveraging private sector investment. Where such investment is not forthcoming, certain projects might be pushed out for a year or two. I am confident that we have the balance right. We still see oil and gas as very important indeed. We are spending a lot of time looking for alternative funding models. We are looking to our local authority partners' prudential borrowing powers, for example, to see whether we can find even more innovative ways of funding beyond the normal routes.

Lewis Macdonald: You have presented figures to us on the balance between longer-term innovation or commercialisation on the one hand and property infrastructure investment on the other hand. Have you collectively made a conscious decision that property infrastructure investment is the correct priority in dealing with the impact of the recession, or is it simply a case of needs must, because there are opportunities there and you are finding it difficult to find private partners for the innovation stuff? It seems a curious response to recession to increase the budget for property investment at a time when investment opportunities in property seem less significant for the recovery of the economy than the innovation, skills and infrastructure that we need to go forward.

Lena Wilson: There is perhaps a combination of two or three things. We had the opportunity to accelerate capital expenditure, which is a way to get people into jobs and on to sites and a way to attract business and give businesses that are still growing the opportunity for premises. That is one aspect. It has the immediate effect of giving people jobs on the ground on construction sites.

One of the big challenges and opportunities is in ensuring that Scotland has adequate infrastructure for renewables. Much harbour-wall development, deepwater site development and cranage development requires intensive infrastructure development. Scottish Enterprise's role is to leverage other investment for that. We have done that in Campbeltown, in Fife, in Dundee, up at Nigg and in Peterhead. That presents a series of opportunities. We must be ready because, all over the world, our team in Scottish Development International is working up hot prospects in offshore renewables, for example. We must have somewhere for those projects to land.

Lewis Macdonald: Why is private funding not available to develop those technologies—the kind of things that ITI Energy and other ITIs have supported? Is that problem permanent or temporary? What is your role in getting going again the projects that you talk about pushing back because of a lack of private investment?

Lena Wilson: Several ITI projects are still going—they are a very important part of our portfolio. For example, exciting developments are happening in marine renewables and in smart-grid technology. We are still investing in that.

I am sure that Crawford Gillies has his view, but I feel that the issues of access to private sector funding are temporary. Our role is to keep as much of that funding alive as possible. Scotland has some great companies with terrific technology. We must ensure that they do not run out of funding. A key role is keeping those companies going so that, when the market comes round, they can seize the opportunity again.

Lewis Macdonald: From what you say, I am concerned about whether you feel that you have struck the right balance between investing in technologies and investing in property assets.

Lena Wilson: We have a balance that reflects the market opportunity and the development of the sectors. The continuing investment in and exploitation of Scotland's technology capability remain a strong focus for Scottish Enterprise.

Gavin Brown: I will focus on the table in Scottish Enterprise's second submission, which compares the projected spend in 2009-10 with the potential projected spend in 2010-11. SE does not—obviously—have a huge amount of control over its total budget; it can seek to influence that, but the budget is decided for it. However, SE does control how to allocate what is given to it.

I will ask about a couple of budget lines to get a feel for why some decisions were taken and what their implications might be. For company start-ups and growth, the projected spend in the submission to the committee in October 2008 was £44 million. That was reset to £40 million after definition changes and was £27 million in the published business plan for 2009-10. The potential spend on that in 2010-11 is £20 million. I presume that some changes in that figure resulted from factors being removed from SE but, even between the business plan spend and the potential projected spend, a cut of about one third has been made. Why has that budget line been cut by one third and what are the implications of that?

Lena Wilson: The explanation has a few aspects. Most of our company delivery is through account managers. We have a few hundred account managers who work with businesses all over Scotland. We made that delivery more efficient and brought even more of it in-house, so our account management costs fell by about 19 per cent, but the impacts increased by about 47 per cent. That was a saving on account management expenditure.

We made the offering much more consistent. We had 800 products in 2007, whereas we now have 40, so local enterprise companies no longer compete with one another to offer different products. The bulk of the saving came from that.

We also reclassified marketing support for enterprise. All that—some £4 million—used to fall under the company start-ups budget heading, but it is now reclassified in the research and development line. Perhaps the cut is not as stark as you thought.

We have moved towards advice being much more important than cash for our customers. For example, we doubled the Scottish manufactoring advisory service, but we did not have to double the cost because the main benefit is the advice that it gives to companies rather than grants or the money that we spend on companies. Much better advice is a more meaningful and sophisticated offering to our customers.

13:00

Gavin Brown: To summarise, the figure is less, but the implications on the ground are not substantial, partly because you are being more effective and efficient and partly because of a change in the marketing profile. You think that we should not be concerned about the end result.

Lena Wilson: We are working with more companies now than we were in the past. We are working with 6,000 companies, 2,000 of which we are working with in the intensive way that I described.

Gavin Brown: The research and development line was £6 million for 2009-10 in the initial submission, £16 million in the reset figures and £12 million in the business plan, and the projected spend for 2010-11 is £10 million. However, we have just heard that £4 million of that has come from the company start-ups and growth line. Does that mean that, if we take out the £4 million that comes from marketing, there has been a cut in funds for research and development?

Lena Wilson: Our research and development line is about how we support our staff development, marketing and communications, and policy and research. We share much more on the research and development side across the public sector alignment and we aim not to duplicate research and development. For example, the Scottish funding council has told us that it will use aspects of our research and development rather than duplicate it. We have made savings where we have shared resources with other public sector bodies.

Crawford Gillies: There are also savings from the Government. In the past, there was duplication of policy effort between SE and the Government that we are now endeavouring to eliminate.

Gavin Brown: Again, although the cash sum is reduced, you are not concerned about the outcome, which you think will be the same if not better.

Crawford Gillies: As I look at the split of that £10 million, the biggest chunk relates to marketing and communications, where we are upping our game with some of our programmes—we launched the now's the time to ask campaign last year and a new one on staff development, policy and research just a few weeks ago. Refocusing our resources towards customer-facing staff to the extent that we have has been the right thing to do.

Lena Wilson: The marketing and communications expenditure has not been to market Scottish Enterprise; it is to market initiatives, projects and programmes that companies can take advantage of and to make them aware of the offering. That accounts for the bulk of our marketing expenditure.

Gavin Brown: The other area that I want to ask about concerns customer-facing staff, support staff and related costs. The projected spend on customer-facing staff for 2009-10 was £46 million in the reset submission figures and £47 million in the business plan for 2009-10, and the projected spend for the next financial year is £44 million, which is a slight drop. At the same time, however, the projected spend on support staff for 2009-10 was £6 million in the reset submission figures and £12 million in the business plan, and the projected spend for 2010-11 is £17 million. It seems that there is a slight drop, of about 5 per cent, in spend on customer-facing staff, and quite a big increase in spend on support staff. Will you explain that?

Crawford Gillies: First, I understand your question. Secondly, I apologise to the committee on this matter. I agree that it is confusing. Essentially, with regard to these figures—the £11 million in last year's submission to the committee, the £12 million in the business plan and the £17 million in this year's submission—there was an increase of £6 million as a result of an efficiency investment made between last year's submission and the business plan. Another efficiency investment of £6 million is going in this year, but that has been offset by a £6 million overestimate of the transfer to Skills Development Scotland. If we strip out the Skills Development Scotland confusion and the additional efficiency investment, we find that, year on year, top-line support costs are absolutely flat.

I apologise if that is still not clear. Would it be helpful to send you a note on that?

The Convener: Probably.

Crawford Gillies: Okay.

Gavin Brown: I know that your overall budget has gone down, but I note that the funding for customer-facing staff will drop slightly from £47 million in the published plan for this financial year to £44 million for the next financial year. Was that decrease forced on you, or is it an efficiency saving?

Lena Wilson: Through a severance programme, we have reduced the number of senior director and director positions in Scottish Enterprise by 35 per cent. We have not taken anyone away from customers; indeed, we have increased the number of account managers and international advisers and expanded SMAS. In short, we have grown all the aspects that help companies but, as I say, we have taken out a large layer of senior staff.

Gavin Brown: Although some of those senior staff were included in the category of customer-facing staff in the budget, they did not meet any customers.

Lena Wilson: They might have met customers, but they did not form the bulk of our delivery to customers. We have not cut back on any customer-facing delivery staff; in fact, we exempted those staff from our severance programme.

Ms Alexander: Thank you for coming this morning, Crawford. I want you to take us to the very highest level of your strategic thinking and guide us through your choices in next year's budget. Like Gavin Brown, I feel that the most helpful information that you have provided is the table of figures that you sent us on 6 November, and I would like to dwell on one or two of those numbers.

In October 2008, we were two quarters into the recession. We now have figures for November 2009 and it seems that, 12 months on, we are still looking to encourage recovery. What has shaped your thinking in the areas of enterprise, innovation and commercialisation? The enterprise budget is set to decline 35 per cent from £65 million to £42 million; the total innovation budget is to drop 33 per cent from £39 million to £26 million; and the commercialisation budget is to decrease by 47 per cent from £51 million to a projected spend in the coming year of £27 million. Putting aside minor reclassifications—we will come to management accounting issues later—I have to say that, at a high strategic level, those are very significant changes over a 12-month period, especially given that 12 months ago we were already in recession. What is the board trying to achieve with such shifts in those areas?

Crawford Gillies: I think that, at the highest level, we are trying to focus on the long-term changes that need to happen in the Scottish economy while ensuring that we make a real impact in the short term. We are also trying to strike a balance in the areas that you highlighted.

Ms Alexander: If you are cutting those budgets by more than a third, which areas are you rewarding?

Crawford Gillies: You can see the other areas where the money is going. Would it be easier to go into the individual subcategories that you are asking about?

Ms Alexander: No. I am simply asking why, at the highest level and in the space of a year, you have decided to cut by a third your enterprise, innovation and commercialisation lines. Most observers and businesspeople in Scotland would not find that consistent with the published position. I am trying to get at the board's strategic thinking on why shifts of that magnitude are appropriate for the 12 months beginning in April 2010. There is, as you said, a new regime. What economic thinking underlies the shifts at the highest level of more than a third in your three biggest lines?

Crawford Gillies: For an organisation such as Scottish Enterprise, strategy comes down in large measure to resource prioritisation and allocation. We start with a certain amount, and the question is how we allocate that across the various opportunities. The board has not yet looked at the numbers, but will do so later this week. However, the view is that this is the budget that can best help us to recover from the recession in the short term and set us up for longer-term success.

Ms Alexander: Forgive me, but I am not clear about what the priorities are and why they are priorities. Let me take company start-ups and growth, which we have discussed. Last year, you were going to spend £44 million, and you thought that, by the end of the year, you had spent £27 million, perhaps because of the depth of the recession. However, it seems slightly strange to cut that figure even further. We heard that there was a 19 per cent efficiency saving and that marketing has been reallocated. However, over 12 months, you have a cut of 60 per cent. The 19 per cent figure does not explain why it seems strategically right to cut the budget by more than half. That will surprise people, and they will ask why you are doing that.

Crawford Gillies: I understand. One of the things that we need to do is communicate properly the number of companies that we work with across Scotland. In round numbers, no one has the real data, but there are probably 10,000 companies in Scotland, leaving aside individuals and so on. We work, in one way or another, with 6,000 of those companies. We work intensively with 2,000, which are the account-managed companies to which Lena Wilson referred, and most intensively with a subset of those 2,000.

Ms Alexander: You understand my point. Why is it that a 60 per cent cut seems the right thing to do for next year, given the point that we are at in the recession? I do not doubt that there might be more companies, and that you will spend a lot less on supporting more of them. However, you could support a much larger number of companies if you had maintained the budget. I just want to understand the strategic thinking involved.

Lena Wilson: Our budget—or forecast, which is what it is at the moment—in the business plan absolutely reflects what we understand to be current demand out there. We are not constrained by budget in supporting companies; that is not an issue. In fact, we have started to go out and prospect for the very first time. We went to the market and said “Have you ever even heard of Scottish Enterprise? Do you have ambition? Do you have technology? Do you want to grow your business?” That is how we got some companies through the door that had never come through before. We are therefore not constrained by budget in helping companies. In fact, our current budgetary allocation reflects the demand that we have.

There have been transfers out of the budget line that was originally submitted to Skills Development Scotland, which has taken on some of the skills aspects of what used to come under enterprise. We have seen quite a lot of transfer out into local authorities, with the transfer of business gateway. We can perhaps send the committee another table with more clarification so that it does not appear as if there is a 60 per cent cut, because that does not represent the reality.

Ms Alexander: But if the programme is demand led, that also sends the interesting message that you anticipate a 25 per cent reduction in demand next year, when we are meant to be starting to recover.

Lena Wilson: Definitely not. In fact, we are out there encouraging demand. As Crawford Gillies said, we are working with around 6,000 companies. There is a common misconception that Scottish Enterprise works with 2,000 companies. Those are the companies that we work with most intensively, but we work with another 4,000 through internationalisation support and the manufacturing advisory service. We will not cut services or the number of companies that we work with—that number will absolutely be protected; in fact, we are seeking to increase it. That means not simply taking in more companies—we have an excellent business gateway service that is now doing that—but growing our pipeline for companies that are going to grow. We are still lacking in companies of scale in Scotland, so we want to work with more companies.

13:15

Ms Alexander: I have two final points to make on the overall profile of Scottish Enterprise’s spend. I say to Crawford Gillies, the new chairman, that the reclassification of marketing and communications expenditure under research and development would give any chairman of a public organisation concern about management accounting practices. There is no clear line between spend and strategic priorities if spend is constantly reclassified. Moreover, it is extraordinary that marketing of any description should be described as research and development. That does not help anybody—the board or any observer—to have a clear sight of the line between the accounts and the organisation’s objectives. I say that not as someone who is hostile, but as someone who is favourably disposed towards the organisation. If there is no clearly visible line between the strategy and the management accounts on a year-by-year basis, how can we have any sensible discussion?

Crawford Gillies: I am absolutely keen to get more consistency year on year. I hope that we are turning a corner. Because we have been through so many different restructurings of one type or another, with things coming in and out over the past few years, there has been some confusion. I hope that, going forward, we will have far more stability. That will help us as well as outsiders such as yourselves.

Lena Wilson: Can I supplement the answer to the R and D question? Wendy Alexander is absolutely right that the reclassification of marketing and communications is perhaps not helpful. As I said, it is not about marketing Scottish Enterprise; it is about using initiatives to attract business, and a huge proportion of that is the research that we undertake to allow us to understand the market in order that we can attract companies. A big element of that spend is, indeed, what I would regard as true research.

Ms Alexander: I make one final observation. As you will know, we are going to have one more in-depth look at whether the changes that have been made over recent years have worked. In that context, we asked the parliamentary research service to examine the trend in the organisation's spend over a decade, and it believed in good faith that, since 2007, on a like-for-like basis, there has been a decline of 33 per cent in real terms. That is obviously highly significant given the fact that, over those two years, the overall Scottish budget was growing. In fairness, Scottish Enterprise says in one of its written submissions that £79 million came in one-off additions to the budget in 2007-08 and that the real like-for-like decline has been of the order of 17 per cent.

I do not intend to pursue the matter here; I simply suggest that the committee needs to get a handle—on a like-for-like, factual basis—on where the trend line sits between 33 and 17 per cent. That is a not inconsequential difference as we think about the role of the organisation going forward, and it poses a fundamental challenge to the board. If an organisation has seen its resources cut by 33 per cent in real terms over two years and has no public voice of any kind on the matter, people will start to ask about the role of the board—whether it is one merely of stewardship or whether it is also one of advocacy. That is not an issue that we will resolve around the budget process, but we will want to come back to it and, before we start that dialogue, some clarity on the numbers would be helpful.

Crawford Gillies: I will say two things in response. First, we will do anything that we can to help you to get clarity around the numbers. Secondly, there is a change in Scottish Enterprise that we need to recognise and do a better job in communicating. Scottish Enterprise is moving away from being an organisation that people on the outside—and, frankly, within the organisation—thought of as one that simply wrote big cheques to being an organisation that has influence across the Scottish economy without necessarily writing big cheques. As we make that transition, we can have a greater impact on the Scottish economy but with less resource.

The Convener: Before I bring in Chris Harvie, I will follow up on Wendy Alexander's questions by approaching the issues from a slightly different direction. She asked about the reduction in the enterprise, innovation and commercialisation budgets, but the counter to that is that you have increased the investment—or infrastructure—budget.

Last year, £30 million of capital was accelerated, to which, as you state in your submission, you added £17 million. If you strip that £30 million out of this year's budget, you should have a figure for the business infrastructure/property portfolio budget line of -£3 million or -£2 million, compared with where you were before the extra figure was included, but you have maintained it at £27 million. It would appear that the £30 million of accelerated capital is essentially being found from elsewhere in the budget, rather than from the capital budget. Is that a fair assessment?

Lena Wilson: I think that you are referring to the investment that we have made in supporting Scotland's key sectors, such as the investment that we continue to make in Edinburgh in the BioQuarter around life sciences and the investment that I mentioned in the renewables space. That is infrastructure investment, which is targeted at opportunities to grow Scotland's key sectors and attract inward investment into Scotland, and it is important that we maintain it.

The Convener: The purpose of advanced capital is to spend money a year before you would have been able to spend it otherwise. You appear to have spent it a year ahead, but you have maintained the budget for next year as well, so you are willing to spend the same amount of money again, and you have taken that money from elsewhere in the budget. Is that correct?

Crawford Gillies: There is a slight increase. If you take—

The Convener: It is a significant increase.

Crawford Gillies: If you take the £75 million from last year, the acceleration of the £30 million should lead to a £60 million reduction in the following year. You would expect—everything being equal—the figure to go from £75 million to £15 million. We are proposing that it goes from £15 million to £27 million, so in that respect there is an additional £12 million. That is driven by the quality of the projects that are coming forward, and it recognises the short-term impact that capital expenditure can have on the economy.

Lena Wilson: It is focused exclusively on our key sectors.

The Convener: The £75 million includes an extra £17 million that you added, so it is not like for like.

Crawford Gillies: An additional £17 million was added between the production of the original submission and the finalising of the budget.

The Convener: So if we compare your starting point under the “Committee Submission October 2008” heading and the number under “Potential Projected Spend Scenario”, we can see that you have actually increased the budget by £27 million, not by £12 million.

Crawford Gillies: With regard to last year’s submission, it is unfortunate that our interaction with the committee comes at a time when the budget is, to be frank, very much a straw man. The number to which you refer before the £17 million was added falls into that category.

Lena Wilson: But the infrastructure investment is—

The Convener: I am trying to make the point that, as part of the strategic structural change that you have made as an organisation, you have taken the strategic decision to concentrate more on infrastructure investment than on the revenue support that you provided in the past.

Lena Wilson: Yes, indeed, but that is a key way to unlock private sector investment. Our ratio is 1:2, or 1:2.5, so for every pound that we spend on infrastructure, we get very high leverage. That unlocks greater investment in Scotland, helps the supply chain and gives Scottish subcontractors business—there are much wider multiplier effects from that investment than simply the effect on our expenditure.

Christopher Harvie: I will make two points that pertain to internationalisation—for which, I noticed, the budget seems more or less level. That work will involve co-operation with other regions. One of my points is positive and one is rather negative. The positive point is something that I notch up to my own initiatives in the area: the links that we, in my own office, have managed to make with the minister for research in Baden-Württemberg in Germany, which is now the biggest industrial region on the continent, with an output that is roughly equivalent to that of Sweden. That co-operation has been achieved largely through one of my assistants, an economics graduate who has applied himself to the task. It will soon reach the stage when we will come to Scottish Enterprise to seek your involvement.

One thing that has emerged from talking to the minister, Dr Frankenberg, is that there is a student exchange project between the University of Offenburg and Edinburgh Napier University. Every year, Offenburg sends nine students to Edinburgh, but Napier sends no students to Offenburg. The region is very much involved in new technologies—particularly environmental ones—and produces 10,000 qualified technicians every year, compared with 2,000 in Scotland. It is evident that things could be better.

With regard particularly to the development of renewables, we have to look beyond the undoubtedly excellent research that is done in Scotland to a level of technical back-up that involves not simply apprentices, but laboratories and the level of instruction that is available within firms—75 per cent of Baden-Württemberg’s training comes from firms, not from colleges.

Can you tweak your internationalisation budgets to accommodate more of the Napier to Offenburg traffic? We have a problem there, and it is a problem of language as much as a problem of relationship.

Crawford Gillies: I am not sure that Scottish Enterprise can resolve that, but we can take that up with the funding council and ensure that it is aware of that opportunity.

Christopher Harvie: Another issue, which is ultimately rather tragic, is the closure of the headquarters of Chambers Harrap Publishers in Edinburgh. Some 24 redundancies have just been announced by Hachette in France—it is an example of foreign direct investment gone wrong, in a way. The work that Chambers does is a marvellous example of an area that could have been developed in terms of systematised interchange of information, which is one of the crucial aspects of what we are talking about. Instead, we are going to lose the Chambers editorial office. Surely the securing of that office should be a priority for a body such as Scottish Enterprise.

Lena Wilson: The global recession has seen the closure of foreign investors in Scotland and in countries throughout the world. We have had a great number of success stories that have involved our turning around what would have been closures and moving some companies up the value chain. However, a greater part of the resource of Scottish Enterprise and SDI has been devoted to trying to prevent closures or helping workforces to access new opportunities.

I believe that we were involved in the case that you mention and that we tried to do everything possible to help the situation. However, not every firm or project can remain here. Regrettably, that is not viable, but it is the reality of the global economy.

Stuart McMillan: The budget lines for the urban regeneration companies, which are important to Scottish Enterprise, have remained the same, according to the 6 November figures. What behind-the-scenes alterations have been made to the URCs over the past 12 months or so due to the recession?

Crawford Gillies: I will kick off and then hand over to Lena. What I say will be largely influenced by recent visits to Riverside Inverclyde, where I was yesterday, and the Clyde Gateway.

A couple of years back, we made a commitment to a three-year funding package for the URCs worth £12.5 million a year. What I have taken away from visiting those organisations, over and above the incredible work that they do—I find their plans and what they do on the ground impressive—is their desire to continue to be supported by Scottish Enterprise expertise. They are almost as appreciative of, and focused on, that as the money that we put into each of them annually.

13:30

Lena Wilson: In my previous role with SDI, I talked to the urban regeneration companies. I met the chief executive of the Clyde Gateway URC to help it develop its product for the inward investment market—to give it a sense of the inquiries that we get and of the kind of facilities that inward investors are looking for, and to ensure that it does the right thing for the market. We have really upped the advice that we are giving and consider the URCs' work to be extremely important not only for local communities but as part of Scotland's offering for some national-scale projects that I hope can emerge from it.

Stuart McMillan: I stay in Greenock, so I am aware of Riverside Inverclyde and meet that URC regularly. I cannot fault the level of ambition in the Inverclyde area. It is refreshing, because there has been little ambition there over the years—I have said that to Alf Young and Bill Nicol. However, one thing that niggles me about RI is that much of its plan is predicated on the former housing boom. Obviously, we do not have a housing boom at the moment. It appears that there has been a lull in developing some of the company's ideas because external capital is no longer available. That is why I asked my initial question. Have you not so much applied any pressure but, in general discussions, recommended that it alter X, Y or Z?

Crawford Gillies: I discussed that situation with Riverside Inverclyde yesterday. It was confident that it would continue to bring in the housing investment that it seeks. As you know, the project involves a mixture of tenure from social housing to very high-end development down on the waterfront. The company thinks of that as a 10-year project of which it is in year three, but it was confident that it could continue to attract the external, private sector investors that it needs, in partnership—and it has some creative partnerships—to drive the plan forward. I am not sure that there is anything that I can add.

Lena Wilson: Riverside Inverclyde also has good leverage. I think that it is getting 1:3.5, so it seems still to be attracting the private sector leverage. We are certainly available to give any advice or expertise required. Indeed, Bill Nicol at Riverside Inverclyde is a former member of our staff, so he knows how to use that expertise very well.

Stuart McMillan: I will meet him next week or the week after.

Lena Wilson: If anything arises from that meeting, please let us know.

Stuart McMillan: My next question concerns recreational boating opportunities and the knock-on effects of such opportunities. I am looking at the 6 November figures that you provided to us. What threat is there to the growth in recreational boating from the changes in some of the budget lines? Recreational boating provides a massive opportunity not only for tourism from within Scotland and the UK but international tourism. It is also a massive opportunity for job creation—we have only to look at the Largs yacht haven and Inverkip to see what can be done—and there are infrastructure possibilities not only on the lower and upper Clyde but north and south of the river.

We should also think about the knock-on effects of people taking part in recreational boating, such as the health benefits of the activity, and indeed the health benefits of being in work rather than being unemployed. However, I fear that some of those opportunities might be stymied.

Lena Wilson: Led originally by what was Scottish Enterprise Ayrshire, we did quite a lot of research into the opportunities in recreational boating, particularly for the Clyde coastal area, and that project is still very much alive. Recreational boating is a key tourism opportunity. Scotland has significant, large-scale opportunities for boating, mountain biking, hillwalking and other activity pursuits. The coastal project and the development of boating facilities are very much within our portfolio. We are looking to leverage as much private sector investment as possible because quite a lot of infrastructure is required. That is still very much in our plans, and we hope that it can be accelerated as the market picks up.

Stuart McMillan: On private sector investment, I have spoken to a few people in recent months who have said that they are prepared to invest substantial amounts of money in recreational boating in Scotland but that they are put off by the bureaucratic nature of the system.

Lena Wilson: Is that to do with planning, or—

Stuart McMillan: It is not just about planning. It is basically the whole gamut.

Lena Wilson: We would be delighted to talk to them as investors.

Crawford Gillies: Perhaps you could pass on the information about that. We will then follow it up directly with them.

Stuart McMillan: Sure.

Crawford Gillies: It is an opportunity that we are keen to help to exploit.

Stuart McMillan: Thank you.

The Convener: I have a final question on the Scottish Investment Bank. You helpfully produced some figures on that. What progress has been made on developing the Scottish Investment Bank and is there any information on when it is likely formally to be set up?

Crawford Gillies: We are participating in a Government-led policy process. For our part, we have set up a subsidiary with the title Scottish Investment Bank, which is on the stocks and is ready to be used should that be the desired process. We are prepared to transfer in some £150 million to £170 million of assets. I think that that is set out in the information that was provided to you. As for the timetable, I am not sure that I can enlighten you today, because that is in the Government's hands.

The Convener: That concludes our questions. I thank you both for coming along. We look forward to continuing our dialogue in the coming weeks and months.

I thank everyone for their attendance.

Meeting closed at 13:38.

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