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Policy Response

Scottish National Investment Bank: Views and Ideas

A Response to the Scottish Government's Call for Consultation on the Scottish National Investment Bank Initiative

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Gordon MacIntyre-Kemp

Director

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Introduction

The Scottish Government has recently published the Scottish National Investment Bank (SNIB) bill and the accompanying documents. In these it provides information with regards to the establishment and operation of the SNIB. In particular, it makes the case for the Bank to be a public company that will finance investment projects that private banks would not support. The main aim is to promote sustainable economic growth through a mission-led approach.

This report presents our views and ideas with regards to mainly the purposes, legal structure, and governance of the SNIB. So, our fundamental view is that the Scottish National Investment Bank (SNIB) should be a lender of first resort that aims to fill the finance gap that exists for particular sectors and groups of the Scottish economy. As a result, we think that the SNIB should have the legal structure of a Community Interest Company (CIC), whose investment decisions are underpinned by Scotland's values; those principles that the people of Scotland ascribe to.

Subsequently, we believe the ethos of the bank should be defined by the principles of honesty, openness, social responsibility and caring for others. In the same manner, we argue that there should be a pluralistic approach to the governance of the Bank that will provide the opportunity to communities to have a say with regards to the investment projects the SNIB should finance. We agree that the capitalisation proposed by the Scottish Government should be adequate. Finally, in the Appendix section, we make an additional suggestion for the legal structure of the Bank, proposing the 'B Corps' as an alternative to the CIC model.

It must be noted that the report is based on our responses to the Scottish Government's call for consultation on the Scottish National Investment Bank (SNIB) in 2017 and 2019. Subsequently, the format of the report is structured in accordance with the Scottish Government's questions and does not follow the usual format of our other reports. This was considered a more appropriate way of presenting the views and ideas we have submitted to the Scottish Government's consultation call.

The SNIB's Role

According to the SNIB Bill the aims and objectives of the Bank are set out to be:

- investing in inclusive and sustainable economic growth,
- promoting and developing the activities of enterprises, where lack of financial investment is holding back economically viable commercial activity,
- promoting and developing the activities of small and medium-sized enterprises,
- creating and shaping markets through the provision of patient capital.

Meanwhile, based on the policy memorandum document that accompanies the Bill, the fundamental role of the SNIB is to benefit the people of Scotland by providing them with the financial means to invent, design and manufacture the innovations that will shape the future. The Bank aims to create future markets and help define how the Scottish economy develops, by serving businesses who wish to innovate and grow but find the traditional routes to finance challenging.

What is a National Investment Bank (NIB)?

Investment banking refers to the creation of capital, also known as underwriting, and merger and acquisition advice, services provided by commercial banks, through their investment banking division. However, an investment bank, as an organisation that specialises in investment banking, is a financial intermediary that offers a wider range of services. So, apart from services such as underwriting and M&A advice, an investment bank operates within a wider spectrum of complex financial transactions. These may include sales and trading of equites through either acting as agents or advisors as well as asset management.

Unlike commercial banks, investment banks do not offer account and loan services. They are not the institutions that deal with the everyday banking needs of the people. They are rather specialised institutions providing services mainly to governments, corporations and large investors or investment groups. Some of the most well-known investment banks are: Goldman Sachs, Morgan Stanley, JPMorgan Chase, Bank of America Merrill Lynch and Deutsche Bank.

A national investment bank (NIB) though should not be confused with an investment bank. This is because a NIB is an independent institution supported by the state that does not aim to make profit out of providing services similar to an investment bank to large investors. Instead, it aims to provide funding opportunities to those groups or businesses that are adequately supported such as SMEs. Due to the fact that it is established and usually financed by the state, at least initially, it is able and seeks to finance projects with long-term returns, whose objectives are more social rather than financial.

Nevertheless, even if it is state-backed it is not a part of the state mechanism per se, but it operates autonomously. The NIB's borrowing and spending is not reported in the state budget. It also should not be confused with the national or central bank. A NIB, unlike a

central bank, is not a financial institution that has control over a nation's production and distribution of money. It rather is a company that utilises the financial markets to raise funds through issuing bonds and/or selling shares.

The best examples of NIBs operating around the Europe are Germany's Kreditanstalt für Wiederaufbau (KfW) and the European Investment Bank (EIB). The former was formed in 1948 as a public law institution which is 80 per cent owned by the Federal Republic of Germany, 20 per cent owned by the German states. The KfW has been primarily funded through retained earnings and bond issues, and it is considered as one of the safest banks in the world. It is mainly financing social projects concerned with housing, environmental protection, infrastructure, and innovations as well as business start-ups, SMEs and liberal professions.

The EIB was founded in 1958 and is the European Union's investment bank. Even though it is more of a multinational than a national bank, it is state-backed and the UK currently holds 16% stake. This is expected to change if Brexit goes ahead. The EIB is an EU public body that is however operating autonomously - guided by a public policy mandate. Much like the KfW, it mainly addresses the demand for patient capital by SMEs as well as financing infrastructure projects.

There most relevant examples of similar initiatives in the UK are the British Business Bank (BBB) and the Green Investment Bank (GIB). The BBB initiative is a very recent one and even though it shares some of the characteristics of the above mentioned NIBs, it is not itself a NIB per se. It is owned by the UK Government, but independently managed, while its main aim is to support SMEs through guarantees and supports lending from partners; banks, leasing companies and so on. In other words, it does not provide finance directly to SMEs.

The GIB is also a recent initiative of the UK Government, established in 2012 to provide finance to green projects. The GIB's structure and operation is more similar to that of a NIB. However, it was established to specifically help the UK's transition to a greener economy. What needs to be noted is that it has been set up as a Public Limited Company (PLC), to allow for the possibility of future involvement of private capital. This is interesting because the PLC structure is what the Scottish Government proposes for the SNIB. What that means and what are our views on this are discussed later. For now it is worth mentioning that the GIB was indeed sold to private investors in 2017.

Plugging the Equity Gap

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

In particular, the SNIB should address; access to finance for SMEs, target investments in high-risk research and development (R&D), innovative start-ups and lengthy innovations, areas that private capital investment models may not address; and provide finance for transformational technologies to reduce carbon emissions. It should do this while emphasising the fact that the Bank should target groups that evidence shows have less access to capital than others such as women and BME entrepreneurs.

For instance, the contribution of women-led businesses to the Scottish economy is substantial. Estimates suggest that women-led businesses contribute (at a minimum) £5bn Gross Value Added (GVA). If rates of women-led businesses equaled those of men, this would equate to 5.3% growth in the size of the Scottish economy. The SNIB should have a major role in terms of addressing this funding failure and that is even more crucial given the economic impact of Brexit on funding availability will be devastating.

Furthermore, in recent years Scotland's productivity has been behind that of comparable countries. Not only is Scotland's productivity 3% behind the UK average but it is also as much as 40% behind closely comparable economies such as Norway, Belgium, Ireland and The Netherlands who outperform Scotland on R&D spend. These faster growing, more prosperous, smaller European nations spend an average of 3.4% of GDP on R&D but Scotland spends only 1.25%. A report by the innovation think tank NESTA claimed if Scotland started to build towards an R&D spend of 3.4% of GDP over a five year period, this would mean that Scotland's economy would grow by around £12 billion a year. It is common to associate Scotland's economy to oil, but Scotland has massive human capital potential that is dependent upon its ability to innovate that is being hold back by the lack of SMEs access to finance versus comparable-sized European nations.

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

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

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

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

However, it is equally important for the SNIB to be able to provide more than financial assistance. The Bank's personnel should be able to provide guidance through its expertise. Having personnel that possesses financial as well as scientific expertise could be beneficial in identifying the best investment opportunities for the bank as well as help those interested in being financed by the bank. In general, it should be concerned with tasks and activities that promote the common good of the people of Scotland focusing on sustainable prosperity.

For instance, the SNIB should provide advice and support to assist entities/projects in becoming "funding ready." There are many existing public bodies that give advice to businesses, such as Scottish Enterprise and Highlands and Islands Enterprise (HIE). There are also private sector incubators and mentoring networks. Providing ongoing advice is already catered for in the Scottish business community, however, more significant vetting of advisers and mentors would be required than may have been the case for advisers for local enterprises in the past. This needs to be accomplished before advisers are approved to work with Scottish National Investment Bank's (SNIB) clients. Consequently, we strongly believe that the bank should not work independently, instead it should be partnered with existing bodies to provide mentoring, advice and support.

SNIB's Legal Structure

The SNIB Bill and the accompanying documents published by the Scottish Government in March 2019, propose the legal structure of a PLC as being better suited for the purposes of the Bank. In particular, article 46 of the policy memorandum that followed the SNIB Bill, states that the PLC model is preferable because it will enable the Bank to raise finance from wider sources in the future (for example, a public bond or share issue) and issue dividends to the Scottish Ministers, while allowing the Scottish Government to retain the option of how surplus funds could be utilised.

In the same article, it is also stated that the Community Interest Company (CIC) model was considered and apparently rejected or not chosen because it introduces an additional layer of regulation as well as a lock on assets. However, it is our view that the SNIB should not be a PLC and that the CIC model, despite its own disadvantages (see Appendix), is the model that is better suited for the aims and objectives of the SNIB. We consider the legal structure of the Bank as probably the most important issue for the establishment and long- term operation of the SNIB. Consequently, we are sceptical about the PLC model, since a similar structure and reasoning was employed in the case of the UK's Green Investment Bank, which was eventually sold to private investors after only a few years from its establishment.

The PLC Model

To start with, the PLC model falls into the company limited by shares type of limited company; the other type is the company limited by guarantee. The limited company model is the most popular one and it basically refers to a company that is owned by its members, in the form of shares, but is formed as a separate legal entity; the company's finances are separate from the personal finances of the owners and the company can do business in its own name.

This means that the personal assets of the shareholders/owners are not at risk but they only stand to lose what they have already invested or committed to invest. In addition, the day-to-day management of a PLC is undertaken by a board of directors, minimum two, which are separate from the owners. A PLC can float its shares on a stock exchange, to create a wider market, and become a listed company that is subject to greater regulatory requirements in the form of listing rules and information disclosure.

The advantages of the PLC model can be summarised as follows:

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

Nonetheless, in the case of the SNIB, because of the peculiarities of its aims and objectives that differentiate it from other banks, these advantages may also be seen as disadvantages. To make this clearer, having the ability to issue shares means that everyone can buy them and the amount of capital that can be raised is higher than in the case of the Private Limited Company. This can also share the risk, by spreading ownership to more shareholders, which can be advantageous. However, if anyone can buy shares it is possible, after a period of time, that the initial owners, in this case the Scottish Ministers, lose control of the direction of the Bank or at least it may become much more difficult to control it.

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

There is then problems associated with issuing bonds. While it can be a stable and long-term source of finance, raising capital in this way could, nonetheless, place the bank in a situation where it is under the informal governance of financial markets. Were the risk in taking on such debt obligations to go wrong, that is it did not result in an effective income stream to service the debt, the Bank would have to take on new debts to repay old ones – i.e. issue new bonds or take out loans. The Bank's ability to take on new debt to pay old debt would depend on the confidence of financial markets and not simply on the basis of being guaranteed by the Scottish Government.

To gain confidence, the Bank would need to make the investment attractive, and to do this it may need to sacrifice some control to private investors. One example of such a sacrifice would be to allow investors to purchase shares in the Bank, its subsidiaries, or shares it owns in other private enterprises at a future date. Another option may be to sell investors securities in the form of a collection of income streams flowing in from the Bank's own investments, such as dividends or loan repayments to SNIB. Again, this would risk an encroachment of private interests in SNIB's operations.

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

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

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

Why the CIC Model is Preferable

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

This is because the values upon which co-operatives are based are arguably more appealing to the Scottish people, such as: self-help, self-responsibility, democracy, equality, equity, and solidarity. A co-operative, as defined by the International Co-operative Alliance, is:

> "an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through jointly owned and democratically controlled enterprise".

In relation to that, we propose the SNIB to have the legal structure of either that of the CIC or the community benefit society. Our reasoning is that in this case the ownership stakes (shares) cannot be sold, much like in co-operative banks operating around Europe, but can only be redeemed or sold back to the bank. This seems more appropriate considering that the shares will belong to Scottish Ministers and thus ownership may unavoidably change over time. This eliminates the risk of a takeover and thus of the potential of change in the Bank's direction.

The fact that it is not possible to issue new shares or to sell shares to an open market arguably minimises the funding sources. However, this can be turned into an advantage as it may put some constructive pressure on the directors because the absence of the option to finance the Bank through other routes will make necessary the seeking of investments that will be more likely to be profitable in the short term and then upping the investment risk profile once the banks success has been fully established.

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

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

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

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

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

Finally, 'the regulator' issue does not seem to be reason enough to reject the CIC. The role of 'the regulator' is arguably unclear in the relevant publication by the UK Government.

However, it is clear that the purpose of it is to make sure the company, in this case the SNIB, is going to actually operate for the common good, which is certainly something that needs to be clear and not an issue considering the aims and objectives of the SNIB. In addition, it is also clarified that 'the regulator' will not make the process more lengthy with unnecessary bureaucratic formalities, which arguably means its role is that of the guarantor rather than of the decision-maker.

SNIB's Governance

The Scottish Government proposes that the Bank should be governed in the following way:

> "The Bank will be operationally and administratively independent from the Scottish Ministers. It will have autonomy to determine its investment strategy and how to manage its portfolio of assets. Scottish Ministers will not have a role in the Bank's internal governance or the operational decisions made by the Board. While the Bank will be operationally and administratively independent, the Scottish Ministers, as the Bank's sole shareholder and sponsor, will set the parameters within which the Bank should work. Scottish Ministers will also set direction for the Bank's investment through setting it strategic missions"

We agree that the autonomy of the directors is important for the day-to-day efficient operation of the Bank. However, in line with the CIC model we have proposed for the SNIB, we believe that the a pluralistic model of governance, consisting of three independent bodies, should form the ultimate decision-making mechanism. To clarify, following the First Minister's recent announcements, we suggest that one of the bodies should be the Citizens' Assembly. This would enable the participation of people from the wider Scottish society and the representation of the diverse ideas and views that make up Scotland. The process of choosing the members of the Scottish Citizens' Assembly has not been set yet, but if it follows the Irish model then this will follow random selection. It follows that the membership/ownership rights are going to be transferable.

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

In other words, we consider that the fundamental role of this ultimate decision-making body should be to establish and whenever it is necessary to rethink the strategic purpose of the Bank. With regards to that, the mission-led approach proposed by the Scottish Government for the Bank is indeed the one that is most commonly used by other NIBs around the world. According to Mazzucato and Macfarlane, mission-oriented policy is distinct from traditional approaches to economic policy in a number of key ways with the major one being is concerned with co-creating and shaping markets to achieve societally agreed missions driven by public purpose, rather than limited to 'market fixing'.

This is what the Bank should be aiming to do and thus, the mission-led approach is probably the most appropriate one. However, we would like to add that the mission-led approach of the SNIB should be informed by the Scottish values put forward by the Scottish Government in its 2015 Economic Strategy as well as in its 2018 National

Performance Framework (NPF). We believe that the powers of the Scottish Government should be used for a purpose and this purpose should be informed and driven by the values of the Scottish society.

Consequently, we think that the mission-led approach should be a values-led approach or investing in projects that promote the Scottish values should be the end the Bank's missions should aim to attain. For instance these projects should aim to promote sustainable and inclusive growth rather than short-term profit or projects that have the potential to improve the society's well-being overall and lead to societal development. Arguably, this would be possible through the Bank addressing the finance issues of the groups and companies referred to in Section 2.

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

SNIB's Capitalisation

With regards to the capitalisation of the Bank, the Scottish Government has proposed it will be initially capitalised by the Scottish Government to the level of £2bn over the first 10 years. Capitalisation will be achieved in part by passing financial transactions to the Bank. Financial Transactions Capital (FTC) are a form of capital budget allocated by HM Treasury to the Scottish Government which can only be used for the provision of loans or equity investment beyond the public sector and cannot be used to fund public services. The proposed plan for reaching the capitalisation of £2bn can be seen in the following table.

Table 1. Capitalisation of the Scottish National Investment Bank

	2018-19 Budget (£m)	2019-20 Draft Budget (£m)	Identified for 2020-21 (£m)	Future budgets over 2021-28 (£m)	Total (£m)
Building Scotland Fund	70	50	30	-	150
Funding for other pre-cursor investment	-	120	220	-	340
Further capital to be provided (average £216m per annum)	-	-	-	1,510	1,510
Total	70	170	250	1,510	2,000

Source: Financial Memorandum pp. 3-4.

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

The borrow-to-lend model of investment banking can be a risky model as the 2008 financial crisis revealed. Some of the problems of borrowing have been outlined in the previous sections but there are other problems too. For instance, in the event of a financial crisis, were one to happen, if SNIB required borrowing to keep its capital levels up to a sufficient level to avoid insolvency, interbank lending could seize up – as it did in 2008 – leaving the Bank without necessary funds. As the credit system consists of a concentrated market of global banks, borrowing will likely increase the exposure of

SNIB to international financial markets and the threats that come along with that, such as the consequences of financial speculation from elsewhere in the world economy.

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

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

The Ethos of the SNIB

We believe, in line with what has been said above about the legal structure and the values that should direct the mission-led approach of the Bank, that the SNIB should hold to the following principles: equality; transparency; diversity; and inclusion. It should be established and run following the spirit and practice of open government. We would like to add, in the same manner, that it should be characterised by an ethos of honesty, openness, social responsibility and caring for others.

Following our proposal that the Bank should be a co-operative it should, subscribe to the following set of co-operative principles as they are set by the International Co-operative Alliance: voluntary and open membership, democratic member control, member economic participation, autonomy and independence, provision of education, training and information, co-operation among co-operatives, and concern for community.

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

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

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

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

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

Conclusion

To sum up, we consider the Scottish Government's SNIB initiative as a very important step in moving towards our vision of a Scotland in which a strong economy will be supporting a strong society and vice versa. For this to take place the SNIB's operation should be inspired by and follow the values and ethos identified above. We are optimistic that the SNIB will not end up being privatised as the UK's Green Investment Bank; a result that would arguably not be in the best interest of the Scottish people.

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Appendix

The 'B Corps' Model as an Alternative to the CIC Model

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

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

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

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

- The ICFC established local branches and got to know local businesses. Staff, with expertise in specific industrial sectors, took account of these relationships and did not make sweeping decisions about entire sectors.
- It invested for the long-term in companies that were well-run firms with good management teams.
- It would be unwise to establish a new industry bank as a limited company where the drive for profits leads to short-term investment strategies. If funds are to be raised from private investors, it should be in the form of bonds and other instruments to insulate the bank from short-term pressures.
- The ICFC was established by the Bank of England and relief heavily on the existing banking sector which used this dependency to undermine the competitive threat imposed by the ICFC. An industry bank should be established as a rival the main banks, not as a dependent offshoot.
- Unlike the Green Investment Bank, the ICFC was not focused on a narrow sector to deliver political ends, rather it supported any business with a sound business plan.

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

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

- It would keep the cost of borrowing lower as it can raise money at state bond rates.
- A public body can take the higher risk for the common good.
- It would deliver a more stable patient capital, as state ownership can permit a much longer-term view to be taken and allow time for ventures to become profitable and succeed.
- State owned bodies are less likely to allow ventures in key sectors to fold.
- State investment can deter the acquisition of successful ventures, allowing value to remain within Scotland. Indeed, it may be possible, for key ventures at least, to rule out private sector acquisition, at least for a period.
- State lending is more likely to have social outcomes attached to its terms (such as investment in local economies) than private investment, which is more likely to be purely profit focused.

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

- State bodies may be more susceptible to political interference – what wins votes rather than what investments make the most sense.
- The decision-making process can be more bureaucratic, with a broader range of stakeholders and views to consider.
- A state-owned entity cannot issue shares to raise more capital, although it may have greater access to grant funding than a PLC, subject to State Aid rules.

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