

ENTERPRISE AND CULTURE COMMITTEE

Tuesday 20 September 2005

Session 2

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ENTERPRISE AND CULTURE COMMITTEE

19th Meeting 2005, Session 2

CONVENER

*Alex Neil (Central Scotland) (SNP)

DEPUTY CONVENER

*Christine May (Central Fife) (Lab)

COMMITTEE MEMBERS

*Shiona Baird (North East Scotland) (Green)

*Richard Baker (North East Scotland) (Lab)

*Susan Deacon (Edinburgh East and Musselburgh) (Lab)

*Murdo Fraser (Mid Scotland and Fife) (Con)

*Michael Matheson (Central Scotland) (SNP)

*Mr Jamie Stone (Caithness, Sutherland and Easter Ross) (LD)

COMMITTEE SUBSTITUTES

Mark Ballard (Lothians) (Green)

Fiona Hyslop (Lothians) (SNP)

George Lyon (Argyll and Bute) (LD)

Margaret Jamieson (Kilmarnock and Loudoun) (Lab)

Mr Brian Monteith (Mid Scotland and Fife) (Con)

*attended

THE FOLLOWING GAVE EVIDENCE:

Tony Amor (ITI Energy)

John Chiplin (ITI Life Sciences)

David Creed (ITI Techmedia)

Roger Dickinson (ITI Operations)

Gavin Don (Equitas)

Gerard Kelly (Scottish Enterprise)

Ricky Muir-Simpson (ACM Catalyst)

David Sigsworth (ACM Catalyst)

Peter Syme (ACM Catalyst)

CLERK TO THE COMMITTEE

Stephen Imrie

SENIOR ASSISTANT CLERK

Douglas Thornton

ASSISTANT CLERK

Seán Wixted

LOCATION

Committee room 1

Scottish Parliament

Enterprise and Culture Committee

Tuesday 20 September 2005

[THE CONVENER *opened the meeting at 14:00*]

Item in Private

The Convener (Alex Neil): I welcome everybody to the 19th meeting in 2005 of the Enterprise and Culture Committee. We have not received any apologies. I remind everybody to switch off their mobile phones before we start.

Item 1 is to decide whether to take item 5 in private. Does the committee agree to do that?

Members *indicated agreement.*

Deputy Convener

14:01

The Convener: Item 2 is to choose a deputy convener who will, based on the formula, come from the Labour Party. Are there any nominations for deputy convener?

Susan Deacon (Edinburgh East and Musselburgh) (Lab): I nominate Christine May.

Richard Baker (North East Scotland) (Lab): I second that.

The Convener: I take it that there are no other nominations. I therefore declare that Christine May has been chosen and congratulate her on her election.

Christine May was chosen as deputy convener.

Christine May (Central Fife) (Lab): Thank you very much, convener.

Business Growth Inquiry

14:01

The Convener: Item 3 is our inquiry into business growth. We have three panels of witnesses this afternoon. The first witnesses represent the intermediary technology institutes. I ask Roger Dickinson to introduce the team and to say some words by way of introduction.

Roger Dickinson (ITI Operations): It is a pleasure to be here to address the committee's inquiry. Over on my far left is David Creed, who is the chief executive officer of ITI Techmedia and who is responsible for communications and digital media. Next to him is Tony Amor, who is CEO of ITI Energy and is responsible for the whole gamut of energy from creation to storage—a wider subject than it might at first appear to be. To my immediate left is John Chiplin, who is CEO of ITI Life Sciences. I am responsible for the infrastructure that supports my colleagues in their endeavours.

Our organisation has been set up to nurture innovation as being merely one part of building sustainable business growth in Scotland. We are pleased to have been set up by Scottish Enterprise and that the degree of independence with which we need to operate has been recognised.

Throughout our submission, there are key points that we will draw on in respect of our continued success. The first is our market focus—how much we rely on analysing the market in deciding on the best projects to follow. The second is our commercial credibility. All of us are from commerce and industry, as are virtually all our staff; that gives us a certain credibility when we deal with the small and medium-sized enterprises and with multinationals. We are also a fairly small group and we pride ourselves on our speed of response in putting together and delivering projects.

We are a company limited by guarantee. We operate very much as a company, with a full corporate structure of audit committees and so on. The three market ITIs operate from three different locations because we are, in fact, a virtual operation and there is no specific advantage for us to being in any one location. David Creed's team works from Glasgow, Tony Amor's team works from Aberdeen and John Chiplin's team works from Dundee. I am with the central core, which is based in Glasgow.

Without further ado, I will hand over to my colleagues to speak about the different aspects of our work. I ask David Creed to outline how we focus on market needs, which relates to pages 3

and 4 of our submission, if members are interested.

The Convener: The sun is shining right into John Chiplin's eyes and to some extent into Roger Dickinson's. We like to put people under the spotlight, but not to that extent. The blinds are down. If the witnesses want to move sideways, that is no problem.

John Chiplin (ITI Life Sciences): I was always taught that the sun shines on the righteous.

The Convener: That is why you are looking in my direction.

David Creed (ITI Techmedia): Good afternoon, convener and ladies and gentlemen. You are fortunate that the sun is not reflecting off Roger Dickinson's and my heads, otherwise you would have a bigger problem.

I will talk a little to what we have designated market foresighting, which is a key generic approach throughout the ITIs. As Roger Dickinson said, that is important in setting our strategic direction on the basis of analysis of global market trends by sector.

As everyone will know, the ITIs have been established as a medium to long-term enterprise that will focus on applied research and development. We are in the arena of the three to 10-year window for delivery. In that sense, technologies and markets spar with one another. As a result, we undertake a sophisticated and robust market foresighting process.

I will explain a little about what that means. Rather than being just jargon, market foresighting ensures that we establish the right global connections with subject-matter experts in our sectors throughout the world. It involves discussing with them, from a primary research perspective, how they expect their industry segments to evolve in the next decade, what the challenges in those markets will be and what the markets' needs will be.

Each ITI has collected that information by organising events, such as global workshops, with experts from throughout their industry sectors and we have had one-to-one interviews with experts worldwide. We have built up a picture per market of the needs that will be important in targeting some of the challenges that those markets face in the three to 10-year timeframe. We supplement that with secondary research—it might be called desk-based research—on some market trends in the sectors and some projected growth data.

We bring all that together to paint a picture of commercial challenges in the various markets in the next 10 years. In pulling those challenges together, it is evident to us—given our mandate—that we must prioritise some aspects. We derive

from those needs and challenges what I determine to be technology platforms. We identify priority needs in several sectors and translate those needs into technologies that need to be developed to progress the market. We also look across markets for common areas in which we can reuse technology.

From that market research, which we have written up and published to all our members, we have created a valuable pool of knowledge that is the basis for the programmes that we undertake and launch. From our market research, we have all established key priority technologies, which are used to drive our individual programmes.

Once we have done that, we enter a period of programme scoping, which involves digging down in detail into the market that we have identified and the technology needs that require development. We have put together a sophisticated diligence process in which we consider technology and market assessment, the intellectual property landscape, the competitive advantage to be achieved for Scotland from a programme, exploitation routes to markets in Scotland, regulatory issues that might affect our undertaking a programme and how we can continuously manage risk in a particular programme. From all that, we put together a detailed programme plan and bring the correct people together to deliver on the research and exploit its output. The process links market evaluation with sector priorities, which leads to technical priorities, which links to well scoped-out programmes for which we can bring on board the right people to deliver on what we seek to achieve.

Roger Dickinson: I ask John Chiplin to recap on intellectual assets and knowledge transfer. Pages 5 and 6 of our submission deal with that.

John Chiplin: I want to talk about knowledge transfer, or technology transfer as it is often known. Knowledge or technology transfer is important, but I like to view it as an innovation continuum. Obviously, technology transfer is an important component, as are foresighting—as David Creed said—and research and development management. If I were asked whether technology transfer or R and D foresighting is more important, I would ask which wing of an aeroplane is more important. In other words, taking technology that has an identified market need and putting into the equation all the strange variables that constitute a viable, growing company means that there is a lot of detail and that the dots must be connected. Technology transfer is just one part of a necessary innovation continuum for starting and growing companies.

Thomas Edison said that genius is 1 per cent inspiration and 99 per cent perspiration. That equation applies also to entrepreneurship and

growing companies. A massive stack of intellectual property might be gathering dust on a lawyer's desk, but that 1 per cent spark can ignite it into becoming a business. We spend a lot of time on that aspect in the ITIs. The issue is not only about buying in IP or considering whether one IP fits with another, but about asking whether there is a sustainable business model. Much of our foresighting and programme management is geared towards that.

On how IP links with the other programmes, you have heard the real estate analogy: it is all about location, location, location. Back at the ITIs, we say that it is all about management, management, management. We could do great foresighting in an area, identify great market needs, associate some IP with that, which could be bought or acquired in another way, and put it all together. However, if the programme cannot be managed, it all counts for naught. Tony Amor will elucidate how management fits into the overall IP continuum and how programmes are put together effectively.

Another aspect of the IP agenda is the growth of the ITIs and the catalytic function of their being in the community. A key concern of mine is what we call internally the “fear of orphans”. I will define that. People often ask me whether I am worried that things will go wrong and I reply that I am not. I know for sure that some things will go wrong—that is the nature of the beast—but I am more worried that things will go right. In other words, I am worried that we fund projects that meet all their milestones and manage successfully but run into a brick wall because of a lack of follow-on funding. The equity gap, which will be the topic of a later discussion, is defined as the gap in the marketplace for early-stage companies that is generally too large for sophisticated angel networks and too small for institutional investors.

I stress that knowledge management and technology transfer is one part of an overall innovation continuum.

Roger Dickinson: Tony Amor will conclude with remarks on delivering successful R and D.

Tony Amor (ITI Energy): The R and D programmes that we undertake are an interesting blend of insight, imagination and discipline. Among our key tasks as ITIs is figuring out where to compete and get technology from and how to establish a sustainable niche for Scotland. This is a very competitive world. The things that my colleagues have described are really about trying to figure out where we have an edge, which takes a lot of insight, experience and imagination.

14:15

The R and D programmes that we have put in place—we have about 11 at the moment—require

a lot of discipline on top of the insight and imagination. They require discipline as we put the programmes together. The due diligence that we undertake with the parties that will be involved and with the intellectual property that we are seeking to acquire and/or to create requires discipline. A lot of discipline is required in putting together the right people to participate in projects and to manage them as we put them together, and to define a set of rigorous milestones that we want to achieve along the way in order to get the results that we are looking for. It is not a trivial task.

In case it has not come out in the comments so far, we are now involved in real programmes. It is all about implementation. The ITIs were conceived about three years ago, but this is the first year of their operation. We are engaged in real stuff now.

As was recognised in the initial ITI concept, in everything that we do it is vital that we identify how technologies will be commercialised. As David Creed said, we start from the market. It is not about finding a cute widget and trying to figure out where to put it. We are driven by opportunities to solve real problems in the marketplace. Early on in our programmes we try to identify what the products are going to be, what the value proposition is going to be, what the channels to market are going to be, and who is going to buy and sell the product. We endeavour to put into the programmes some of those parties to help us progress projects to the market as we develop technologies. Indeed, as John Chiplin mentioned, lining up financing at the same time is a key part of ensuring that we get over the famous gap. Gerard Kelly's presentation will illustrate an important part of that picture.

I am happy to answer members' questions.

Roger Dickinson: It is time for us to answer members' questions. I point out that we have just completed our first full year of operation, so even for us there are many unknowns in respect of how things will go forward. In answering questions, we have to be mindful of commercial confidentiality issues that might arise in relation to some of the programmes. On that basis, we will do our best to be helpful.

The Convener: That is helpful, as were the papers. I want to keep this fairly flexible—I do not want it to be like a courtroom. We are trying to generate a discussion on the role of the ITIs, therefore I want you to regard this as a round-table discussion rather than a witness evidence session in the High Court. I will start with Richard Baker, and anyone who wants to can chip in.

Richard Baker: I have questions on identifying markets. What balance should be struck between investing in innovation in industries that are already well founded in Scotland and investing in

new companies and technologies that are further away from developing their full potential? In Tony Amor's case, to what extent should we invest in the existing energy industry—in oil and gas—compared with renewables? I am interested to know how you have struck that balance in the 11 projects so far.

Tony Amor: If you are asking about our approach in the energy sector in particular, we have, as you know, focused on particular areas in which we think that there is not only an opportunity to satisfy global market needs, but in which there is Scottish capability so that we can embed projects in Scotland and take advantage of capabilities in the research, SME and company sectors. That is very much a part of our thinking.

On whether we deal with existing sectors or look for new sectors, we are all trying to get a balance in our portfolios. We try to balance things that are a little stretchier, further out and further from the market with things that are a little closer to the market. That is particularly demanding in energy because getting a lot of energy technologies into the market takes a long time. Things happen a little more quickly in other fields.

David Creed: I agree with Tony Amor. Things move much more quickly in my sector, which is rather more dynamic. We have taken a conscious decision to select priorities on the basis of what we believe to be real market opportunities, and we look to achieve a balance between near-term opportunities and longer-term opportunities. We have a mixture of programmes under way. Programmes typically stretch from two years to five years, but the whole thing is driven by the recognition that substantial opportunities exist and that there is a good tie-in with the skills capability in Scotland from an exploitation and a research-and-development perspective. I would not say that there is a 50:50 balance; projects are considered on their merits from a market viewpoint.

Richard Baker: Are there industries or companies in whose innovation you would like to invest, but have found that you cannot do so because the research, skills or leadership are not here to develop them? Have you found the right companies?

John Chiplin: The objective is to create a balanced portfolio, so that stuff will come off in the short term, medium term and long term. Scotland has a great installed base for some things that we try to leverage, and we try to introduce things to the community to take advantage of. I am speaking about the life sciences, but what I am saying also applies to energy and digital media. One will see the true balance of the portfolio being developed around years two and three. The early projects—whether there are two or four programmes—are never representative of the

strategy as a whole, because it is starting off, if you will, but one should see the balance taking shape by years two and three.

Christine May: I want to explore foresighting—which you have discussed—not only in the context of the ITIs, but in the context of how you use techniques with the Scottish Enterprise network and the universities and colleges. You are doing something that involves crystal-ball gazing and you hope to be more successful than some people have been. What discussions have you had with other colleagues to match skills capacity to the research and development capacity? Richard Baker mentioned that.

David Creed: I do not know whether what I will say will answer that question.

I mentioned earlier that in putting foresighting initiatives together, we pull in real people from industry and academia for discussions around the table—rather like the discussion that we are having—on priority issues. We have a membership of some 230 companies and academic institutes. The market foresighting that we undertake and the conclusions that we draw are shared with that community and a wider community, as we are building up a total network. Therefore, there is input not only from the industry sector, but from the academic sector. Our challenge is to pull everything together and to achieve a conclusion that everybody will recognise as being solid and substantial. In fact, we have summarised our conclusions and fed them back to the people who have taken part in those sessions because such information is extremely useful to them. The process is about membership, engagement, building networks, sharing information and—crucially—drawing conclusions in order to drive programmes. We are given confidence by the fact that, once the programmes are in place, many folk get involved in them because they see value in doing so.

Christine May: That answered part of the question. You have talked about inputs, but how do you measure outputs? You know what you are doing, but do you know what others are doing as a result of your sharing of information?

Roger Dickinson: It is fairly early days for us in that arena. All the Scottish universities are members of our organisation and we have a large number of SMEs and multinationals, one or two venture capitalists and various research institutions. Because of the ways in which we work, such as the seminars that we hold, our members can share information, take it away with them and use it in their organisations.

From our point of view, if an SME discovers from our work that its market is disappearing and that it should do some R and D to get back on to the

market and then goes away and does so, that is a positive point. Similarly, if an SME and a university department happen to strike up a conversation at one of our seminars and find that they are working in the same field and they then work together, that is a positive point. It is not only the projects that we fund that encourage the R and D skills out into the marketplace and that get universities, SMEs and multinationals working together.

John Chiplin: We are helped by the fact that our agenda is Scotland-wide and that we do not necessarily represent a university or a company. The networking and the relationships that are built around programmes are fostered by the fact that our agenda is about what is in those relationships in terms of innovation in Scotland; we do not just represent a particular region or company, which helps to level the playing field with respect to programmes.

Roger Dickinson: Part of my role, which is more a cross-ITI activity, is to talk to the Scottish Higher Education Funding Council and Universities Scotland to inform them of the latest position so that they are aware of where we are looking and what we are interested in. If that gives them an indication of where the market trends are, that is a benefit.

Christine May: My second question is about the panel members. I do not mean to sound as though I am asking you to put a time limit on your tenure but, given that you came with good business contacts and credentials and up-to-date business experience, how long do you reckon that experience will remain current before it needs to be refreshed?

Tony Amor: You are asking what our sell-by date is. We refresh our experience all the time. As all of us have been in business for a while, we all bring a valuable network. All of us are bringing technology and companies to Scotland as a result of those networks. I am not personally going to volunteer to go back to school in the next couple of years—I can stay up to date without doing that.

We were all excited by the vision of the programme and impressed by the quality of the work that had gone into setting it up and by the degree of commitment from the Executive and the stakeholders in the programme. We all saw an opportunity to use our experience, networks and knowledge of our sectors to make something happen and to make a difference. That is why we are here and why what is happening is happening. You would not believe the amount of interaction that we are having. Our next two projects will bring companies and technologies from California to Scotland, purely as a result of our networks. I do not think that they will go stale overnight.

14:30

Shiona Baird (North East Scotland) (Green): You talk about vision; my question is about how you interpret the meaning of "vision". I see the term as relating to the world that we are going to be in. Particularly in energy, people are looking 10 to 20 years ahead. However, in 10 or 20 years' time, we could be in a completely different world due to climate change and oil depletion. How far ahead do you look and what sort of vision do you have for ITI Energy, bearing in mind that we could be facing a completely different set of circumstances?

Tony Amor: We look hard at the scenarios relating to energy demand and the impact that various technologies can have in that regard.

We had better take this one offline, but the hard fact is that, in 25 years' time, we will still be in a hydrocarbon-dependent world, given the rate of adoption of new forms of energy and the difficulty in changing the infrastructure that is in place globally. I do not mean that there will not be other technologies, specifically renewable technologies, that will make a dent in the supply side of the equation. However, if you add the numbers up, you can see where we are headed.

We look at the amount of funding that we have available and at the number of programmes that we expect to create over the next few years. I do not have the facts at my fingertips, but we have a vision of what we will have done to the Scottish economy 10 years' hence. First of all, we would like to be self-funding 10 years from now. We do not expect to be funded out of the public purse after that time; we expect our programmes to be generating revenues, income and benefits for Scotland that can be put back into the programmes for the future. We expect that we will have increased research capability in certain key areas that we are going to focus on, because we cannot focus right the way across the spectrum. We expect that we will have increased capabilities in the research sector. We will have enabled the SME and corporate sectors to see the benefits of R and D programmes to their businesses. Further, we expect to have created 20 or 30 successful new companies as a result of the technologies, which will bring with them jobs and economic benefits.

We have a clearly defined view of where we want to be and the benefits that we hope to achieve after 10 years.

Shiona Baird: I am a bit disappointed that you are not considering the possibility that oil will not last and the fact that we cannot afford to be dependent on hydrocarbons.

Tony Amor: I did not say that; I was careful not to. Talking about the global infrastructure, I said

that the demise of oil has been predicted consistently for the past 30 or 40 years. There is a famous person called Mr Huppert, whose model is the guiding principle behind people's views on when oil reservoirs will run out. On the issue of conversion, I was simply saying that, for example, to convert the transport sector to an alternative form of energy to hydrocarbons is a massive proposition. If you consider how long cars stay in service and work the numbers back, you are forced to conclude that the world will rely on hydrocarbons for the next 20 or 30 years.

I also said that there are many different technologies. As you know, we have invested in hydrogen technology, so we are not in any way dismissive of that. I have worked in renewable energy for the past 20 or 30 years and have run some substantive companies in that area. We are looking closely at other areas and we will invest in them.

Shiona Baird: I am pleased to hear that. I must admit that I was concerned to see that one of the projects that you are supporting to the tune of £3 million is a new pipeline technology.

Tony Amor: That is correct.

Shiona Baird: Bearing in mind that the pipeline is for the oil industry, is that an appropriate use of R and D? I would have thought that the oil companies were reaping such rewards at the moment that they would be able to fund the pipeline themselves. I would expect to see ITI Energy supporting innovative projects that need support in a way that the pipeline does not—unless I misunderstand the project.

Tony Amor: No. I am sure that you understand it correctly. Our perception of the Scottish economy is that the oil and gas sector, its supply chain, the jobs at stake and the contribution that it makes to the Exchequer and the balance of payments are so important that extending the life of the North sea fields is a key objective. We think that it is possible to capture a lot of technologies that will not only enable mature oil and gas regimes to get more oil out of the ground, but bring benefits to the infrastructure that is in place in Scotland. That is the basis of the sector and we think that it is very important.

The Convener: I will raise a few strategic points. According to the evidence that we have had from the Scottish Executive and others, in order to achieve business growth rates in Scotland that are comparable with those of our international competitors, one of the major challenges that we face is to substantially increase—probably by a factor of three or four between now and 2014—the level of spend on research and development in the private sector in Scotland. Even to get up to where our Organisation for Economic Co-operation and

Development competitors are just now would require an additional £1.4 billion a year on top of the £600 million that the private sector spends on research and development in Scotland.

It is clear to me, as it is to the Executive, that the ITIs have a major role to play in closing that gap and trying to boost private sector spend on research and development in Scotland. You are scheduled to spend £450 million between you over 10 years. That sounds like a lot, but it is equal only to about one fortieth of what we need to increase R and D spending by in Scotland over that period to be on a par with our competitors. Do you have scope to spend, or are you constrained by that budget? I know that it is early days and that you have been up and running for only a year, but if twice that amount were available in four or five years' time, would the opportunities be there for you to make twice the impact that you make with the current budget? Is money a major constraint? Is there a lot more potential in this area than the £450 million suggests, and if so, how much more?

Secondly, you cover three crucial market sectors for Scotland, all of which are growing globally at a fantastically high rate compared with the global economy as a whole. However, I can think of many other sectors, such as nanotechnology, which is going to be a major technology in the next 10 to 15 years and in which Scotland already has an intellectual presence of the highest order. Is there scope for more ITIs?

Thirdly, if we compare you with your sister organisations in Singapore and Scandinavia, we see that although the scale of investment here is high by Scottish standards, it is not all that high by international standards. If we consider what the city state of Singapore is spending on its ITIs, we see that we ain't at the races, and we ain't going to be at the races unless we are prepared to commit an awful lot more to this concept. Will you give us a flavour of the constraints vis-à-vis the potential and where the areas for further expansion are likely to be?

Roger Dickinson: I ask John Chiplin to take the first question, and I will probably start on the second one.

John Chiplin: On the amount of money, when one starts up a programme such as this, one is busy recruiting people, getting up to speed and establishing the processes. It can be difficult to get started in terms of a venture capital deal flow. Ultimately, this is all about deal flow. You have probably read the press releases over the past six months. What we have seen is that deal flow is starting and is increasing. We will reach the point—if not now, certainly by the end of the year—where the deal flow exceeds the capital available. It is my prediction that we will see that in this fiscal year and that deal flow will increase.

The Convener: Is that across the board or is it specifically in life sciences?

John Chiplin: That is across the board. It is difficult for me to be quizzed further on this, but I think that the quality of the deal is increasing. I am noticing that each deal we do is better than the previous deal, which was better than the one before it. Things seem to be going in the right direction for establishing a balanced portfolio; at some point it will be limited by capital.

You mentioned nanotechnology—the whole world is jumping on that. We are going to put together a foresighting report on bionanotechnology. We cannot ignore nanotechnology, although we could debate further whether we do it in an individual ITI or have a separate ITI. That is a critical area.

I am delighted that you mentioned the competition that goes on around the world. The names are obvious: Singapore, Ireland and Israel. Everybody is competing for high-quality biotech or technology jobs in their own back yard. We recently did a life science deal with Inverness Medical Innovations—IMI. If we had not done that deal, it would have showed up in Israel or Ireland in about 30 to 60 days. It is intensely competitive out there, and we see ITIs as a strategic initiative—a strategic chip, if you will—that Scotland can use to be competitive in the innovation arena.

Roger Dickinson: On the more general issue of whether there should be ITIs in other areas, what we find, particularly in the ITI Techmedia space, is that electronics and communications affect all our industries. To a degree we have a spread into other areas that are not immediately obvious; for example, ITI Techmedia is doing work that is to do with an agribusiness. We can go into completely different spaces and still be doing electronics. I think that the same is true in life sciences. John Chiplin has spoken about nanotechnology in life sciences; we have enough flexibility in the ITIs to do nanotechnology in the ITI Energy field and in the ITI Techmedia field. However, that does not mean that there is not some advantage in doing nanotechnology as a coherent group in itself.

Nanotechnology is also greatly used in material science, which is not an area in which we directly operate, although we are on the fringes of that sort of activity. There is always scope for doing things more widely, but the reason why energy, life sciences and techmedia were chosen is that they were seen as the strongest areas in Scotland. We have to play to those strengths at the moment. We are unable to comment as to what other areas there may be. We are fairly focused on operating within our space.

The Convener: Roger Dickinson, in deciding where to go next—the next frontier—if that were to be nanotechnology, could you do that within your current charter, or would you have to go back to Scottish Enterprise or the Scottish Executive?

Roger Dickinson: If a project in, say, material science was completely outside of what we were set up to do, we would have to go to Scottish Enterprise. If it were a project that we could see as having benefit in our field, we would not need to go to Scottish Enterprise.

14:45

David Creed: It will come as no surprise to learn that ITI Techmedia is also looking at nanotechnology. That technology could be significant for the electronics sector and has been the subject of basic research for some time. Our interest in the technology is more focused on the longer-term application that some of that work could have in our individual sectors. John Chiplin hinted that his institute is looking at nanotechnology, but I can confirm that we, too, are looking at it. Nanotechnology is very much part of our market foresighting activity and will form part of our next tranche of foresighting focus. Like everyone else, I should point out that we are in our first year to 18 months but we are continually looking at what areas to include in our portfolio.

In answer to an earlier question, I should highlight the fact that we do not take one shot at market foresighting and then roll out a programme. Even when the programme is running, we continue to look at the market and to ask whether the objectives of the programme are still valid. If they are no longer valid, we need to refocus and redirect the programme. We need to do that because, as my colleague John Chiplin said, we will definitely end up with an orphan if we do not drive projects dynamically according to what is happening. The processes that we have in place for market foresighting are not simply to manage existing programmes to check that they are still valid but to ensure that we pick on strong emerging areas, such as nanotechnology, so that we can start to get a focus from a programme perspective. I can assure you that we are doing that.

The Convener: I also want to pursue what was said by John Chiplin, who mentioned the prospect that, by about this time next year, the number of high-quality deals could outstrip the resources that are available. He said that, given more capital, more high-quality deals might be achieved, with consequent knock-on effects on the creation of new businesses, jobs and all the rest of it. Are the ITIs looking at where they might get additional capital for those deals? Must all the capital come from the public purse, or are you still at too early a stage of development to be able to go out and

raise that money privately? Alternatively, are the deals too high a risk for the private sector? Is there a need for some kind of private and public fund that the ITIs could tap into to fund those deals?

Roger Dickinson: The first point to get across is that we deal with what is very much pre-competitive research. Therefore, if a venture capitalist was prepared to fund one of our projects, we should not be involved in it. Obviously, we are going where others fear to tread.

The Convener: Does that mean that there is a need to go back to the public well?

Roger Dickinson: I was just about to come to that point.

We have looked at European funding, which is money from the greater public well. However, our organisation does not come within the definition of a research organisation for European Union framework 5 or framework 6 funding. We are trying hard to get the wording for framework 7 changed, so we would appreciate help in that area. At the moment, we are constrained by the terms of EU funding. We have also talked to the European Investment Bank, which has talked about getting more involved in innovation. However, the EIB has not yet decided what its appetite for risk is and that will depend on the level of assistance that it receives from the EU.

However, we have already managed to bring money from the private sector into our projects. For example, John Chiplin has been leading on a deal involving Stirling Medical Innovations.

John Chiplin: The deal is quite complicated, but basically it involves, on top of our investment of £30 million, a commitment from Stirling Medical Innovations of around £67 million. That deal will give us on our back doorstep—in Stirling—a significant project on cardio-biomarkers with £100 million dedicated to its success. To be frank, that is a nice bet to place. IMI is certainly massively committed to the project and we have intellectual property arrangements with IMI to leverage the IP that it is developing in the health care sector into environmental testing, defence testing and the whole veterinary market.

The issue is not whether such investment should necessarily be publicly funded or privately funded but how the public sector and private sector can work together to leverage each other's assets. That is how we try to view the issue.

The Convener: Basically, you are saying that we need to address the issue of the missing mechanism for doing that. Murdo Fraser and I attended a meeting last night with representatives of one of the major Scottish banks. They are willing to work in partnership in this sort of area. We might pursue that later when we make recommendations.

I know that it is early days and I know that this question is like asking how long a piece of string is, but if you had no financial constraint, or if you had, say, £2 billion available to you over the period—we were originally talking about £450 million of public money being invested in ITIs over the first 10 years—do you reckon that you could do £2 billion-worth of deals?

John Chiplin: Over that period?

The Convener: Yes.

John Chiplin: Absolutely.

The Convener: What is the practical limit?

Tony Amor: Ambition and self-belief—and I am not being trivial in saying that.

The Convener: So the sky's the limit if the resource is available.

Tony Amor: We have an opportunity here to create something that will show the rest of the world how to do it. The one thing that we need to do is to keep our nerve. This is a critical time. As John Chiplin said, we are already budget constrained, and we are having to manage our deal flow to avoid disappointing people who are interested in what we are doing.

The ITIs have some compelling competitive advantages. Our people are from the industry, so we speak industry language and we are commercially focused. We have funding. The minute we do not have funding, we are dead in the marketplace and people will go elsewhere. Keeping a sense of commitment, with everybody involved pointing in the same direction, is critical to the long-term success of the ITIs.

The Convener: We have read in the press this year about the board of Scottish Enterprise. You are still under Scottish Enterprise's umbrella and have to send back your business plan to it and so on. There will be some financial constraints on you because of that. Have those problems been resolved? Would you operate better outwith the umbrella of Scottish Enterprise?

Roger Dickinson: It is the nature of the business. We need to be credible to businessfolk. That requires us to have a degree of independence from public sector bodies. We also have a clear focus and remit. In the wider context, Scottish Enterprise's remit is much greater and it has other objectives to achieve. We are very grateful to Scottish Enterprise for putting us at arm's length from it, to a degree, when it founded us. It is essential for us to have credibility with the market that we serve, as well as credibility with our own staff. What attracted our staff to us is the fact that we are a commercial organisation. That is what they see us as and that is how our market sees us.

The Convener: Is that diplomatic language for, "Let's get out and get free of Scottish Enterprise"?

Tony Amor: We in the ITIs accept that it is essential that we have clear performance measures and are accountable for the money that we spend. We also accept that it is essential that what we do fits within a strategy for Scotland, so that everything is joined up. It is very important that we make that connection. Roger Dickinson's point, which I think we all share passionately, is that, to be successful, we must be able to do the job that we have been brought in to do, which is to apply rigorous commercial and business principles to the work that we are doing. We cannot allow that to be diluted by other stuff.

The Convener: I find it incredible that we can bring in guys of the calibre of yourselves and the board of ITI and tell them that they need to report to another board. Having operated in multinationals and SMEs in the private sector, I find that astounding.

Christine May: Of course, if you achieve your first objective, which you outlined to us earlier, and you are self-funding 10 years out, you will be freed from those constraints because in effect it will be your own money. The Government money will have gone somewhere else.

Following on from what you said about being oversubscribed, have you noticed any excitement being generated purely by the fact that you are there? If so, has that resulted in better-quality proposals coming to you, with activities that are more likely to generate joint support from the private sector?

John Chiplin: The intention is to be catalytic, if you will, and not to be too self-serving. The impression that the ITIs in our three areas have created in the community is largely positive. As we put the money to work in the marketplace, that impression gets even more positive because people can see that things are happening: people are being recruited and milestones are being hit in R and D programmes. I foresee that that forward momentum will continue for several years. I do not necessarily foresee a peter-out point but I do foresee the prospect of insufficient capital. The real issue is the quality of the deals and not necessarily the capital. If we do not fund a quality deal, it will go to Singapore or Ireland. What we have been busily ferreting out in our networks and in talking to people are deals of the appropriate quality. We will hit a point—we are not at it right now—at which the flow of quality deals exceeds the available capital.

David Creed: We are not yet in a position to know how much more money will be required, but we can say that our ability to pull down the money faster is a critical issue. With the best will in the world, there was an initial idea, with various

assumptions, about how the money would be spent year on year. However, we have moved a lot faster. If we are constrained by the original funding models, we will not have a problem this year, but we will certainly have one next year because we have already committed to a number of programmes and they might take us up to the limit of the money that we have available for next year. That brings us back to Tony Amor's point that that severely limits our ability to launch new programmes.

John Chiplin: We also need to take a leaf out of the private sector's book. The private sector has access to venture capital companies, so it has an amount of money on call. In some years it does not spend any of it and in other years it spends £50 million. If the good-quality deals are not there, we do not fund them. That is why you are not hearing us say, "We need more money." It is not as simple as that. It is about deal flow, deal quality and deal quantity.

David Creed: It is also about flexibility of funding, which is the key.

John Chiplin: Yes, absolutely.

Christine May: Earlier, you said that the quality of the deals is improving all the time. If I were you, when I got to the stage of saying, "We can't do this," I would go back to Government and say, "Look, we know from our previous experience that these are good deals. We know for a fact that if they don't stay here, they will go somewhere else." You have at least got a basis on which to argue much more cogently and with a greater degree of certainty that you are not just guessing and that that is a fact. You could not have done that before.

John Chiplin: If the quality is right but we end up hitting a brick wall, we will in effect have turned away our highest-quality deal. That would be a ludicrous situation for us to be in.

The Convener: Is there anything else that you would like to say?

Roger Dickinson: On business growth in general, one of the issues that arises as we go forward is not the funding that we need but the next stage funding that is needed for the start-ups, spinouts and so on that come from us. I know that you will address that with the next panel, but we see gaps in the funding vehicles and so on at the stage after us. We come earlier in the process. We wanted to record that point.

The Convener: I hope that we will solve that problem with Gavin Don and Gerard Kelly.

Thank you for your paperwork and your oral evidence, which was exceptionally helpful.

14:59

Meeting suspended.

15:04

On resuming—

The Convener: I resume the meeting without Michael Matheson, who unfortunately has had to leave, but with Jamie Stone, who has just joined us.

Mr Jamie Stone (Caithness, Sutherland and Easter Ross) (LD): An obvious improvement.

The Convener: It is not for me to comment on that.

I welcome to the meeting Gerard Kelly, head of investment at Scottish Enterprise, and Gavin Don from Equitas. Both witnesses are probably well known to committee members.

Gerard Kelly will give a presentation, which I hope he will keep reasonably short to leave plenty of time for discussion and questions. Gavin Don will then make a few introductory remarks, after which I will open up the discussion. Again, I want to make the meeting more of a round-table discussion than a High Court evidence session.

I am sure that Gerard Kelly will keep his presentation very tight.

Gerard Kelly (Scottish Enterprise): I will definitely do so.

As Scottish Enterprise has already provided the committee with a substantial submission, I thought that, instead of presenting more evidence from the investment perspective, I would walk the committee through some of the investment products that we have introduced over the past couple of years to give you a flavour of the type of things that we have been doing, why we have been doing them and where we intend to go with them. I hope to get through the presentation in less than 10 minutes.

Public sector investment has been around since the 1920s and certainly since the Macmillan report, which identified an equity gap in the UK when compared with America. It was believed that investing in that area would solve the problem of early-stage development. That provides the background to many of Scottish Enterprise's efforts in 2000 to 2002 to improve the early-stage investment market.

Just after the technology bubble burst, there was a significant downturn in the performance of the equity markets not just in Scotland but in Europe and America, and, indeed, throughout the world. In Scotland, there was a substantial reduction in the number of institutional investors, the amount of money that was being invested and the size of the deals themselves. By 2000 to 2002, the market for early-stage investment had collapsed in Scotland and business angels were the only people who were consistently investing in that market. When

we re-examined the matter, we concluded that we had to intervene to stimulate the private sector market so that it exceeded the levels that it had reached before 2000-01.

As Gavin Don has pointed out in his submission, the money invested in the early-stage market in Scotland as a percentage of gross domestic product has, over many years, significantly and consistently amounted to less than the money that some international competitors have invested. If we do not do something about that, we will seriously disadvantage our ability to stimulate economic growth. As a result, we have been trying to move the economy in a way that would improve the situation.

Our previous attempts to do that met with a lot of objections; however, our reasons for taking such an approach boiled down to two things. First, we wanted to get more money into the Scottish economy, because the volume of investable cash had dried up. Secondly, we wanted to get more investors into the economy. Obviously, if there are fewer investors, people are constrained by the number of deals that they can do. Our joint strategy was to get more private sector players to invest more money in more companies, because if those companies were able to grow, the Scottish economy would benefit as a result.

We approached the matter from two angles. On the demand side, we focused on improving the quantity and quality of investments in the marketplace by introducing an investment readiness support programme. However, as we also wanted to increase the amount of cash and number of investors, we built a new business growth fund, which I will describe later, and introduced the new and innovative Scottish co-investment fund, which partnered with the private sector rather than the public sector in doing deals. We wanted to bring in more partners who would invest more regularly in more companies in Scotland and, with this new approach, they could take the decisions and make the call on the investments.

As the propositions made by companies that are looking for investment are very often not of a quality that interests investors, the investment readiness support programme, which is operated through local enterprise companies, provides support and financial aid to allow those companies to seek private sector help in making their propositions more investable. I will provide the committee with some of its results in a moment.

The business growth fund had been introduced three years previously; however, we changed it from a loan scheme to an equity or loan scheme. The fund provides loans or equity of up to £100,000; the amount is at least matched by funding from the private sector, which could

include the owner's own equity. The fund's aim is to boost growth-oriented businesses' propositions for investment and their ability to secure capital to allow them to grow.

The money from Scottish Enterprise's brand new Scottish co-investment fund, which has been set up with £20 million from the Scottish Executive, matched by £25 million from the European regional development fund, goes to private sector partner organisations. They identify, negotiate with, conclude deals with and contract with the companies, and we syndicate with them on an agreed basis. The process is free of bureaucracy and is very slick. It provides capital when companies require it in a way that means that the private sector is leading the process.

The next slide shows the different products that we have introduced during the past two years and the effect that they have had. Through the investment readiness support programme, we have put in 312 grants and committed £1.2 million by way of support, amounting to leverage of £25.4 million of equity raised. There are other benefits in the form of quite substantial loans and grants, but I used the equity figure because that is what we are dealing with.

During the four and a half years that the business growth fund has been operating, we have done almost 250 deals. The public sector has put in £19.5 million, which gives leverage of a further £55 million, plus the private sector. That is all going into businesses in Scotland that are growing and competing.

The Scottish co-investment fund figures were completed about two weeks ago, so they are slightly behind. There were 93 deals in approximately two years in which £11.5 million of public money was committed, leveraging in a further £27.5 million of private money. If we compare those results with similar results for the United Kingdom as a whole—England and Wales have taken a slightly different approach with regional venture capital funds—we can see that the rate of investment per head is substantially greater in Scotland. We have had inquiries from all over the world—Sweden and other Scandinavian countries, China, Australia and New Zealand—about the co-investment fund approach. New Zealand has just committed itself to a co-investment fund. Sweden has also done so and is operating several such funds. The idea has been widely promoted—it has reached as far as Chile. A couple of people from Chile were in the country recently trying to understand the process. It has been a very successful model and has delivered direct benefits for Scotland.

The co-investment fund has a range of partners indigenous to Scotland, such as business angels Archangel Investments Ltd and Braveheart

Ventures Ltd. We have also brought in several new partners from outside Scotland that are committed to investing in Scottish companies and to bringing in additional money and new talent with investing skills.

We have a list of candidates who want to become co-investment partners but we do not have the resources to bring them in just now. However, we regularly update and review expenditure against plans, so we regularly free up resources in order to bring those people into the scheme.

The proof of the pudding is in the eating and during the past two years we have been able to invest in some of Scotland's most exciting young companies, giving them capital that they have used to grow. A recent report that was produced jointly with the University of Edinburgh business school showed that in our first year of operation, with 4 per cent of the capital invested in Scotland, we had influence over 44 per cent of the deals. The catalytic and cumulative effective of such schemes has been quite significant, even in the short time during which they have been operating. At the other end of the process, some of them have been able to go on to raise capital from other markets. Four of the companies that we have invested in during the past year have gone into the alternative investment market to raise additional capital for growth.

That is where we are at present. We have been investing quite heavily to stimulate the growth of the early-stage market in Scotland. While we have been doing that and the deal flow has been increasing, we have recognised that there is a growing need for capital that is not being satisfied by the marketplace in this round of development, which could impede the growth of businesses during the next few years. As my ITI colleagues suggested, a company in early-stage development that is seeking to move towards being a global competitor requires a quite substantial volume of capital. If the markets are not there to satisfy that demand, it is up to the public sector to stimulate the process in conjunction with the private sector. That is the key to creating more companies of scale in Scotland.

15:15

Throughout the inquiry the committee has asked how we get larger companies with a bigger economic footprint to maintain themselves and grow in Scotland. One of the secrets is for those companies to get the capital flow to take them all the way from proof of concept, through the development process and into becoming part of the mergers and acquisitions process, potentially by buying up other smaller businesses in Scotland or by growing organically in Scotland to become

one of the bigger businesses that has a substantial impact on the overall economy.

We have also identified an issue at the seed end of the process. As the committee knows, Scottish Enterprise schemes such as the proof of concept scheme stimulate the commercialisation of research at our universities. We have the Royal Society of Edinburgh fellowships, under which individuals are taken on and matured into becoming business leaders with their own companies.

The small firms merit award for research and technology and the support for products under research scheme exist to stimulate growth. As one gets further towards commercialisation of a product, the issue in the marketplace becomes the need to provide or raise capital. Some of our partners are beginning to step into that process. For example, Braveheart Ventures Ltd has a new fund. It works alongside the Bank of Scotland and the universities to co-fund companies that have won SMART awards. However, increasingly the issue is one of trying to get more companies to take up capital. Certainly, our view is that that is an area for the public sector to consider in the long term.

In December last year, the board of Scottish Enterprise discussed how to release more high-growth potential ventures and authorised us to look at the issue in more detail. Working through the board, we identified a second equity gap, as we have coined it. We identified that companies that we have been able to stimulate successfully over the past two years will shortly get to the point at which a lot of them will be looking for additional capital, probably in the £2 million to £5 million range. In Scotland, the market is not providing such capital in a meaningful way at the moment and, with the Scottish investment fund, we hope to return to the process and put a substantial fund in place. The Scottish Executive has earmarked £20 million for that process and Scottish Enterprise has committed £20 million to it. We are looking to raise capital from the private sector to match that; we hope to start off with something in excess of £100 million. The aim is to stimulate the growth of companies at that level.

Eventually, when we get the time to do so, we will look at stretched seed funding to cover issues that relate to the commercialisation of early-stage research. Collectively, we are talking about building in a process that will support the companies in which we and other businesses in Scotland have invested to date. When the outputs from the Scottish ITI system start to mature and flourish, the process will also cover the types of resources that those companies will require. Sophisticated capital will be in place to provide the money for them to grow, to put them in contact

with the markets and to stimulate the growth of the Scottish economy over time.

That was a short Cook's tour of what we have done over the past two and a half years. I would like to claim that what we have is probably the most successful early-stage intervention anywhere in the world—but I would say that. Genuinely, with my hand on my heart, I think that what we have done is ground-breaking. The people who should really take credit for it are not just those in Scottish Enterprise but all the private and public sector partners with whom we work and our European colleagues in the RDF who changed the rules to allow us to work in this way.

The next stage is the most difficult one. We need to take those companies from being small companies with huge potential to being huge companies that will go global but keep their roots in Scotland.

The Convener: Thank you. That was 13 minutes.

Gavin Don (Equitas): I will take up a little less of the committee's time in my introduction, but rather more of it in answering questions.

It is now generally accepted that economic growth is a function more of the investment ratio than of the economy. Our average trend growth rate is two to three points behind that of our peer economies and our overall investment ratio is perhaps a quarter of that of our peer economies—certainly, it is half that of the United Kingdom. The two are connected. Investment ratio as a whole is not just investment in young companies but in all value-creating fixed assets, although investment in young companies is a key part of that. As the committee saw from Gerard Kelly's figures, we are perhaps at 25 per cent of, or 75 per cent below, the numbers that we should be at. The business growth issue is about solving that problem, which will not solve itself. We have to look at why it exists, which is for a complex blend of reasons.

One reason is that the people in Scotland have a perception problem when it comes to the creation of businesses, which is driven, not least, by the fact that they think that three quarters of all young companies die within eight years. In fact, three quarters of young companies survive, but the mortality myth is endemic. When someone sits in their kitchen with their spouse and says, "I want to start a business because I'm fed up working for someone else," their spouse's instinctive reaction is that they must be mad because three quarters of new businesses die within whatever number of years the myth that they have heard has told them. The fact that starting a business is perceived to be a pretty stupid thing to do is the killer right at the start of the process.

People who get over that first hurdle then face the problem of where to get the money. The

Scottish population is not intrinsically rich—we do not have a high density of wealth—and it costs money to start a business. A service business of modest ambitions can be started for a few hundred thousand pounds, much of which might be bank debt and retained profits. The price tag for starting an interesting high-growth business can range from £10 million to £60 million. I am not talking about life sciences businesses, which cost £100 million to start. Starting an interesting growth business costs a lot of money.

As Gerard Kelly's numbers show—I have been researching the numbers for five years, too—we live in an economy in which there is a dearth of investment flow. Our flows are roughly 10 to 15 per cent of what they should be according to the OECD average. In a bad year, they are at 10 per cent of the OECD level and, in a good year, they are at 20 per cent. I think that 2004 was a good year and 2005 has been a reasonably good year so far. However, investment is still 80 per cent below the level at which we should be working. That gap has to be filled at every level. I am talking not just about middle-size investments, but about seed capital, middle-stage and early-stage development, large and small businesses and high, low and medium-growth enterprises. The problem stretches right across the board and it cannot be solved by waving a magic wand. We have to find a source of hard capital.

What are the sources? Scotland has a second problem, which is that, in comparison with our peer economies, we are quite poor as regards personal wealth. The density of investable wealth is much lower in Scotland than it is in the United Kingdom. I will give a numerical example. If we add up the richest people in the UK to reach a net worth of £20,000 million, we need three people. If we do the same for the USA, we need half a person. To reach the same figure in Scotland, we need 1,500 people. In other words, the richest 1,500 Scots produce the same amount of investable wealth that three people in England and half a person in the USA can provide. We cannot just shake the trees to find rich people whose portfolios are invested in unit trusts. That is not the answer.

I would like to shake the financial institutions. Some large and powerful financial institutions operate in Scotland. Our largest and most powerful institution left the market unilaterally three years ago—in about 2002, the Royal Bank of Scotland made a policy decision not to work in the market. It is quite encouraging that the Bank of Scotland still works in it, but the fund management institutions do not; they are not interested at all. We do not have the corporates to fill the gap, because we keep selling our corporates. Investable wealth comes from rich, mature, privately-owned corporates rather than from

foreign-owned corporates, which send the investable money back to the home base for investment somewhere else on the global scene.

We have a complex situation, which is a pipeline of solutions, problems, errors, mistakes and opportunities. Some of the problems have been solved. Up until 1994, when I started my practice—I am not saying that things changed because I started my practice—Scotland had an incredibly hostile emotional reaction to entrepreneurship. If someone had asked a schoolteacher in 1994 to take an entrepreneur into their classes to talk about business, they would have been shown the door quite aggressively. The attitude would have been, "We are not letting one of those in here, thank you very much." That has changed—that part of the problem has been solved. Among people aged up to about 38, the attitude is that entrepreneurship is a good thing for society, but the over-40s are not too sure about entrepreneurs or think of them as a bunch of shysters. The change in 1994 is reflected in the attitudes of people in those age brackets.

The problem of the raw amount of capital that is available in the market has not been solved. We are running at about 20 per cent below our capacity and we need somebody to take the lead on the next bit of the problem that we want to solve, which is the one to which Gerard Kelly pointed: what is going on inside young companies?

Inside the young company world, we have a good tranche of emerging seven, eight, nine and 10-year-old companies that are finding that they now need another £5 million to £25 million to exploit the opportunities that they have created. It is like someone who has discovered an oil field, but does not have the capital to exploit it. At the moment, that capital does not flow in the economy so, quite rationally, the companies look outside the economy and, quite rationally, the suppliers of that capital say, "We would like to buy the company, please. That is our price for providing the capital." That produces a nice headline and a £30 million exit, with three business heroes getting prizes at the next awards event because they cashed out £10 million each. However, five years later, that company is somewhere else. All the value added from the first 10 years of work has emigrated. That is the next problem that we need to solve.

I have probably talked for long enough, convener. I am happy to take questions on what is a complex problem.

The Convener: Thank you both; your presentations were very helpful, as were your submissions.

Murdo Fraser (Mid Scotland and Fife) (Con): Access to capital is at the heart of the business

growth inquiry that the committee is considering. You were both at the round-table session that we had in Dundee at which, it is fair to say, there was a frank exchange of views on how risk averse Scottish financial institutions are. As the convener said earlier, he and I had dinner last night with representatives of a certain financial institution that we will not name, who took great exception to my putting it to them that they were risk averse. How difficult is it to deal with Scottish financial institutions and to persuade them to invest in the Scottish economy?

Gavin Don: It depends a little on the institution and on what one might call its attitude to corporate social responsibility. However, I will name names. I put that point to senior bankers with the Royal Bank of Scotland, and the standard Royal Bank response is, "Our job is to invest the shareholders' money. We are not here to help the economy." As far as it goes, that is a fair response. Behind that lies a perception that what we are talking about is very risky, which is partly driven by the mortality myth—bankers believe in the same mortality myth as the rest of the economy, which is that three quarters of what they invest in will go wrong—and partly driven by a perception of time, which is driven by financial engineering and property transactions. That perception is that it is a good idea to get out after three years in a deal. If one can get out of something with a profit after three years, that is a good risk.

The world that we are talking about has a 10 to 15-year play with very high growth rates and results. However, the people to whom one talks are not empowered to look 15 years ahead. To be fair, even the chief executive of the Royal Bank probably does not feel empowered to do that because he is driven by next year's earnings, as are the rest of his team.

When bankers say that something is too risky, they actually mean, "We think that 75 per cent of that investment will fail". In fact, it does not, but the bankers do not know that yet. They also say that they are not allowed to take a risk for 15 years, with companies dying in the first five years, followed by another 10-year wait for the good ones to show themselves to be good. It is very hard to get round that reaction because one is fighting against the deeply embedded perceptions of reality in banking. The mutuals are worse because they say, "We're not in business to take risk; we are in business to invest the money of our pensioners and policy holders, and although we are empowered to take 15-year views, the area that you are talking about is incredibly risky."

The Bank of Scotland looks ahead a little, because it has a residual sense of responsibility to the economy from which it came and it feels that it is part of Scotland. Senior people in that bank feel

that they are the richest guys on the block—well, the second-richest now—and it is their job to put something back. They know that it works because they have taken some long punts in the past that have worked out. The Bank of Scotland is much more entrepreneurial. It is the perception of mortality and time that is in the way.

15:30

Gerard Kelly: Gavin Don described the traditional view. For good business reasons, people have adopted a strategy that will benefit their shareholders, which is understandable. We have consulted widely on the Scottish investment fund—we have talked to more than 100 organisations and individuals in the process. We have noticed a change in attitude among some of the banks and institutions towards wanting to become involved in our processes. I am not saying that they have committed themselves to anything, but they have shown an interest and a willingness to have further discussions about the possibility of involvement.

One issue for those organisations is that the markets' financial performance in the past few years has not been particularly good. Many people who invested in the likes of venture capital funds lost much of their investment, or at least did not receive much back, because the technology bubble burst. People using the traditional ways to interact with the sector have not made the returns that were hoped for.

We would construct the Scottish investment fund with a longer-term approach to returns on investment that is based more on dividends than on internal rates of return models, which is the typical way in which venture capitalists operate. The organisations need to make a commitment and to be convinced that they will receive a financial return. As Gavin Don said, there are economic and moral reasons to participate. If we combine those factors in a fund that provides returns and has an economic impact on Scotland, we are mildly optimistic that we can involve some of those people for a variety of good commercial and economic reasons. Being Irish, I am probably more optimistic than I should be, but I think that we can see a way towards making more of the capital that is managed in Scotland work for the Scottish economy.

Murdo Fraser: Gavin Don's paper suggests creating two or three large long-term private investment funds and using public money to catalyse them. Given what you have said, are you confident that if we went down that road, enough private capital to make such funds work could be attracted from all the institutions that we have talked about?

Gavin Don: That question is very challenging. My answer is that a combination of elements is needed. An example must be set: you must be out there in front with your cheque book, I am afraid. Facts are required, which means that people must listen. Sometimes, people do not want to listen to the facts and they refuse to consider the evidence. A little bit of moral persuasion and perhaps even blackmail is needed—an element that would say to the five, 10 or 15 biggest strategic decision makers for the funds that we are talking about, "Look, you guys. You live here. Your people live here. You want to have a high-value economy from which to draw people into your business in future. You want to go home and not be vilified by your society for being completely indifferent to what is happening beyond your corporate gate. You want to be corporately and socially responsible. This is a chance for you to do so and to make money."

We are not talking about charity. Such people's attitude to the subject is that they will do a bit for the good of the economy but they will write off the investment on the day on which it is made. Such activity is not charity. The largest fortunes—both personal and corporate—are made by those who invest for the long term. I will give a domestic example. Sir Angus Grossart started with practically nothing in 1965 or 1966—about 40 years ago. He now has a net worth of £85 million, which was built by taking 20-year punts on companies such as Stagecoach and the Wood Group. That approach works, but people must be taught that it does.

Gerard Kelly: There are good examples of the process working domestically and overseas. I will refer to two instances that overlap, in a way, with the ITIs. In 1992, Scottish Enterprise invested £250,000 in Wolfson Microelectronics, which is a technology firm. When it went private on the markets, we recouped in excess of £20 million from our £250,000 investment. Everybody else who invested in that company made substantial returns on their investment, because it was a good investment in a business that had real good management, real good technology and a real good understanding of the marketplace. The firm succeeded because people were willing to invest in it over the longer term. It took the firm more than 12 years to become of sufficient strength and value to have that impact on the marketplace. That can happen domestically.

I was involved with the team that set up the ITIs in the first place. One of the things that convinced me most was a company just outside Toronto called Research in Motion Ltd—RIM—which produces the little BlackBerry devices. It started off on the back of a scheme that was very similar to the ITIs. People were willing to invest in new technology and to support the company over the

longer term. It is now a multi-million pound business. It floated and gave \$100 million to a university to produce PhD students who are used to create the new sources of technology that go on to develop businesses.

If you get capital inflow into the right kind of companies and provide them with the right kind of support, you can have a dramatic impact. The first company was committed to Scotland and the second company was committed to Toronto. If you want to have such an impact, you must invest for growth. We have to create an environment and an infrastructure in Scotland that will take businesses all the way from the research stage through to the stage of initial public offerings but which will keep their roots in the Scottish economy because they are big enough, ugly enough and financially strong enough to stay.

Shiona Baird: I find the discussion interesting. I have been to only a few Enterprise and Culture Committee meetings as I have just joined the committee, but there seems to be a huge gulf between abstract theorising about business growth and what is happening on the ground. When Gerard Kelly was talking the discussion was abstract and I wanted real examples of what is going on; Gavin Don brought it more down to earth, so to speak.

It seems that we are still not making the connections. What are we looking for in our economy? Are we here to support just the nice, clean hi-tech jobs? The jobs that quite a few entrepreneurs want to create are being held back by rules and regulations. For example, the promotion of biofuels is being held back by the Clean Air Act 1993. There needs to be investment in sewage sludge so that it can be used for other purposes, rather than being dumped into the sea. Such developments are all being held back.

A company in Dundee wants to expand and it has been trying to negotiate with Scottish Enterprise for assistance to buy land. The fact that there are so many constraints makes it difficult. We keep saying that we are not a country of entrepreneurs, but we are and we have been historically. How can we bridge the gap and provide support for businesses that are failing through no fault of their own? I am thinking of paper recycling companies that are going down at a time when we really need them. How can we be more aware of the impact of rules and regulations on small businesses that want to get into the market and keep going?

Gerard Kelly: I have to answer the second question by saying that Parliament has as much effect on the discussion about planning rules and regulations as Scottish Enterprise.

Quite a few of the companies that we have invested in are in environmental technologies. For

example, Envirocon in Renfrewshire is a recycling business. We recently put direct investment into Envirocon, which is an attempt to create offshore wind farm activity. We are investing in a variety of other organisations that are not technology based but are in traditional manufacture. We are putting money into a range of companies that have growth potential. The Scottish co-investment fund has a number of partners that are specifically interested in renewable energy and how to promote it. We are, from an investment point of view, picking up the message that there is a commercial market for that type of activity as well as an economic good to be achieved. We are trying to get benefits from being able to change the shape of the economy and move it in that direction. Progress is slow, but there is progress nonetheless. As those businesses prove themselves to be capable of generating sufficient revenue, more investment will go into the sector, more companies will be established and we will be there to support them.

Shiona Baird: Does Gavin Don have anything to add?

Gavin Don: Well, I live in the private sector, so if you are asking me whether I would vote for a bonfire of the regulations the answer is yes, with both arms, tomorrow. You are right. Every field of endeavour has regulatory tripwires in it. We live in a regulated world and, as an entrepreneur, you just have to work your way round them as best you can. If you can remove them, that is great.

As a class, the regulations that give entrepreneurs the most headaches—serious, life-threatening headaches—are employment protection laws. I am an employer and I know that most employers will spend perhaps 10 or 15 per cent of their time dealing with and worrying about employment protection issues. When you hire any new member of staff at any level, you know that you are writing a deferred cheque for £10,000 for when you want to remove them, so you do not hire quickly if you can avoid it, because there is a long-tail liability. For every person you hire, you know that you will one day end up paying £10,000 to them, one way or another, when you want them to go.

I will give you an example of an extreme case. Last week, one of my clients had a member of staff who resigned and went off to a different job, and even she is saying that she would like some compensation. The chances are that they are going to have to pay her, because she has the right to raise an action on grounds that are fundamentally spurious, but she will get something out of them and they will spend a day or two worrying about it. Let us leave that to one side.

My private sector head says, "Well, actually you can mollycoddle young companies too much." It is a bit like growing a tree. If you plant a young tree

and cover it up with weather protection devices to shelter it from the elements, you will get a fast-growth tree, but the minute the elements hit it, it will die. You have to let trees get a little bit of robustness from learning to cope with problems early in their lives, otherwise they just grow up weak and feeble, expecting to be mollicoddled.

I would not tear up all the regulations—maybe just half of them. We cannot solve all the problems in one go either, but let us deal with those that we can.

Susan Deacon: I wanted to ask Gavin Don a couple of relatively specific questions, but he has said much in his paper and in his written evidence that lends itself to free-flowing discussion. It would be ideal if we had a free-flowing bottle of wine to aid that discussion, but I will resist that temptation. I was interested to note that you highlighted the mortality myth as one of your two key points about where to go from here. I would like you to elaborate on why you believe that to be all-pervasive, and how you think that we can dispel something like that. It is quite difficult to get your hands around it in a way that allows us to have a tangible discussion. We can have a tangible discussion about investment, but not about that contention.

Gavin Don: The mortality myth is pervasive because everybody thinks that that is the way it is. Every press article that you read, every website that you read and even the banks' websites with advice on start-up businesses all state that three out of four will fail within a period that varies from one to five years depending on where the myth has come from. In extreme cases, I have seen websites saying that nine out of 10 businesses fail in the first year. I am sure that you will all have heard that or read it in newspapers at some point. It is an urban myth. It lives in everybody's consciousness. Every press article that covers the subject will have that as a strapline. Even presentations in this forum will say something about starting businesses being risky.

It is part of the systemic belief about what it is like to start a business. We reinforce that belief culturally by awarding prizes for success—and I think that prize ceremonies are great and I am a great believer in rewarding success—but the subtext of every prize ceremony for entrepreneur of the year is that it is bloody hard being an entrepreneur. It is actually not very hard being an entrepreneur; it really is not. It is not dreadfully easy, but it is not really hard. When you look at some of the complete idiots that you find running companies—naming no names, but there are individuals whom you probably know—you think, "How does he or she manage to run that business? This person is actually pretty thick, or even incompetent, but they're still running a

business." Running a business is not that difficult. That is one of the great secrets. It looks awfully difficult because the myth says that three-quarters of businesses die very quickly.

I think that that answer provides some background on why the myth is systemic. Even the United States Small Business Administration, which you would think knew what it was talking about, used to have on its website the statement that three out of four new companies die within three or four years. It removed it last year when it was pointed out—with some robust proof, which is coming out at the end of this year in a paper that I am writing with John Levy—that that is a complete myth. We can talk about the evidence if you like, but we may not have time right now.

The second part of your question was, I think, about why the mortality myth is important or why it is so lethal.

Susan Deacon: I wanted to know how you would disabuse people of that notion.

15:45

Gavin Don: We do it like a marketing exercise. There is a population that is firmly in the trench of brand A, which is the belief that three quarters of young companies die within one to four years. We must persuade them to believe that three quarters of such companies do not die within that period, but live for over eight years. That is a fact; I would not be persuading anyone to believe a myth.

We can market that fact by, for example, writing about it in the press. I talk to journalists all the time, just as I am talking to you. When a trusted source refers to the fact—I hope that you trust what I am saying; I can show you proof if you do not—then the next time you have a conversation about the myth with somebody, you can echo the fact. Gradually, the fact will permeate. That can take five, 10, 15 or 20 years, but it will eventually happen.

We can speed up that process. It would be great, for example, if Gerard Kelly felt that the issue was so serious that public money should be invested to market the myth's death. Putting information on television and in the newspapers would also be great. We could also put it in seminars and training courses, and the committee could tell Fred Goodwin about it when it next sits down with him. It is a case of constantly dripping the truth and wearing away the myth. I wish there were a faster route.

Christine May: This has been interesting and I could ask all sorts of questions. Let us suppose that we have Gerard Kelly's new fund for the maturing ITI system, and that we have got rid of the mortality myth and the philosoraptors and the bloatocrats—although everybody thinks that

politics is easy and that they could do it, being a politician is very, very difficult; we could tell you all about that. However, suppose that we have done what I said, do we need to do the intangible stuff to which Shiona Baird referred? Does the Government and/or the business sector need to do something to get the sort of attitude that says to HBOS, the Royal Bank of Scotland and other institutions that this is a good place in which to invest their money?

Gerard Kelly: The Scottish co-investment fund has been successful for a number of reasons. First, it works like a private sector product. There must be a commercial deal that satisfies the fund's partners that they will like the outcome. Secondly, the public sector engages with that by facilitating the process and keeping bureaucracy to an absolute minimum. Thirdly, there is a cultural aspect that is about our trying to work as professionally as we can to deliver a product that does what it says on the tin. When we say that money will be available to companies with high potential in a way that will be a good commercial investment, but will also bring economic benefit, that is exactly what happens. If we are seeking to replicate that in any products that we have, it must be this public-private partnership writ large. We must be committed to what we are good at doing and the private sector must be committed to what it is good at doing, which is investing and making money available. It is about working together to achieve the same goals. However, as Gavin Don has said previously, we often have the same goals but disagree about what they mean. If we can agree on that, it makes the process a hell of a lot easier than it would be otherwise.

Gavin Don: On the large scale, the public sector and the Government, but not many others, could probably get the big things out of the way. On the small scale, the Government could tinker with business rates and with 57 different things in detail to get them out of the way. However, in practice that will not happen, so I will not waste the committee's time by listing the 57 things that I would like the Government to change in the next week. However, I will give an example of something that is, sadly, not within the committee's or the Scottish Parliament's ambit, although I believe that it should and will be within the next decade or so.

Let us say that a 10-year-old company is beginning to work and that one of its owners is beginning to make money. He could be sitting on an asset that is worth £30 million or £40 million, of which he owns a quarter, while his partner, another investor and the staff own a quarter each. Therefore, our owner is sitting on enough money to give them financial independence for the rest of their life. They take out £1 million a year as income, which is taxed at 50 per cent. However, if

the business was sold and they got £10 million from that, it would be taxed at 10 per cent. Most rational people will quickly take the 10 per cent route if there is a problem. Should you push the business forward through the next grinding stage of growth, which will be capital constrained, or cash in, pay a million quid, bank £9 million and have some fun? Resisting the temptation to bank £9 million and have some fun is incredibly hard. If I could, that would be the one thing that I would change tomorrow.

The Convener: From previous evidence and from today's, there is consensus that access to capital is a major issue. Obviously, investment by the Prince's Scottish Youth Business Trust is on a much smaller scale than that which we are discussing. The trust was set up in the United Kingdom with £80 million and help is targeted at 18 to 25-year-olds, which is a very high-risk market. The public sector has matched pound for pound what has been put in by the private sector and we have ended up with a revolving fund and a 20 per cent bad debt ratio, but the loan has helped to set up 10,000 businesses in Scotland, many of which survive and are prospering. Some businesses that are said to have failed have not failed at all, but have simply been sold on by the young person, or the young person has been offered a much better job and, in effect, been bought over.

Essentially, Gavin Don is saying that we need a large-scale PSYBT on a private-public basis for the adult population. However, is not scale the key issue? Gerard Kelly has spoken about the success of the proof of concept fund, the growth fund and the Scottish co-investment fund in the past few years, but, in truth, total investment has been peanuts compared with the figures that Gavin Don has highlighted—he spoke about investment being 80 per cent below what it needs to be. Is it not the case that we need not only one private-public sector fund at least, but a fund that is worth hundreds of millions of pounds rather than tens of millions of pounds if we are going to be at the races?

Gavin Don: Absolutely. It is wrong to conclude that the work of Gerard Kelly and SE can be described as peanuts, as we are talking about something that represents roughly 25 per cent of the market. The market is 80 per cent too small, but there would be no market without that 10 years' work and we would be now where we were in 1994, with £10 million to £15 million flowing around and 99 per cent below capacity. We have solved perhaps 15 per cent of the problem, but we must solve the other 85 per cent of it.

Hundreds of millions of pounds need to sit in the machines. I do not see the £20 million that you are talking about as anything more than an example or

catalyst to persuade the 10 largest institutions, private companies and family funds to come into something that is worth perhaps £200 to £300 million—there is a handful, or five fingers' worth, of very rich family funds in Scotland. That is not the answer by itself, but will take us forward to the next step, which I think is required because in principle I believe in competition rather than in monopolies—although it would be great to own a monopoly. A third step is needed after that.

We should not try to solve all the problems at once—we must remove the blocks along the pipeline one by one. Some psychological blocks have been removed. The PSYBT is fantastic and removes a little block at the start of the process for one kind of company. The next block that needs to be removed occurs when companies reach a £20 million, £30 million or £40 million value, but have not stopped using new capital. They still have the opportunity to use £30 million, £40 million or £50 million of new capital, but there is nowhere in Scotland for people to get that at the moment. The alternative is to sell their £40 million asset and pay 10 per cent tax. People have nowhere to go except to pay a 10 per cent tax charge and obtain financial freedom. Which route will be taken? At the moment, that situation is pushing a flow of interesting companies—the names on the final slide in Scottish Enterprise's presentation are only a sample of the interesting companies that have been created—into the hands of non-Scots. Stopping that flow is urgent.

The Convener: And I notice that you recommend that taxation be devolved.

Gavin Don: Absolutely, but this is not a political forum. I might add that I am not a Tory, or anything else for that matter—I am a businessman.

Gerard Kelly: Your point is right, convener. There is a need for more entrepreneurs, more investment and more companies across the board. PSYBT has been a great success on that front. To pick up Gavin's point, the market changes substantially from group to group in terms of the companies' sophistication, the rules and regulations, and the skills that are available to those who run the companies. It is difficult to have a one-solution-fits-all approach.

One of the reasons why we were driven down the co-investment fund route was that, as a public agency, we have to work on a purely commercial basis. If we do not, we have to apply to Europe for derogations which, if you look at the English schemes, take up to two and a half years to move on. We went to the private sector and said, "We want to work in partnership with you. Would you prefer it on a purely commercial basis or would you prefer subsidiarity or guarantees," and they said, "Purely on a commercial basis, because

you're taking the same risk at the same time as us."

There are many complicated issues. Even within local enterprise companies, Scottish Enterprise maintains the right to provide capital to companies of up to £50,000. Shortly, we will introduce a single product across the whole of Scottish Enterprise which will, for the first time in a long time, give companies access to capital on a single basis, which should help the process. Anything that goes into the system and gives more companies the capital that they require can only be a good thing.

However, we have to ask where the money is going to come from. It should come from the private sector, because they are the people with the volume of resources to do it. Ultimately, the job will be for the public sector to stimulate that process, rather than substitute for it. Our interventions have to be about promoting and developing the marketplace in a way that brings commercial benefit to companies and investors, and also brings the economic returns for which we are looking.

There are many answers to the question, and the situation will not be fixed with just one. We need to get the full range, from early stage through to larger company growth, working actively. As an economy, Scotland has all the attributes to be among the best in the world.

The Convener: That is a good point on which to conclude this evidence. Thank you both for your excellent oral and written evidence. You have given us a lot to think about.

I introduce Peter Syme, David Sigsworth and Ricky Muir-Simpson from ACM Catalyst. I believe that you will give a brief presentation, Ricky, then we will open it up to discussion and questions. As I did with Gerard Kelly, I ask you to keep it as tight as possible. He did not keep it as tight as I would have liked, but I am sure that you will.

Ricky Muir-Simpson (ACM Catalyst): I will do my best.

Convener, ladies and gentlemen, we have listened a lot this afternoon to the point that Scotland is smart, but not as smart as it should be, and that it is a long way from being as commercially successful as it should be. We believe that the time is right for a new business-driven approach that enables that success to be achieved. To set the scene, first, we practice what we preach. Our company's objective is the building of successful businesses through the provision of intensive day-to-day management. Secondly, our selection is driven by the commercial strength of the case. We are not influenced by tax breaks. Tax breaks benefit only the investors, not the company.

We are all aware of Scotland's historic inventors: James Watt, Joseph Lister, John Logie Baird, Robert Watson-Watt, Sir James Black and many others. The fundamental interest in novelty continues. While universities and corporate projects normally have predetermined objectives, timetables and budgets that are carried out by project teams, the private inventor continues in glorious isolation and is driven by his or her own motivations.

16:00

The shocking statistics speak for themselves. We collectively neglect at our peril the growth in private patent, the failure to commercialise all patents and the assessed loss to the Scottish economy. I would like to give two examples of dormant UK patents that succeeded. The first is for lithium ion batteries, which we all use every day in our mobile phones, personal digital assistants, laptops and cameras. The chemistry for them was invented by a British company but remained completely dormant until a Japanese company picked it up. The second is magnetic resonance imaging—MRI—scanners, the patent for which lay dormant until an American company picked it up.

From this point on, the private inventor takes front of stage, as collectively they are the largest source of innovation—but the one with the lowest commercial success. There are four Scottish players with varying degrees of interest in private innovation: inventors, progressive companies, the private financial sector, and the public sector. However, they all have varying degrees of self-imposed tunnel vision.

At best, those four participators speak at one another while not managing, or in many cases not even attempting, to understand what the other is saying and not making any allowance for their needs and motivations. At worst, their restricted vision comes close to a positive obstruction hidden behind overregulation, too many confusing initiatives, and massive inertia when it comes to lateral thinking.

The following may be of note: over the past 20 years, Scottish institutional providers of private equity have fallen from approximately 28 to eight; and business angels have moved their investment range from a mid-1994-95 figure of £10,000 to not less than £250,000 to £500,000.

Match funding is closed to inventors. I emphasise both match funding and inventors: in 99 per cent of cases inventors have no money, and therefore they cannot match.

Finally, the banks, despite Gavin's comments, do not provide risk funds. They have been further restricted by the new roles that have been applied

to the small firm loan guarantee scheme; that makes it even more difficult to get in. Please be under no misconception: the baseline equity gap is alive and virulently damaging.

Having spotted the problem, what do we need to do to solve it? We must recognise now that it is essential to establish an entirely different approach that links appropriate inventors to commercially strong, forward-looking businesses. Unless circumstances change, the annual £16 billion loss to the local economy will be perpetuated. There has to be a matching process in this challenging arena. It has to be orchestrated by an outsider; by that I mean someone who is neither the inventor nor the commercially interested party. A hub management company should be made up of experienced managers who fully understand the needs of all sides. Most important, however, is that they command the respect of the other players.

An outstanding example of corporate venturing, under which such a hub company would nestle, is Intel. Intel commits up to \$300 million annually to inventions and to new start-up companies. No UK company comes close to that. The implementation starts and ends with the hub managers driving the commercial process every day. As far as we can establish, no Scottish financial institution, venture capitalist or business angel group uses that approach.

Comments from major companies in Scotland and the rest of the United Kingdom indicate that our company is leading the way and proving the principles through its actions. It therefore gives me considerable pleasure to read the following endorsement from the Weir Group, and I quote directly from a release that the group has authorised me to repeat:

"Weir Services are very interested in the capabilities and technology of ACM Catalyst's client and are actively investigating proposals to invest in the future development of the business.

This sort of corporate venturing provides an innovative and attractive way for the Weir Group to develop its own capabilities and technology, while harnessing the expertise of small start-up companies with the global reach and experience of an international business."

To my way of thinking, that means that everybody should win as long as the process is managed properly.

Over the past two years, we have seen well over 100 opportunities. Our company's take-up capacity has been significantly curtailed by its lack of funding from all existing sources both for itself and for its potential clients. On this side of the table, we know exactly what it means to suffer from the equity gap. We believe that corporate venturing, as implemented by us, is the mould-breaking channel for smart Scotland to be

successful. We would like to explore that idea with the committee and we are happy to answer any questions that members may wish to put to us.

The Convener: In the discussion, we want to focus on the process and concept of corporate venturing. We cannot use a parliamentary committee as a sales pitch for an individual company. Let us stick to the principles.

Ricky Muir-Simpson: I appreciate the point, but principles have to be illustrated.

The Convener: Absolutely.

Mr Stone: I am interested in what you say about the apparent absence of the banks. I find that rather curious, although I do not contradict what you say. When I was a child, the local bank manager had a certain amount of power to take a risk or have a bit of a punt on a business; that is how businesses grew and how banks prospered. What you suggest is happening seems to contradict the fundamental philosophy of expanding banking business. Why is it happening?

Ricky Muir-Simpson: We have a heavy regulatory regime. As you say, the opening of a bank account used to be driven by the manager's personal judgment, but there is now no such thing as a local bank manager with authority. Everything is computer controlled and driven, and forms are filled in. Credit is assessed by a credit committee that never meets the client, the management or anybody who has anything to do with the business. As a result, the process is wholly dependent on the liaison between a representative of the bank—who never has the capacity to commit—and the company. The bank representative is driven by the regulations that the bank has imposed, so the concept of personal judgment is lost.

I accept that the situation is somewhat different when someone is dealing with buyouts worth tens or hundreds of millions, but at the lower end of the scale, direct liaison has gone. I will give you a small example. When we opened a bank account for one of our clients the other day, we were offered a relationship manager in Inverness. I ask you, what use is that when we are based in Stirling? We never meet the person, they are a voice at the end of the phone, and the voice changes every time.

Mr Stone: What evidence is there that things on the banking front are done differently in Norway, Ireland or the United States of America—or in any other country that you care to name? Is this a global disease, or a British or Scottish disease?

David Sigsworth (ACM Catalyst): I have been involved with the Executive's energy groups through the forum for renewable energy development in Scotland. I also chair an

investigation into the hydrogen economy and fuel cells, and their use and support in growing the Scottish economy. A key point to emerge from that inquiry concerns the blockages that we have heard about: Government sources cannot invest beyond a certain point because of state-aid rules. Many of the people in the marketplace who are trying to drive forward their businesses in the sector claim that other European economies find ways round that are different from how the rules are applied here. That may be just a perception, but the group that I chair will explore and present in its findings the differences for that sector.

Murdo Fraser: Your submission refers to the success of corporate venturing in the USA, where it is an established part of the mix to provide capital to company growth. Is corporate venturing in the USA purely private sector driven or does it have a public funding input?

Ricky Muir-Simpson: Corporate venturing is principally private sector driven, but it includes pension funds in a big way. A small example is the California public employees retirement system, which is the Californian pension scheme. That is worth \$185 billion and 8 per cent of it is invested in private equity in one shape or another. That is the clearest differentiator that I can give.

The lion's share of corporate venturing comes from and is driven by the corporates—the Boeings, the Intels and the Microsofts of this world—which receive support from the VC houses, because the question whether somebody wants to invest in a company alongside Fred Smith or alongside Microsoft and Intel is a no-brainer, to be blunt. Does that answer your question?

Murdo Fraser: Yes. That leads me to a second question. Why is it difficult to persuade similar blue-chip companies in the UK or Scotland that such investment is a good idea?

Ricky Muir-Simpson: I will pass that question to Peter Syme and David Sigsworth, who are in a position to answer it.

Peter Syme (ACM Catalyst): The question is fair. In a limited way, we manage to generate such interest. We have two—potentially three—high-tech start-up companies in which three UK public limited companies have a serious interest. By serious interest, I mean that the plcs are very interested in investing in those start-ups. They recognise that by investing sums that are relatively modest but are significant to the start-ups, they can grow those businesses far more quickly than those small companies could on their own.

I refer to only two or three companies because the company in which I am involved—ACM—has virtually no funds. Ricky Muir-Simpson has had about 100 people through the door to say, "I have a great idea. Please help." Our funds are relatively

limited and small, so we cannot put as much effort into developing such small businesses. We must be selective. Because of ACM's contacts, we have been able to introduce the companies that we have identified commercially as having a good and innovative product to the properly focused plc that has recognised a good idea. We now have three plcs that want to invest a small amount of money in and to develop those companies. That is terrific. To be blunt, in the short term, money is not needed for that. However, money is needed to bring companies to that stage, and that funding is not available.

David Sigsworth: Murdo Fraser asked why corporate venturing has not happened in the UK when it has happened in the USA. Our submission tries to bring out the fact that many inventors have personalities that mean that they cannot deal with the commercialisation process. Many things other than money that are offered to them are supposed to help them to reach the point when they can make those steps. Often, they cannot do that or that takes too long. The vehicle that we are trying to establish and which we hope to have replicated is a new type of agency that would help such people and hold their hands. It might write business plans for them and help them to present such plans and to understand what corporates will need to be able to progress, because our experience is that that is totally misunderstood.

Just a few months ago, I used to see things from the other side of the fence, when I worked for Scottish and Southern Energy. People would come to me to ask whether we would be interested in their idea, but we found that sole inventors and other small-scale set-ups just had not reached the point at which they could interest a company such as SSE, which did not have the time to invest in them. However, ACM Catalyst is a vehicle for dealing with that issue.

16:15

Richard Baker: You seem to be challenging other opinions that we have heard. Our inquiry has heard that people who come up with a concept that can be made into a successful company are sometimes reluctant to let go of the idea and that venture capitalists who would love to invest in ideas cannot find people who can manage them. However, your company seems to offer that management capability. Are you surprised that more venture capitalists are not flocking to your door? Is that because your company identifies ideas that have been missed by the venture capitalists? Would VCs require to be involved at an earlier stage in the process?

Ricky Muir-Simpson: There are two key answers to that question. First, the committee will not find it strange to learn that, if I had 10 grand for

every time that I have been told by VCs that I do what they do, I could have retired a long time ago. Having spent 15 years in the venture capital industry, I know from personal experience that no VC does what our company does. Therefore, yes, a certain amount of pride makes VCs think that they cannot possibly touch something if we have already touched it.

To answer your first question, we indeed provide the management capability that venture capitalists ask for but we find that, when we approach them, the ground rules change. A classic case is one of our current clients who is developing some extremely clever electronic technology that has massive international potential. When we first told VCs about the idea, they said that they would invest as soon as our client had a customer. However, when we phoned them up the other day to say that our client now has two customers, we were told, "Ah, well, come back and talk to us when you have six months' trading record." The problem is that we have a fundamental blockage in the system. Venture capitalists want to be the only people in control and, unlike corporates, they cannot get their heads round the idea of subcontracting the management of a company to someone else.

Richard Baker: That is not the experience in places such as the USA. Is that experience peculiar to Scotland?

Ricky Muir-Simpson: One example of a company that benefited enormously from US corporate venture capital is a biotech company in the west of Scotland. That company was kept alive because it was heavily backed by what is now GlaxoSmithKline. The institutions were happy for Glaxo to pour in the cheques and for their shares to be diluted, but they did absolutely nothing to help the company and left it to Glaxo to provide much of the skilled management input. Today, that company is profitable, with a turnover of £300,000 per employee, and it is still based in Scotland. That is one significant success story, but we have to bless the Americans for that.

David Sigsworth: We keep concentrating on capital as if it were the thing that is always required, but capital can be provided in third-party packages if the start-up gets orders from customers. However, even capital will not resolve the problem if the person with the idea is not thoroughly connected to his market in a way that enables him to access a stream of orders that will make the whole thing come true. In corporate co-venturing, whereby the inventor and the corporate have a joint interest in the idea's success, the corporate can provide the customer base that can form the basis of an order stream to drive the development of the product. Therefore, the issue is not always simply a lack of capital; corporate co-

venturing can also establish a fast order stream to get the new idea into the marketplace.

Christine May: That is an interesting point, which the committee has not heard before. I presume from what you have said that the interaction between large companies and smaller ones brings mutual benefits and that the original investor also gets something back. I would be interested in getting more information on Intel's approach, which you mentioned in your slide presentation. What does Intel do and how does it do it?

Secondly—this is my real question for you—if corporate co-venturing is a good idea for business, what role should the public sector have in that? As part of our inquiry, we are considering what the Scottish Parliament and Scottish Government need to do to encourage business growth. Corporate co-venturing sounds like a great idea, but it sounds like something that the private sector should do for itself.

Ricky Muir-Simpson: I will pick up the second point and let Peter Syme answer the first. We believe that corporate venturing lends itself to participation in the co-investment fund, but we have been turned down flat for that, because the fund required us to provide a list of 37 metaphorical investors that would back every project that we came up with. We pointed out that a biotech company requires different corporate backers from those that a chemical or construction engineering company requires, but, as we could not tick the boxes, we were told no.

Intel has a completely different attitude. The Intels and the Boeings of this world set up their corporate venturing projects as almost independent entities—they are staffed by specialists, not by lifers from within the company. The larger companies contribute to the new businesses as if they were interim managers, but it is the enabling that David Sigsworth talked about that really matters—they channel a company's efforts to produce the goods that the market or the larger companies want. There is a much better focus on delivery of what is needed rather than on what the inventor thinks would be awfully nice. There is discipline and a readily accepted mode of operation.

I have seen thousands of business plans from US companies, every single one of which contains the immortal phrase, "Within three years, we expect to have 50 *Fortune* 500 companies as our key customers". By definition, they look to those companies to generate the order flow quickly so that they can get up and running. That is the motivation. We do not find that to the same extent, if at all, in the UK and particularly in Scotland.

Christine May: So you are saying that any daughter of the co-investment fund would need to

be tweaked to take account of the sort of service that you provide and that that would be the role for the public sector.

Ricky Muir-Simpson: Yes.

Christine May: I am interested in more details on what Intel is doing and how it does it. Could you provide those to the committee?

The Convener: A follow-up paper would be useful.

Christine May: Yes, that would be fine.

Ricky Muir-Simpson: We will certainly see whether we can do that.

David Sigsworth: I have a subsidiary point. Gerard Kelly said that the public sector has to be the catalyst that drives forward and supports entrepreneurs. The important point is that, at the moment, when we search for match funding, for one reason or another—I know that the committee has heard lots of views about the issue—there is a distinct disinterest in businesses at the small end of the scale. Even if there is interest, one issue is that most investments are made, ultimately, with tax breaks in mind. The money will come out at a certain point, just as it went in for three or five years for tax breaks. One great feature of corporate venturing is that the investments, as well as providing a source of matched funding, do not simply exist to drive a tax-break benefit; they are enduring investments with the aim of maturing the business—they are a long-term investment to allow the new company and the co-investor to succeed together. The two sectors are not distinct; they need to work together. Corporate venturing is another piece in the equation to which Gerard Kelly referred that we need if companies are to find good match funding.

The Convener: Corporate venturing was studied when Scottish Enterprise conducted an inquiry into business start-ups. Perhaps that work needs to be updated, because nothing much happened as a result of it, even though the concept has been around for some time, particularly in the States.

Peter Syme: The point is well made. The concept has been around, but unless it is managed and developed, nothing will happen.

The Convener: Exactly.

Peter Syme: A gap exists in the market. There is always a market for people who are looking for millions of pounds to develop a business that has started, but the entrepreneur—the original Fred in the shed—is missed, because there are few occasions on which he can get through the doors of corporate UK. That is where corporate venturing comes in. We have three examples in which we have managed to get a Fred through the door,

which opens up huge markets. Funding is required to provide management to get the process started. That does not just mean a consultants' report; it means managing the entrepreneur by using people who have contacts in corporate UK so that they can get through the door. That is the hard bit.

The Convener: Yes. The situation is similar for academic spin-offs.

Peter Syme: Yes, but the big issue is about getting in and getting corporate interest, which accelerates the process.

The Convener: The point is well made and has been registered.

I thank the witnesses for their written evidence and their presentation.

Bankruptcy and Diligence Law (Reform)

16:26

The Convener: A paper has been circulated for agenda item 4. The committee's permission in principle is sought to appoint an adviser on the forthcoming bill to reform bankruptcy and diligence law. The Minister for Enterprise and Lifelong Learning is the primary sponsor of the bill, but people from the Justice Department will also be heavily involved. As the bill will be technical and substantial, it goes without saying that we will require professional advice as we proceed. Do members agree to appoint an adviser?

Members indicated agreement.

The Convener: The committee's agreement is also sought to invite the Executive's bill team to give us an informal briefing, ideally after the October recess, once the team knows precisely what will be in the bill. Do members agree to that suggestion?

Members indicated agreement.

Christine May: I have already had one briefing paper on the matter and I confess that I struggled to understand it. I think that we will need a fair bit of support in considering the bill.

The Convener: Absolutely. The timescale looks quite good, but, because of the size of the bill, it might be tight. The Executive wants the act to receive royal assent by May next year. That will be tight, given that we will not see the bill until at least the end of October.

We will now consider agenda item 5 in private.

16:27

Meeting continued in private until 16:59.

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