ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 16 December 2009

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ECONOMY, ENERGY AND TOURISM COMMITTEE
34th 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:

Benny Higgins (Tesco Bank)
Professor Alexander Kemp (Council of Economic Advisers)
Sir George Mathewson (Council of Economic Advisers)
Jim McColl (Council of Economic Advisers)
David Thorburn (Clydesdale Bank)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Katy Orr

ASSISTANT CLERK

Gail Grant

LOCATION

Committee Room 6

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 16 December 2009

[THE CONVENER *opened the meeting at 09:32*]

Council of Economic Advisers (Annual Report)

The Convener (Iain Smith): Good morning and welcome to the 34th and final meeting in 2009 of the Economy, Energy and Tourism Committee.

I welcome Nigel Don to the committee—he is substituting for Rob Gibson. We have apologies from Gavin Brown, who is unwell, and Wendy Alexander, who will be a little late, for family reasons. I apologise for our slightly depleted numbers. We will go for quality rather than quantity.

With us for our first agenda item we have members of the Council of Economic Advisers, who are here to discuss the council's second annual report. I welcome Sir George Mathewson, the chair of the council, Jim McColl and Professor Alexander Kemp. I invite Sir George to make some opening comments and introduce some of the report's key features.

Sir George Mathewson (Council of Economic Advisers): It is nice to be here again. I am pleased to speak to the committee about the contents of the second annual report of the Scottish Council of Economic Advisers. I am delighted to be joined by Professor Alex Kemp and Mr Jim McColl.

The council's remit is simple: to advise the First Minister directly on increasing sustainable economic growth in Scotland. We met for the first time in September 2007 and we have met a further six times since then.

Over the past year, Scotland's economy, like the rest of the global economy, has been through a recession, and Scottish gross domestic product has fallen substantially. There are now some signs that the recession has passed its worst, with an encouraging improvement in the latest labour market statistics in Scotland, which I believe are being announced this morning.

Obviously, what will happen in Scotland in the near future depends on what happens to the global demand for goods and services and the fiscal stance of Governments, particularly the United Kingdom. We face challenging times ahead due to the tight financial settlement for the Scottish Government from 2011-12.

I should make it clear that, although the council has offered the Government advice on navigating recent events, most of our work has focused on the longer-term strategic thinking that is required to put Scotland on a higher growth path.

Over the past year we have focused on the following areas. First, to promote sustainable economic growth, we have advised the Scottish Government on how best to achieve Scotland's 2017 population and productivity targets set out in "The Government Economic Strategy". Secondly, we have provided advice on developing Scotland's key sectors. We have looked at two of the seven key sectors set out in "The Government Economic Strategy"—financial and business services, and food and drink. We have also considered the contribution that schools can make to economic growth and advised on how the Scottish Government can maximise borrowing opportunities within the current devolution settlement. We have said in clear terms that the Scottish Government should have the ability to borrow that virtually all comparable Governments have in the Organisation for Economic Co-operation and Development.

Our discussions on those topics are reflected throughout our second annual report, which represents an overview of our thinking and conversation during the three meetings that we had over the past year. Our report makes 17 recommendations to the Scottish Government on six areas of discussion. I draw the committee's attention to four key areas that we feel to be particularly important.

Following our initial discussion on productivity last year, we have had two further discussions this year on productivity and innovation. Productivity is a significant component of economic growth as it leads to an increase in added value and a reduction in unit cost. That helps economic growth by raising earnings and increasing the competitiveness of the Scottish economy and its capacity to expand. Labour, capital and total productivity in Scotland are still some way behind that of the rest of the UK, the US and our competitors in Europe. Research and development and innovation are relatively high in the public sector; business R and D spending and innovation is at half the UK rate and less than the European average. However, Scotland performs comparatively well in process and services innovation and the council recommends that the Scottish Government conduct a review of the scope for further innovation in that sector.

The council has identified the need in Scotland to encourage co-operation between universities, commercial firms and supporting agencies to combine the source of innovation ideas with those who can implement and commercialise them. In chapter 3, we offer some ideas about how to develop that co-operation. The Scottish Government could induce greater innovation through its procurement process, influencing competition and regulatory policy and encouraging engagement with foreign markets and foreign capital. We have presented three recommendations to the Scottish Government to develop in those areas to promote innovation and increase productivity.

The key sectors are those that are identified as having high growth potential and the capacity to boost productivity. The first of the key sectors that we discussed is financial and business services. Given the rapidly changing nature of the sector over the past year, our chapter offers a high-level overview that looks broadly at the state of the three components of the sector in Scotland, which are banking, fund management and insurance. We recommend that the Scottish Government ensures that it has the knowledge and influence to enable Scotland to obtain the best possible result from the reorganisation of the UK banks. Related to that, the Scottish Government should ensure that financial services are represented in education and lifelong learning to build strong foundations for the sector in the future. The council will return to look at specific areas of the financial and business services sector at future meetings.

In last year's annual report, we made recommendations on the Scottish universities sector. In this year's report, we have turned our attention to the schools sector and the contribution that schools can make to Scotland's economic growth through improving the stock of human capital. Despite its international reputation and the emphasis that it places on education, Scotland holds only the middle ground across the range of OECD countries when performance indicators are compared. It is interesting that the OECD data also suggest that average spend per pupil is above the OECD average for both primary and secondary schools. Therefore, the long-term shortcomings of Scotland's education are not the result of underspending on teachers and schools per se. The challenge that Scotland faces relates to the effectiveness of resource use in education over recent decades, rather than to the volume of spending. For Scotland to achieve its potential and become an international centre for education, a more fully integrated schools policy that is based on strong analysis and good data should be developed. A highly open and transparent system is required to ensure that independent research on, and rigorous evaluation of, Scottish education are carried out.

One of our key recommendations in chapter 6 focuses on the need to prioritise teacher quality. The development of the chartered teacher system is one step towards that. We also recommend that academic excellence be promoted and rewarded to ensure that students and their families commit to educational attainment.

Finally, I turn to borrowing. Last year, the council began a review of the economic role, current condition and means of provision of infrastructure in Scotland, and emphasised its concern about the long-term underinvestment in Scottish infrastructure. In this year's annual report, we have set out why the Scottish Government needs to borrow and what limited borrowing opportunities exist under the current legislative framework. Any borrowing that is carried out by the Scottish Government should be independently reviewed to ensure that it is sustainable and presented transparently.

Therefore, we have recommended that, when Scotland's borrowing powers are extended, a fiscal policy commission should be established to review the future fiscal position and outlook. In addition, public accounts will need to present a clear and fair view of such borrowing. In the meantime, the Scottish Government should make the maximum use of current borrowing opportunities and should seek to have the ability to deploy accumulated year-end funds without discussion with the UK Treasury. The Government should also seek access to the local authority prudential scheme and to have the current £500 million borrowing limit increased. The council will return to borrowing at future meetings to provide further recommendations to the Government.

In the coming year we will keep exploring how to secure greater comparative advantage for the Scottish economy in order to boost sustainable economic growth. We will advise the Government on how to achieve some of the remaining longer-term purpose targets, and further work is planned on the key sectors that are set out in the Government's economic strategy. We will highlight future challenges and identify how Government policies can be more supportive.

In our second annual report we have set out 17 recommendations for the Scottish Government that we believe will help to deliver increased sustainable economic growth for Scotland. It is now up to the Scottish Government to consider them, and we look forward to receiving the Government's response in the new year.

Are there any questions? My remarks were rather longer than I thought that they would be.

The Convener: Thank you very much for that useful introduction.

I will start by looking back at last year's annual report. This year's report gives no indication of how you feel that the Government has responded to the 22 recommendations in last year's report. Does the council have any views on the progress that has been made on those recommendations?

Sir George Mathewson: First, it is important to say that we do not regard it as our job to audit Government against our advice. We advise Government on what we think is right for the economy. Other factors, such as political implications, are outwith our remit. We do not regard it as for us to give the Government nine out of 10 or whatever on the extent to which it has accepted our advice. However, in general, I think that it has accepted, and has attempted to go along with, our advice.

The Convener: That was not exactly the question that I asked. I asked what progress the Government had made on implementing last year's recommendations, rather than whether it had accepted them. As well as accepting your advice, has the Government taken action to implement it? Are there are areas in which it needs to do more? Are there others in which you are happy with its efforts?

Sir George Mathewson: I think that the Government has taken action to implement our advice. The most immediately relevant example is planning, on which the Government has taken action that has resulted in more activity. There are figures available on the time that it takes to get planning approval. I cannot remember them off the top of my head, but they have improved dramatically over the most recent period. That is one example.

09:45

The Convener: You indicated at the outset that your focus is more on the longer term than the immediate term. You also said that you had discussed with the Government its handling of the immediate economic situation. What was the nature of your discussions with the Government on issues such as its economic recovery plan and how the Scottish Government's budget is being utilised to get Scotland into recovery?

Sir George Mathewson: In general, we approve of what the Government is doing on the recovery plan. Obviously, there are limits to what it can do. We are not the Government. We give the Government ideas and advice. It is up to ministers to decide—politically—what to do.

The Convener: I accept that point, but given that you were set up as a council of economic advisers, part of your role is to advise the Government on how it handles the economy. I am trying to get a feel for the extent to which you are involved in discussions with the Government on how to see Scotland through the current economic crisis.

Sir George Mathewson: We have discusssed, for example, how we could accelerate infrastructure projects. My colleagues may remember other examples.

Professor Alexander Kemp (Council of Economic Advisers): The discussion on accelerating infrastructure projects is linked to the on-going work on borrowing.

Lewis Macdonald (Aberdeen Central) (Lab): You said that you have witnessed some improvement in planning. Do you accept that such improvement as there has been is the result of legislation that was on the statute book prior to 2007 and that has been implemented over the recent period?

Sir George Mathewson: No, I do not accept that it is just that; it is an attitudinal thing.

Lewis Macdonald: What is the added value? What specifically has Government done in response to your recommendations? That is what we are keen to find out. We want to know how far that can be measured.

Sir George Mathewson: As I understand it—again, you are probably in just as good a position as I am to make these judgments—John Swinney has been very strong with the councils in emphasising that planning is a development process, not just a control process.

Lewis Macdonald: That is fine. It is one thing for ministers to express a view, but have they taken any action?

Sir George Mathewson: They have. I look at the results. The results appear to indicate that they have.

Lewis Macdonald: I am keen to establish whether there is any way at all in which you measure actions. You have described attitudes and outcomes, but the bit in the middle is missing. Did your advice on planning produce any actions that you can demonstrate are a causative link between attitudes and outcomes?

Sir George Mathewson: I think it did. The Government communicated with the local authorities. It acted to change attitudes within the local authorities to the whole planning concept. Our advice was very much to remember that planning should be a creative exercise and not merely a control exercise. The Government took that on board. What matters are outcomes.

Lewis Macdonald: That is right. I am interested that you picked that example. I think that all parties and governments would agree with the principle and the attitude and would seek to achieve the outcomes, but we are interested in understanding whether—if at all—the advice of the Council of Economic Advisers has had consequences. Has the Government taken actions as a result of that advice that it would not otherwise have taken?

Sir George Mathewson: I cannot define that absolutely other than to say that our advice appears to have got a lot of sympathy from Government in moving this forward. It is all very well to say that everyone would agree about how planning should happen, but the reality is that it was not happening and now it is happening. That is important.

Lewis Macdonald: It is interesting that you are as positive and optimistic as you are. I have seen the targets that the Government set for Electricity Act 1989 consents for renewable energy. The targets are admirable, but the Government is missing them by a mile. I am sure that you are aware that the Government is nowhere near achieving them.

Sir George Mathewson: All I am saying is that, in general, the planning environment has improved. The time needed to get standard approvals has shortened dramatically.

Lewis Macdonald: You made recommendations last year about universities and this year about schools. Some of the measurables that you and we are interested in concern Government investment and engagement with the process. Have you seen any measurable outcome in relation to the recommendations that you made last year on universities?

Professor Kemp: The role of universities in the economy has been fully acknowledged. What we said about universities and the higher education sector being among the drivers of economic growth has been accepted by the Government. The idea, for example, that we should be encouraged to take on more foreign students, who provide income for all the economies in which higher education is based, is perfectly well understood. The idea that university research should be encouraged has been acknowledged. My own institution did quite well in the research assessment exercise, and it was duly rewarded for that. That sort of evidence is positive.

Lewis Macdonald: It is, but that reflects the quality of the university, rather than the engagement of Government. Are the two being confused a little?

I presume that, if you are advising Government this year that it ought to emphasise quality in schools, you are seeking additional investment in continuing professional development.

Sir George Mathewson: You are thinking of it in terms of spend.

Lewis Macdonald: No, I am talking about investment. If you want to improve quality, you presumably have to invest in continuing professional development. You cannot improve quality without it. It is not necessarily a question of additional spending; it is a matter of where the spending is put. Would you expect the Government to increase investment in CPD or teacher training at universities?

Sir George Mathewson: Yes, but we must consider the philosophy behind education. Our council is saying that we need more emphasis on academic attainment in order to compete. That is achieved by having teachers who are committed to academic attainment and by having families and a culture that is committed to academic attainment. We do not achieve that just by investing money. The council has strongly emphasised the need to base education policy on hard evidence, on the results that you want and on the results as they are. There is a lack of evidence about the right measures to take now, and more work is required.

Lewis Macdonald: You will be aware that, a number of months ago, the literacy commission published evidence that demonstrated that about 18.5 per cent of children leaving primary school are functionally illiterate. Some of the priorities in education might not be at the elite end of the business; they might be at the basic end of the business. Do you accept that? Do you acknowledge that Government has to make choices, and that sometimes the investment in academic excellence might have to follow the achievement of a higher standard across the board?

Sir George Mathewson: That figure is absolutely appalling. My idea of attainment is not focused just on the elite. We are failing some children very badly. We must think about our whole philosophy of education, based on evidence, rather than theory.

Lewis Macdonald: I am asking about priorities. You said that you do not consider it your job to measure how far the Government accepts your advice but, nonetheless, if you make recommendations, you look to it to act on them. For you, what would be the evidence that it had listened to what you had to say on schools?

George Mathewson: It would take time for schools, obviously. It is extremely difficult to change education policy. It has become ingrained into the system over the past however many years and changing it is a real challenge for any Government. Some years down the road, I would like to see a radical difference in the numbers that you cited. Our present place in the international leagues is terrible. It is simply not satisfactory.

Marilyn Livingstone (Kirkcaldy) (Lab): I will ask a follow-up question to Lewis Macdonald's question on planning. There was an article in *The*

Herald on 13 December with the headline "University funding cuts 'will ruin Scotland's architectural prowess'". Interestingly, it also discusses planning. It says that there are

"plans to cut funding for architecture courses at Scottish universities by nearly a quarter."

I will read you some other quotations from the article, which fly in the face of some of what has been said. It says:

"heavyweight groups—including ... the Royal Institute of British Architects (RIBA) ... and the Royal Town Planning Institute (RTPI)—warned they might not accredit students at Scottish institutions as architects or town planners."

There is a move to cut the funding from £6,700 a year per university graduate to £5,000 a year. According to the article,

"Veronica Burbridge, national director of the RTPI in Scotland, said the cuts would be 'at best short-sighted, and at worst a severe dereliction of duty by the'"

Scottish Further and Higher Education Funding Council.

"'These cuts, if implemented, could mean the end of planning education in Scotland as we know it, which would be a terrible end to a proud history of innovation'".

There are two pages of all the different institutions discussing the impact that the proposed cuts would have on town planners in Scotland. In light of what you said about planning and education being the key, what is the basis for cutting the funding to planning and architecture courses in Scotland?

Sir George Mathewson: That is way outwith our remit. I cannot possibly comment on it, as I do not know the numbers or the demand for planners. The council has not considered that matter.

Marilyn Livingstone: Week after week, the committee heard in evidence for its previous inquiry that there were not enough planners and that councils were struggling to get suitably qualified planners. Then we read this two-page article, which says that the decrease in funding will hit town planners. There is a whole page of quotations from people who are outraged about the cut and who say that they will not be able to accredit town planners in Scotland, which is serious. The matter needs to be raised and I will raise it through my cross-party group on construction, which will meet to discuss it today. However, it is an issue for the Council of Economic Advisers because, if one of the biggest barriers to economic development is planning—we all see that in our constituencies—it surely does not make sense to cut funding. It does not add up and is not joined up.

Sir George Mathewson: It is outwith my remit to comment on that except to say that we have to examine the system and decide how many planners we really need. Is the system optimum for the number of people and is what they are asked to do all necessary? I am sorry that I cannot really assist you on the matter, but I am sure that you will make representations to the people who can.

Marilyn Livingstone: It is well worth bringing the matter to your attention.

I will ask about further and higher education. Throughout the report, you raise issues to do with technical education. What consideration did the council give to the policy for further and higher education in Scotland's colleges, which are a big contributor to our economic recovery?

10:00

Jim McColl (Council of Economic Advisers): As an employer, we have been working with the Government on building better links between the universities and business and industry; there is a push towards that in general. We are trying to link the research that has been done in the universities with the areas of interest that businesses are currently exploring.

Work is currently going on to develop a Wikipedia-type search engine so that those matches can be made. For example, if people are interested in carbon capture, they could use the search engine to find out which universities in Scotland offer relevant courses. A great deal of that type of work is currently taking place, and the Government has been pushing to bring the universities and industry closer together. My business colleagues and I have been involved in a number of events that are encouraging the development of those links, and some positive programmes are in place that will help greatly.

The further education colleges are an important area. I have seen the universities working more flexibly. The universities that are former polytechnics are working more closely with companies to accredit some of the work that staff are doing internally. For example, we are currently running three masters degree courses in our pumps business in Cathcart. We take on students who have a general degree, and provide them with an honours degree through working with one of the universities in Glasgow, which enables us to let staff attend on a part-time basis or to have lecturers come to our company.

We are working with universities on honours degrees for mechanical engineering students, which will allow them to achieve chartered engineer status, and on three masters degrees. We work with universities such as Glasgow Caledonian University, the University of the West of Scotland and the University of Strathclyde, and we are currently discussing another possible course with the University of Glasgow.

Marilyn Livingstone: With respect, there is quite a bit in the report about the work that you are doing with universities, but Sir George Mathewson spoke about the need to consider schools and disadvantaged young people. It is the further and higher education colleges that are developing the inclusion agenda and bringing people back into education. The two-plus-two approach has been developed, in which the first two years of a university course are undertaken at a further education college. That helps to encourage adult returners who do not live in a city to take a degree course.

I have read a lot about your views on the university sector, but I would like to hear your views on the further and higher education sector and getting people back into education. Many 16-year-olds who are dissatisfied with school are going into the further and higher education colleges. What are your views on the current funding issues and the impact of that sector on the economy?

Jim McColl: A good bit of activity is currently going on to increase the number of apprenticeships. One of the challenges in that respect, which was mentioned earlier, is that many people who leave school are not fit even to begin apprenticeships. Pre-apprenticeship courses are being run in response to that challenge, and we and other companies are being asked whether we can work with schools to give pupils some work experience.

We are currently developing a project that was initiated through discussions with the Government and Glasgow City Council, which looks at secondary schools, in which some kids just switch off at age 14. There may be a way that we can get pupils to work with the further education colleges—for example, there are programmes that allow them to attend for a day or a week.

However, there are mixed feelings among teachers about whether it is better to take such kids out of school—the course might be just a way for them to get out of school—or whether that kind of education should be taken into schools. Talks are currently going on with secondary headteachers to establish what the best way would be to intervene with 14-year-olds to link them up with some sort of learning-by-doing activity so that we can catch those who are not suited to academic instruction. There is certainly a swell of activity just now to see whether more of that can be pieced together in a structured way.

Professor Kemp: I can add a little bit from the university side, which has acknowledged the problem that the question raises. For a long time, my university—like most other universities, I am sure—has had access programmes that allow young, or not so young, people who do not have the normal qualifications to attend summer schools where they can sit exams and, if they pass, then be accepted into the university system. We have done that for a long time, usually with relatively mature people who left school at an early age without highers but who have, as Jim McColl said, learned by doing. When such people come back, they often do well. We can do a little bit. My institution has certainly done that for a long time, but I am sure that others have as well.

Christopher Harvie (Mid Scotland and Fife) (SNP): I was interested to hear about the technical training work in which Jim McColl is involved. I have two questions, the first of which deals broadly with education and the second of which is about the implications for borrowing and about possible international collaboration.

First, on education, my university department has had a couple of visits from Professor Frankenberg, who is the research minister of the German state of Baden-Württemberg, which has an economy that is the size of Sweden's. Manufacturing accounts for 35 per cent of the state's GDP—an increase of five percentage points since 1999—and most of that is in the energy and low-carbon sector. What emerged from those visits and from the visit to Stuttgart that my assistant, Stefan Büttner, and I undertook to talk to departmental heads, was that, rather as Jim McColl hinted at, 75 per cent of the training of qualified non-university-level technologists is carried out in firms rather than in technical colleges. It was pointed out, however, that the colleges largely provided such training in the former East Germany, where so many firms have closed down. Of course, in Baden-Württemberg, which has firms such as Voith and Siemens, which now jointly own Wavegen, firms have their own academies in house.

It seems to me that, if we are to generate the technical back-up that will pick up our very considerable university advances—the Germans have the great disadvantage of having no sea, whereas we have marine and offshore capability—we will be dependent both on firms such as Jim McColl's and on advanced educational means, such as perhaps a technical adaptation of the Open University and the use of high-definition television to replicate laboratories. We will also be absolutely dependent on co-operation with continental regions, which are in advance of us.

As a former lecturer in engineering pointed out to me, Motherwell College had 170 people studying engineering in the 1970s, but the number now is not even in double figures. That is an example of the ground that we need to make up.

How do we arrange that? What role does educational innovation play in that? What role does co-operation with the European regions that already own a lot of our productive capacity in that area play? That picks up Sir George Mathewson's point about the criteria by which we want to evaluate our education.

Jim McColl: You are absolutely right. It is key to do a lot of this training in the workplace. We have an academy at our pumps business. Babcock has an academy—it has a training centre and it is offering a masters degree—as does Howden's. Some of their people will come to do our modules and some of ours will go to do theirs. Quite a bit of activity is going on there. That includes the further education colleges. There is good co-operation and a willingness by universities and further education colleges to engage in that type of more tailored education for these kids.

Professor Kemp: I can add a bit to that, which might give you some ideas. Over the years, the oil and gas sector in the north-east of Scotland has had a problem getting well-qualified technicians—it has had that problem for a long time. OPITO was set up by the employers as an independent organisation whose job it is to facilitate training for technicians and apprenticeship schemes. It does not do the training itself; it facilitates and validates training programmes that are run by Aberdeen College—I am talking only about my area—which deals with apprenticeships; by the company that used to be the Robert Gordon University training company but is now part of Petrofac in the private sector; and by a whole lot of others. OPITO is a kind of umbrella organisation. It is not Government owned at all, but the Government is fully supportive of the idea. It has brought together trainers and the needs of the industry in what is proving to be quite an effective way. That might provide ideas for industries such as engineering.

Sir George Mathewson: We looked at schools in the report and took international advice. Schools have to do the job of producing literate and numerate pupils at all levels. As Lewis Macdonald pointed out, they are failing to do that at the moment.

Christopher Harvie: There is a size factor. Baden-Württemberg, which has the background of big companies such as Daimler-Benz and Bosch, produces, every year, five times the number of trained technicians that we produce—even allowing for population differences. That means that the existence of industry is a crucial factor. Not every place is as fortunate as Jim McColl's area in having several big firms in situ.

The second point is one of culture. The Baden-Württemberg worker, coming out of his work and taking the daily paper will read the *Südwest Presse*, which is roughly on the level of *The Scotsman* or *The Herald*. The equivalent Scottish worker would read the *Daily Record* or *The Sun*, which is a sobering notion. What is literacy worth if that is what you get at the end of it? That has to be said bluntly. Some 19 per cent of the German population read *Bild*, which is roughly on the level of the tabloids, whereas something like 50 per cent of people in this country read our tabloids.

Sir George Mathewson: I think that you are just saying in a different way what the committee was saying about the education system.

10:15

Christopher Harvie: Following on from that point is one about finance. In all our discussions with bank chiefs, the inflexibility of the banking model and the problems that have to be contended with have been very much to the fore. I have heard the point echoed in discussions in Fife and elsewhere with local chambers of commerce, whose members have talked about difficulties of access for small and medium-sized enterprises.

Would it be advisable to explore what sort of partnerships we could develop with the Landesbank system and the system of local, mutual banks in Germany? There is not a totally unspeckled page in that regard, because some of the banks have speculated badly, although on the whole their losses have been much less than has been the case in this country. The banks have a proven record of established lending to industry and involvement in the creation of industrial policy, and they are willing to think in terms of joint participation, as far as I understand from discussions in Stuttgart. Given that Voith Siemens and other companies are heavily involved in the North Sea, is it logical to explore such a means of facilitating borrowing, particularly for the purpose of getting renewables up and running?

Sir George Mathewson: Your question is difficult to answer. We are going through a period that is atypical in bank lending and I know from personal experience and feedback that the situation is difficult for companies. I do not expect that to last for ever. I am not sure what the Landesbank system could bring to the party that is not already there, but I am always open to ideas.

Christopher Harvie: We are not the only renewable energy option on the menu as far as big German finance is concerned. You might have come across the Desertec industrial initiative, which envisages the creation of large solar-powered units in the Sahara desert, which will pump electricity into south Europe—and help to overcome certain in-migration problems at the same time. It will cost £500 billion to set up, but Munich Re, the very large reinsurance concern that heads the initiative, is thinking in terms of a five-year programme to set it up. The initiative could offer alternative investment opportunities for German financiers, who, after all, have a proven track record of working with a highly sophisticated industrial economy.

We might not be the only option, but I think that we can offer something better. A combination of wave and wind power, along with carbon capture, should be extremely attractive to Germany, but we might lose out if we are not fast enough off the mark, particularly in arranging borrowing powers. That was a statement, rather than a question.

The Convener: Do you want to comment on that, Sir George?

Sir George Mathewson: No.

Stuart McMillan (West of Scotland) (SNP): On page 13 of your annual report, you refer to the 43 per cent growth in Ireland's population. When the population was increasing, not just because more Irish people were being born but because people were being encouraged to come to the country, was more money being invested in training and retraining?

Sir George Mathewson: I cannot tell you the details, but I know that Ireland has invested a lot in education and training during the past few years. Our recommendation is that we re-evaluate the targets for population and try to understand better the reasons for migration and who is migrating and so on. We have used instruments that are too blunt so far.

Stuart McMillan: In paragraph 1.14, on page 9, you said:

> "Looking forward, the UK economy has tended to bounce back more quickly from recessions than Scotland has and forecasts indicate that this may be the case again this time round."

What can we learn from the past, to help Scotland to come out of recession more quickly, and—if it is legitimate to ask this—what would have helped in the past?

Sir George Mathewson: There is no magic answer or we would all have done it. The latest unemployment figures in Scotland are quite encouraging—we are perhaps not going to be so negative with regard to the rest of the UK as we might have thought, going on past figures.

Stuart McMillan: Last week, the pre-budget report was published, and we heard about the chancellor's decision not to accelerate additional capital spending. When you were here last year, the issue of accelerating quality investment was commented on. Would accelerated capital expenditure, have benefited the Scottish economy?

Sir George Mathewson: Yes. We make the point that there has been underinvestment in infrastructure. That is one of the reasons why we have discussed borrowing powers.

Stuart McMillan: In paragraph 3.8 on page 19 of the report, you refer to how people can develop a management career. I have studied in France, Germany and Sweden, and I was in Sweden at a time when the country was a test bed for American companies when they were investing in Europe and introducing products and service here. I found that fascinating—it was a tremendous incentive for people to stay in Sweden. Does Scotland have the capacity to do likewise, and to compete against Sweden to become a test bed? Is that legitimate?

Jim McColl: I am not quite sure what you mean by a test bed. For management or—

Stuart McMillan: If Scotland were used to try out products and services, it would create management and marketing opportunities here. If companies tried to get products and services operational and used fully in Scotland, it would create opportunities here. It created opportunities in Sweden; it certainly ensured that people stayed there. Because the Swedes have technical expertise and are good at learning languages, they are very mobile, but the test bed gave them the incentive to stay in Sweden to progress their careers.

Sir George Mathewson: Inward investment has done that in Scotland over the years, although perhaps not so much now because there is more competition.

Stuart McMillan: Sweden was used as a test bed—it formed quite a niche market for itself. Do you see that as an opportunity for Scotland? Could Scotland do something similar?

Sir George Mathewson: You would have to be more specific. It is possible.

Nigel Don (North East Scotland) (SNP): Good morning, gentlemen. I start by progressing thoughts on borrowing. I am not sure that I have read every word that you have written on the subject, but I get the impression that the Scottish Government has the ability to borrow £500 million as a sort of rolling debt. Would that be a fair way of looking at it?

Sir George Mathewson: That is the amount that the Government is allowed to be out—

Professor Kemp: On a year-by-year basis. Not allowing that would be terrifically harsh if the Government had just miscalculated slightly from one year to the next, but it is not to be used consistently.

Nigel Don: So, in effect, it is a rolling overdraft facility, which is not really a borrowing facility; it is more a way of getting over the end of the financial year.

Professor Kemp: Yes.

Nigel Don: I just wanted to clarify that because, realistically, that is money that no business would normally use for funding. Again, if I have read the words correctly, I think that you are suggesting that local authorities can borrow by using prudential borrowing in the conventional way—essentially, borrowing against expected revenue, which I am sure that local authorities are happy to do. However, I failed to pick up where you thought that the Government could make real sums of money available, if we are going to have to live with the consequences of not having accelerated capital expenditure. We have all identified that we would like to spend money on infrastructure, as it ticks all the economic boxes. What options does the Scottish Government have?

Sir George Mathewson: The reality is that, currently, we do not have many options. We are suggesting that we should have such powers. If not, we will be forced back on financial initiatives such as—help me, Jim.

Jim McColl: Special purpose vehicles.

Sir George Mathewson: Yes, special purpose vehicles and so on. If that is all that we can use, perhaps we will have to go that way. However, that is expensive and, in a way, dishonest, because it is still debt, even though it is off the balance sheet.

Nigel Don: And the only way of getting those borrowing powers is to go down to Westminster and ask for them.

Sir George Mathewson: Yes, at the moment.

Nigel Don: I simply wanted to put that on the record.

To pick up on some points of detail in the report, bouncing around almost at random, I read what it says about food businesses taking advantage of niche markets and export opportunities, which makes good sense to me, particularly as I represent North East Scotland. However, I am left with the impression that the marketing skills have traditionally come with people who have been trained by larger businesses before migrating into other businesses. Is that the case? Your body language suggests that it is not. That seems to be the bit that we are missing. We are good at innovation and production but not so good at marketing.

Jim McColl: We found that there was a lack of innovation in the marketing of food. We saw some success in cases in which a range of food was grouped around an area such as Arran, but there is probably a lot more mileage in innovative marketing than has been exploited so far. There are many small companies in the food industry, and they are not focused on exporting, except down south. In some of the mid-sized companies, there are opportunities to be more innovative and to grow exports.

There are some successful companies. For example, even in remote parts of India, you can get Walker's shortbread.

Nigel Don: Is the problem to do with a lack of imagination with regard to the opportunities that are available to businesses, or—as I suspect—is it to do with a lack of marketing skill?

Jim McColl: I think that it is to do with a lack of marketing skill.

Nigel Don: How do we address that issue?

Jim McColl: It was not obvious to us that Government could do much about it. Ireland, Norway and Finland have been exceptionally successful in developing differentiated brands and marketing them worldwide. Our suggestion was that we should investigate what they did and how they did it. There is no reason why we should not be able to do the kind of thing that they have done, but we have not investigated the matter; we recommended that the Government should do so in order to see whether a more coherent policy could be put together.

10:30

Nigel Don: I turn to research partnerships and start-ups. Paragraph 3.13 on page 22 of the report makes good sense—I buy everything that you say—but the issue sounds incredibly complicated. I wonder whether your answer to this question will be the same as the one that you gave to my previous question. Are you suggesting merely that the Government should consider the issue, or can you point it to models of success and offer specific suggestions on how to proceed?

Sir George Mathewson: There is no rational reason why things should necessarily be manufactured in the places where people invented, developed and researched them. In today's world, knowledge flows to where it can be put to use more cheaply. The real added value in development and research is in that development and research. That point is important. Over the years, I have asked continually how we can commercialise research. In reality, research is commercialised in the places in the world where that can best be done.

Jim McColl: Universities in Scotland punch above their weight in research output and Scottish Enterprise has been fairly successful with its proof-of-concept initiatives, but we seem to fall down on commercialisation, after concepts have been proved.

Discussion has been initiated and followed up in one area that I have mentioned. If a company is interested in a subject such as carbon capture or biomedical sciences, how does it find out what is happening in the universities? It is easy to capture those data, but that is not done. Efforts are now being made to join up the system, so that companies can enter a key word in a database or website—whatever the term is for sites such as Friends Reunited—and find out which universities are doing research in the area.

Often people in universities want to keep their research secret and to tell no one about it. In my view—this is not the Council of Economic Advisers' position—those who have received research grants or proof-of-concept money should be required to record information about their work on a database. That would make things easy for companies that are looking for research to commercialise. A commercial entity may see that two or three separate pieces of research that are under way can be brought together, which may not be evident to the independent researchers. It is all about making information more visible and accessible to companies. Action is being taken to move matters forward.

Nigel Don: What you suggest does not seem to be unreasonable, if the innovations are supported by public funding.

Jim McColl: Absolutely.

Nigel Don: If they are supported by private funding, people will want others to know about them. Your proposal seems to tick all the boxes.

You mentioned intellectual property. I suspect that it causes real difficulties because many people run away as soon as patents and lawyers—which tend to go together—are suggested. Is the issue causing difficulties, or do we have structures to deal with it?

Jim McColl: I do not know whether it is causing difficulties.

Professor Kemp: I can add something from the university side. We are aware that our research is not fully commercialised. Often there are no incentives for academics to commercialise research. Their reward is to publish a good paper in a good journal.

More and more, we are being encouraged to do knowledge transfer, which is one of the in things at the moment in the research councils. Many academics are not good entrepreneurs, so how to commercialise and, even, their being willing to do so, are issues. Scottish Enterprise, which is already knowledgeable on the issue, should play a greater facilitating role in getting more widespread commercialisation.

Universities are, of course, keen to protect their IP, but that does not mean that it cannot be commercialised, as long as the rights are protected. That is not necessarily a hurdle. If the incentive to commercialise exists, spin-out companies—which are prevalent in my organisation—can do it. To get over the capital cost barrier, universities can spin out to bigger companies and make profits as a consequence. That is all fine: everybody gains at the end of the day.

One other point to make about IP at the commercial stage is that, in the oil and gas sector, we have the Industry Technology Facilitator, which facilitates joint industry projects. It was formed by a group of companies to finance projects for the general benefit of all. When the organisation started about 10 years ago, it was agreed that the IP rights had to be given to the SMEs, university engineering departments or whatever that had developed the technology, but they were encouraged to put in place a commercialisation process from the research—indeed, there is a clause in the contracts on that. In other words, the departments cannot just do the research, write a nice paper and then go on to the next subject, because it is a condition of their getting the funding that they put in place a commercialisation programme.

Nigel Don: I presume that that model does not exist in all areas of activity.

Professor Kemp: I do not think that it does. After a lot of painstaking work, that is the model in the oil and gas cluster.

Nigel Don: I take it that it would be a good model for the rest of the nation.

Professor Kemp: I think that there is merit in it.

Nigel Don: The annual report mentions the procurement process as a route to productivity. Why are public services not procured properly at the moment? Given that we have arguments about best value, that everyone is looking at their budgets and that nobody actually wants to waste money, how can we make money from better procurement?

Sir George Mathewson: We suggest in our annual report that, under European Union law, things can be procured that are perhaps not the cheapest if doing so fulfils other valuable functions. Government could use more discretion on that.

Nigel Don: To interpret that, and possibly to put words in your mouth, that means that it might be sensible to buy something in Scotland rather than from outside Scotland, even if it costs 2 per cent more, because it achieves other economic benefits.

Sir George Mathewson: Yes—it might achieve economic benefits or advantages for R and D or whatever.

Professor Kemp: I know a bit about that, because EU law was a big issue when it was applied to the oil and gas sector. The term "most economically advantageous" is not as vague as it might seem. It has to be clarified that the process will be timely and will bring wider knowledge benefits—that kind of thing. That approach is certainly not protectionist, which the EU directorate is dead against. It acknowledges that quality, timeliness and wider external benefits could be part of what constitutes "most … advantageous".

Nigel Don: Are we failing to make use of that opportunity because we do not know about it, because we are scared of it, or just because it is easier to go for the bottom line?

Sir George Mathewson: It is probably the last suggestion.

Lewis Macdonald: I would like to ask about a couple of things that are not covered in the report but which are clearly relevant to the advice that you may or may not choose to offer now or in the future.

Sir George Mathewson in particular has emphasised the importance of investment in infrastructure and the lack of investment in it. It is clear that the chapter in the report on borrowing is designed to offer a way of dealing with that matter in the future. In the context of the current recession, the public-private partnership model is tried and tested, but the Government has not used it. Many people think that to have stopped PPP projects two and a half years ago but to have not put something else in their place was recklessly negligent. What is the view of the Council of Economic Advisers on that?

Sir George Mathewson: Special purpose vehicles are mentioned in the report. We reluctantly believe that the PPP approach that you mention should be taken if that is all that is available to us and we have no option. However, we disapprove of it. We think that it is expensive, and I think that it is dishonest.

Lewis Macdonald: Do you recognise that, in a time of recession, the pipeline of projects has ended, that it has been estimated that £2 billion of spend and 20,000 jobs have been jeopardised as a consequence and that, most significantly, the infrastructure investment that the economy has needed has simply not been made or initiated in the past two and a half years?

Sir George Mathewson: I am not sure that I agree with your numbers. I will put it like that.

The way in which public-private partnerships were constructed was not good. It means that we are left with massive annual payments—the payments would have been substantially less if there had been straightforward borrowing—so it is not a good idea to move forward on that basis. However, we reluctantly reached the conclusion that we might have to use public-private partnerships.

Lewis Macdonald: Do you realise that there is huge concern that reluctantly reaching the conclusion that action is needed two and a half years after work stopped is a source of loss of employment and business during a recession? You and ministers have sat and not made any decisions on the matter for two and a half years.

Sir George Mathewson: We do not make decisions.

Lewis Macdonald: You give advice. You must be concerned about the hiatus.

Sir George Mathewson: We have just given advice.

Lewis Macdonald: Two and a half years without any movement is a long time.

Your advice on special purpose vehicles is interesting in the context of the Scottish Futures Trust which, as you all know, has finally emerged from the cobwebs. As far as I can see, it proposes to proceed entirely based on the use of special purpose vehicles. Last year, John Kay told us that that is not a good idea. Is it your understanding that there will be non-profit-distributing PPPs?

Sir George Mathewson: Yes. We can only do what we can within the current Government system.

Lewis Macdonald: By finally bringing forward that PPP model as its alternative to conventional PPP, has the Scottish Futures Trust responded to your advice? Has it responded to concerns that the Council of Economic Advisers has raised with it about the lack of movement in the area?

Sir George Mathewson: I think so.

Lewis Macdonald: That is helpful.

The other issue that I am keen to explore is energy. You will be familiar with the "Scotland's Generation Advantage" report, which is dated September 2009, but was published only last week. It was commissioned from Wood Mackenzie by the Scottish Government. I understand that it was commissioned to inform your considerations. It was not published in September, when it might have been published; it was published last week, as I said. You have not published the report that you commissioned.

Sir George Mathewson: We have not yet considered it. We simply did not have the time available at our previous meeting to study and consider it. The consideration of its implications is on the schedule for our next meeting.

Lewis Macdonald: So, the report is complete and has been submitted to you.

Sir George Mathewson: It is complete and it has been submitted.

Lewis Macdonald: Is there any reason why you cannot publish it in advance of your consideration of it? Can you publish it and then publish your response to it in due course?

Sir George Mathewson: The report is in the public domain now.

Jim McColl: Was it not published a few days ago?

Lewis Macdonald: So "Scotland's Generation Advantage" is all that there is. I understood that you were commissioning a report on the comparative costs and advantages of different generation methods, but "Scotland's Generation Advantage" does not appear to be that.

10:45

Sir George Mathewson: This report focuses on the energy production methods in which it is felt that Scotland has a comparative advantage.

Professor Kemp: The work is in progress in the council; the report is an input to our work. We have to think more and do our work on the subject. The report gave us some background information, which is helpful. We are now doing our preparatory work using the report and other information. As Sir George said, we will have a full discussion on the subject at our meeting in February.

Lewis Macdonald: I understand that Scottish Government officials indicated that the council had commissioned a further report on energy matters that was still to be published, but you are telling us that there is no report other than your conclusions on this Scottish Government commissioned report.

Sir George Mathewson: We will publish our conclusions on energy. They will not be limited to the report.

Professor Kemp: We are doing our own thinking and investigation. The report is part of the input to our knowledge.

Lewis Macdonald: As you will be aware—I guess that Alex Kemp is particularly aware of this—Ian Wood said at the weekend that Scottish ministers were "in denial" in terms of their reluctance to consider nuclear generation as part of the future picture, but the report appears to disregard nuclear power as a possibility. Is that a fair analysis of the contents of the report?

Sir George Mathewson: The report is focused on particular methods of power generation. It does not analyse the nuclear power option. It says that the lights will not go out in Scotland without the nuclear power option.

Lewis Macdonald: Why did the remit to which Wood Mackenzie worked not include the nuclear option?

Professor Kemp: I understand that the consultants were given the title and then interpreted things in the way that they have done. That is all we can say.

Lewis Macdonald: One of your colleagues—Lord Smith—said on the public record that some issues that existed for nuclear power in the past do not exist for the current generation. Scotland clearly stands to miss out entirely on the next generation of nuclear technology. Are you "in denial"? Do you deny that nuclear power could have a role to play?

Sir George Mathewson: That debate has still to come.

Lewis Macdonald: That is a debate that you anticipate having at your meeting in February.

Sir George Mathewson: Yes.

Lewis Macdonald: Will you consider options other than the narrow options that are laid out in the report.

Sir George Mathewson: The options that are laid out are not narrow.

Lewis Macdonald: They are not entirely narrow, but they omit the largest single generation source we have at the moment.

Sir George Mathewson: That is correct.

Lewis Macdonald: You will consider all the options in February.

Sir George Mathewson: Yes.

The Convener: I turn to the banking and financial services section of the report. You suggest that there has been some success in retaining head office and corporate functions in Scotland. However, the evidence that we have heard in our banking inquiry suggests that many of the key decisions—for example, on lending to businesses—are being taken not in Scotland but in London, Birmingham and elsewhere. Does Scotland have a banking sector to call its own at the moment?

Sir George Mathewson: To call its own?

Jim McColl: Members may have read at the weekend that Lloyds Banking Group has set up a new division in Scotland. From experience, I know that decision-making in its credit operations is also based in Scotland. Lloyds is making efforts to base its decision making in Scotland.

Sir George Mathewson: In the report, we make the point that the Government should exercise what influence it has in getting the best solution from the restructuring of the banking business as we look forward within the United Kingdom. That is where we are at. Obviously, there are a lot of difficult pressures at the moment because of what has happened. Our recommendations to the Government are exactly right.

The Convener: One issue that has arisen is the lack of competition in the banking sector as a result of the various mergers that have happened over the years. Given the current situation and the divestments that the European Commission requires, could a Scotland-based bank take over some operations?

Sir George Mathewson: I do not wish to comment on that.

The Convener: Would it be in Scotland's interests for a Scotland-based bank to take over some of those operations?

Sir George Mathewson: It is an obvious benefit to Scotland to have a large head office here—period. The more decision making is located in Scotland, the better. That is a general statement. I am here to represent the council: I should not comment on what could happen in banking.

The Convener: I raise the issue because your report refers to financial and business services.

Sir George Mathewson: The report says that we should watch the situation closely and that we should attempt to maximise—

The Convener: All I am trying to do is to form an idea of your advice to the Scottish Government about the type of banking sector that it should look for.

Sir George Mathewson: We are in a fluid situation.

The Convener: Given what happened to the Royal Bank of Scotland because of its acquisitions strategy—it is clear that ABN AMRO was one acquisition too far—and what happened to HBOS because of its lending strategy, which led to problems, do we need a different banking system? Should some of the casino banking of which we have heard be split from retail banking and traditional small-business banking?

Sir George Mathewson: Scope exists for many types of banks. We should be careful not to throw the baby out with the bath water. We should remember that there are large corporates in the world and in the UK. Large deals will be done and companies will need to borrow large amounts of money. If the UK as a whole were not in that business, that could represent a substantial loss of tax revenue and jobs. I hope that that answers your question.

The Convener: Christopher Harvie has a question. I ask him to be brief as we are running short of time.

Christopher Harvie: My question will be brief. You talk about deficiencies in secondary education. How high among those deficiencies is the collapse of modern languages teaching? These days, one cannot guarantee that English will be the means of communication among advanced technological countries.

Jim McColl: The issue is more basic. We are talking about English and arithmetic—the basics.

Christopher Harvie: To understand how technologies flourish, knowing Chinese and Spanish might now be more important than English, because the United States and Britain have moved over to the service sector in a direct way. When I worked on North Sea oil a long time ago, I could grasp some of the technology only by understanding German. It was common in the Lanarkshire—

Sir George Mathewson: Deutsche Bank holds its board meetings in English.

Christopher Harvie: It may do so, but the spare-parts branch of BMW operates completely in German, even in Oxford.

Sir George Mathewson: Another point relates to modern languages. We have a modern educational system that is difficult to change. Over the years, French has been the dominant modern language that has been taught in the UK, and in Scotland in particular. French is very much a minor language in comparison with Spanish. My view is that I would like our English teachers to have the same knowledge of grammar as our French teachers have.

Professor Kemp: As a footnote, I say that the fastest growth in rates of studying English is among people in China who are learning it for business purposes.

The Convener: I thank Sir George Mathewson, Professor Kemp and Mr McColl for giving us the benefit of their wisdom on the council's annual report. We look forward to next year's report and to the Government's response to this year's report. Thank you for your time.

Sir George Mathewson: Thank you all for inviting us.

10:54

Meeting suspended.

10:58

On resuming—

Financial Services Inquiry

The Convener: Item 2 is our banking and financial services inquiry. We have two panels today. Later we will talk to Clydesdale Bank, but I now welcome Benny Higgins from Tesco Bank.

Mr Higgins, if you wish to, you may give us a few opening remarks and then we will open the meeting to questions.

Benny Higgins (Tesco Bank): Good morning. I thought that I would open by giving the committee a brief history of how we find ourselves where we are today.

Tesco Bank, or Tesco Personal Finance as it was known, was established in 1997 as a joint venture between Tesco and Royal Bank of Scotland. At the time, the Tesco strategy was set out as it is today to focus on its core business in food retailing and also to concentrate equally on non-food, international businesses and retail services, of which banking was deemed to be an important part.

The joint venture was very successful by any standards. I have been involved at close quarter with a number of joint ventures over the years, and this one was very successful. However, by the time we reached 2008, Royal Bank of Scotland and Tesco had changed beyond all recognition from where they were in 1997, and the business was deemed to be at a stage of development at which it would benefit from having a single owner. Given that Tesco was the name above the door, it was obvious that that owner would be Tesco.

In the summer of 2008, it was announced that Tesco was assuming full control of Tesco Personal Finance, which is now called Tesco Bank. We completed the transaction on 19 December last year. We have 6 million customer accounts, so the business has substantial scale. We also have 8 per cent of the credit card market. For every £8 that circulates around the UK, £1 comes from a Tesco ATM, and we have just less than 4 per cent of the car insurance market. It is already a substantial business.

11:00

During the 12 months since we completed the transaction, we have increased the number of people who are involved in the business materially. When we completed the transaction, we had around 200 people in the joint venture and we had to decide where to base the business. The decision was taken to base it in Scotland and, since then, we have increased the number of full-time members of staff to around 450. A lot of those staff are in quite senior roles in the head office banking function that is based at Haymarket.

Since then, we have taken a 20-year lease on a building in Glasgow, which will create 800 new full-time jobs—although, taking into account the fact that some staff will work part time, there will probably be around 1,000 new jobs. We will also transfer 500 people from the Royal Bank of Scotland who have been working on the Tesco business for some time. In addition, we announced 1,000 jobs in Newcastle to support our general insurance business.

What are we trying to do at Tesco Bank? To put it simply, we are seeking to put Tesco into financial services. One of Tesco's core values is that no one tries harder for their customers. I could give you lots of evidence of Tesco doing things that could be interpreted only as for the benefit of the customers and following the customer, and that is what we are trying to do in financial services. The financial services landscape is often based on complexity, opaqueness and not rewarding loyalty—indeed, punishing inert behaviour. We are seeking to develop a business that follows the customer, that gives customers simplicity and transparency, and that rewards loyalty.

That will not be straightforward, but running a business well in the complex area of financial services is a challenge that we are up for. We will deliver services to Tesco's loyal customers in 14 different countries around the world, including the UK. Since 2004, Tesco has had more floor space outside than inside the UK, and we already have about 2.4 million branded credit cards outside the UK. That business will be run from Edinburgh.

The Convener: Thank you for those opening remarks, Mr Higgins. Can you tell us a bit more about where you see Tesco Bank going? Will you continue to focus on personal banking, or will you expand into other areas including the mortgage markets and business banking for SMEs in particular?

Benny Higgins: We will focus on the loyal Tesco customer base, but that does not mean that all our customers will be Tesco customers. For example, although three quarters of our credit card customers are loyal Tesco customers, a quarter are not. Our focus initially will be to serve our existing customers and sell more of the products that we already sell. Our next priority, however, is to broaden our offering to a fuller service. That will require our offering current accounts and mortgages. We have not set any dates for offering either of those, but they are the next priorities in personal products. We also have a large body of small business customers who are Tesco customers, particularly among sole proprietors. Although we do not have any definite plans yet, I see further opportunities to serve Tesco customers down the line.

The Convener: You have indicated that you are not particularly interested in developing a branch network. Is that likely to continue to be the case? If so, you are not likely to have an interest in any of the branch divestments that are coming from some other banks as a result of the EU rulings—is that correct?

Benny Higgins: You are asking two questions. We never comment on speculation, but I will give you enough information to reach a conclusion.

First, we already have a very big physical presence that is visited by our customers. There are 20 million visits to Tesco stores around the UK every week and there are not far short of 2,000 Tesco stores, a large number of which are in Scotland. We think that having a physical presence is important. In recent studies, 70 per cent of Tesco customers said that they would like to do banking while they shop, 65 per cent of current account customers in the UK said that they had been in a branch in the past three months, and 50 per cent of people who said that they were telephone bank users said that they had visited a branch in the past three months.

A physical presence is therefore very important, but we have that presence, and not just through large stores. In the UK, we have more than 1,000 Express stores, which are the equivalent of convenience stores. We have a presence in the high street, in big stores and across the four formats of Express, Metro, our superstores and Extra. We think that a physical presence is extremely important, but it is clear that we have one. At the moment, we are building back-office infrastructure. We still rely on RBS—that was agreed at the time of the deal—and in theory we would have been interested if any of that infrastructure had been available, but we already have a physical presence for serving our customers.

Marilyn Livingstone: Good morning. You have made public commitments to organic growth, but there has been considerable speculation about a potential purchase of the good part of Northern Rock. Do you want to comment on that?

Benny Higgins: I refer you to my previous answer: we do not comment on speculation as a matter of course. I have already articulated what we have and what we need. We have a relationship with a large customer base—the Tesco customer base consists of 15 million households in the UK. We have a large physical network that customers visit, we do 65 per cent of our business online, and we have a strong brand.

That is what we have; we are well on with building infrastructure.

Marilyn Livingstone: Although Tesco has primarily offered insurance products and credit cards, has it been exposed to any bad debt?

Benny Higgins: Yes. I am afraid that that is the nature of the market: by definition, companies that lend money will have bad debts. However, when it comes to arrears and bad debts, our experience with credit cards and personal lending has been extremely good, relative to the rest of the market.

Marilyn Livingstone: My final question is about remuneration, which is a controversial issue at the moment. How important an issue has remuneration been in attracting well-qualified staff to Tesco Bank? How have the remuneration practices at Tesco been agreed? Do you have a remuneration committee, for example?

Benny Higgins: Yes. Within Tesco Bank, we have a remuneration committee, in line with the guidance from the Financial Services Authority, and it links with the remuneration committee at group level.

Much of the public outcry and the commentary on bonuses has been about investment banking bonuses and people who appear to have benefited from taking extremely large risks. We are a stable, cautious retail financial services business. Our remuneration of the people in Tesco Bank is in line with Tesco practices and fits in with how an extremely large and successful food retail business that has expanded has rewarded its staff. It is all about the alignment of targets and customers' interests.

Marilyn Livingstone: So you have had no recruitment problems at all.

Benny Higgins: We have recruited extremely able people. I am delighted with the quality of the people we have hired.

Stuart McMillan: My first question is about the new facility in Glasgow, for which Tesco received some regional selective assistance moneys. Given the profits that Tesco makes and the size of the company, why did you need RSA funding to help set up that facility?

Benny Higgins: The answer to that is quite simple. We could have based our big service centre anywhere in the country and, when we looked around at where to base it, many parts of the country expressed a great desire for us to do so there. The same was true when we chose to set up a customer service centre in Newcastle.

A wide range of factors was taken into account, of which economics was only one. The most important factors were the pool of talent and the availability of the right kind of skills in the area. Economics was a consideration, but I, for one, am delighted that Scottish Enterprise supported us in making a decision that was based not just on economics but on a wide range of factors.

It is good for Scotland that we have created 800 jobs and that we have secured 500 jobs that are currently in RBS but which are moving across to us in the summer next year. That is good news. The RSA was one factor and it was good that we had the support to make that decision.

Stuart McMillan: I do not decry creating new jobs or safeguarding employment, which is certainly not a bad thing. Everyone in the room welcomes that and I am sure that we all want to give Tesco credit for going to Glasgow. However, on the day that the announcement was made, I got a text message from a friend—a Scot who has been in London for about 14 years—asking why the Scottish Government is subsidising Tesco when the company has so much money.

Benny Higgins: The Scottish Government was supporting a decision that would create a lot of jobs in Scotland. I am delighted that it did.

Stuart McMillan: When I was growing up, I was always told not to put all my eggs in one basket. I have a Tesco club card and unfortunately—shopping is not my thing—I visit the local stores regularly. Whether in finance or its stores, Tesco appears to have a strategy of getting people in the door and, once they are there, hooking them to as many Tesco products as it possibly can. From a business point of view, that is an ideal strategy to follow, but I am concerned that, if something went wrong that caused stores to close in local communities—such as a double dip in the recession—while Tesco was trying to extend its loyal customer base and the products and services that it offered, there would be a negative effect on the customers as well as on Tesco itself.

Benny Higgins: Tesco sets out to listen carefully to customers and understand what they want. The business is run cautiously and sensibly and is very customer led. It has come through a number of economic conditions and, over the past few years—even this year—proven that it can continue to serve its customers well in different and changing environments. When Tesco's customers say that they want to spend less in a shopping trip, the focus of the business is enabling them to do that. It is a fine example, if not the best one that I know, of a business that knows how to look after customers in different conditions. In offering financial services as well, we are simply setting out to do for customers what they want us to do for them: to reward their loyalty and to be there, be stable and be cautious. In difficult conditions, that is important rather than a concern.

Stuart McMillan: Are there any models in the EU that compare to what Tesco is trying to do in Scotland and the UK?

Benny Higgins: There are other supermarket banks in the world—I can think of one and I am sure that you can too—but none is highly successful, although a number have made pretty good progress. We are not trying to emulate anybody else; we are trying to do in financial services exactly what Tesco has done for its core business in retail, which is follow the customer.

Christopher Harvie: You may have heard that my attitudes to Tesco are not exactly uncritical. I spent 28 years teaching at the University of Tübingen in Germany, where there is what could be called a Mittelstandskultur—a culture of small businesses. We have no big supermarkets in our part of Germany, because they cannot rise above a certain size. Instead, in Tübingen we have street markets four days a week, small businesses, public transport, cycling and co-operative banks. Also, 35 per cent of our output is in high-technology, environmentally oriented manufacture. It seems to me that all those things hold together.

In Britain, Tesco has provided cheap prices for the consumer but produced a structure of purchase and marketing that is oriented towards the motor car and the heavy delivery lorry. Incidentally, heavy delivery lorries are not allowed to operate in Germany on Sunday, which is the prime day—

11:15

The Convener: I remind you that our inquiry concerns the banking crisis.

Christopher Harvie: Yes, but banking in Baden-Württemberg is based on small, locally and mutually owned banks—that is part of the network that I have described. I see Tesco as threatening to subvert that structure.

Benny Higgins: As the convener said, the purpose of today's session is to discuss banking. I refer you to some of my earlier comments. Tesco is about serving customers well—that is its focus. If we can bring that focus to financial services, we will make incredible progress. As I said, more than 1,000 small Express stores are on the high street around the UK to serve customers who want the convenience of a convenience store.

That is what Tesco is about. When it opened its doors on a 24-hour basis, it did so because customers said that they wanted that. In 1997, we decided to award clubcard points, which involved giving away 1 per cent of revenue—in the food retailing business, that is 20 to 25 per cent of margin. The move was not terribly popular with analysts, but we were looking after customers, who have been rewarded. We need to try to do that in financial services.

Christopher Harvie: I offer a couple of observations. When my pupils in Germany go into work, they will get apprenticeships at local firms, be highly skilled and come out as engineers working in a dynamic local manufacturing economy. In various areas of Fife, the only possibilities for people are shelf stacking, call centre work or fighting out in Afghanistan. The difference is vivid. I find Tesco's structure oversimplistic for a sophisticated society. We must emerge from that if we are to have an effective and diffuse small business sector. What will happen if small grocery businesses come to you for finance in an area that you have monopolised?

Benny Higgins: There are 20 million visits to Tesco stores every week, and the customers in question are well served. Fifteen million households in the UK are loyal Tesco customer households. It is about serving customers well—that is what we seek to do.

Nigel Don: I am sure that you look often at the competitive environment. What is your perspective on the duopoly against which you are ranged, which has a staggeringly large share of the market and receives Government support? Will you reflect on the fairness or otherwise of the playing field on which you find yourself?

Benny Higgins: We do not view it as unfair. We believe that, because of the relationship that we have with our customers, we can serve them well in financial services. Clearly, these are atypical times in the financial services marketplace. Things are not likely to settle down very quickly, but no one should think that the market is not competitive. Some of the most competitive saving rates that have been around in my time in banking are available today. The market is competitive, but we believe that we can thrive in it if we stick to our strengths and serve customers well.

Nigel Don: How far do you think that you can go in terms of market penetration?

Benny Higgins: We do not think in terms of market share or market penetration—we are focused on doing the right thing. We have 8 per cent of the credit card market, but we still have relatively modest penetration of our loyal clubcard customer base. There are opportunities for us to make progress, but our approach will be centred on doing the right thing for customers in an environment in which they think that, too often, that has not been done for them.

Nigel Don: I get the impression from what you have said that you regard your customer base as made up substantially of people who shop at Tesco. I generally do not shop at Tesco, because I live more or less next door to one of your competitors and have only to walk across the road to get there. I get the impression that, if I was a Tesco Bank customer and I could not do something online, I would have to find a branch, which would be a store. Is that a fair impression?

Benny Higgins: It is not far wrong, but it is misleading. We are open to all—there is no question about that—but as a business we are focusing on serving Tesco customers. We principally serve customers online; we have only six bank branches around the country, although we have some in-store deposit-taking facilities. I hope that you become a Tesco customer, but as a non-Tesco customer you can still become a customer of our Tesco bank or insurance products, and our online facilities will serve you well.

Nigel Don: Lots of things cannot be done online. I think that you said that 50 per cent of customers go to a branch for some reason or other, which makes sense to most of us. How will you facilitate the face-to-face contact that will be necessary? What model do you envisage?

Benny Higgins: As I said, we are focused on Tesco customers, and we are here to serve them primarily. Currently, between 55 and 65 per cent of consumers of most of our financial products are Tesco customers—the proportion is a bit higher for credit card customers. If someone is not a Tesco customer they can still use us, but we are focusing our energies on serving Tesco customers.

Nigel Don: Forgive me, but you evaded my question about how you will facilitate face-to-face contact. Will that be in store?

Benny Higgins: It will be in store—I am sorry; I was not trying to evade the question. A person would need to go to a Tesco store, and there would be nothing to prevent them from doing so. However, it is right that we are focusing our energies and efforts on serving Tesco customers.

Nigel Don: Part of what the committee is doing in its inquiry is to consider how we got here and what banks are doing; we must also consider the regulatory environment, which has changed. Do you have thoughts on the regulatory environment in which you find yourself and on what the Financial Services Authority is up to?

Benny Higgins: There is no doubt that regulators worldwide are emboldened by recent events. They have acknowledged that they had a part to play in how events unfolded, as did many other people.

We are operating in the retail financial services market. At a wholesale level it will be important for regulators around the world to co-ordinate their activity; if they do not do so there will be opportunities for regulatory arbitrage. However, that will not affect retail financial services.

The regulator must focus on serving the customer, and the customer is best served if competition is encouraged and products are not overregulated. Overregulation is likely to lead to less choice and less competition. I think that we will come through the current situation in good shape, but it is important that regulation should serve customers. That is what we are trying to do, and I hope that regulators will continue to do that, too.

Nigel Don: Will Tesco Bank, or whatever you call it, be on the same balance sheet as Tesco supermarkets?

Benny Higgins: Tesco Bank has its own banking licence and its own balance sheet. We are regulated by the FSA as a stand-alone entity. We have a cautious balance sheet, because we are entirely funded by retail deposits, as of now. We are setting out to be a stable, cautious bank that stands on its own two feet and is regulated as such.

Nigel Don: In effect, although Tesco Bank is part of the Tesco empire and wears the Tesco badge, it is a wholly separate and distinct banking entity.

Benny Higgins: It is a wholly owned subsidiary of Tesco, but it is regulated and it stands on its own two feet in relation to its balance sheet.

The Convener: Are you comfortable with the recommendations on how banks should be governed in future, in relation to the setting up of boards and to risk management, remuneration and audit committees? Is Tesco Bank as it is currently set up well placed to deal with the recommendations?

Benny Higgins: I am entirely satisfied that Tesco Bank's governance and the relationship between Tesco Bank and Tesco plc are satisfactory and fit for purpose.

The Convener: The Building Societies Association feels that, although building societies and mutuals are essentially low-risk, deposit-taking and lending-from-deposits retail operations—which is similar to what Tesco Bank does—in a sense they are being unfairly charged to cover the bad banking practices of some of the larger banks. Are the charges that you have to put up with for guarantees and so on fair for the type of banking that Tesco is involved in?

Benny Higgins: We have not complained, and we do not propose to.

The Convener: You have mentioned the headquarters operation that has been established in Edinburgh and the 800 full-time equivalent jobs in Glasgow. Do you envisage any further expansion of jobs in Scotland as you develop the bank in future?

Benny Higgins: I am certainly hopeful that the bank will continue to grow. As it grows and we launch new products, we will require additional resources. We will make sensible and measured choices about where we base additional activities, and Scotland would certainly be a strong candidate in every instance.

The Convener: I have one final question; I do not think members have anything to add. As you move into the current account and perhaps mortgage markets, do you envisage more of a presence of banking staff in some or all Tesco branches so that people who want to have a face-to-face meeting will know where to go?

Benny Higgins: That is something that we are working through. There is definitely a latent demand from customers for physical presence, but what that physical presence looks like must be given a great deal of thought. Increasingly various levels of automation are available for banking; you will see other high street banks using high levels of automation. We are going back to first principles, asking customers what they want and what they would like us to do for them, and we are starting to establish what we should do. Physical presence is certainly very high on our agenda, but it does not always mean people; it can mean a mixture of automation and people.

The Convener: That concludes our questions. Thank you very much for coming along and giving us one of the better news stories for Scotland from the banking sector. I certainly hope that that continues, certainly in terms of jobs expansion.

Benny Higgins: Thank you.

The Convener: We will suspend until 11.30 to allow the panel to change over.

11:27

Meeting suspended.

11:30

On resuming—

The Convener: Colleagues, we resume to hear from our second panel to give evidence today as part of our banking and financial services inquiry. It is my pleasure to welcome David Thorburn, who is executive director and chief operating officer at Clydesdale Bank. I will allow him to make some opening comments before we move to questions.

David Thorburn (Clydesdale Bank): Good morning, ladies and gentlemen. I will be brief.

Obviously, the past 12 to 18 months have been difficult for our business customers and for our personal customers. Over that period, Clydesdale Bank has focused on two things: helping our customers through this particularly challenging period and, quite frankly, trying to keep the bank safe. I do not have much to add beyond that, but I am happy to answer any questions that the committee has.

The Convener: How have Clydesdale Bank and National Australia Bank Group in the UK managed to withstand the financial crisis in better shape than some of our other banking institutions?

David Thorburn: There are probably three main differences between Clydesdale Bank as a UK bank and those organisations that have ended up in difficulties.

The first is the nature of the lending in which we participated. Clydesdale Bank is a very traditional, conservative banking organisation that has never really strayed away from its roots. A key cause of the crisis was that banking organisations entered into what might be called more aggressive forms of lending, such as lending to highly leveraged organisations or developing higher-risk products for the fringes of the market. Self-certified mortgages and sub-prime mortgages are clearly examples of those. Clydesdale Bank did not participate in any of those markets at all.

The second is that Clydesdale Bank has been conservative in how it has leveraged—to use that word again—its own balance sheet. By “leverage” I mean the amount of growth that the bank allows on its balance sheet in proportion to its capital base. Up until recent times, the long-run average in banking was that the amount of leverage would not be any higher than about 20 times the bank’s capital base. Clydesdale Bank has never really strayed above 20 times its capital base at any point in the past five to 10 years. In our analysis, a common theme among the banks that failed was that their leverage ratio was a multiple of that and could be anywhere from 50 to 70 times their capital base. That makes such an organisation very fragile if problems emerge in the marketplace or in its assets. Such organisations were almost doubly leveraged, in the sense that they had engaged in more aggressively leveraged lending and were quite aggressively leveraged organisations.

The final material difference is in how we have funded Clydesdale Bank’s lending. Our policy on funding and liquidity was also quite traditional and quite conservative; by far and away our largest source of funding was the deposits that we get from our customers. Over the past few years, we have tried very hard to make those longer-term deposits rather than short-term overnight deposits. Secondly, of the funding that, like every bank, we use from the money market, we have used a much smaller proportion than many of those other organisations appeared to have done. Over the past five years in particular, we have tried to diversify the nature of that funding and to lengthen the maturity profile. When the money markets froze last October, we had only a small proportion of short-term wholesale funding, a large proportion of medium and long-term wholesale funding and access to retail deposits. That gave the business a lot of resilience and, basically, meant that we could hang in there for much longer than the organisations that were at the other end of the spectrum.

Those were the three main differences between Clydesdale Bank and the organisations that found themselves in some difficulty.

The Convener: It is clear that your organisation has adopted a different risk management culture from that in other organisations, particularly HBOS I suspect. How does that come through in your corporate structure, governance arrangements and risk management committees?

David Thorburn: It is worth pointing out that we have not really had to change anything as a result of the recommendations that have come out of the crisis. For example, one was to establish risk committees, but we have had a board risk committee and an executive risk committee for as long as I can remember. I do not have much to add to that. Our approach is conventional and traditional. I am not sure how the risk functions operated in those other banks, but they clearly did not operate in the way in which banks used to operate.

The Convener: Can you give an indication of your current market share in the markets for personal current accounts, mortgages and business banking, particularly SME lending?

David Thorburn: Do you mean the Scottish market share?

The Convener: Yes.

David Thorburn: Our market share for personal current accounts is of the order of 12 per cent. For mortgages it is about 4 per cent and for business banking it is 18 to 20 per cent. That is as far as we can gather from the published Bank of England statistics. It is not always easy to gauge the precise market share, but the Bank of England statistics are probably the most reliable way to do so.

The Convener: Has your share in those markets changed significantly in the past few years or have you been running at roughly the same level for a period?

David Thorburn: Clydesdale Bank changed its strategy significantly in 2004. I will not go off the agenda too much, but to answer that question effectively it is probably important for the committee to understand that, at that point, we entered into a pretty deep-rooted three-year turnaround of the organisation. In 2003-04, Clydesdale Bank's business was suffering from several shortcomings for reasons that included underinvestment for the best part of a decade. That had to be attended to. One decision that we made at that time was to change the mix of our business, because the bank was fairly skewed towards unsecured consumer credit. Credit cards and personal loans were about 14 per cent of our business and our loss rate in the area was really poor.

We decided to change the focus of the business away from unsecured lending and towards secured lending in the form of mortgages and business lending. In the five years since then, we have deliberately reduced our market share in unsecured consumer credit, although it was gradual and progressive, not dramatic. Over the same period, our market share in mortgages and business lending has increased. Looking at the net movement, one offsets the other to an extent. Nonetheless, in 2006 and particularly in 2007 and 2008, and in 2009 Clydesdale Bank was one of the fastest growing banks in the UK.

Marilyn Livingstone: Will there be any enduring impacts of the financial crisis? How will it affect Scotland's financial services industry?

David Thorburn: It is difficult to be precise at this point, so I can give only a personal sense based on where we are and what we know today.

I sat in on the previous two panels of witnesses. It was interesting and right that the witnesses from the Council of Economic Advisers focused on the protection of head office functions, as the extent to which those functions are affected by the changes in ownership and the Government support is probably the key issue. It is too soon to tell what will happen, but that will be the key driver. As well as being large direct employers, particularly in the east of Scotland, those two large banks provide a great deal of indirect employment—they buy a great deal of professional services and so on, which is critical. I remember seeing an estimate, I think from Scottish Financial Enterprise, that about 140,000 jobs in Scotland were directly or indirectly related to the financial services sector.

There is a lot at stake, but it is important to remember that there are three legs to the financial services sector in Scotland. Banking is one, and it has had its difficulties, but fund management and insurance have come through the downturn remarkably well, which is a credit to businesses in those areas.

Marilyn Livingstone: When are we likely to see the impacts?

David Thorburn: None of us has previously been through precisely what has happened over the past 12 months. When we go through things of this nature, we cannot form a clear view about what has happened such that some dramatic announcement can be made about it. It is a progressive process, which takes place over years.

With restructurings and reorganisations, a gradual drift of jobs can be seen in a particular direction. Organisations tend to have a centre, even if their businesses are spread around a country. There tends to be a gravitational pull in an organisation towards one centre. Normally, it is where the management is based, but that is not exclusively so.

We are seeing, and will continue to see, reorganisations progressively rolling through organisations, with different departments moving at different speeds and changes cascading down. Reorganisation tends to start at the top and progressively cascade its way down. Over time, we can build a picture of where the jobs are. There will probably not be just one movement in one direction. We need to observe the situation over a period and assess where the overall gravitational pull is headed.

I am sorry that that was not a precise answer, but it is difficult to give you one.

Marilyn Livingstone: How has the restructuring in your organisation already affected jobs? What will the future hold?

David Thorburn: No major reorganisation or restructuring is planned; we never know what is around the corner in business, but we have nothing planned at this point. Over the past four financial years—for eight half-year periods in a row—the cost base of Clydesdale Bank, which is the net cost of running the business, has been flat or fallen. That is a necessary element of staying competitive in financial services nowadays. Whatever people might write or think, it is a very competitive industry and we simply cannot afford to let our costs drift up by the rate of inflation every year.

Looking forward, as much as that is possible, we see a similar trend. Over the past 12 months there have been about 450 job losses net in Clydesdale Bank. Of those, only 75 were in Scotland. I cannot guarantee that the trend will remain the same; different departments reorganise as they see opportunities at different times. I hope that gives you a sense of the absolute numbers. There is nothing major there—although every job is important. Nothing major is planned that will particularly change that overall trend.

Marilyn Livingstone: Are there any areas of significant growth, in Scotland in particular?

David Thorburn: Strangely enough, there is an opportunity in this crisis for Clydesdale Bank. We are already taking advantage of it and I imagine that we will continue to have that opportunity for some years to come. It applies particularly to business banking, to services for SMEs and to the corporate space. Clydesdale has been able to stay open for business—basically, it has not changed its lending policies through this whole crisis. At the end of it all, it now finds itself the only medium-sized bank left in the UK. We are the only medium-sized, full-service commercial bank in the UK with a UK footprint. We offer choice in the market. There are the big banks, Clydesdale and a few niche players—although not many of those are left. We have an opportunity to gain market share, we are taking advantage of that and we intend to continue to do so.

Similarly, but to a slightly lesser extent, there is an opportunity in the personal space, which we have been pursuing in relation to deposits. Our growth in deposits last year was about four times the market rate of growth, so we are clearly acquiring market share in that area, and in mortgages.

11:45

Marilyn Livingstone: The other side of the coin is that there has been a lot of controversy about remuneration packages and what is necessary to attract well-qualified staff. What is your view on remuneration? How necessary have remuneration packages been to your bank to recruit well-qualified staff? What are Clydesdale Bank's remuneration practices? How do they work? Is there a remunerations committee, for example?

David Thorburn: Yes, we have a remuneration committee, which links in with our parent company's remuneration committee. Our framework already essentially fits in with the FSA's recommendations about remuneration; we need to make some minor tweaks at the edges to align with them completely, but no major changes in Clydesdale Bank's remuneration practices are required for us to meet the new paradigm.

To be competitive in the market and attract talent, banks need to offer packages that are in the middle of the pack, and that is broadly what we seek to do. An organisation that is the size of ours cannot control the market, so if others bid the market up we get dragged up too to some extent. As the tide rises we go up with it, but we certainly do not chase the market up.

Stuart McMillan: In your written evidence to the committee in September, you mention

"£2.9 billion of new lending to our customers"

and

"plans to lend an additional £1 billion".

How much of the £2.9 billion is new money and how much comes from converting overdrafts into loans for small businesses?

David Thorburn: I can update those numbers because we have since published our year-end results and made further commitments to continue lending. I will share that information with the committee in case you are not familiar with it.

When we submitted that evidence we had not yet finished our financial year. By the end of the year our new lending totalled about £4 billion, of which broadly 50 per cent was mortgages and 50 per cent was business lending. That is the figure for gross new lending to existing customers or non-customers.

The net growth in our balance sheet under the headings in business lending was around 10 per cent, and in mortgage lending it was around 4 per cent. To return to my earlier point, the net drop in unsecured consumer credit was about 9 per cent. Overall, the balance sheet grew and we did a lot of new lending.

Wrapped up in all that is an element of converting overdrafts into term loans, but we do not have a policy of migrating people from overdrafts to term loans. I do not think that I can work out how much of the figure that practice comprises, but those are the edited numbers—I hope that they are helpful to you.

We made a commitment at the time we announced our annual results: we have set a target of £10 billion of new lending over the next two years, in comparison with the £4 billion of lending that we managed to carry out last year.

Stuart McMillan: Can you provide the committee with further written information on the conversion of overdrafts into loans for small businesses?

David Thorburn: I am happy to look at that and write to the committee as quickly as I can. I am not sure how easy it would be to track that through our systems—it might involve an element of examining manual returns from our people.

As I said, converting overdrafts into loans is not really a policy of ours; it does not happen all that often. If someone develops a hard-core overdraft and they want to amortise it over a period of time, we might do that, but it is not our policy across the board.

Stuart McMillan: Has that practice increased in your company during the past two years, specifically throughout the recession?

David Thorburn: Only to the extent that, in a recession, many more customers and businesses get into financial difficulties so you end up with a lot of people facing hard-core overdrafts that no longer fluctuate into credit and have no repayment plan attached to them. They will often sit down with the bank manager and try to work out how they repay the money in an affordable way over a period of time. You reorganise it and turn the hard-core element of the overdraft into a term loan and repay it over whatever period can be managed; you sometimes create a new overdraft at a smaller level that will fluctuate into credit. Converting overdrafts to loans tends to happen more during a downturn because more hard-core borrowing tends to develop, but it is not anything that is unhelpful to customers. They often find it helpful because it helps them to deal with an issue that has arisen in their business.

Stuart McMillan: In the Clydesdale Bank, would you seek a face-to-face meeting with a business customer before converting an overdraft into a loan, or would you write to a customer saying, "This is what will happen and these are the new terms and conditions and the new rates that you will have to adhere to."?

David Thorburn: It is possible that we could write to a customer about it, because you cannot always meet your customers. I cannot guarantee that there would be a face-to-face meeting on every occasion, although whenever possible we try to have face-to-face meetings. Our business managers are based in branches or in business centres around the country. We have a branch manager in almost all our branches who is available to conduct such meetings, but sometimes the customer cannot get in during opening hours and it is sometimes necessary to communicate in writing. Occasionally, there will be a bit of a breakdown in the relationship, so you might need to write to a customer and say, "In the absence of alternative proposals, we need to take this approach." That could have happened in the Clydesdale Bank in some areas, but it is not the norm and it is not the preferred option.

Stuart McMillan: I look forward to reading the further information that you provide.

Do you consider that the marketplace has been unfairly distorted by the state support received to date by the two major players in Scotland? Do the European Commission's decisions on divestments adequately address competition issues and market concentration?

David Thorburn: That question addresses two points. The first is the support that was provided to the two Scottish banks about a year ago. It seemed to us that that was necessary at the time, in the interests of financial stability. Money markets were effectively frozen globally and, as a result, some organisations were left vulnerable. We now see, with the benefit of hindsight, that the steps the Government took at that time were sufficient to stabilise the situation. In the fullness of time we will see all the benefits and downsides of that, but at this point it seems to me that it was the right thing to do and that it had the desired effect.

The Clydesdale Bank does not at present have a view or any complaints about competition. We do not have a view that we would want to share on the EU remedies but, clearly, significant parts of the businesses are being divested, so that will make a difference to the competitive dynamic.

Stuart McMillan: Some would say that we are in a global marketplace and that the Adam Smith approach to markets, rather than what the UK Government did in respect of the other two banking institutions, should have been adopted. What would have happened if the Government had not stepped in and provided the funds, but instead let one or potentially both of the banks go to the wall in accordance with a true capitalist marketplace?

David Thorburn: We are speculating to some extent, but probably the nearest proxy—on a much smaller scale—is what happened with Northern Rock. Stories started running on the “Ten O’Clock News” that Northern Rock was in difficulties and the next day there were queues outside all its branches. I imagine that we would have seen that on a much larger scale, because the two Scottish banks are very substantial organisations in their own right. That would have been terrible, so I am glad it did not happen.

Lewis Macdonald: You said earlier that you fundamentally re-examined your business model about five years ago. You also said that, in essence, your approach to business lending has not changed. Have there been changes either in your approach to dealing with existing customers or in your operation in the marketplace as a direct result of the financial crisis over the past couple of years?

David Thorburn: One of the most important changes was the establishment of specialist units to help people in financial difficulties. I can give you an example, which again is based on some of our management’s experience of previous recessions. We can have personal customers with borrowings, particularly mortgages, who find themselves in a difficult situation because of short-time working or losing their job. A centre of expertise is needed to help such people; we cannot rely on the branch network for that, because a branch might receive only one or two such requests a year. We therefore established a specialist unit, staffed by experienced mortgage advisers, to help customers to reschedule their borrowing in a way that prevents a crisis turning into a personal drama for them. One of our principal aims in doing that was to prevent the number of repossessions from mounting. We have therefore had only a very small number of repossessions over the past year or so.

The second change that we made was to seek to grow our lending a bit less aggressively than we did in the boom times. We are still growing our lending at a significant enough rate of knots to acquire market share, but we have been a bit less aggressive over the past 12 months, because the same people who do that work need to be free to help customers who need more time with the bank, therefore we need to free up those people so they can do that. We have trimmed lending growth a bit so that our experienced business managers can spend more time with their customers to help them with difficulties that they might face.

Those are probably the main changes that we have made. However, it is probably worth sharing with the committee the point that, because some sectors are more vulnerable in a downturn, we ensure that we provide extra education for our people so that they understand the dynamics in those sectors. We try to spend a bit more time with customers in those sectors to help them understand what might be happening in their business and the consequences for them.

Lewis Macdonald: We have heard evidence in the past two weeks about changes in practice by the banking sector in general. For example, in dealing with business customers, we have heard about practices such as converting overdrafts to loans and calling in and withdrawing overdraft facilities when there appeared to be little substantial evidence that a business was in trouble and when the business operated with an overdraft as part of its normal financing mechanism—for example, where a large capital investment was required to get the payback over time. Have you changed your practice in that regard in any way?

David Thorburn: There has been no policy change. One difficultly in that regard is that you hear stories from constituents, but the assessment of viability in business lending is not a precise science, which can sometimes make it difficult to be clear about what is going on.

We have had no need whatsoever to change our general policy. In fact, I am happy to share a policy with the committee. If a business customer is in financial difficulties, we will always, as a matter of policy, want to work with them to help them through that, provided that two things apply. One is that the relationship is sound; in other words, that we feel that the customer is being open and honest with us and that there is good mutual respect—the same applies to us, of course. The second is that we think that the business is viable. That has been our policy for as long as I can remember, and there has been no need to change it.

In the long run, we can help to nurse back to good health 70 to 80 per cent of our customers who end up in what might be called intensive care, and they continue to be customers. That does not work out for a smaller proportion, for a variety of reasons, but that ratio has held pretty steady in the past five or six years.

12:00

Lewis Macdonald: If you converted an overdraft customer into a loan customer, would that count as new lending business?

David Thorburn: If borrowing did not increase, that would not be new lending.

Lewis Macdonald: Even though the customer previously had an overdraft facility rather than a loan.

David Thorburn: Yes, because that would just be a straight swap. Of the numbers that I cited earlier, the net increase in our business lending is the best proxy of what has happened overall. That showed double-digit growth of 10 per cent in the year that ended in September, which is pretty sizeable. In the British Bankers Association figures that have been issued periodically through the year, the absolute market size has fallen for much of the time and has just stabilised more recently. It is clear that we are lending more than the average.

Lewis Macdonald: We have heard from small businesses that deal with the range of banks that the relationship managers with whom they work daily have no power or authority in practice. Do you recognise that in your business? Do you enable relationship managers to make significant local lending decisions?

David Thorburn: We do—I am generalising across our business. SMEs and mid-corporates are managed from our business centres. As part of the three-year turnaround, we took the key decision in 2004 that we would decentralise much of our credit decision making to local centres. On average, about 90 per cent by number of our lending decisions are made in local centres. We have credit managers based in Inverness, Aberdeen, East Kilbride and elsewhere who are empowered to make most of the decisions there. Managers can make many decisions; they do not all have to be made by one person in a centre. Beyond managers' immediate approval authority, the next step up is the credit manager in the centre.

The idea was to bring the centres closer to the business community, so the credit person could meet customers and professional advisers. We implemented that for selfish reasons, because such a service had disappeared in banking, and it made Clydesdale Bank different if we operated in that way. We hoped that that would be more attractive and allow us to do more business. As it turned out, that struck a chord in communities, which persists to this day.

Lewis Macdonald: In broad terms, on how large an amount can a credit manager in a centre make a decision?

David Thorburn: The sum varies according to the credit manager's expertise and whether the facility is secured or unsecured, but it can be seven figures. Decisions on most SME requirements should be capable of being made in the centres, which is the reason for the 90 per cent figure.

Lewis Macdonald: That is helpful.

Do you envisage changes—not only in your bank but in the whole retail sector—in how services are delivered to small businesses and personal customers?

David Thorburn: We plan no material changes. We have developed a winning model. In retail, we put branch managers back in branches. We handle small businesses through business managers who are based in branches, and for larger businesses we have business centres that are based in communities with as much decentralised decision making as we feel comfortable with. Nothing has happened in the past 18 months to prove that that is wrong. Our bad debt experience has been much less than that of most other institutions.

Lewis Macdonald: One suggestion for the sector is that cheques might be phased out by 2018. What is Clydesdale Bank's view on that proposal?

David Thorburn: The Payments Council is meeting today to start to consider that proposal. We have not reached a view on that. We understand that the use and acceptance of cheques continue to fall year in, year out, but we are in no rush to decide to phase them out. We are participating in the discussions. As the proposed timescale suggests, the phasing out of cheques is probably a long way off, but discussing it now might be good to allow us to consider what else the financial services sector needs to do because of the migration to electronic forms of payment settlement.

Lewis Macdonald: You do not see the proposal disadvantaging customers.

David Thorburn: That argument needs to be heard. The discussions have just started. Our board, for example, has had no discussions whatsoever on the issue, and it does not have a view on it. There are consultation processes on such issues. If something will disadvantage many customers, one must think long and hard before doing it.

The Convener: Bouncing electronic transfers does not have the same ring to it, does it?

David Thorburn: No.

Nigel Don: You were here when the representative from Tesco Bank gave evidence. Will you contrast your model with its model? The business models seem to be a long way apart. Are you confident that your model will be robust for a sizeable fraction of the population? Tesco certainly thinks that its model will work for its customers.

David Thorburn: I would like to say a couple of things about that. First, the UK market for financial services is large and mature, and our view is that several different business models are capable of succeeding in it. Another way of saying that is that there is not only one way to be successful in the marketplace. We have chosen not to go down the route that you mention and to carry on essentially as we are, with the branch at the centre of our interaction with the retail customer.

Secondly, it is probably worth the committee being aware that retail banking in the UK has not been a growth area for us for a long time. It is an important area for us—it accounts for around half of our bank—but the market is very competitive nowadays. Our results show that we are holding our own year on year, but we are not growing in that area, and I do not expect that dynamic to change. One more competitor, such as Tesco, entering the field will not threaten us or change things drastically.

The space is very competitive. Clydesdale's income growth and profit growth since the start of the turnaround in 2004 have been driven by a combination of greater efficiency year in, year out—our colleagues in the branch network have made a big contribution to that—and income growth in the business banking operation in the main.

Nigel Don: That is my point in many ways. You do not need me to tell you that you have bricks, mortar and space overheads on the high street, but Mr Tesco and possibly others who will follow the Tesco model do not; they have very different overheads for very large selling spaces. Will your service necessarily be more expensive? If retail banking does not make you much money anyway—

David Thorburn: It is profitable for us and is a significant business line, but the difficulty that I am highlighting is income growth in that space. I do not think that Tesco Bank's model will be for everyone any more than our model will be for everyone. Our model is poles apart from its model in some ways. As a medium-sized organisation, Clydesdale has chosen to focus on tailoring financial solutions for customers on an individual basis; by and large, we do not follow the off-the-shelf philosophy. Our mortgage business provides an example. If someone wants a face-to-face meeting, a sophisticated service and sophisticated advice, they will get that from us, but they will not get it from many of the direct players. That is attractive to many people, and we can provide it at a rate that works for us and is competitive in the marketplace. I do not think that that will change. The competition keeps us on our toes, but it is not a major concern. In Clydesdale, it is all about the individual tailoring of solutions to customers' needs, not trying to shoehorn them into our product range. That is even more true on the business banking side.

Nigel Don: One common comment from small businesses for the past while is that, although their overdraft facility still exists, it costs them a lot more than it used to. In other words, the margin above base rate has risen dramatically. Is that your perception of what has happened? Will that ever reverse? Are we now in more cautious times, such that the margins above base rate will stay?

David Thorburn: That has definitely happened throughout the industry. It is probably worth while for me to try to explain in simple terms what has driven that. If we think of the simple balance sheets of banks such as mine and Tesco Bank, from which you heard evidence earlier, they need to bring in £1 of deposits to make £1 of lending. That is a simplistic explanation, but that is broadly how it works.

If we consider what it costs today to fund the loans that those banks make, including overdrafts, there are three main sources of funding. By far the largest source is retail deposits. If you walk into one of our branches today, you can get more than 3 per cent for a one-year-term deposit or more than 5 per cent for a five-year-term deposit. For us, the cost of raising retail deposits therefore ranges between 3 and 5 per cent; there is no correlation with the base rate. The second largest source of funding is medium-term funding from the wholesale markets. Again, on average, that has cost us well over 3 per cent in the past 12 months. The final source is the capital base, and the cost of that funding is about 8 per cent. All the sources of funding are north of 3 per cent and the average is somewhere in the middle of the range.

In effect, if a bank lends to someone at 1 per cent above the base rate, it gives away £1 notes for 50p—it makes a loss on every £1 of lending. There has been a big change in the cost of deposits or the cost of funding liquidity for banks as a result of the crisis of 12 months ago. If the banking industry had not sought with its customers to reprice overdrafts, the losses would have been much greater. As an organisation, we have done that as well. I would not pretend otherwise. We have sought to absorb as much of the burden as possible, but we shared some of it with our customers. I will give you some numbers to demonstrate the effect of that. The net reduction in our profits last year as a result of our absorbing most of the increased costs was of the order of £150 million. In comparison, we made profits of £108 million. We absorbed a great deal of the additional costs. That is predominantly why the cost of overdrafts has increased.

The other point is that banking nowadays is risk based in its pricing as a result of the Basel I and Basel II accords, and as customers' risk weighting deteriorates in a recession—which it does—that methodology requires banks to charge more, otherwise their capital will be affected. About 40 per cent of most banks' SME customer base will have had a measurable reduction in their risk-based scores. That is significant.

Nigel Don: Thank you for that admittedly simplistic analysis of where your money comes from, but if neither the customer deposit rate nor your capital costs have anything to do with the base rate—in other words, if the base rate only affects what you take in from the market—why on earth would you correlate customers' interest rates with the base rate at all?

David Thorburn: In an ideal world, we would not. We are not talking about a huge proportion of our business. Overdrafts related to the base rate total £1 billion or so in our organisation. That business exists because it is the only way in which to provide customers with a facility that fluctuates in and out of credit. We cannot do that against the three month London interbank offered rate because, by definition, that is fixed for a three-month period. The customer need is for a fluctuating facility, and the custom and practice over the decades has been to peg that to the base rate. That is as close a proxy to the actual cost as we can get, but it has not been much of a proxy in the past 12 months.

Nigel Don: That is genuinely news to me. The base rate correlation is largely irrelevant. It just happens to be the best thing that you have that mirrors something that might be relevant.

David Thorburn: It is important to bear in mind how extreme the situation has been in the past 12 months. If we consider the average in the 10 years up to 2007, before the crisis started, the difference between the base rate and LIBOR was about 0.17 per cent. That is not a precise figure, but it is not far off. The two rates were very close, therefore the base rate was a good proxy, but when the global money markets froze the correlation fell apart and organisations were forced to flex their customers' pricing accordingly.

The Convener: Another issue that has been raised with us—in addition to the increased margin on loans—is that arrangement fees have increased excessively in a number of banks. What is your bank's position on arrangement fees? For example, if someone renews their overdraft, they are charged £1,000 just for going through the door. People are being charged a lot more than they were. We have heard of someone who went from paying £1,000 to paying a £10,000 arrangement fee. It was not your bank, but that is an example of the increases in arrangement fees for businesses. Is your bank involved in that as well?

12:15

David Thorburn: We charge arrangement fees. As we discussed earlier, our pricing is negotiated individually at customer level by the relationship manager, so we do not have one standard charge. We have a broad range of charges that depend on, for example, the risk score of the customer, the term of the facility and the security that is available. Relationship managers have discretion to operate within a matrix, and that has not changed materially during the past 12 months.

A real cause of the crisis, and one that we have not discussed, was the systemic underpricing of risk. The financial services industry has woken up to that as a result of what happened, and an unfortunate consequence is that it is now much more aware of the need to price risk appropriately, so prices have gone up. That is why you have heard so much about that across the business.

The Convener: Is risk not priced in the interest rates that you charge? Are banks not just using arrangement fees to cash in, because they are able to say, "We are in a crisis, so we are going to charge more"?

David Thorburn: I can speak only for our bank; I do not know precisely how others calculate their pricing. Our pricing is based on a return on equity percentage for the relationship. Our business managers use a fairly sophisticated model, the inputs into which are the costs of handling the relationship and all the different forms of the customer's business, the customer's preferences for what they want and how they pay for things, and the margins and fees that they pay. We try to arrive at an overall risk-based return on equity that is within a range that makes sense for us as a business. For example, sometimes customers prefer higher fees and lower margins, and sometimes higher margins and lower fees—obviously, they always prefer lower both, but they have to be reasonable about that. Some have preferences, and our model provides the flexibility to tailor pricing to get the return on equity. To really understand the nature of risk-based pricing for a relationship, we need to be able to look at all the income and costs associated with the relationship, which is why we do what we do.

The Convener: Essentially, you are saying that the matrix is pretty much the same, but where customers sit within it might have changed significantly in the past year.

David Thorburn: We do a risk assessment of the lending in the relationship with the customer, and where they sit within the matrix changes only if the assessment shows a deterioration, for example because the business is making losses or one of its large customers has got into difficulty. The customer's position changes only if there is a deterioration in a risk assessment.

I will give you some numbers to underpin the argument. During the past year, about 40 per cent of our small business customers have seen a deterioration in their risk score, and about 40 per cent of our customers have seen some element of repricing of their facilities. One follows the other.

Christopher Harvie: I want to ask about your relationship with your Australian owners. The experience of the other two big Scottish banks has shown that ownership ultimately has a considerable impact on the interface with customers. What degree of intervention did you experience from Australia pre-crash, for example in 2004? To what extent did that influence your reconstruction of the bank at that point? Have there been any developments in light of the crisis?

David Thorburn: In 2004, our parent company made a conscious decision to change its approach to how the business was managed. A new team came together during 2002-03, and it came up with a plan to turn the business around, a key part of which was the group's agreeing to adopt a regional business model, as it was called. That meant more autonomy and more of a hands-off approach to the running of the business than it had taken previously. We needed to agree annual performance targets and the broad thrust of our strategy with the parent company, but beyond that there was local autonomy for the board and executive committee to pursue that agreed strategy and then be judged on the results. That was an important factor, although not the only one, in successfully concluding the turnaround.

One of the interesting things, in terms of Moody's and Standard and Poor's ratings, is that AA has become the new AAA. Only eight financial services organisations in the world are rated AA. Our parent is one of them, and four of the eight are the four big Australian banks. The culture of the Australian banks has been to be prudent, cautious and conservative in running their organisations, which has made them more resilient in this crisis.

Our parent company has been supportive throughout the past 12 to 24 months. We have not had to rely on it overly; Clydesdale Bank has been able to get by under its own steam, but the parent injected some capital into the business last December, which was helpful when the FSA was looking for increased capital ratios across the board.

Christopher Harvie: You say that you were burned in that earlier crisis. Deutsche Bank also went through an upsetting time after the Vodafone Mannesmann takeover. Did that experience inspire a greater degree of prudence in the later period?

David Thorburn: I do not think so. I have been with the group since the early 1990s, and Clydesdale Bank has been owned by National Australia Bank since 1997. One of the consistent aspects of its culture throughout that period has been a conservative approach to risk.

Christopher Harvie: People from Scottish Enterprise gave evidence last week and talked about the number of firms that they account manage. If an SME account is managed by a body such as Scottish Enterprise, does that alter your relationship?

David Thorburn: I am not hugely aware of that. Although Scottish Enterprise does a great deal of good work, in my experience it does not tend to get too involved in negotiations with the banks. Its advice seems to be more about opening up new markets, new product development and finding a suitable location for expansion—things of that nature that the bank does not do and which I am sure is helpful for the management team. That work is complementary to but not particularly involved in the raising of finance.

Christopher Harvie: Scottish Enterprise would not come to you on behalf of an SME client to make financial arrangements for, say, an export.

David Thorburn: It does occasionally, and that can be helpful. I have had the odd phone call from Scottish Enterprise to say, "We're particularly excited about this business. We'd like to introduce you to the management team. We're introducing them to all the banks. We think they're very good. It's worth your spending some time with them." It is always helpful to get that insight, and we put some store by that judgment.

Christopher Harvie: Much of the crisis concerned the expansion of the mortgage market. The people who are examining carbon footprints have sketched out for us the need to increase the efficiency of our housing stock, particularly its heating and carbon efficiency. I imagine that that will require the provision of considerable and sophisticated mortgages in future to enable expensive expenditure on housing to be recouped. It seems to me that quite a degree of co-operation between Government bodies, house owners and the sources of finance will also be required. Are you providing for the impact of such complex financial arrangements on the householder market over the next five or six years?

David Thorburn: Not directly. Providing finance to support the purchase and extension of houses is a core product for Clydesdale Bank and will be for the foreseeable future. Helping our customers to finance such work, to the extent to which we can play a part in that, sounds like an opportunity for us rather than anything else, but it is not one in which we have been particularly engaged. We will certainly make a note of that and follow up on it after the meeting.

Christopher Harvie: My final point is on the approaching demise of the cheque, the survival of which has always amazed me. In Germany, where I have banked, it is simply a case of doing a giro transaction, either on a terminal or in a bank branch. Why has that extremely rapid and cheap way of settling up accounts never appealed to bankers in Britain?

David Thorburn: Cheques have probably survived because our customers still use them. Their use has been in long-term decline for as long as I can remember. At one level, a cheque facility is quite an expensive service to provide to customers, but for as long as a significant proportion of customers continue to need it, it is one that anyone who wants to be in the current account marketplace will need to provide. We will see. The considerations on the future of the cheque have just started. What happens will depend on how the consultation with customers goes.

Lewis Macdonald: It is important to give you the opportunity to respond to the wider debate on regulatory reform and the proposed changes in corporate governance and to tell us how they would affect you. Do you agree with what we have been told in evidence about the changes that are required in the banking sector? How do you propose to respond to some of those issues?

David Thorburn: In simple terms, we agree with the changes and intend to comply with them; in most cases, we already do so. As I mentioned, we already have a remuneration policy, which requires only minor tweaks, and risk committees. The proposals will not have a huge effect on us. We have noticeably more interaction with regulators than we used to, but we have no complaints about that, as they are doing an important job. It seems to us that a lot of important lessons have been learned as a result of the crisis. The governance structure is being strengthened and we will fall into line behind that.

Lewis Macdonald: Do you think that, fundamentally, the existing tripartite structure that is subject to reform works and can continue to work?

David Thorburn: We do not have a position on it; we certainly do not have any complaints about it.

Lewis Macdonald: Thank you very much.

The Convener: I have a final question about the divestments that are being required of RBS and Lloyds TSB, which I should have put to a number of the other organisations that have appeared before us. I am not necessarily asking you to say whether you are interested in bidding, but are you aware of any reason why you would not be able to do so, particularly in relation to the Lloyds TSB branch network in Scotland? Would you be able to bid if you wished to do so or would the European Union’s rules bar you from doing so?

David Thorburn: In general, our publicly stated position, certainly since 2004, has been to pursue an organic growth strategy. Doing that successfully does not require us to make any acquisitions. The position is still the same. Equally, we have said that we will look at anything that becomes available that might allow us to accelerate that organic growth strategy. To an extent, the events that are playing out in the market at the moment fall into that category. It is still early days. It is clear that there would be no competition barrier at a UK level, because our market share in the UK is small in any product line. I cannot answer your question about the branch network in Scotland because we have not examined the situation.

The Convener: Thank you. In that answer and all the others that you have given, you have been extremely frank and open with the committee, for which we are grateful. Thank you for your evidence.

12:29

Meeting suspended.

12:31

On resuming—

Proposed International Trade Inquiry

The Convener: The final item is consideration of a draft remit for our proposed inquiry on international trade and inward investment.

The clerks have produced a paper with a suggested remit. I open the discussion up for comments. The hope is that, if we can agree the draft remit today—subject to any tweaking that the clerks and I agree—we can get the call for evidence out before Christmas so that people can start to prepare their evidence, which will allow us to pursue this inquiry fairly soon after we conclude the banking inquiry.

Lewis Macdonald: I have a thought about the call for evidence. This is clearly not the best time of year to approach organisations, even those that are in the forefront of our economy. Therefore, although it might be appropriate to put a call out this week, it would also be appropriate to follow it up in the new year.

The Convener: Absolutely. The aim is to give organisations as much notice as possible. The proposal is for written evidence to be in by the end of February, so there would be plenty of time. We would ensure at the beginning of the year that organisations were aware of that.

Lewis Macdonald: That is helpful. I will highlight one phrase at the end of the fourth paragraph of the terms of reference. We are doing the inquiry because we think that international trade is important, but saying

“future growth may need to be driven by an increased focus on international trade”

perhaps slightly overstates the point. We are certainly looking at an increased focus, but I am not sure that international trade is the sole driver of future economic growth, important though it is. Perhaps a slight tweak is needed.

In the same paragraph, a point is presented in a rather complex way through negatives and double negatives. It might be simpler to say, “Exports are important and we already have some success stories.” In other words, we could make the same point in a slightly more positive way, because it is important to recognise that a significant element of the economy is already exporting successfully.

Stuart McMillan: I would be interested in considering international comparisons with the services that smaller European countries provide so that we can try to gauge Scotland’s position and results relative to theirs. That point might come out in the evidence, but perhaps we could consider it before we issue the call for evidence.

The Convener: That point is covered by question 8 in the draft remit. The intention is to do at least some paper-based comparisons with other countries. This is really just about the terms of reference of the inquiry; we will come back with an approach paper on how the committee will pursue the inquiry. At this stage, we are just trying to get the thing into the public domain so that we can start to gather evidence.

Christopher Harvie: Possibly, we could identify some key companies in that time. I am thinking of companies such as the Wood Group, Denholm and Aggreko, which have a big export market for their services. Also, we ought to be circumspect about looking at inward investment, as that often means just a takeover. We have just seen Borders, which wiped out the native Glasgow bookselling industry, itself wiped out to the great disadvantage of Scottish publishing companies. We should, therefore, ca’ canny about inward investment. We want it where we need it, but we do not want it where it will check the development of small businesses in Scotland.

The Convener: The nature of inward investment will obviously be part of the focus of the inquiry, which will also look at the type of businesses that we are trying to attract and our purpose in doing that.

Christopher Harvie: The jacket that I proudly wear is from yet another menaced Scottish industry—it is Harris tweed. There is a need, bound up with Common Market regulations and that sort of thing, to preserve and enhance native specialities. I could go into a long disquisition about how cuckoo clocks saved the Black Forest—curiously, it was the companies that specialised in wood-motion cuckoo clocks that survived; those that went into electronic clocks went bust.

The Convener: If you wish to spend the Christmas recess producing a report on that, that is entirely up to you.

Nigel Don: I echo Lewis Macdonald’s comments about being positive. We must be careful not to pretend that it is broke when it ain’t. Let us just see what we can do. It is worth taking out every pejorative term. For example, the penultimate paragraph on page 3 says:

“This new inquiry will focus on the merits of the current approach”,

which implies that there are demerits. I know exactly what the clerks mean, but I suggest that we take out the reference to merits and say, “The inquiry will focus on the current approach.” That will include the merits and demerits without our having to mention them. I am not nit-picking; I think that we need to be careful about the tone of the remit. What is going on is good, but we are looking to see whether we can do something to improve it. I also make a plea for no double negatives—they may be used correctly, but they do not half confuse us.

Lewis Macdonald: The draft remit is good and what we want. It is important to recognise that, for many export industries, there is no choice between working with UK export bodies and working with Scottish export bodies—they work with both. However, I do not think that we need to adjust the remit to recognise that, as we are bound to focus on the relationship between different export bodies and industries in the course of our inquiry.

The Convener: That is absolutely right.

In relation to question 2, we will want to check whether the support that is given is appropriate for the current economic circumstances—that is, whether we are still providing the appropriate support in a changed economic situation. In particular—perhaps to please Christopher Harvie—we might place the emphasis on the manufacturing side.

We also need to ensure that we look properly at the issues to do with our relationships with other UK-wide bodies, such as UK Trade and Investment and the British Council. VisitBritain is also important in the context of the services that it provides to VisitScotland. I was shocked to discover that VisitBritain has only four members of staff covering the whole of China.

Christopher Harvie: That is important. It would also be worth while to find out how individual countries handle marketing within themselves. In Germany, it is very much concentrated around big trade fairs, but the situation could be different in other countries. It is a question of finding out who the key people to contact are.

The Convener: Okay. Are members content with the draft remit with a little bit of tweaking? No major question has been left out that members feel should be added to the nine questions, and no question is being asked that members feel should not be asked.

Members *indicated agreement*.

The Convener: Are members happy for the clerk and me to finalise the call for evidence? I take Lewis Macdonald's point that we may have to make a double call, as people might forget because it is Christmas.

Members *indicated agreement*.

The Convener: I wish you all a merry Christmas and a happy new year. Thank you for your support for the convener, not just today, when he was feeling a little fragile, but throughout the year. It has been greatly appreciated. By and large, the committee has worked extremely well as a team over the course of the year.

Meeting closed at 12:40.

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