House of Commons

Scottish Affairs Committee

Oral evidence: Sustainable employment in Scotland, HC 762

Monday 20 February 2017, Aberdeen

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Watch the meeting

Members present: Pete Wishart (Chair); Deidre Brock; Margaret Ferrier; Chris Law; Ian Murray; Anna Soubry.

Questions 361-491

Witnesses

I: Mike Tholen, Director of Upstream Policy, Oil and Gas UK, John McDonald, Interim Chief Executive, OPITO

II: Gordon Inglis, Director and Principal Consultant, Accord Energy, Fred Bowden, Managing Director, Woollard and Henry, Carole Leslie, independent adviser

III: David Watt, Executive Director, Institute of Directors Scotland, Barry McCulloch, Senior Policy Adviser, Federation of Small Businesses

Examination of witnesses

Witnesses: Mike Tholen, Director of Upstream Policy, Oil and Gas UK, John McDonald, Interim Chief Executive, OPITO

Q361 **Chair:** Welcome to the Scottish Affairs Committee's session on sustainable employment in Scotland, which is here at Aberdeen University. We are very grateful for the hospitality of Aberdeen University, which, once again, is hosting this Committee in the wonderful surroundings of the Linklater rooms, I believe.

For the record, can our two guests say who they are, what organisation they represent and anything by way of a short opening statement? We will start with you, Mr McDonald.

John McDonald: Good morning. I am John McDonald. I am the Interim CEO of OPITO, the skills body for the oil and gas industry. I am very pleased to be here with the Committee this morning and I am looking forward to a discussion. I have a number of things that it would be useful to raise with you, and we will come to those in due course, no doubt.

Mike Tholen: Thank you for the invitation to speak this morning. My name is Mike Tholen. I am the Upstream Policy Director at Oil & Gas UK, which is the trade association for the industry, representing both the oil and gas companies as well as the main supply companies that service our industry.

For me, the industry is at a crossroads and has competed well in what has been a very difficult time over the last two years. It sees a great deal of opportunity ahead of it, but it faces many challenges to compete for those opportunities in an ever-changing energy world.

Q362 **Chair:** I don't think it is an overstatement to say that there have been particular issues in the oil and gas sector in the course of the past few years. Could you summarise what has been the overall impact of the fall in the oil price in the past few years? We will start with you, Mr Tholen.

Mike Tholen: Thank you. Over the last years, clearly, the industry has seen some huge changes in the face of some very big changes in the oil price. Two and a half years ago, we were looking at a world where $100 a barrel was the accepted norm and we have seen oil prices fall to under a third of that. They have now moved back over the last year, so we are sitting at a low $50 a barrel, but a very big change for an industry.

Believe it or not, two years ago we were struggling to make a profit even at $100 a barrel in some cases. Companies have had to adapt enormously: change their cost base, become more competitive and become much more efficient. Now we are producing more and being much more productive in a low oil price era than we ever imagined even two years ago.

John McDonald: I would echo my colleague's points there. As the Committee will be aware, that has put the focus on resizing and reshaping of the workforce. We have seen many people lose their jobs in the industry. Moving forward, the huge task for us is to protect the jobs that are there and to make sure that people within the industry have the right set of flexible skills to be able to move to other opportunities as and when those arise. We also need to make sure that we have the youth of tomorrow—young people—coming into this industry, knowing that this industry will serve this country well for many years to come. We need to make sure that we have opportunities and progression pathways for young people to follow.

Q363 **Chair:** We understand that the oil and gas sector is a significant direct employer, but there are also something like 300,000 jobs that are indirectly dependent upon oil and gas activity. How has indirect employment been affected by the fall in oil prices? Has this impacted on Scotland more than the rest of the United Kingdom as a whole?

John McDonald: Let's remember that oil and gas is a UK-wide industry. Certainly the north-east has taken its toll. There is no doubt about that. But this has affected companies elsewhere in Scotland: at the Central Belt, in the north-east of England and in the east of England as well, so it is something that reverberates across the country.

Q364 **Chair:** We have here in our notes that 10% of all jobs are predicated indirectly on oil and gas. Is that the sort of figure you recognise as the contribution the oil and gas sector makes in Scotland in terms of employment?

John McDonald: I have seen that figure used fairly regularly, but I would just ask my colleague to confirm that. He will have the more up-to-date information.

Mike Tholen: The sector has seen an enormous change in employment over the last two years, obviously with the reduced spend and the pressures on the industry. That has had a very deep and personal impact on many, many people. About half the employment within the sector is within the Scottish economy, so clearly, given that concentration of employment in Scotland, it is going to be particularly felt across Scotland, both in the north-east as well as in the Central Belt, so your figures are probably of the right sort of order of magnitude.

Q365 **Chair:** The other figures that we have here—you can tell me if you think they are right—is that direct employment has fallen by 7% between 2013 and 2016 and employment supported by the sector has fallen by 25% since 2013. Are those figures that you recognise?

Mike Tholen: Those feel about the right sort of magnitude—painful though that is to say—across the sector, yes.

Q366 **Chair:** Another thing on your general employment, we understand that contract workers now make up something like 20% of your workforce.

Have contractors been more significantly affected by the fall in oil prices than some of your permanent employees?

John McDonald: In some respects, yes, contract workers have seen a very difficult time. There are many contract workers out there looking to engage with Government in Scotland and south of the border, looking for new opportunities and retraining opportunities. That is where some of this data would come from. New programmes like PACE—which the Scottish Government does through the Energy Jobs Taskforce and SDS—there is some really good work there. In many cases, contract workers feel that they don't have the protection that workers who are salaried have. They also have or had a number of benefits in many cases as well. So, yes, there is a feeling among them, and some of the data that we see suggests, that they have been particularly affected.

Q367 **Chair:** Does this reliance on contract workers suggest that the sector has not been investing in its core staff? Why are there so many contract workers employed in the oil and gas sector just now?

John McDonald: The sector certainly has been investing in its core staff and continues to do so. We see that through staff development and the continual improvement work that goes on within companies. The sector has been composed of a mixture of contract workers and salaried staff for a long time. That has worked well in the past for both parties, I would suggest. However, clearly at this time, that has been very difficult for contract workers. At the same time, many salaried staff have also lost their jobs or been affected by this too, so there is a balance between the two and I do not see contract workers as disproportionately affected.

Q368 **Chair:** Can I come to you, Mr Tholen, on sustainable employment? Are the same sort of sustainable employment opportunities offered and provided to contract workers that you would expect for those directly salaried from the sector?

Mike Tholen: Over a number of years is—clearly over the early part of this decade—there has been a rapid increase in activity across the sector as we have gone into a very active period of construction offshore. Many companies in the sector have a mix of staff and of contract to allow them both to flex and to recognise the changing nature of their work, even in a year, never mind across the years. As Mr McDonald mentioned, through the downturn we have seen both staff and contract labour take hits because of a loss of jobs. That is probably in a proportionate way, because most companies are still trying to design a business where they have some flexibility around their core staff and contract staff to allow them to accommodate a range of conditions.

The challenge for the industry is to hope to see a period of less boom and bust in the years ahead and to build on the efficiency, capability and stability that are offered currently to create a sustainable business over the next decade.

Q369 **Chair:** In terms of sustainable employment opportunities, what is your view on the difference in terms of opportunities available for your staff on contracts and those that are core staff?

Mike Tholen: Certainly for the companies I deal with, they typically design their companies to have a mix of staff and contract resource, maybe because of specialisms they need in some cases, maybe because of the flexibility they need in others. That is inherent in a lot of the business models of certain types of companies. The success for those companies is in having a strong order book, both in the UK and overseas. The challenge for the sector at the minute, because of the fall in oil price and because of coming off a period of very strong investment, is that the outlook for investment is not looking that good for the industry.

We are seeing little new investment sanctioned, so the challenge for the industry in the next few years is to identify and start to develop new opportunities to follow on from those that we have seen in the recent past. It is the order book for companies that will give companies the confidence both to provide sustainable labour for their staff and a positive outlook for those who work on contract for them.

Q370 **Ian Murray:** If I could go back to the development of the industry, and I wonder if you could give us a little bit of a flavour of the trends in the industry in terms of cost per barrel of oil in terms of production, what that has looked like over the last few years and how it compares with some of the other major competitors of oil production companies.

Mike Tholen: As an industry, we look at two main cost drivers. One is the cost of finding and developing and one is the cost of running the business, the operating costs of running the business offshore. I focus first on the running costs of the business. What we were seeing is operation costs per barrel rising to just under $30 a barrel on average across the basin. That varies a lot by company, by age of asset, how much you are producing and the sort of fixed costs that any fuel bears. Those costs have typically fallen over the last two years to about $15 or $16 a barrel, which is a remarkable change and represents two things: first, a cutting of the costs, and, secondly, an improvement in production. If anything, it is the improvement in production that has allowed us to see a much better performance in the UKCS.

In operating costs, we are clearly going to struggle to compete with some of the onshore parts of the world, not least in the Middle East, where you are looking at a fraction even of the current costs. For baselines to be attractive, you need to be able to do things fast and efficiently, have the right size of volumes to develop and to have the right stability in the tax regime, the regulatory regime and, indeed, the political regime around that to make this a good basin. We have many things still in our favour there. We are at a better place for tax; we are at a better place for regulation than we were even a few years ago.

Generally, on the finding and developing costs, we were looking at $20-plus a barrel. They have come down, but they are going to be tested best in the market by the next wave of developments, so we can do those more cheaply and more efficiently.

Q371 **Ian Murray:** That is very helpful. Obviously, a consequence of the collapse in the oil price—as the Chair indicated in his opening questions—has been the consequence for employment. What has the industry been doing to support those that have lost their jobs in the industry? Are they now completely lost to the industry or is there an opportunity to re-skill and bring them back? Mr McDonald, you used the term "progressive pathways", which I thought was very interesting. Could you unpack what support you are giving to people who have lost their jobs and where they may be able to come back in?

John McDonald: The first thing is that we have been working closely with Government, both Governments in Westminster and in Holyrood and Government agencies as well. For people losing their jobs, what we have tried to do, through the Energy Jobs Taskforce, is to see if there is room within the industry as it is at the moment for them.

Our second level would be to look within the energy sector, more broadly, and then thirdly into other industries across the UK. Initiatives, such as the PACE initiative, where Skills Development Scotland and the Scottish Government have brought together employers who have jobs, and bringing together the people who are facing unemployment or who are unemployed to look at where there may be opportunities there. The transition training fund of £10 million, which the Scottish Government set up, is also important. From meeting SDS on Friday, I understand that we are now into the thousands of people who have been displaced that have been given money to retrain. There is a clever part of the criteria here, which says there has to be a job in sight. It is not just retraining to do something you like and there has to be vacancies within that.

In Westminster, the transition scheme run is TRS, which we have been working with Oil & Gas UK and others to set up. That is for companies—like British Aerospace, other big companies, National Rail—to advertise that they are looking for a skillset, which is probably broadly similar to us. Summing up, there has been a lot of work going on in this area. As I said, we understand through transition training, thousands of people have been retrained into other areas. We want to keep those people as interested parties, in the sense that we might need their skills in the future. We continue to be in contact through those bodies that I mentioned and, as opportunities become available, the market would deal with that directly.

Q372 **Chair:** Is the key task and function therefore to try as much as possible to hold on to existing staff and retrain to provide other functions, and perhaps find other employment, but to make sure that the skills are retained for when there will be the opportunities to invest?

John McDonald: Yes, Chairman, and, at the same time, when we are bringing through the next group for the workforce, the younger people, we need to make sure that—and this is something OPITO is working on—the skillset is a varied and flexible skillset and perhaps not so much in the manner that we have developed skillsets in the past, so giving variety.

The last point I would add here, Chairman, is that OPITO have spoken to PACE in London and we are very keen to lead on a piece of work between ourselves, renewables, nuclear and the onshore industry. That is about standards. People cannot get into the industry unless they have met the competent standard, but what we are keen to see is flexibility. To go back to my point about that pathway, the progression, moving from oil and gas into nuclear, right now that is a bit of a challenge and we want to simplify that for those working in the industry and for the industries themselves.

Q373 **Chair:** So all of this is where every cloud has—I wouldn't say a silver lining—consequences and opportunities. Is this an opportunity for the oil and gas sector to work collaboratively across a number of sectors in terms of its workforce?

John McDonald: Absolutely. It is an opportunity for all those sectors to work together—who perhaps worked in isolation in the past—to make something that is better for the workforce, better for each of the industries and better for the country.

Q374 **Deidre Brock:** Oil & Gas UK acknowledged recently that the industry has been experiencing more turbulent industrial relations than has been the case for many years. Why is that and what are your organisations doing to address it?

Mike Tholen: Clearly, at a time of great change in the industry when, alas, there is change on employment, companies under some considerable duress and there are changes in working practices, then there is bound to be some pressure on the workforce and on work engagement. Companies are trying to work that through with their contractors and with their staff as well and I think that is an inevitable situation we are in.

Q375 **Deidre Brock:** What actions are you aware of that the companies are taking?

Mike Tholen: Trying to negotiate, where they can, a good settlement for their staff. As a trade association, we meet regularly with the unions to discuss working conditions and actions within the industry to try to make sure that there are many channels of communication open to employers and employees.

Q376 **Deidre Brock:** What is the impression you have when you hear feedback from the unions? I am about to ask a question about terms and conditions for oil workers that have apparently been affected by these changes to the industry. Mr McDonald as well, if you wouldn't mind, I would like to hear your answer too.

John McDonald: As the skills body, we are not directly involved in terms and conditions of workers. What I would say to you—and I echo my colleague's thoughts here—is that there is much negotiation and discussion going on between companies and individuals, companies and the unions. Certainly in our own body, in OPITO, we are owned by three constituents: the operators, the drilling community and the workforce itself, represented by the unions. When we are developing initiatives and so on, we have that three-way discussion. That to me is the key in dealing with any of these ongoing issues. There are changes to people's terms and conditions and these are in part as a result of the market.

Q377 **Deidre Brock:** Could you tell us how those have changed as a result of the fall in oil prices?

John McDonald: I am not close to this. It would be wrong of me to discuss this, given that I am representing the skills body that develops apprenticeship skills and standards for the industry, so I would be—

Deidre Brock: Mr Tholen, perhaps you could?

Mike Tholen: Like John, I am probably unable to comment on specific employer instances. The most obvious one though is the change of—

Deidre Brock: You must have personal views.

Mike Tholen: Indeed. The most obvious one is the change in working rotas, for instance, where there have been changes in shift patterns over the last two years, in some cases moving gradually back from two on and three off or variations of that in some cases to equal time rotas. Those have certainly been one of the visible manifestations of the changes.

Q378 **Deidre Brock:** Did I read somewhere that it was three weeks on?

Mike Tholen: Sorry, three weeks on and three weeks off or two weeks on and two weeks off.

Deidre Brock: Yes, so potentially up to 12-hour days, three weeks on, is that right?

Mike Tholen: In some cases, but there is also two weeks on and two weeks off, so effectively moving from a unbalanced rota to one where there is equal time on and off. That is the most visible manifestation, I think, in changes in some companies in working practices.

Q379 **Deidre Brock:** As a representative of the body that you are, do you view that kind of workload as acceptable? What are operators saying to you about why they introduced those changes? Perhaps you can elaborate on that.

Mike Tholen: Sure. First of all, at the heart of this has to be the consideration of the working practices: are those safe and are those sustainable? In some cases, companies have sought to move back to those practices because of the costs of managing the imbalanced work rota system compared with a balanced work system. The evidence that those companies have is that they believe those can be done safely and sustainably.

Q380 **Deidre Brock:** Moving on to that, the STUC has raised concerns that health and safety breaches are not being reported as they should, because workers are worried about their job security in the current climate. How would you respond to that suggestion?

Mike Tholen: Obviously, I would urge the Chair that anyone who is under any concerns on health and safety behaviours offshore should report those both offshore—and there is the facilities offshore—and onshore through the—

Q381 **Deidre Brock:** Of course, but how do they prevent possible reprisals in terms of being employed and being taken on?

Mike Tholen: I cannot condone nor can I think any of my members would condone reprisals against anyone reporting on a safety instance. That would be appalling.

Q382 **Deidre Brock:** Of course. There is no suggestion: from your point of view, you are not hearing of this happening anywhere in the industry?

Mike Tholen: Certainly not. I emphasise we would in no way condone or support any behaviour like that. If individuals, or indeed members or staff of a company, have any safety concerns, safety is the first thing we think about every morning and every day, for the right reasons. No working practices should put that at risk.

Q383 **Deidre Brock:** Thank you. Finally, this is obviously about sustainable employment. Can you point to any particularly good practice within the industry when it comes to sustainable employment and how you think that approach—once you have elaborated—might be encouraged and where it might be encouraged more widely?

John McDonald: This industry and the companies that make up this industry have worked extremely hard to protect jobs wherever they can. That might mean with some operators and contractors moving people on to different pieces of work, giving them, for some people, extended leave even in order to retain the post and not get rid of the post. There is a set of principles that contractors have signed up to, again through Energy Jobs Taskforce, and operators too, which is about how we will behave in ensuring sustainability and within employment.

Within that there is a draft thing at the moment, which is a scheme that is looking at lending people out from one organisation to another. In commercial organisations in the past, this is probably something that wouldn't have been readily considered. So I think it is a sign of the times that we are seeing companies wishing to work together, almost like a football loan scheme. That is in its early stages at the moment, but there is a good head of steam behind that in terms of moving that forward.

Deidre Brock: That sounds positive. Good, thank you.

Q384 **Anna Soubry:** I want to follow-up, if I may, with Mr Tholen. Is it the case that this sector in the North Sea has traditionally had some of the highest operating costs compared to other sectors in the world?

Mike Tholen: Certainly the UK is an expensive place to do business offshore, for the reasons you would imagine. Operation costs, particularly when you look at costs per unit barrel, are towards the top end, top quartile too often. Part of that is simply the geography and the costs of operating offshore. What we have seen, though, is a lot of work over the years to take cost out by being smart, by being efficient and by being savvy. There have been good examples of that by many of the companies in the North Sea who have taken those learnings and even applied those elsewhere around the world.

Q385 **Anna Soubry:** Is it fair to say that, because of the drop in the price of oil, the sector has had to have a radical—and you may not accept that word, it is for you to say—look at how it operates, how it works in order to put some sort of sustainability back into it?

Mike Tholen: I would be very happy and very comfortable with "radical". People have searched their souls on how to make sure they can sustain a safe and durable business for the long term. The good news is the oil and gas are out there and we have a great set of technologies and a great set of people to be able to develop that business. It will only work if we can be competitive at oil prices, which are going to sit in the 50s perhaps for many years to come. Our biggest competitor was probably onshore shale in the States. The water is very shallow there. It is very easy for them to do their work, so we have to be able to do very smart things, very cheaply and very effectively, to be competitive on a global scale.

Q386 **Chair:** There is also talk about the North Sea as a basin having declined. I was listening to something on the radio this morning about possible oil finds around Rockall. Surely that is quite significant and suggests that, as opposed to a decline, there are new opportunities for oil and gas? Are we perhaps talking too much about a decline in the sector and talking ourselves down? Listening to that radio programme this morning, you would think that there were other opportunities to be explored.

Mike Tholen: The industry currently produces about half of the UK's oil and gas. The opportunities to do so remain for years to come. The good news is no authority and no expert says that we are constrained on oil and gas opportunities and there is a lot of oil and gas still to be found and produced in the North Sea. The challenge will be to access the right technology, to get to the right price and, obviously, in new parts of the basin to know where to look. Exploration is at a low point, but there has been a lot of good work with the Oil and Gas Authority, with the help of both the Scottish and the British Governments to try to apply the best technology we can to pursue those opportunities, not least for new seismic. We are looking at what the Rockall basin has to offer. In parallel to that, companies are looking to squeeze more out of existing fields. It is not just trying to find new stuff, but to improve recovery rates in the existing fields that I think will provide a lot of the future business of the basin.

Q387 **Chair:** I know Deidre Brock wants to come in. In my constituents' interests, for example, I have Merlin ERC in my constituency who are examining—and I am told about this—all sorts of new smart technologies to locate and determine where the possible fields are. As we go forward, is this an important feature when it comes to discovering new opportunities in the North Sea?

Mike Tholen: Things like the Oil & Gas Technology Centre are part of the recognition that this industry will be as much technology driven as it will be people and knowledge driven. It is that combination of all three, within a Scottish industrial context, that will make it a success. The company you mentioned—and I am familiar with it myself—is an enthusiast for the technology and the capability. We need to let that entrepreneurial spirit continue, as we have done for many decades in the industry, because there is still a very attractive business to be had, provided we can get the right costs, be competitive and let the skilled workforce do their best in some very difficult geography.

Q388 **Deidre Brock:** You mentioned the OGA. In the evidence they have just produced for the Committee they suggest that, if the service sector builds on global competitiveness and attracts the necessary investment, there could be additional turnover of well over £200 billion over the next 20 years possibly generated. Is that a figure that you would recognise?

Mike Tholen: I am aware of the figures of the OGA. Indeed, they predict, quite reasonably, a strong future for our industry from two means: first, our industry delivers value to the Scottish economy obviously from the oil and gas, the taxes we pay in the first place, and then, on top of that, the supply chain, which is both active in and around Scotland and on the exports that it delivers as well; exports to more than 100 countries worldwide from Scotland I believe. The challenge for the sector to grow—when we see energy demand growing by 30% over the next 15, 20 years—is to get a share of that action and, indeed, an increasing share of that action. That is a challenge for both the British and the Scottish Governments: to help the sector pursue externally as well as hopefully continue to have a strong heartland here in Scotland, activity in the North Sea. It is those capabilities we learn here that make us uniquely attractive overseas, so a strong UK, a strong UKCS and, indeed, an effective economy abroad.

Q389 **Ian Murray:** A much more positive future of course means new entrants into the market and job opportunities. Can you give us a bit of a flavour of what that looks like, particularly, with regards to apprenticeships for our young people?

John McDonald: I think the future looks positive. There is a piece of work that we have been carrying out and we will continue to carry out, which is a youth perception report. That is looking at young people across the UK and what their thoughts are of the industry, knowing the good and not so good times that we are going through at the moment. That report shows very clearly that young people still see this as an opportunity and a career pathway for them moving forward, so that is a great thing. We will continue to monitor that throughout this year and beyond to make sure that that continues.

What we need to do is make sure that we have a range of inputs and opportunities into the system, and so apprenticeships are key and different types of apprenticeship with that as well. At present, because of the safety and technical needs of our industry, an apprentice would normally take about three and three-quarter years to train. That is something you would expect, given the safety aspects of that industry. Moving forward, we can see different pathways and different inputs into that, working with our own industry and with both Governments in London and in Edinburgh.

If I may say, as a balance to that, Chair, the way that the Apprenticeship Levy has been introduced across the UK is something that the industry is not happy with at all. We have an opportunity here—the principles are great—to bring four systems certainly down to one or two. We have ended up with four systems and our industry is very clear on this. This is a new tax. Westminster have told us this before, it is a tax. Because of the size and scale of our industry it means that, in order to be in this industry, you have to be big to start with so of course you are going to be disproportionately affected by this.

What it means is there is a lack of equity, a lack of efficiency and a lack of clarity. Despite the good work that the Scottish Government have done in many, many areas here, to tell us simply that, "This has been imposed by Westminster; it is not something we wanted. The money is not new money and, out of £220 million, £10 million will go into a flexible fund" is simply not acceptable.

Q390 **Ian Murray:** What do you need back from it? Obviously the Government are committed to the proportions coming, plus a little bit extra to make up the shortfall. What does the oil and gas sector need from that?

John McDonald: What we need—again, if we talk about equity, in England we will be able to pay up to £27,000 per apprentice across the lifetime of an apprenticeship. In Scotland, it is £9,000. The cost is about £90,000, so our industry already pays 90% of the cost of an apprenticeship and now we have the tax on top of that. My fear is that what will happen here, the unintended consequence of this tax will mean that there are fewer training opportunities taking place, fewer apprenticeship opportunities. Where do companies find that tax from if not the training budgets? In England we can claim back up to £27,000. In Scotland it is business as usual and £9,000. We would want—

Q391 **Anna Soubry:** Why is that? It doesn't seem very fair at all, so why is it like that? What is the reason?

John McDonald: I can only say what we have been told by the Minister and officials in Scotland and that is that this is not new money—despite Westminster telling us it is new money—and that it will be business as usual. It is very, very disappointing to us.

Q392 **Chair:** When you communicate this to Government, both Westminster and Scottish, what responses are you getting back?

John McDonald: We are getting responses back that suggest a lack of join-up between those who are making decisions in Westminster and those who are discussing this or are responsible for this, Chair, in Edinburgh. The responses are simply from Edinburgh, "We didn't want it. We didn't ask for it and it is not new money" and that is difficult for us to deal with. In Westminster we are being told it is new money and—

Q393 **Chair:** Yes. We know all the tensions between the UK and the Scottish Governments when it comes to this particular issue. I just want your view and whether you have been listened to, when it comes to the various appeals that you have made both to the UK and Scottish Governments.

John McDonald: Chair, our view would be that there needs to be a rethink on this in the Scottish Government. A £10 million fund from £220 million next year isn't sufficient, and that £10 million is tied to college delivery. While we fully support the college sector in Scotland, this needs to be employer-led and employer-delivered.

Chair: We will leave that there.

Q394 **Ian Murray:** I would like to go back to how your skills development portfolio has changed on the back of the reducing oil price. I do want to pick up what you have just said because, if you are saying that the transition money of £10 million that is coming from the new Apprenticeship Levy is to be college-based, what is your actual ask? What do you need back? Not even comparing the £27,000 from the UK Government, what do you need back as a sector to build those jobs for the future?

John McDonald: To be clear, there is a separate £10 million. It is not part of the transition training fund; that is something else. We would like to see clarity on where that money is coming from. Is it from the £220 million? How have things changed for us? We have talked about that multi-skilling, that re-skilling approach that we have been carrying out in the industry. There is a big focus on us on STEM, on science and technology, engineering and maths, on young women as well into the industry—that is a longstanding issue for us—and getting STEM into primary schools.

It may be that what we are doing is projects that have an oil and gas flavour to them, but it may be that these young people decide to go into another branch of engineering, of technology. That is great. It is good for the country. However, we are focusing hard on that. At the moment we are looking at new styles of apprenticeship that may include the foundation apprenticeship, the graduate apprenticeship.

What is our ask? It is two key things for me. One is it is very difficult for a graduate—and these are young people who entered university at a time when things were much better in this industry—to get the experience they need to get into a real job. We would like to see a fund set up that would provide opportunities to become an intern for a fixed period with a company and get that experience. We would like the Government's help with that. That is perhaps an ask from the £220 million that is coming from Westminster.

Secondly, we would ask from that money that we look at fully-funded apprenticeships. This industry is in a very difficult situation. It has served this country well for many, many years and now we have asked the Government's help in saying, "Well, could we fund a certain number of apprenticeships going through over the next number of years to make sure when that upturn turns, then we are ready for that?" Because, right now, companies out there are finding it very difficult to fund this and finding it even more difficult with a tax where there is no return.

Q395 **Chris Law:** You have answered some of the questions I was going to ask about the levy and also went into some detail about what your key asks were. It also made me think a little bit more about what was happening in Norway with their oil investment fund. I know that Chancellor Healey also former Chancellor Darling said it had been grave mistake that there was a lack of tax receipts kept towards the fund. Going forward, however, would you like to see something like that be created, either at a UK or Scottish level or both?

John McDonald: In fact the fund that we see in Norway and other countries, from a skills perspective, the levy may well have done this in a different form. For me, for skills, what I want to see is opportunity for our young people, right across the UK, as a sustainable industry. That can come through an open market, competitive market policy. However, in difficult times like this, it is going to either need Government support or support through such a fund. In terms of skills, I do believe that here is the ideal opportunity. If there is £220 million coming in, why don't we use that to get us through this difficult time on skills?

Chris Law: Mike, do you have a view on that?

Mike Tholen: Yes. Over the years the country has benefited of the order of something like £300 billion to £350 billion of taxation in today's money from the industry. Looking ahead, because of the changing nature of the cost in the basin and the changing nature of production from the basin, we don't see the same depth of yield to taxes in the years ahead simply because of the pressure the industry is under. It is probably ill befitting for a trade association to recommend how the country spends those monies. I think that is much more of a political decision than one for the trade association.

Q396 **Chris Law:** I guessed you were going to say something along those lines, but just more of a recommendation rather than an instruction, would it be something that perhaps the industry would like to see?

Mike Tholen: I am going to step back from recommending how the Government spend the taxes. We are after a stable tax regime and one that, hopefully, demonstrates that we are profitable and delivering funds to the country.

Q397 **Chris Law:** Just staying on the tax regime and receipts at the moment, you are quite correct, it is between £300 billion and £350 billion being paid in taxes, and obviously at the moment we are in a position where revenue is falling. Can you tell me if the current tax regime is helping in recovery for the sector, or what more can be done?

Mike Tholen: The tax regime has paid a lot over the years in UKCS and in recent years, in particular, it has gone through some very big changes and I hope ones that are making the industry more competitive. The challenge for us is to make sure that we see fiscal stability over the long term, so that we make the most of a competitive tax regime, which we now have and one where we have a competitive cost base. That combination of the two together is probably the best thing we can do to allow the industry, frankly, to get out and do its stuff, which is to invest in the future opportunities in the basin. So, stability and preferably a very boring tax regime would what we would be after. Thank you.

Q398 **Chris Law:** A last question: when do you see the oil and gas industry making a positive contribution to public finances in the future?

Mike Tholen: I hope it is doing so even now, not least through the employment taxes and the broader contributions in corporation tax in the sector. I think we are just about holding our heads above water this fiscal year, just about balancing tax receipts. Over the next five years the industry is looking to deliver something like £7 billion or £8 billion in taxes over the five-year period, based on the last budget book. We will see the new one not very long away. I think that will factor in the benefits both of the cost changes we have seen, the improved competitiveness of the industry and maybe a better outlook for production. I hope to see that we are contributing our share to the economy as we work hard to deliver a good future.

Q399 **Ian Murray:** You mentioned the £78 billion in the Treasury red book in terms of the next five years. Can you give us some context to what that looks like in comparison to, say, the five or 10 years before? To give us a flavour of how much the industry has really struggled with this oil price downturn.

Mike Tholen: There are probably two ways of trying to assess that. One of them is the ONS—Office of National Statistics—that publishes rates return for the sector, which show how much cash the sector is generating. Over the last five years that has fallen from 20% or 30% down to barely 1% or 2% most recently. The industry is struggling to make a margin on its money, and it needs to be able to do that to reinvest, to get the next barrel out of the ground. It is, alas, a very simple industry we are.

The fiscal yield has fallen. In 2011 it was about £12 billion and it has fallen almost to zero and then it is just coming back up above now. That represents two factors: first of all, a big change in oil price but, also, we are taxed on a cash-flow basis, so it recognises how much money you are spending as well as how much profit you are making, so it helps to attract investment early and is taxed on that basis. You get heavier taxes, better benefit later, as investment slows, so quite a change but one that I think reflects the torment of the sector.

Q400 **Ian Murray:** It is a change but it is absolutely dramatic. I have just seen the figures here. In 2010-11 tax receipts from oil and gas were around 5% of total Government tax receipts, and in 2015-16 it is predicted that for the first time it will be negative in terms of tax receipts. That is huge in terms of a downfall in what the Government would expect to secure from sectors as important as oil and gas. Again, I am just looking at how you are taxed. Maybe you could help us here to try to understand how all this works out and how we could come to figures like that. You have the ring-fenced corporation tax, you have the supplementary charge and then there is the petroleum revenue tax. How does all this impact and how do we start to understand figures like that: 5% of total Government receipts being negative in this current year?

Mike Tholen: There are two main themes to the taxation. One is we typically have what are known technically as cash-flow taxes, so they represent both the profits and the spend of money. You benefit by allowing depreciation of your capital early, which helps to drive investment. The Exchequer then benefits from the profits as they come once you have made that investment.

Even five years ago, tax rates were sitting between 60% and 81% in the pound. They went up on 2011 to that rate. The challenge in the industry at the time was that those taxes represented a high point on the low competitive edge for taxation. Taxes were going up at a point where we were becoming more competitive, so it hit us in the midriff when we really did not want it.

That started to drive investment out of the basin, some of which has returned since over the last few years. It shows the pressures that have been on the industry over the last few years when, as I say, with the cash-flow tax, much of the profit is going straight to the Exchequer. The low point last year represented the fact that the industry was spending more than it was earning, which was clearly not a healthy point to be at. That dynamic is, gradually the industry is spending less and earning more, so we are coming to our head above water, and the recent wave of investment is depreciating through the tax regime. Those two things together mean that, hopefully, we will be a positive taxpayer this coming year and, indeed, for years to come with that combination of new production and investment.

Q401 **Chair:** You reckon last year was just a one-off when it was negative in terms of tax receipts?

Mike Tholen: It represented a year when we saw the torment of low oil prices, big changes in cost and still the impact of a wave of investment. The industry has invested something like £60 million on new production in the last five years. Those things gradually get eaten off the tax bill, as you see that represented in the way the taxes have gone. In the coming years we would like to think that we are again a net taxpayer, but that depends on many things: costs, oil price and, indeed, activity.

Q402 **Anna Soubry:** I think it was in 2012, wasn't it, when Sir Ian Wood did his review? All recommendations were accepted by the Government in about 2014, when of course the price of oil was very different to what it is now. Taking into account things like the new college in Aberdeen that is being introduced as part of the city deal, I wondered whether or not, given the fall in the oil prices, the expectations about the volume of petroleum that can be recovered should be looked at again with the fact that there has been the fluctuation and the fall in oil prices.

Mike Tholen: I would not want to stop Mr McDonald having a say in this one. I had the pleasure of working with Sir Ian Wood on the Wood review. I think it caught an opportunity to reflect where we were on maturity of the basin and try to right-shape the industry for the years ahead, in terms of its thinking, its maturity, and to allow the industry to build on its past but have a much more independent future—maybe a little step back from Government—with a more focused set of regulation to try to drive the future of the industry.

Coupled with that, the Oil & Gas Technology Centre—which is now part of the firmament as well—recognises that we will be driven by technology, we are good at technology, and that is an essential part of our future. The combination of improving the infrastructure in and around Aberdeen and the north-east of Scotland as well is a vital part of delivering, to make sure that the capability of the sector here in Aberdeen is not held back by its distance from other markets.

In terms of the prospectivity and the outlook for the basin, at the minute companies' plans are to produce something like 6 billion or 7 billion barrels. None of those are in the bank, but they are the things that companies are currently connected to trying to produce in the North Sea. Every single billion barrel taken above that needs new investment, new focus, and in many cases has still to be found. So the shape of the industry to come will be turned by what we do over the next few years. If we can get activity to be at the right place and we can sustain a competitive supply chain, we will be in a good position. We need all of those elements—technology, supply chain, exploration and costs—to be right if we are going to see a positive future for the industry.

Q403 **Chair:** On decommissioning, there is lots of talk and suggestions that this will open up a number of opportunities for those that are currently working in the oil and gas sector. Could you help the Committee understand better what these opportunities are, what difference that will make to the skillset that currently operates within the oil and gas sector and what is required in order to move forward to decommissioning? Just for myself and Mr Law, part of our cities' deal too, decommissioning is going to feature as quite a large part. Could you help the Committee understand a bit more what is required in order to meet this transition?

John McDonald: In terms of decommissioning, there are huge opportunities across the UK and particularly in Scotland, so it is important that we make sure that we are ready for those. From a skills perspective, the skills that put together a rig are the same skills that take a rig apart. There is also a whole series of scrapping the rig and so on, and making sure that that is done in as effective and as green a way as possible. For me, while there will be jobs here in decommissioning, what is a good thing for us is that the skillset is similar. That means that we can upskill/re-skill people quite readily from those who are working on maintenance on rigs, on construction, to the deconstruction and the decommissioning of those rigs.

We are looking to develop something this year that would look at a small piece of work—and we want to talk to Skills Development Scotland about this—as a piece of that transition training, where we take people who have perhaps lost their job or are in danger of losing their jobs, and then move them over to that decommissioning sector. As we all know, that will grow as time goes on here but the important thing here is to be ready for that. I would say to the Committee that it is not the wholesale new set of skills that sometimes we read about, but that is a good thing.

Q404 **Chair:** Do you feel that both the Scottish Government and the UK Government understand the significance of the opportunities presented by decommissioning and are you getting the necessary support from both Governments in order to try to progress this?

John McDonald: Yes, in different ways. The Scottish Government are very firm and helpful in this, and are certainly looking at different ports and speaking to us about, "How can we help you develop something quickly here?" The industry needs a response and will do the job.

Q405 **Anna Soubry:** When I was a Minister, we specifically had a working group that looked at—among other things—decommissioning because it is so important. Am I right in remembering two aspects to it? Yes, there is the dismantling of rigs and the actual decommissioning, which of course we can become a world leader on because we are not the only part of the world where that will happen. But isn't there also end of life—I think that is the unfortunate term—where there is still oil there to be extracted if you have the right skillset and the right equipment?

John McDonald: Absolutely. I am just going to say one more thing, if I may, Chair, and then my colleague probably has something more to add. In terms of across the UK, again BEIS have been working with constituents there to ensure that in the north-east of England there is an offering there. For me to finish off, Scotland is very well placed to take advantage of this. We have the right skillset and we have the right resources to deliver on it.

Mike Tholen: The decommissioning opportunity is something that will last maybe 30 years. Mercifully, it is not a one-night wonder. It is going to be something for a generation to come, and in today's money will typically be a spend of about £1.5 billion to £2 billion a year. To put that in context, we currently spend about £7 billion to operate the North Sea and even this year we are still—on legacy investment—seeing something like £8 billion being invested in the North Sea basin, based mostly on already-sanctioned investments. So it is an important part of a much bigger pie.

The opportunities over the next generation to come will be as much around being very smart at how we do decommissioning offshore, and those technologies, as it will be the activity onshore. The onshore dismantling—much though it is a very visible part of it—is still a smaller part of a much bigger pie, and it needs to be looked at in that context to make sure that companies and individuals recognise there is value and opportunities here. Then there is exportable knowledge and exportable capability, much of which, alas, is over the horizon in terms of being done offshore.

Q406 **Anna Soubry:** Can I ask a supplementary? Another point that was always made when I was in the Department was that there had been historically—to be blunt—a lack of co-operation between the different companies. I heard lots of stories, Mr Wishart, about different bits of equipment for a one-off company that was not the same as another company, which was then a nightmare, obviously, for supply chains and efficiency. Have you seen in recent times an improvement in that so as a sector you are much more efficient?

Mike Tholen: It is never pleasant to be pointed to by your failings, but I think those failings are true. The classic would be that component A does not fit in component B's opportunities, valves, a whole range of things, where I know myself as an engineer the novelty is amazing but, frankly, you would rather avoid it.

Part of it is the way the industry has grown up, but the challenge for the next years will be to be smart and efficient. We have been leading a lot of work within the industry to really focus on efficiency and to share best practice. Companies are trying to deliver almost an "Amazon of the future" type approach, where you can get that component off a single warehouse service anywhere. It takes time to do but companies recognise the one-size-fits-all-almost approach is needed to pull the cost down, to be efficient, to be smart and to compete against onshore American shale oil, putting it bluntly.

Q407 **Margaret Ferrier:** I am going to swap my questions about if you don't mind, Chair. We have done really well so far in not mentioning the B word, but I am afraid it is now time. In 2015 all UK gas exports and 75% of oil exports were going to the EU. On 10 February this year it was reported by *The Times* that a leaked Government document had ranked industries by priority for the Brexit negotiations, and that the oil and gas industry had been ranked as a low priority. How significant do you think the UK's departure from the EU is likely to be for the oil and gas sector?

John McDonald: I will go first on this one, if I may. First of all, we would want to say that our industry works in many, many countries across the globe and works well within those regimes. The Brexit decision by the British people is one that we will continue to work within. This is Government policy. We need to make sure that when we have workforce coming into this country, perhaps from other countries with a set of skills that we don't have here, that there is a fast and efficient, clear process in order to bring people in from other countries. Sometimes we need a set of skills quickly. They may not be available locally and we may have to bring them in from elsewhere. We would ask both Governments on this to be sure there is a process in place that allows us to do that.

Mike Tholen: To build on that slightly, some of the things to do with Brexit are common across the industry and some things hit different parts of the industry in different ways. As Mr McDonald mentioned, in terms of access to labour, we work in an industry where we need access to the best skills from around the world to serve around the world. The free movement of labour—when done efficiently and effectively—is a vital part to our success, and you will see that in the north-east of Scotland and right around the world.

Access to markets is important, whether you are within the supply chain or, indeed, whether you are an oil and gas company itself. How that then rolls out depends in part on the activities of that company. Oil and gas companies, per se, are probably much more focused on the impact of sitting currently within a common energy market and the ability to buy and sell energy across Europe. We have to see how that emerges, but it is vital to recognise that we will, de facto, still be part of a common energy market with or without the changes that are going ahead.

As you look further afield, companies right across the supply chain import and export across Europe. Again we will have to see how that emerges and hope that we have the minimum barriers to trade, whatever happens in the future.

Q408 **Margaret Ferrier:** Would you say that there is a lot of uncertainty at the moment around the negotiations? You don't know what is going to happen, and would you say it is important that you do have access to these skilled workers from the EU and also, as you said, access to market without trade barriers and tariffs? You mentioned the need to keep commercial codes and tariffs consistent in the future. Is there anything else that worries you? Do you see companies still wanting to investment or is there a pullback on investment because of this uncertainty at the moment?

Mike Tholen: Clearly no industry likes uncertainty, and that tune is as much for any industry and not just our own. As Mr McDonald mentioned, we are active and, indeed, Scottish supply chains are active in 100 countries around the world based on what we do here. Only a few of those are clearly within Europe, so the destination for our goods and services will still be there. The challenge is to make sure that we can access those markets in Europe as efficiently and as cheaply as possible. Again, like others, we have to see how the negotiations emerge.

Q409 **Anna Soubry:** Just to follow this up—and I am aware you might not want to prioritise and we would not criticise for that—what are you more worried about? Is it the lack of access to this free movement of labour, or is it the uncertainty and perhaps the lack of access or the diminution in the access to the market?

Mike Tholen: It is hard to prioritise one against the other because they do different things, but access to skilled labour—some of which comes from within Europe, some of which is from outside Europe—is part of how we succeed as companies. Almost every company in the oil and gas industry has an international footprint and has to find a way to be efficient and effective doing that, and movement of labour is part of what we do.

In terms of access to markets, we ourselves are commissioning work at the minute with a number of consultancies looking at the micro detail, and certainly we will be very pleased to share that outcome with the Committee once we have it. Access to markets is important both for goods and services as, indeed, for the end product, some of which are around energy policy that we will see emerge in due course.

Chair: We would be very grateful for that, because we are also doing an inquiry into the Scottish relationship with Europe and exploring some of these issues, so if you could that would be very helpful.

Q410 **Margaret Ferrier:** Another couple of questions. Do you feel that the industry, the regulator, the UK and Scottish Governments are all on the same page when it comes to supporting the oil and gas sector and maximising the economic recovery of oil and gas?

John McDonald: If I could answer first on that one. Mostly yes; I think it would be a qualified "Yes" on that. That is not because anyone is not getting involved. It is just the complexity around negotiations. It is the complexity of our industry, which often I describe as a series of industries within an industry. Certainly, from a skills perspective, there is a clear direction from both UK and Scottish Governments. We need to do what is best here around maximising economic recovery: how can we get the right skillset in order to assist with that? I have particularly mentioned Skills Development Scotland and OGA are certainly pushing forward with that as well and, again, the Energy Jobs Taskforce in Scotland and BEIS in Westminster are working very closely with OPITO on those things.

Mike Tholen: To build on Mr McDonald's comments: the industry, the regulator, BEIS and the Scottish Government I think are very strongly aligned on trying to make our industry a success as, indeed, they would like to see strong industrial success of the countries as a whole.

The sector does have some pretty difficult challenges to face, though, because for a good future we need to continue to invest and we need to continue to develop new opportunities. That hunger for new developments and the need to attract new capital to the basin is probably the most immediate challenge the industry faces. There is no easy solution, but being cost competitive, being comfortable in the regulation of the industry and recognising that this is a good place to invest means everyone needs to align together to deliver that outcome. But I see no lack of resolve to do so.

Q411 **Margaret Ferrier:** You would say that there is still gain there for investment? Can you tell us how many barrels of oil you think are still out there in the north-east? Have you worked it out?

Mike Tholen: Gosh. I am going to slightly dodge the more than $64,000 prize, I am pleased to say. At the minute I mention that about 6 billion or 7 billion barrels are connected around the UK to oilfields, gas fields for production. The challenge is every single billion barrels—that almost makes it sound easy—every barrel needs new money to attract to develop new stuff. That is then down to the business of the industry being cost competitive. The industry seemed to be a good destination for investment and the Government have to work closely with the industry to make sure we can woo them here in the UK.

Margaret Ferrier: Back in November 2016 Oil & Gas UK called for a recommitment to the industry from the UK Government. What made that call so necessary and has there been a positive response from the UK Government?

Mike Tholen: We have seen a strong and I hope renewed focus from the Government for long-term tax stability, which is important because that sets the context for people who invest now and deliver future opportunity. In parallel to that, one of the things that we are keen on, which is coming out of the Brexit discussion, is this discussion around industrial strategy, to recognise that we have a tremendous supply chain, a tremendous industrial sector, and one of the challenges that we believe the British Government and I hope the Scottish Government will take up is how we recognise the capabilities of the sector so that we can stand alongside aerospace, automotive, as being part of the USP of the economy within Britain. There are some tremendous companies in Scotland, tremendous technology in Scotland and it works offshore and it works overseas to good effect. Success for me is to have us stand alongside aerospace and automotive as being an industry not just for today but an industry that is capable for tomorrow. Oil and gas will be needed for decades to come. For a lot of what we do there is no better solution still for the world economy.

Chair: I know we are close to winding up, but I have two further questions, one first from Ian Murray and then to round things off from Deidre Brock.

Q412 **Ian Murray:** We have talked about prices and jobs and investment, decommissioning, a plethora of complicated topics directly related to the oil and gas industry. The Scottish Parliament used to produce an oil and gas bulletin that looked at many of these issues. Is that something that is still happening and useful and does it allow us to examine what is going on, where the opportunities are and what we need to do as policymakers to exploit them?

John McDonald: I have not seen that in some time. I am not sure if that is just a case of I have not seen it and it is still there and people in my organisation and others, I am not sure if Oil and Gas UK are aware of it, but yes, it was something in the past that was useful. I would have to check and I am happy to respond to the Committee after this meeting.

Q413 **Ian Murray:** If you could that would be very useful. Mr Tholen, have you seen it?

Mike Tholen: I am slightly embarrassed to say I have not seen one recently, but sometimes you do let these things slip. I would say the Scottish Government do publish a lot about the industry and there seems to be a growing expertise within Scotland and within Scottish Parliament of its true capabilities, which is attractive really.

Q414 **Deidre Brock:** This is really probably more for Mr Tholen. There have been big drops in the price of oil in the past. I found something online that adjusted for inflation suggests that, say, in 2002 it was down to US$34 a barrel, 2008 US$51 a barrel. I am wondering why the industry did not look then as seriously as it is now at operating costs, reducing those, getting those down, and do you think if they had that it might have been possible then to avoid now some of the job losses that have been taking place in recent years?

Mike Tholen: The wisdom of age is something that I think all industries would like to have in what they do. I was working in the sector through that downturn in price, as well as in previous ones. I think the differences are twofold. One, we were at a different place then to now, so in 2002 we were producing two and a half times per day in the way of oil and gas than we do now, so while costs were high we were producing a lot, so it felt a less difficult place. The need to change now when you get to mature years in some cases really brings home to you quite where you are at, and forces people to look much more challengingly at where we are. I think that hindsight has made a different approach this time.

Coupled with that, working with the Oil and Gas Authority and with a more robust and challenging interface with Government who have high expectations—quite rightly—of what the industry can do has made us think much more carefully about how we plan our long-term future. I would not want to say we were ever casual in the past about that, but thinking hard about the future now is much more vital when you can see that if you don't things will slip away from you and no one wants that.

Q415 **Deidre Brock:** You feel that this will be subject to a constant review going into the future than was the case in the past?

Mike Tholen: Indeed so. It is probably worth reflecting, I remember sitting with some of our members who were on our management board in 2014 well before the oil price started to wobble and there was a challenge then to become more efficient and to focus on the future because companies knew that where they were at was not as healthy as it should be. I think we are working much more with our eyes wide open to the opportunities and challenges now, and with that wisdom, that insight, I think you can plan a better future than just planning as maybe was done in the years past.

Chair: We are going to have to leave it there and we are very grateful for both of you, gentlemen, for coming along and helping us. We are considering doing a full inquiry into the oil and gas sector from this Committee and I am pretty certain if we decide to do that we will be asking you back again. For now, thank you ever so much for attending the session this morning.

Examination of witnesses

Witnesses: Gordon Inglis, Director and Principal Consultant, Accord Energy, Fred Bowden, Managing Director, Woollard and Henry, Carole Leslie, independent adviser

Q416 **Chair:** Welcome to the Scottish Affairs Committee. We are all looking forward to this evidence session. For the record, can we go from left to right and tell us who you are, and anything by way of a very short introductory statement will be of benefit to the Committee. We will start with you, Mr Inglis.

Gordon Inglis: I am Gordon Inglis. I am an employee-elected Director at Accord Energy Solutions.

Carole Leslie: I am Carole Leslie. What I do is I help companies who are looking to move into employee ownership.

Fred Bowden: I am Fred Bowden, the Managing Director of Woollard and Henry. We are a long-established fabrication and engineering company. We have been on the go for about 140 years in Aberdeen.

Q417 **Chair:** Great. Thank you. In the course of this inquiry as you know we are looking into sustainable employment in Scotland, and we will be investigating some of the issues and reporting back to Government with, hopefully, recommendations. We have heard that businesses can benefit from improving employee engagement in giving workers a stake in their businesses—principles that are essential to the employee ownership model. What prompted you to pursue this model for your businesses? We will start with you, Mr Bowden.

Fred Bowden: We have been employee-owned now for 15 years and we are slightly different in that we became employee-owned because we were in a distress situation. The paper industry in Scotland and the whole of the UK was going through a very difficult time. The previous owners became ill and there were limited options for the company, so with the help of Baxi Partnership Limited we became employee-owned and we have gone from 22 people up to almost 70 people.

Q418 **Chair:** Is there anything that you would suggest that would explain that growth in your employment? Is it the way you do things differently that is attractive to growing your employment?

Fred Bowden: Yes, there are a number of things that help with employee ownership as well. With the employee ownership what you are trying to do is get people engaged as much as possible and the product that we have, although it was world-class—the dandy rolls that we are producing for putting watermarks on to paper—is a very limited market. We had to start to explore options, and look at some ideas from the shop floor, and from different sectors. For example, there are 28 bank note mills in the world, and we now supply to just about all of them, so this is all coming from a small company in Aberdeen.

We just looked at different sectors where we wanted to be and, latterly, we have moved into the oil and gas sector, which I am sure you heard is quite difficult at the moment, but for us we found that a lot of our growth has come through products in that, and we now have another facility in Scotland that we have opened up in Turriff. We have a design service centre in Germany and we have a small machine shop in Poland as well, so we have diversified quite a lot through employee ownership.

Q419 **Chair:** Great. Ms Leslie, why the employee ownership model? Sell us it. How does this benefit workplace organisations?

Carole Leslie: Typically companies who are looking to move into employee ownership tend to be owner-managed or family businesses, and usually it is for exit for the owners, who are probably looking to retire. They have a real connection with the local community and they know that if they are going to sell to a trade buyer there is every chance that that company will relocate and the jobs will go and the company disappears from the area. What employee ownership does is that it anchors that business in the local area and it sustains the jobs, employment skills, opportunities for young people, for the long-term. Typically that is the kind of companies who do it. The examples you have today have come from different angles, but that is typically the companies that I deal with.

Q420 **Chair:** Maybe Mr Inglis could tell us a little bit about how this works practically. How is it different from traditional models of employment?

Gordon Inglis: Before I came to Accord I had worked for PLCs for the previous 30 years of my working career. The people who set up Accord were part of the management team for the last company I had been employed by. We had been acquired. We had been a small consultancy and we had been acquired by a PLC. We had become disenchanted with the type of rewards and type of approach that the PLC took to our work, which is very much consulting.

What we found is that by becoming employee-owned and starting from that perspective we have been able to engage with people and encourage them to join us very quickly. We now have 32 employees, a number of associates, so it has been very much a case of engagement and involving people at all levels in decision-making. We have a very flat structure. We have a board of five directors, three of whom are the founders, two of whom are voted by the employees on to the board. They serve for three years at a time and any of the employees can ask questions at any time. We do a lot of information sharing about business development, about finance, about general remuneration, although individual packages are confidential. Those are the types of things that have helped us.

Q421 **Chair:** I am just looking at your own information that you supplied to us and we received from the Employee Ownership Association. You have stated that employee-owned businesses achieve higher productivity and greater levels of innovation and are more resilient to economic turbulence. That all sounds fantastic. Why are more companies not doing this, if this is the case?

Gordon Inglis: I can say two things about that. When I worked for a PLC we were very much financially driven. There was an expectation you would set annual budgets and you would make efforts to exceed those, regardless of the economic climate and if there was an economic downturn then what you would do is the first thing you would start to look at was how you could mitigate any loss of sales that would come about through that. Generally that was as a result of cutting numbers, whereas in an employee-owned organisation, where we have a very strong commitment of working together then we are in a position where if people are not reimbursable our business model is very simple. It is almost like the bums-on-seats model, where as people give us work we try to fill that demand with our different skill sets.

When people do not have work they will go out and look at either, "Can I develop business by going through contacts or can I think of a new idea of improving what we do?" We have two examples of that we have pursued over the past two or three years where we have developed some new software. That would have been an investment decision for a PLC.

We did not have to think of it in that way because we are not financially driven in quite the same way.

Q422 **Chair:** Higher productivity and more resilience to economic turbulence, are those exaggerated claims? We will come to Ms Leslie, if that is all right.

Carole Leslie: No, not exaggerated at all, and in just about every business metric employee-owned companies will outperform conventionally structured companies. It makes sense. You have two great examples here. When people have a stake in the company—and it is not I find about the financial stake, it is about the influence they have over strategy, the way they do their own jobs, how they have more information about how their jobs impact the bottom line—you can only get positive results when that happens. You asked about why there aren't more. My view is there aren't more because simply not enough business owners know about it. It is like the best-kept secret and Scottish Enterprise, in particular, have been very active in promoting employee-ownership education to lawyers, accountants and bankers, who are the ones closest to business owners who might be considering succession. That is beginning to gather fruit, particularly since the new legislation in 2014, which gives capital gains tax relief to business owners selling to a recognised employee-ownership model, we have now seen a surge in interest from accountants and lawyers, so it is slow but we are beginning to see interest building.

Q423 **Chair:** This is the last of my introductory questions to you, Mr Bowden. I think you mentioned oil and gas. We heard representatives from the oil and gas sector in an earlier session. How does this assist in a sector that is as huge as oil and gas and one that is currently experiencing a whole range of difficulties and issues?

Fred Bowden: I think for us it is because we have people really engaged and we are very open with people, to tell people what orders are coming in. Every week we will sit down with the workforce, have a meeting, and it feels a little bit like this, where everybody is firing questions at you. They can ask questions about anything at all in the work, sales line, so long as it is not about people's pay. People will ask about the finance, they will ask about the cash flows, they will ask about sales coming in, so people will know in advance where the work is going to be coming from, where we might have quiet spells and if we are not spending money why we are not spending money. People are aware of the situation and they also know how the business works, so they are very flexible.

I have also worked in larger companies where people have specific jobs and you don't step outside of that department and the routines and everything. It is not at all like that in Woollard and Henry. If somebody can help in a different department they might not have the skills to do it but they will certainly help to the best of their abilities and most of the time they do not even need to be asked.

Q424 **Chair:** I was not going to ask any more questions but I am tempted to put this one to you to see what your response is. You have painted a very positive and rosy picture about this model of employee ownership. What happens during the bad times? I am presuming that like any company there will be issues and difficulties that you have encountered along the way. How do you respond when things do not seem to be going so well and you need to make difficult decisions?

Fred Bowden: To be honest, just like any other business in that respect but we are honest and we tell people. It has been difficult for us on the oil and gas side of things and we have had to lose some people that through no fault of themselves are good people but just the way the business has gone, but we have explained it to people upfront the reasons why we have had to do these things and it has been a last resort for us. But we have to make difficult decisions for people. We have to look at our cash flows. We have to make sure that we are profitable to make sure that the company flourishes. In that respect, it is the same as any other company but we are honest and open with people, so that they know it is coming.

Q425 **Chair:** Is that roughly your experience, Mr Inglis, when you have to deal with the difficult decisions?

Gordon Inglis: We have found it very similar. I think one area I would talk about is about the management of performance. Again, going back to the PLC model, the management performance tends to be trying to march people out of a business quite quickly if there is a perception they are not performing. Under employee ownership where you have this joint commitment—and I subscribe completely to what Fred has just said about the participation in the areas where people are not so expert—in employee-owned businesses you are in a position where you have a bit more flexibility, a bit more time to help people with performance and what we have found generally speaking during the time we have been in business we have had four people move on from the organisation in six years. That is compared to a turnover of something like 15% in the organisation that I used to work for, so it is quite different.

Q426 **Chair:** Ms Leslie, do you have anything to add about how you observe employee ownership organisations coping and dealing with some of the more difficult decisions?

Carole Leslie: It is just what Gordon and Fred have said because people tend to be much better informed in employee-owned companies. It is not a surprise when you suddenly have to deliver the bad news, and people tend to take it a bit better. It is always horrible. Redundancy is horrible, but it tends to be slightly easier when you know it is coming and you know people are being honest, and it is very transparent.

Q427 **Margaret Ferrier:** Going back to the point Ms Leslie made there, I have been in a company where there have been redundancies. It is not good because everybody is very suspicious of everybody else because there is no transparency from the management down, so I do take that on board that there is always this criticism that they are kept in the dark, so if there can be more transparency then that helps.

Can I just come to you, Mr Bowden, first? You mentioned Germany and Poland. Do you have anybody coming from Germany and Poland, or are they standalone companies?

Fred Bowden: They all come under the Woollard and Henry umbrella but it is a design and service business over in Germany. The reason we did that is because we went out and targeted specific products that were best in the field. We actively head-hunted and recruited the best people we possibly could, to give ourselves a base in Europe. The one in Poland is slightly different, in that we had a Polish CNC operator working with us for eight years and he always said that he was going to go back to Poland. The fact was he was a very good employee, he knew our product, so when he went back we started up a small CNC shop that is proving very good for us.

Q428 **Margaret Ferrier:** So they do not necessarily have to come over here and work? They have work expanding over in the EU countries?

Fred Bowden: They can do. They will come over and help as and when we do some commission. A lot of our products that we make are big capital products for all over the world. Because of their expertise they will come across and do the checking on the systems and make sure that everything is okay before we ship out, and things like that, and if they need the extra pair of hands the truth is they will come over and help as well as we will send people over to Germany to do the same.

Q429 **Margaret Ferrier:** The point I am trying to get at is with Brexit and the free movement of people back and forward maybe that has not been considered yet and I don't know how that will turn out, to be honest. None of us know, but certainly from the free movement I am wondering if that will create a barrier for people coming from Poland to here or Germany.

Fred Bowden: There is concern. Numerous times I have been asked from both Poland and Germany what is going to happen, but the truth is we are not really in a position to tell them at the moment, so we can just reassure as best as possible.

Q430 **Margaret Ferrier:** Thank you. Maybe I can come to Ms Leslie first. In companies where there is employee ownership does that mean there is better conditions and remuneration for staff compared to more traditional business models?

Carole Leslie: It is probably worth emphasising that when a company goes into employee ownership the employment contract does not change. People are still under a contract of employment and they are paid as normal. Yes, in an employee-owned company you don't have external shareholders looking for a dividend, therefore there is more money to go around. Typically what happens—in fact Fred is probably well placed to explain what they do at Woollard and Henry—and what they are likely to do is some of the profits will be reinvested in the company, some will go out to employees as a bonus and some of it will be preserved for the future, so cash reserves for the future.

What you also get and it is quite topical just now about executive pay is quite a lot of companies work with a remuneration committee, where you would have maybe an elected director, like Gordon, who would sit on that and a non-executive director who would then oversee executive pay and pay equality, so that makes the pay structure a lot more transparent. Yes, they do tend to have better terms and conditions but they also have better structures that make things fairer and share the wealth out more equally.

Fred Bowden: I would echo what Carole is saying as well, but we have a couple of ways of getting cash into people's hands. There are no external shareholders. We have two trusts, one that we set up with 50% and the reason for setting that up is to make sure that we cannot be bought over by competitors, so we anchor the jobs here in the UK and in Scotland. The other part is that we use for internal market and, once a year, we have the Inland Revenue revalue our shares. People can buy in shares and we use the SIPs scheme to do that, so people get cash through the shares. We also offer dividends and bonuses but the interesting thing about us, we don't really have wage negotiations as such. At the beginning of the year we will say, "Look, we need so much money to invest back into the company. We will set certain targets and if we reach these this is likely to be what your salary increases will be". It is across the board we have done it, if it is 2%, 3% it is the same for everybody—we try to treat everybody as fairly as possible.

Margaret Ferrier: Would you like to come in, Mr Inglis? Do you want to add anything?

Gordon Inglis: I would say our model is very similar to Fred's, in the sense of having an employee ownership trust that the aim is to have just over 50% and there is a portion of the remainder of the shares that come through our share incentive plan. So far as our wages go, we look at market conditions and about how the business has been going and then the board, which consists of three founder members plus two employee-elected directors, will take a view as to what percentage seems reasonable and if there are exceptional cases in terms of performance or whether we want to promote someone within the organisation, but it is a very flat idea like that. It is not constrained in the same way as Carole has just said, as a PLC would be by having a portion of the money removed as dividends.

Q431 **Anna Soubry:** Gordon and Fred, what percentage of your workers are in unions?

Gordon Inglis: We do not have any of our workers in trade unions. We do not have a particular view on that one way or another, it is just no one has expressed an interest in having trade union representation.

Fred Bowden: We are the same. We have no trade union members. It is not that we discourage it. It is just that every week people are speaking to us in a forum anyway, so they feel they have the voice there to speak about it.

Q432 **Anna Soubry:** Is that common, Carole? I was going to call them co-operatives but that is probably not the terminology to use when an employee is very much involved.

Carole Leslie: I would say it is very typical, but that is mainly because we are talking largely about SMEs, where you don't tend to get a lot of union representation, but it does tend to be unusual to have union representation. Some of the care companies find it useful because when they are working through, particularly, the health and social care integration, it has been useful having union representation talking around that table, so for some sectors they do find it to be useful to have unions involved.

Fred Bowden: Sorry, can I just add? When we first became employee-owned there were a few members who were members of trade unions, but within a number of years I think they came out of the unions.

Chair: Moving on, we have a question from Deidre Brock.

Q433 **Deidre Brock:** Mr Inglis, Accord Energy has said that most employers recognise that people are key to the success of any company and that surely it is time that all companies reflected this when deciding how much people should be paid. Do you think that principle should apply in sectors where there are lots of low-skilled, low-paid jobs like the hospitality or retail sectors? These are two areas that we have been looking at in particular.

Gordon Inglis: So far as employee-owned organisations are concerned, there is a point that is quite simply down to economics, but beyond simple economic performance, then rewarding people adequately should be seen as one of the attractions of employee ownership.

Q434 **Deidre Brock:** Ms Leslie, can you add to that?

Carole Leslie: That is an interesting question. As I said, I work with a number of care companies who are employee-owned and like other care companies we are talking about staff who are on low wages, tend to be zero-hour contracts and the reason they are on zero-hour contracts is because of the way care is commissioned in the UK so there is not really any other way round that. The fact it is employee-owned, there are no external shareholders, so there is more money to go around, so people do tend to be paid the best that can be paid by the company but you are still talking about quite a low level. What these employee owners do have is they have some influence into how the company is structured and how it runs and the quality of care that is delivered. It is probably no surprise that the companies that are employee-owned in care do tend to rate very highly with the Care Quality Commission audits, so it works.

Q435 **Deidre Brock:** Presumably lower turnover of staff?

Carole Leslie: Yes, much lower turnover, which is important in care. Continuity is important.

Q436 **Chair:** Can I ask if there are any occupations or sectors where it would not be appropriate to have employee ownership, or would it work in any business, sector or occupation? Ms Leslie, I will ask you that first.

Carole Leslie: Last year I worked with a lighting company, an environmental science company, a shop fitting company, a care company. What was the other one? I can't remember the other one. It really does cover every kind of sector. I did think maybe hospitality would be a difficult one—

Chair: Yes, that was the one I was thinking of.

Carole Leslie: —because of the high staff turnover. Auchrannie Hotel in Arran has just moved into employee ownership. There is a hotel group down in England, I cannot remember the name, and there is also a Wales holiday camp company—is it Bluestone?—which is making the move to employee ownership. So it is moving into hospitality as well. I am working with a hotel in the Highlands, who do not want to be taken over by a chain, and the owner wants to secure ownership with the local people, some of whom have been working there for 30 years.

Q437 **Chair:** It sounds like you very much evangelise about the benefits of employee ownership, which we are grateful to hear, of course.

Carole Leslie: Sorry.

Q438 **Chair:** When you do suggest this, when you go to perhaps occupations or sectors that are a bit more resistant, what do you say to them in order to encourage them to think about this particular model?

Carole Leslie: I honestly do not encourage anybody to go down one particular path. It is very much up to the business owner, and I see my role as very much presenting the option, which they can choose to take or reject.

Where it does not work is if people are looking for a very high price for the company. These deals tend to be vendor-financed, so the company has to be able to afford to pay the price. For example, in Woollard and Henry, and in fact Accord as well, where you have really unusual and highly valuable IP, a competitor would pay extra for that. You could not really compete with that in employee buy-out.

Q439 **Chair:** I am suspecting that a number of businesses that would consider employee ownership are ones that—I don't know which one of you mentioned this—were experiencing difficulties and were possibly facing close-down or shutting. I have one in my consistency—although I am not too sure if it is employee-owned—which is the Glenshee Chairlift Company, which operates, and they were experiencing all sorts of difficulties, and employee ownership they saw as a means to address this and deal with this. Is it mainly companies that are experiencing major difficulties with the prospect of possibly going out of business that are looking at this?

Carole Leslie: Woollard and Henry is the exception that proves the rule. I don't talk to companies in distress. If a company is in distress, it is very likely that the asset is already gone, that the best people have left the company; the owners have probably taken as much as they can out of it. In that case, why would employees buy the dregs of what is left? This is about successful companies with money in the bank, with a very positive business outlook. This is about successful businesses. It can work for rescue and there are some good examples where it has worked, but that tends to be quite exceptional, and you really need some good, strong backing to get a company out of the hole and back into trading well.

Q440 **Margaret Ferrier:** Just a quick supplementary. I am just interested in finding out if you have any statistics or what your experience is of time out of work in sectors and companies that have employee ownership. Is it similar to the other traditional types of business, or is it less?

Carole Leslie: It is greatly reduced. I cannot give you actual numbers, but I could get them for you and do it with a written submission, if you would find that helpful.

Chair: It would be.

Carole Leslie: One of the most interesting statistics—this is not something that has been happening in Scotland but down across the border—is on public sector mutuals, which are employee-owned organisations spinning out of public sector ownership. A study there showed that the most dramatic changes were that absence levels were reduced greatly, and also the level of wasted resources was resourced. That was in the space of the first 12 months of moving into the employee-owned model. Absence does tend to be greatly reduced in employee-owned companies.

Q441 **Chris Law:** I am excited by hearing all the good news stories so far. I am just thinking of when my own family was involved in the past, which is a big, family-owned company, Tullis Russell in Fife, which sadly is now closed, but it is not as a result of this model. We had nearly 2,000 workers, of which 50% went to employee-owned, so it is quite sad to hear. I wanted to ask you, do you have any large examples of companies that are not SMEs, which are also involved in employee-owned models at the moment?

Carole Leslie: Larger companies. Scotland is an SME economy, and I work mainly in Scotland, although I have crossed the border sometimes.

The larger ones that you would know would be John Lewis Partnership, which is the best known model. Arup Engineers, which has just done the Forth crossing, is 100% employee-owned, and always has been. CH2M Hill is working on the A9 dualling and is 100% employee-owned. Golder, which is an environmental consultancy, has 8,000 employees across the globe. Other big ones?

Fred Bowden: I think that is most of them, yes.

Carole Leslie: It is typically an SME model, but you do have these larger organisations, and in the States you have Southwest Airlines, Publix. They do exist. Financing can be an issue. A couple of companies just now that I am talking to have over £20 million turnover, and it is how do you finance that, and how long will it take? It is not impossible. It is just a wee bit different from your £10 million to £20 million SME business.

Q442 **Chris Law:** I have a further supplementary. It is really about existing employees. I want to ask about new employees in a minute. Existing employees: when you change over to an employee-owned company, let's say you have 10 staff, and one of them has been there for 30 years, five of them have been there the last 10 years, and another five the last couple of years. How do you decide on who should get what shares of the company and what their stake is?

Fred Bowden: For us it has always been equal. I actually worked at Tullis Russell for a period of time, and I saw some of the good things that happened and some of the bad things. What we decided when we went to Woollard Henry, everything was equal. I can buy the same amount of shares as anybody else, and that stopped a lot of this ill-feeling. It has worked well for us like that.

Q443 **Chris Law:** Is that the concentric circle?

Gordon Inglis: Because we were an employee-owned start-up, it does not really apply in the same way.

Q444 **Chris Law:** Using the same model, how do you go about approaching recruitment? Is there a different stance towards recruiting new employees, and what kinds of potential workers are you attracting as a result?

Gordon Inglis: If I could say something about that, Accord is a consultancy business. Our approach to recruitment has largely been looking for people within the niche area that we operate within. We have done a lot of work that has been looking very much at contacts, and contacts of contacts. Where it perhaps changes a bit—because I think that is perhaps true of any business to some degree—is that to a very high degree we look at whether people will fit in within the employee ownership side of things because the mindset is a bit different. When you are in a PLC, you expect to be given certain things or be able to demand certain things. Within an employee-owned organisation, you have to look at it a bit more as being together as part of the whole thing, rather than having an expectation one way or another.

Fred Bowden: The truth is it can be quite difficult for us because the majority of our employees are all skilled. When you are in Aberdeen, they are paying very high pay for some of these skills. What we have to do is when we go through the recruitment process, we try to get people that are going to be here for the long time and explain to them, short-term, we might not be able to match their salary expectations, but in the longer term and with the dividends and the shares, if they put the effort and the commitment into the company, the rewards can be higher longer-term. We are looking for people who are going to come into the company. We will look after them, treat them well, or as well as we can do, treat them ethically, and keep them in that way. It is longer-term that we try to sell that one.

Q445 **Chris Law:** Carole, do you get approached or does your body get approached by recruitment agencies looking, or do you go to recruitment agencies and say, "We have a slightly different offer here. We are looking for these kinds of staff. This is what the package is"?

Carole Leslie: That is a good, challenging question. I have just done a number of recruitment exercises with different employee-owned companies. As Fred and Gordon said, when you are recruiting for skilled staff, then you always have to be aware you are recruiting a future owner of the company who could end up, if you have elected directors, on the board. That changes how you recruit people. You are not just looking for a welder; you are looking for a welder who might possibly be sitting on the board making decisions about strategy in two years' time. That is something.

The challenge is managers. In employee-owned companies, managers have to deal with a much higher level of scrutiny by the people they manage than you have in other companies. It is not the kind of environment where you can be, "You will do it because I tell you to do it". To be honest, employee-owned companies just do not work that way. They do it because it is the right thing to do. That can be difficult for managers, and I am not sure—again, SMEs—recruitment agencies really feature that strongly. It is imperative that they really get why it is different.

Q446 **Anna Soubry:** Can I just follow up on that? Would it be right to say that it is not for everybody, not just the business, but for the employee or, rather, the employee-owner? You are paying in, not just in your own work, that extra effort and time. I don't know—you tell me—but it looks like a lot of people need to have that longevity and commitment to the business.

Fred Bowden: Just on that as well, the employees, it is not for every manager. If you think as a manager, you have to put in a lot of effort not just telling people what to do but convincing them that it is the right thing to do, and giving them reasons, and then giving them the feedback. It does not suit everybody. You do have a lot of work as a manager to put into these things.

Q447 **Anna Soubry:** A lot of people do have a private business, their own business. They will say, "I am prepared to remortgage my own home; I will do anything to keep my business going". That is the level of commitment that they have to it. Can that put people off in these sorts of employee-owned businesses, or are they never in that position because they never have to make a level of investment or security, rather, for an investment?

Fred Bowden: In Woollard and Henry it has not really been financial. People have not put their houses on the line financially. Where they have put it above and beyond is really the level of commitment and the work and the hours. It is a little bit embarrassing, but we have some guys that will put ridiculous amounts of hours in to make sure customers get their goods on time and everything like that, and it is that kind of commitment we see more than the financial.

Carole Leslie: It is worth pointing out that employees do not have to engage with this. When a company goes into employee ownership, there is no downside for employees, so nobody is forced to be evangelistic like me or to work seven days a week. As long as they stick to their employment contract, they are protected by employment laws just like any other employer, so for employees there is no downside. Fred is right; when it comes to the management level, where there is a lot more that is expected, it is maybe a bit more challenging. For employees, I think we are very lucky that people do tend to engage, but they are not forced.

Q448 **Anna Soubry:** My final question is, do you get as a sector good support and, most importantly, enough promotion as a concept by both the Holyrood Government and of course by the Westminster Government? It is probably a question for Carole.

Carole Leslie: Scottish Enterprise is the part of the Scottish Government that is promoting it, and I think Scottish Enterprise is doing a really good job. I think the Wales Co-op—part of the Welsh Assembly—is doing a good job. There is not a similar body in England. There is the employee ownership association, which is UK-wide, which does its best at promoting. Of course I am going to say this: yes, I think people could be shouting louder about it.

The biggest step-change of having employee ownership in the last 10 years was the 2014 legislation that brought in the capital gains tax relief and also allowed employee trusts to pay bonuses free of income tax. That in itself did not make a difference to business owners, and did not make much of a difference to employees, although they were very happy to get extra money. It made a difference because people who advised businesses started taking notice of employee ownership.

Q449 **Margaret Ferrier:** Just a supplementary or a comment really. It sounds to me that the employee ownership scheme makes the employees feel more valued. They have to be part of a team or team-focused. In your opinion, does it make them feel that they have to make the business a success and they take pride in what they are selling and they are more customer-focused? Do you agree with all of that?

Fred Bowden: Yes.

Q450 **Chair:** That was a very short, to-the-point answer. What we have heard in the course of this inquiry is that the UK is very low when it comes to workplace democracy. In fact, we are just about at the very bottom when it comes to the involvement of employees in terms of the workforce, and we also have very much a deregulated labour market with features like low pay and zero-hour contracts. Are you not swimming against the tide when it comes to where we seem to be going in terms of the workplace environment just now? How do you take on these forces when you see them confronted in whole variety of different employers that you must do business with too? Ms Leslie, that is one for you.

Carole Leslie: It is called the rowie meeting because they have their morning rowie, which is a roll in Aberdeen. The translation for Aberdeen is rowie meeting. People have the opportunity to say anything they want and find out what is happening in the business, and once you have that, you cannot ever take it away. You could not suddenly decide to stop doing the rowie meeting, or you would not have a job—

Q451 **Chair:** My questions were about the general culture that exists now and the general workforce. There is a much more deregulated environment and there are these types of issues that confront a number of businesses. How do you start then? When you are evangelising, you are faced with these forces, what do you do?

Carole Leslie: That is difficult for me to answer because I work in a sector that is not like that and it has very strong workplace democracy, so it is very difficult for me to answer. It will be theory because it's not the area I work. I do work with some SMEs, which I've got to say before they move into employee-ownership tend to be quite autocratic, because they are owner managed and that owner manager has had lots of say, tend not to be particularly effective at delegating decision-making down the ranks, and we have to put in lots of effort to get people more involved and educated as to how the business is structured. It can be done and it can be done relatively quickly. I do believe people have a real thirst for knowledge about where they spend 35 hours every week.

Let's move away from workplace democracy and let's move away from people having proper jobs, being on zero-hour contracts, being on casual labour, not having anything or the security of employment. You are missing a trick because that is where the productivity is going wrong. That is where you are losing that engagement, the connection between people and their work, and I think in the employee-ownership sector we have it, maybe, not perfectly right but we have it more right than others.

Q452 **Chair:** Thank you for that. We hear quite a lot in terms of: increased productivity tends to be from businesses that have good workplace democracy. We see that as a culture. My question is, therefore—and I think Anna Soubry picked this up but we would like a detailed response—what sort of support are you getting from Governments, both in the UK and in Scotland? I know you work with the Scottish Enterprise Commission and you do some work on all of this. Could you talk a little bit more about what you do when you are doing this, like how you would take this model to businesses and try to encourage them to think about taking it up?

Carole Leslie: In Scotland, Scottish Enterprise account-manage high growth businesses, larger businesses and businesses that are significant for different reasons in local economies. The account managers are working with the business owners to look at succession plans because succession is a huge danger point for businesses. If they don't make the right succession decisions the company can disappear or be disadvantaged.

It is making sure then that employee-ownership is on the table, so along with the more traditional ways that they might look at exiting the business. Then I would meet with the business owner and talk through what the options are, how that might look if they want to take the employee-ownership structure. Then, if they do, Scottish Enterprise would undertake what is called a succession review, looking at all the succession options. That is a document that the business owner then has to help with their decision-making.

If they then want to pursue the model, Scottish Enterprise will signpost to different employment companies that have done it. Both of them, Accord and Gordon Henry, have been great at talking to businesses in Aberdeen who are thinking about this. They have had a number of events, information, working very closely with lawyers, accountants and bankers to raise their levels of awareness of the model.

I can only talk about Scotland because that is where I have been most active since 2010—seven years.

Chair: I am grateful. We are coming to the end of the session. I wonder if there is anything that we have missed, in terms of a better understanding of employee-ownership, yes, Mr Law?

Q453 **Chris Law:** I want to raise an important point, which is about financing. I worked in finance previously, so I want to know how difficult or how easy is it to find support from investors or banks, in particular, towards your business compared to more traditional models.

Fred Bowden: We were very lucky in the early days that we had the organisation Baxi to help us with the equity part of the funding side of things. If we hadn't had that I think it would have been extremely difficult is the truth and for other companies in our situation near impossible I think. Trying to raise the equity part—especially if you are in a distressed situation—it was a bit of a leap of faith for Baxi when they helped us out with that side of things, so the financing is a bit of an issue. Luckily now, because we turned the business around and everything we get a lot of support from the Royal Bank that we use at the moment but that can be an issue. I believe that is one of the biggest.

Q454 **Anna Soubry:** It might be interesting, Mr Wishart, if we can get figures to see whether there are more in Scotland or, indeed, if Aberdeen has a higher percentage maybe because of the work that Carole, does compared to England and Wales and so on.

Carole Leslie: Be able to look at the number of employment companies?

Anna Soubry: Yes.

Carole Leslie: In the private sector I did a quick count up, there are about 130 private sector employment companies in the UK; 41 of them are in Scotland. Scotland does have a higher proportion of employment companies comparative to the size of economies.

Q455 **Anna Soubry:** Why do you think that is?

Carole Leslie: I think that is because you have Scottish Enterprise doing the signposting and the awareness raising. I think that does help. Similarly in Wales; Wales has a disproportionately high number as well because of the efforts of Social Business Wales, where Wales's co-ops are very active as well.

Financing is an issue and all the deals I've done in the last few years have been largely vendor financed. That is fine because it is a kind of soft lending. The owner understands the business. They are more likely to be more flexible if things get a bit difficult. Banks might not be. That does not limit that route to people who are happy to wait for their money for five, six, seven years, depending on it. Some people, entrepreneurs, who might want to set up another project, they want the cash up front and you cannot do that with vendor financing.

The banks are generally supportive but when it comes to individuals, because you have this collective ownership, things like personal guarantees—they like to have a name they can hang the debt on. In this collective ownership model that is a bit more challenging.

Chair: Unfortunately we have come to the end of the session. The question from Ms Soubry was a big question, so if there is anything further that could help us. We don't have time to go around now if there is anything that we have missed, so perhaps you could give us that in written evidence, perhaps an overall on how all this works, the types of companies that you have supported in the past, and the approaches that you make in order to try to encourage companies to take this up. It would be very useful for us as written evidence. I am sure Ms Leslie will be able to supply us with that.

Carole Leslie: I was going to get Fred to do it.

Chair: Well, you can get Fred to do it then.

Carole Leslie: I am happy to do it; happy to do that.

Chair: There you go; there are a number of willing volunteers to do that task. We thank you ever so much for coming along. It was a very interesting and fascinating session for us, so thank you.

Examination of witnesses

Witnesses: David Watt, Executive Director, Institute of Directors Scotland, Barry McCulloch, Senior Policy Adviser, Federation of Small Businesses

Q456 **Chair:** Thank you, both, very much for attending this session. The last session today at Aberdeen University and, again, it is worth saying how grateful we are for their accommodation today. Just for the record, could you tell us who you are, who you represent and anything by way of a very short introductory statement? We will start with you, Mr Watt.

David Watt: I am David Watt. I am the Executive Director for the Institute of Directors in Scotland, a business organisation representing 1,850 business leaders from a whole variety of different organisations, large and small, primarily in the SME market as most of the Scottish economy is.

The only opening comment I would make is that the whole area essentially ties in quite closely to other aspects of the economy. It is quite difficult to disengage sustainable employment from other parts of the economy, like affordable housing and a whole lot of other issues that tie into that that maybe we will come on to discuss later on as well. It is a linked situation and it is very difficult to separate it from other places. That would be my only opening comment.

Barry McCulloch: Thank you, convenor, and thanks for the invitation. Barry McCulloch, the Senior Policy Adviser at the FSB. We have 18,500 members in Scotland, roughly 60:40 urban/rural split, and around 170,000 members across the UK.

By way of an opening remark, I would probably just direct you to our consultation response. What we were trying to articulate was that there was a need to move beyond national level discussions about the labour market and focus on the places that generate jobs and: what is it that makes these places successful? Is it the type of businesses? Is it the sectoral makeup? Is it post-industrial issues that they have struggled to adapt to on the knowledge-based economy? We are trying to shift that discussion away from up here right to the granular level.

Q457 **Chair:** I am grateful. Just on the general labour market, in the UK we have a relatively flexible labour market with low fixed cost employers. I don't know if that is something that you would buy into and agree with. How important is that type of flexibility, therefore, for businesses? We will start with you, Mr McCulloch, given that you first put us on this thread.

Barry McCulloch: Sure. I think, if you spoke to most small business employers, that would not necessarily be a characterisation they would agree with and they would point to, in particular, the increase in labour costs. I think, it is just over a year to 18 months that labour costs have increased by 11.5% and for those—

Q458 **Chair:** What is that down to then?

Barry McCulloch: That has been driven by the introduction of the National Living Wage, and there is—

Q459 **Chair:** Has that already led to that type of increase?

Barry McCulloch: Yes. I think, when you include the increase from the minimum wage for the 21 year-olds in October and then you factor in the increase in April, which was 7.5%, you get an overall increase of 11% and I think from that point some businesses have been struggling to recoup their costs.

Just to return to the original question, between 2008 and 2013, in particular, the flexibility of the labour market was, particularly within the SME segment, which allowed the SMEs to hoard labour and that is why we did not see the unemployment rates that other countries saw. If you compare us to France in particular—which have quite protective labour rights—you do see this divergence between labour market flexibility and unemployment and employment rates.

Q460 **Chair:** In your view, is there a tension between employment and this flexible labour market and things like the National Minimum Wage, the Government initiative?

Barry McCulloch: I think there is always going to be an inherent tension between Government objectives and what businesses set out to do, which is broadly generate profitability. There is a particular issue now because the flexibility, which was inherent in the labour market between the recessionary years, has now normalised so you have the increased use of zero-hour contracts. Just on that issue, I would point out that only 3% of the workforce in Scotland is covered by zero-hour contracts. The majority of employers who use zero-hour contracts are in the public and voluntary sectors and in a rough score small businesses come out very well; less than 10% of small employers use zero-hour contracts.

Q461 **Chair:** It is a theme that we want to revisit in the course of this session. Mr Watt, would you agree with my poor characterisation of the flexible labour market in the UK? How would you describe it? What is your view about some of the issues that Mr McCulloch raised?

David Watt: You will not be surprised to hear that I would not agree with the characterisation being poor. Inevitably, in a modern society and a modern economy, the workforce and, indeed, companies have to be more flexible. One of the things that irritate me is politicians using the phrase "exploited" if there are zero-hour contracts. Where they are exploitative, they absolutely should not be allowed to be exploiting workers, but that is the different from saying that they should not exist because, in this university and in other places, there would be people who would be quite happy to have them apply to them. I think it is always dangerous when we take a political view and impose it on business and, indeed, on individuals and employees, so we should be a bit cautious about that.

In general terms, flexibility should be seen as a positive thing. Perhaps they fear it. Where I would agree is it should be applied by employers as well as employees, and it should be to the benefit of the business and the employee. For example, obviously, flexible working round about domestic arrangements would be a sensible approach to that and, indeed, flexible hours that suit the individual as well as the business.

Q462 **Chair:** You give the example about domestic arrangements, but how many employers work on that basis where the flexibility is provided in order to support the employees?

David Watt: I think a lot do where they can and I do think it is growing. I think technology makes it easier to grow. I could not put a number on it but certainly, when we surveyed members a few years ago, I think about 58% were offering flexible working practice even then. That was five years ago I think it was. That was across the UK to be fair, but there were a significant number who were offering that. I think it was mentioned just a moment ago.

If you get a good employee you want to retain them. You don't want to lose them, so you are prepared to work with them for the benefit of the business. There may come a point when it does not suit either party but, in general terms, flexibility for both the employee and the employer works.

There are a number of industries—again probably rehearsed before—that cannot give that flexibility because of the demanding nature of their business. There are certain hours where fish are taken out of the sea or whatever it may be, so there are certain challenges there. Certainly, if we are an office-based financial service, for example, I think anybody who did not offer flexible hours there would be cutting off their nose to spite their face.

Q463 **Deidre Brock:** We have been told by other witnesses that the costs for businesses—such as VAT, say—restrict the ability of employers to pay their workers more. Do you think there is a relationship between the tax burden on businesses and what they pay workers?

David Watt: Absolutely, 100%. I think Barry put it beautifully. People are in business to make money fundamentally and to make it for the stakeholders, perhaps for themselves or as much as they can. That is why people go into business. As has just been talked about, the employees can well share in that and that, to me, is a sensible business approach. But, absolutely, the more business costs there are, and there is a massive debate—both in England and in Scotland—around business rates and the impact that is going to have and it will have two impacts. There is a potential for it to freeze or even reduce staff costs, either in terms of numbers or wage levels. Secondly, it will potentially reduce the number of businesses. So these impacts are very significant.

When you are faced with a rates increase of over 100% then you have a real challenge to keep that business going. All of the costs, and there have been a lot from the Apprenticeship Levy, as mentioned as well, and the changes to the minimum wage, which maybe will be welcomed by society as a general principle and clearly we have all said, as far as business rates are concerned, let's phase it in and let business catch up with that increase. You don't need to go far to hotels locally that are incandescent with rage and genuinely believe they might disappear, so absolutely the increase in any business cost will have a direct effect on employers and the business.

Barry McCulloch: Yes, likewise, Governments can either enable or inhibit growth in the economy. We can have an argument about what that growth is, what it looks like and how it should be distributed, but I think, as a fundamental premise, Governments should do what they can to support businesses.

On the point that David made about business rates, it is very good and it is a very topical example where you have draft revaluations being posted out to businesses and many are seeing large increases, and often an investment allowance, where if you

improve your property naturally your rateable value will increase, but just phasing that in so that the business can understand why their bills have gone up and why the—

Q464 **Deidre Brock:** Sure. I mean your SMEs, so many of your businesses pay no business rates at all because they are under the Small Business Bonus Scheme. So what are some of the other areas that could perhaps be changed that would enable employers to pay workers more?

Barry McCulloch: We have argued in our budget submission to the Chancellor that there is a good case to extend the Employment Allowance. If you look at the success of the original scheme, if we could extend that remit to cover more it would lower the costs of employment. The costs of employment fall disproportionately higher on the micro businesses, those that are very, very small, and for those who take the first step it is progressively more expensive. It becomes less expensive the more you employ, the better you get at it, the more you skill up. I think that is another example where we would look to the UK Government, in particular, to do what they can.

There is ongoing debate within Scotland about the role of income tax, with the devolution that we have seen, and whether the choice that the Scottish Government have made will either deter higher rate income tax payers from growing their business within Scotland, or whether they will carry on regardless. At the moment we are unclear—as a nation and as two Governments—what impact the income tax has on businesses that operate across the UK. We are going into different territory here, where we don’t know what the policy path will be in the next five to 10 years and what impact that will have on business.

Q465 **Chair:** Before we lose the business rates issue—because you are right that it is particularly topical just now—you represent small businesses, so could you tell us how many are covered by the Small Business Bonus Scheme?

Barry McCulloch: Sure. At the moment there are just under 100,000.

Q466 **Chair:** Out of how many?

Barry McCulloch: There are roughly 350,000 businesses in Scotland. Out of those 350,000 98% are small and 94% are even smaller—within the micro range. It depends whether or not you have commercial premises in the first instance. Roughly about 50% of small businesses operate from the home. They will not pay rates unless they allocate a proportion of their domestic situation to business rates.

Just to go back to the point that Deidre Brock made about the Small Business Bonus Scheme, it does provide the lifeline to many businesses who take that choice to locate in a town centre or an area of high economic activity. I think some of the anomalies and—

Q467 **Chair:** I want to come on to that. I am grateful for that response because I don’t hear all that much from the general debate just now on domestic business rates. It seems to me that the businesses that seem to be getting clobbered—if you want to use that word—tend to be in licensing and hospitality. Why is it they that seem to be at the sharp end of this real devaluation just now? Maybe Mr Watt could help us with this one.

David Watt: I just had the conversation about Aberdeen. It is partly because the valuations are historic. If you valued a property in Aberdeen or hotels—based on turnover, for example, a certain turnover—in an Aberdeen hotel on turnover two years ago, it was a licence to print money, let’s be fair. It was a very successful business. Two years later the occupancy rate has probably fallen from the thick end of 95% to probably 55%, so the turnover is out of kilter. So, where you are now paying business rates on your turnover two years ago, you don’t need to be a rocket scientist to understand what a difference this is in Aberdeen. Whereas you were probably looking at £250 a night for a hotel bed in

Aberdeen two years ago, you would probably get it for £80 now. That is a massive difference.

Q468 **Chair:** This is an issue that seems to be particularly difficult for Aberdeen and the north-east when it comes to this reassessment. Is that your view?

David Watt: To some extent it is partly because they have come first. It is not alone. Gleneagles, God bless them, are faced with £1.4 million extra this year. Even for Gleneaglesthat is a significant amount of money. So it is causing problems all over the place, particularly for the license trade and the hotel industry because it is based on a turnover basis.

There are obviously a number of businesses who will be paying less because either the value of their property is down or their turnover two years ago was less than it is now or less than it was previously even, but it is not a happy place.

Q469 **Chair:** I don't want to go into this further but I was just interested because it was raised at a previous evidence session we had in Westminster. Is there a better way to do this then when it comes to the assessment of businesses?

David Watt: One of the problems you will be aware of as well, is there has been a long gap since the last assessment. That is probably the first problem. The second issue is that the Scottish Government—and I cannot speak for England on this front at all—had the Barclay Review undergone to look at how we spread that more fairly or over a period of time or how we do it more regularly. It does seem a shame that we have come with this massive increase before that review was reported, which I think would have been a better place, personally, to go for it as well.

The third point I made earlier on is about perhaps a gradual introduction, even if you are going to increase Gleneagles£1.4 million perhaps if you do it over a three or four-year period to let them catch up. Because of the significant gap—and Barry will tell me exactly when the last assessment was—there is a real delay in that and it is across the UK at the moment.

Chair: I think the Committee wanted to try to better understand some of the dynamics that have gone on behind it, so we are grateful. Maybe Mr McCulloch could help us at another point; not just now. Thank you.

Q470 **Deidre Brock:** Moving on to some of the discussions we have been having about greater workplace democracy. We have been told that companies can bring a benefit from putting in place policies to allow more of that and to allow employees to contribute to the running of the business. We have just heard some terrific evidence about that and how successful that can be. Do you recognise the benefits of giving employees a voice in the workplace? How does it apply to the businesses that you represent, in your experience, and how would you say that that is best achieved?

David Watt: A very good question. You have heard a number of examples so it is probably not worth going over it again. For example, a business in Fife was one of the last jute mills that survived, basically, by turning the executive floor into a workers' think tank room so they could come up with innovative and different ideas about what new products and things their existing equipment could devise. So ideas like that work. There is no question. I can bore you rigid about businesses who have told me that, perhaps after many years of not doing that, they have started to listen to their workforce, either individually or globally, and this proverbial thing "My door is always open to new ideas". I think since the recession that has happened and the businesses that are thriving and successful do listen to their workers. I think the ones who are struggling are the ones that don't listen to their workers, if I am honest with you.

Quite how we get to them I don't know. I preach to them daily but whether they are listening I don't know. I have lots of evidence, as I say. A lot of it is just bluntly storytelling of people who genuinely do listen to their workers and they see improvement, they see new ideas coming to the workforce. Somebody even in a call centre saves £30,000 a year as a result of an idea that somebody who had been there for 20 years told them, just because they asked them at the height of the recent recession, "What new ideas have you got?" and it worked.

Barry McCulloch: One of your previous attendees said that they didn't evangelise about employee-owned companies. I evangelise about micro and small businesses. I think the solution to what we are trying to arrive at, in terms of workplace democracy, is within the business base. We just don't really understand it. If you understand the dynamics between running a micro business with five employees, in quite possibly a small office, the door is always open. There is no other option.

In speaking to members before the session it was clear that they couldn't not have a constant dialogue with staff, because they would get it in the ear—to use a Scottish expression—and they believe the culture is so ingrained. I would disagree about the autocratic comments. I think it is participative and collaborative, and that is seen in independent evidence on job satisfaction levels. It is either the TUC or the RSA who show that, on some of the indicators that the Fair Work Commission in Scotland evaluate us on, the small and micro businesses perform very well. They are happier, more satisfied to work because they have a voice.

Q471 **Deidre Brock:** Is there something that the two of you are going to be helping to grow? Are you going to put in place something formal, like surveys perhaps of members, and trying to make sure that that gets around to all of the members so that they can see the proof for themselves, because it does sound like you are both completely converted to the notion of it?

Barry McCulloch: We are led by our members. If our members want to hear more about employee involvement then that is exactly what we do. You heard previously that Scottish Enterprise do a fabulous job of promoting that initiative north of the border, but it is very niche. What was it, 41 companies out of 351,000? I think it is better to support the wider business base on how they can provide a more effective voice to their employees; many of them are already doing so.

David Watt: I would just quickly add that IoDs fundamentally exist to make directors better and to make the boardrooms of Britain and Scotland better. Part of that is a very significant part of our director development programme. We are just about to launch another session, for example, on talent management, talent development in business, so absolutely I would hope that literally every session we organise that sort of engagement with employees is talked about in a positive way from the boardroom down—if that is the right expression—or probably boardroom up. It is important as part of a director's education; of course it is.

Q472 **Anna Soubry:** Gents, we have heard from a number of witnesses over the last couple of months, certainly since I have been on the Committee, who have told us that Scotland has a huge pool—I am just quoting—of cheap labour that is ruthlessly exploited, it seems north of the border, by some terrible owners of businesses in a way that I thought had disappeared in Victorian times, if not certainly the 1960s. Could you help me with this? Is it not the case that any business's most important assets is indeed its workforce and it would be a very foolish employer that abused its workers and did not recognise them as its assets? Could you tell us whether or not, in your opinion, Scottish business is being run in this exploitative and ruthless way or is your experience something rather different?

David Watt: I will happily jump in and probably Barry has some better figures that I may have but, certainly I don't recognise that picture at all. I am not saying that there aren't bad businesses in Scotland—I am sure there are—and badly behaved directors. I don't meet a lot of them. I meet people who are working 24/7 to do the best for the business and their employees. I could list long stories, but I will talk about one business in Glenrothes that I know very well where the chairman came—again a few years ago now, in the recession—to the workers, about 150 of them, and said, "We are going to have to lay off 25 people. We have been told this morning they are going, but if we all work hard then in six months' time we will reemploy them". He was deeply upset when he told me the story because he personally felt he was mentally sacking members of his family, although they weren't.

So I think businesses are much more like that in Scotland. There are a significant number of family businesses in Scotland. The last thing a family business wants to do is sack anybody or certainly members of their family. Although I can tell one slightly whimsical story of a young man who took over the family business, where there were 26 on the board when he arrived and within a year he sacked 19 of them in order to get the business to be more effective. But that is a slightly separate issue. That was mostly with family politics I think.

Genuinely I think smaller businesses—and Barry will speak about that—it is literally like your family. It is like people you meet in the supermarket at the weekend. It is not some remote person. So I don't get that impression at all, and my members are certainly working very hard to employ people because, bluntly, through employing people you make more money. That is how you build a business: you employ more people, you grow the business and off you go and become successful. Making people not want to work for you or being unkind to them is not a way to make money. I just don't see how that works, certainly not in the long term.

Barry McCulloch: The one thing that I would pick up—just to complement David's comments—is that in the past two to three years where in Scotland we have had the Fair Work Commission we have had discussions about how employability policy should function more effectively through the Fair Work Commission, and we have started to look at how we can better support the unemployed into work.

It is topical but it is also frustrating because there is this false distinction between good and bad, low and high. I think it lacks nuance and it lacks comprehension because, when you peel back some of the rhetoric, there is no objective measure of what job quality is and I think that is a fundamental flaw. The conversations we have had are not based on evidence, and I think if we do have that evidence then we can contribute in a more meaningful way. Certainly it is not—

Q473 **Anna Soubry:** Can I just establish these figures? Maybe I did not hear this. Did you say that 3% of all contracts in Scotland are zero-hour contracts? Of that 3%, small businesses—the definition, is it not, is 250 employees or under—were 10%? Is that right?

Barry McCulloch: Yes. That is right, s small businesses zero to 49. That was from the Scottish Government briefing note that I stumbled across and from the Fair Work Commission's contribution to this inquiry, so we are talking about a small number of contracts in existence in Scotland.

Q474 **Chris Law:** I want to ask you to comment on corporate governance. The Business, Energy and Industrial Strategy Committee are going to hold an inquiry into corporate governance. I suppose what I want to ask you is: is the current system working for directors and its workers?

David Watt: Led by the policy team in London we have just submitted or are in the process or submitting a response to the Corporate Governance Review as well, so that will be either submitted to yourselves or others as appropriate. I suppose that is our daily bread.

The answer: in some ways it is working and in some ways it isn't working. For example, we have never been strong supporters of what we would call colloquially "fat cat" salaries or pensions. We don't favour a set number but we absolutely do favour the very strong feeling that the stakeholders involved in the business should have an input to the salary level, and they should make their voice heard at AGMs and other places so that the proper remuneration is paid, as one example as well.

In answer in Mr Law, there is no question that some of the aspects of corporate governance are not working. Equally, we have to watch—and this is the next bit—how far that remit extends and how far it goes into smaller family businesses and things. That is the thing to consider very carefully, is what corporate governance may be applicable to a FTSE100 company need not necessarily be the same for a small food business in Aberdeenshire, for example. That is a very dangerous road to take and we will need to consider very carefully where we go with that.

Absolutely, for us, corporate governance is about making sure the company is properly run to the benefit of all its stakeholders and I absolutely include the employees.

Barry McCulloch: There is very little I would add to that, other than saying that I think the notion of corporate governance in a small business is somewhat alien. If you spoke to some of our members about it they would genuinely be nonplussed about what that means, because the organisational layers between owner, management and staff, they just don't exist in the same way. They exist because of scale where, as the business grows, you need better ways to channel employee involvement, you need to look at pay ratios, and that just isn't the issue for smaller businesses. I think that was something that the CBI research articulated quite well, in that there is this issue about corporate governance for businesses with employees of 1,000 or more and then—back to David's point—there was another issue about how you get sound governance within the running of, let's face it, the majority of businesses in Scotland.

Q475 **Chris Law:** Tell me, I have a note then for both of you, you said earlier there are good and bad practices and perhaps we have been behind the curtain. In fact we heard earlier today that, if we compare ourselves to some of our European neighbours, we are well behind the curtain. What culturally is going on to get it to this position now and what changes would you like to see? Perhaps it is differentiated corporate governance for small structures. What other changes would you like to see develop in the coming months and years?

David Watt: The number one thing is to make sure we have mechanisms that genuinely do involve all the stakeholders, whether that is employee consultation committees. I am never personally very much in favour of representatives and boards. I have seen too many boards in the past personally where representation does not work but, absolutely, workers should be consulted and that consultation should be fed back to the board, for example, as should other stakeholders. They should not stand back and watch things they believe to be wrong, either in salary levels I talked about or, indeed, in working practices going on and not have it fed back to the board that ultimately make decisions on these things. Because I think—and this is where I almost lecture in this section on corporate governance—the key thing about corporate governance is it is not just all about policies and procedures, it is about the board and the directors knowing what is going on in the business, and what they want to deliver in terms of strategic direction being delivered. That applies to all businesses.

Everybody has to make sure that—not just through statute but through practice—they have things going on that they believe to be going on, that they are following the correct practice all the time, they are checking that on a regular basis and they listen to all the stakeholders, so perhaps forming employee groups.

A slight digression: I sit on the board of British Gymnastics and we are going to form a small group for performers so that, rather than sit on the board—which in truth will probably bore them rigid anyway—they are going to feed in to the board what is the interest of the performers and in that sport. In the same way, the workers should have the opportunity to do that. Very often on boards, for example, you will have a number of members of staff who, of right, are directors of the company anyway. There are different ways of doing it and there is a slight worry about too much restriction on what is done. It is about good practice and we need to encourage that at all levels.

Q476 **Margaret Ferrier:** I am going to come to Barry, if you don't mind, for my questions. How do the needs of small businesses and their ability to provide employment opportunities compare to larger businesses?

Barry McCulloch: They approach employment in a completely different way. They are often criticised for their informality because they quite often won't advertise vacancies. They will be heavily reliant on their own personal networks, but that is how they do it. Their business is a precious thing and they want to make sure that, if they are expanding their headcount and their staff numbers, they get the right person. I think one of the things they find particularly challenging in the current climate is access to skilled staff. If anything, you have about 30% of small businesses who are actively employing at the moment. We have a small business index and for the last six quarters access to skilled staff has been a barrier to growth. When they do get the staff they have to put in quite a lot of work to address some of remedial skills issues that they believe the education system should be solving for them, so there is that transition.

To make another point, what we don't understand particularly well is the role of small businesses in the labour market. Over half of all small businesses pay more than the voluntary Living Wage. If you look at the Scottish Living Wage Accreditation Programme, out of the private sector employers more than three-quarters are paying the voluntary Living Wage.

There are good stories out there about how local small businesses based in the communities are turning a profit and running a good business with their employees, but I don't think we talk about it enough. I think we focus on the behaviour of a small minority and I would quite like to see more discussion about: why is that? Why are the dynamics different? Why are they arriving at different outcomes? Why do they feel more satisfied at their workplace?

Q477 **Margaret Ferrier:** You mentioned obviously the recruitment of employees. You have mentioned previously about Scottish Enterprise and how good they are. Are there other agencies that help the small business sector? Do you think there should be more, with more support, to enable small businesses to provide more or better employment opportunities? Maybe you can highlight some of the skills that you mentioned that you feel we are missing.

Barry McCulloch: The Enterprise Network does a fairly good job at providing traditional business support and Scottish Enterprise is a good example of that. You have Business Gateway. You have Highlands and Islands Enterprise and you have various local authority-run schemes. Where it performs less effectively is in the skills dimension. We have our national agency—Skills Development Scotland—but its primary focus is on delivering apprenticeships. Their main task by Government is to meet the target and that consumes much of their energy. That is a slight disappointment from our perspective because so few small businesses take part in the modern apprenticeship programme. Quite often what our members tell us is that they are not sure where to go for advice. It is a complicated, congested marketplace because there is a lot out there and to the extent there was a report by Cambridge Policy Consultants done for, I think, the Scottish Employability Commission. They found that Scotland, when you tally up all the spending on employability, all the support out there for employers, it costs about £0.7 billion to no discernible economic impact. They couldn’t point to the relationship between the money being spent and the impact and the labour market.

I think the Scottish Government are very alive to this. They have published a new labour market strategy and they are trying, through their Skills and Enterprise Review, to address some of these big issues but I will continue to come back to this, this disconnect between what the employers get from the education system and what they need. Some of those skills are slightly basic and things, like communication, the attitudinal, the turning up on time, they are the things that our members tell us. It is not the technical. It is not even the qualifications. It is just that relationship in the first six to eight weeks to hit the ground running to come into work with the right attitude because their workplace is so small. If they don’t fit in the team it creates a different dynamic for the business, it hurts productivity, it hurts growth and so they are quite cautious about who they employ and what skills they are looking for.

Q478 **Margaret Ferrier:** Thank you very much. I am going to ask you now about the increase, because you highlighted an increase in self-employment in Scotland in recent years as a positive development but we have heard otherwise from some of the evidence that we have taken. In fact, a lot of people get into the self-employment route because they are unemployed but they don't have the necessary skills or the finance to make it a success long-term. Also it is going to result in low paid jobs and in work poverty. Maybe you could say: are people being encouraged to consider self-employment without the support and skills to make a success of it long-term, and what support, if any; do we need to make improvements in that?

Barry McCulloch: I don't think that is the case. You won't be surprised that I disagree with that. We had research out last week looking at self-employment levels across 479 towns in Scotland. I think what we found is that self-employment thrives in healthy labour markets. It thrives where jobs are or where they take place and we found a massive gap between the areas like Ullapool, which is top, where there are small, rural, wealthy towns quite distant from a major market. They are getting on and selling their goods and services to the market. We found an equally large gap between them and the areas of low self-employment, which were typically post-industrial communities in the central belt who are facing a whole host of socioeconomic challenges.

What we tried to gently suggest, because we don't have all the answers, is that poverty is a barrier to starting a business rather than an enabler. That follows on from the views of Mone Review that the UK Government commissioned, where they found a massive gap between the correlation between levels of multiple deprivation and business starts. You can almost draw a line. In our studies we found that there are some areas within Scotland where you can draw out a relationship between high levels of social housing and low levels of attainment. What that tells you is that those areas aren't conducive to starting a business because they might never have thought about it. They might not know how to do it, but the support is most certainly there.

To go back to your original point, there is a growing characterisation of self-employment in quite bleak exploitative terms and, if you look at either the research FSB has done or the Bank of England or the RSA, they paint a very different picture. It is quite complicated but the people who start businesses, the people who become self-employed are overwhelmingly in their 50s with assets, resources and expertise that they want to sell into the market. The converse is true of those without assets, without the expertise. Despite the fact that the UK has 11.8% of our workforce in self-employment, we do lag quite considerably. So my advice and my inclination is how we make people start more businesses rather than have a discussion about whether or not those businesses are under stress, because it is not something that I would agree with given the research that we have conducted.

Q479 **Margaret Ferrier:** You said that the support is there but I think it is about getting that message out about: where is the support? We possibly all have constituents coming to us that have started a business and they are still not sure and they are looking for that extra support, so it is:

where do they go to and how can we signpost these people as well?

Chair: Just before you answer that, we have received quite a substantial suite of evidence that suggests the otherwise rosy picture that you have painted, Mr McCulloch, about self-employment, in work poverty being high. In fact, it has been put out almost as some sort of contractual labour instead of being directly employed, so what we will need to see is your evidence when it comes to this. We will look forward to that because there does seem to be this movement into self-employment. What we have heard is that, with that movement to self-employment, there is a whole range of work-related issues that concerned us in some of the evidence. I don't know if Mr Watt has a particular view on this at all.

David Watt: I want to make the point that you can send them is me, because I see on average probably five people a week who are moving into self-employment. If I am honest with you, that tends to be retired bankers, either voluntary or not, people in professional services who are moving out, and people who have been corporate workers who want to go and set up their own business because they don't want to go back into corporate life. Most of them are either looking for a different lifestyle, or they are also potentially looking to build a business.

I take the point there is a social divide, but what I think is really important and what we should be doing on that front is we should be working with colleges. In my view, all colleges and universities should run alongside any course they run the option for young people—or any person, bluntly—to opt into a self-employment course at the same time, so they can actually choose that option. It is a real option. It is not a poverty option. I have been self-employed for 15 years. If I looked at my hourly rate it was pretty poor because I worked all hours that God sent, but it was probably the best working time my life because I was controlling my own destiny but I had the skills to do that. So, if you build the skills, availability and the knowledge to do it, it is a great way for people to work, but I do think there is a social divide in how it works in practice.

Q480 **Anna Soubry:** A question perhaps for you, Mr Watt. There is this profound difference between somebody who positively chooses to start their own business, which means they will be self-employed, and somebody who finds themselves deemed self-employed by—I was going to say employer, Mr Wishart, because that is what they de facto are—their employer. We have seen there is hard evidence, whether it is Uber or some of those kanga, whatever they are called, Deliveroos. I knew there was a "roo" there somewhere. People who in the past would have had all the attributes, all the benefits of being employed suddenly being told, "No, you are self-employed. You don't therefore have the security". Would you not agree, there is a big difference between that and somebody who says, "I am going to start up my own business. I am now self-employed"?

David Watt: Absolutely, and that is the point I make. If it is done through economic necessity and it is the only sort of paid employment or work that people can get, that is not necessarily a way to go and I take that point absolutely. Equally, there are a lot of people—and it is why the unemployment figures probably haven't moved significantly even through the recession period—at the top end who have decided not to consider themselves unemployed, or registered as unemployed, that went off and found some other type of paid work, self-employment. I completely agree that it is a completely different situation from driving a car. I get that completely.

The point I was going to make as well, the world of work is changing so much that even almost what we are talking about is changing. While I recognise your reservations about Uber, Uber and Airbnb are the two biggest businesses found in the world probably in the last five years. They are massive and they are just an algorithm. There is no substance to them at all but they are employing—for lack of a better expression—a lot of people. The fact that they are not doing it in the way we would like to see it happening, we have to react to that and we have to upskill people to even quality test what they are getting as a result of that involvement as well. It is a real challenge for us all. That is where all the skills we are talking about are moving on literally day to day.

Q481 **Chair:** We will be speaking to representatives of these companies in the course of this inquiry because we want to understand more about all this. I think we accept that it is a million miles away from some of the organisations that Mr McCulloch represents. What we are hearing is this is quite a profound issue just now. A lot of people leaving the labour market are finding themselves in the realms of the self-employed and what follows then is a whole range of sustainable employment issues. That is what we are trying to explore. Anything you could do, Mr McCulloch—and I think you said that you have been doing some research this—we would be very pleased to see that, and if you don't mind submitting it to us we would certainly like to have a look at that?

Barry McCulloch: Sure.

Q482 **Anna Soubry:** It is normally Mrs Ferrier who mentions the B word, which is Brexit. We know obviously about that. We also know that the Government has an industrial strategy. My question would be this—sorry, I am losing my voice, Mr Wishart—we are all agreed on this around this table. We all think that Brexit is going to cause a really serious economic downfall for our economy. What more could the Government be doing, given what we believe it faces, and given it has set out its industrial strategy, and what could it be doing less of to help businesses of whatever size throughout Scotland?

David Watt: I will have a go at this one first, I think. There are quite a number of things. As I said earlier, what you are looking at is so closely related to a whole lot of other issues that come along and affect business.

We have mentioned one or two already in terms of business rates and taxation. I will mention one or two others in a minute or two.

The Brexit effect has been varied. The business I've talked about, the change to have an innovative think tank of its workers, is really challenged because they import the raw materials in a marketplace where they cannot really put their price up. They have real challenges. Other businesses I know are putting their price up to try to keep up with the developments. Other businesses are laughing because they sell services abroad and they are getting a lot more rate of exchange. So the picture is quite varied but definitely for some businesses, particularly I think in the manufacturing field, engineering field, there is a real challenge. There is no question about that whatsoever and we have to be aware of that.

I personally think the industrial strategy is a great innovation and a good idea. It is something I hope very much that the Scottish Government too can tie in with and we can have a co-ordinated industrial strategy across the UK that also applies and works. The Scottish devolved bit fits into that as a picture rather than any disconnect. This is the thing we always say about infrastructure and transport spend, which is even more important when you are facing challenges like Brexit.

The thing I was going to mention about self-employment. The one key to self-employment in this day and age is effective broadband. If you go to the Western Isles, for example, where I can illustrate houses where people have moved in because in that particular spot they can get broadband, but they cannot move elsewhere because they cannot get broadband. It is the determining factor to setting up a business now. I think we need to be aware of that.

If I am honest with you, we just haven't got up to speed with that—sorry, that is a pun—in this country. We just haven't got there at all. We are so far behind. We have move much, much faster in implementing our broadband strategy and make sure any blockages are removed. It is vitally important if we want to encourage self-employment for anybody or business growth for anybody as well. I do think the points Barry made about skills and facing up to the skills we need as well.

One other thing I have perhaps said to this Committee before, looking at investment allowances. For example, it is not that long since Germany had 100% tax relief on capital purchases for businesses and I think there is something there is really important. I know the Chancellor has recently put it up. I think it is something that can be done even more because it does encourage people to spend and reinvest into our companies as well, particularly when you are talking about significant expenditure in engineering, or even in modernisation of various places. So there are things the Government can do.

Again, I suppose the other point about this—my final point—is the Scottish Government and the UK Government working together. This is really important. Whatever your political beliefs are, we have to get together on some sort of strategy to help business grow. Finally, just keep talking to people, obviously, but, even more importantly, individual businesses—as you have just been doing—and listen to what we are saying and listening to what they want and what they say.

Q483 **Chair:** Just on that, both your organisations—the Institute of Directors and the Federation of Small Businesses—were signatories to a joint statement that called on the Scottish and UK Governments to focus any devolution settlement on driving economic growth. Have the new devolution arrangements secured that?

David Watt: That is a really good question. Is it based on what it would there otherwise have been? What can I say? I don't know if the recent changes have really rolled out completely but I do think there are some signs, shall we say, even around Brexit, that some of the Government institutions are working together better to face up to that challenge. I think that is true of devolution as a whole as well.

If I am honest, I still think there are political noises and voices sometimes in public that are not terribly helpful. I don't care about politics. I just care about business and my directors getting a chance to do better, that sort of thing. I would like all institutions of Government to facilitate that and not get in the way. Sometimes politics can get in the way of that but I gradually think that some of the civil servants are beginning to work together, and Brexit is a good example of that because they recognise the challenges that have just been identified.

Q484 **Chair:** Leaving politics aside then—if you possibly can in a Committee of politicians—given the devolution of these new powers, do you think the Scottish Government have been doing enough to use them? Are they doing enough to support your sector when it comes to what they can do now with the power they have? Mr McCulloch, do you have view on this one?

Barry McCulloch: Sure. I think few business owners will set out to opt for any constitutional changes that would drive externalities that are beyond their control. I don't think that is a controversial thing to say, whether that is at a local, national or regional level, because they don't know what will happen afterwards. What we have seen since the constant devolution of powers in the last few years is the Scottish Government trying to better acknowledge their role in the economy. We have had a number of discussions recently about how the Scottish Government, in particular, can exercise the new social security powers and extend unemployment protection for the self-employed. But I would add that we are at such an early stage. The Scottish Parliament is relatively young. It is slowly progressing into a forceful chamber but it will take time. The Scottish Government, and the UK Government for that matter, are very conscious of the powers that they have and how they discharge them.

I think with Brexit it creates that level of uncertainty that paralyses almost. We have been trying ourselves to make sense of the situation within the FSB. We will be publishing a series of reports between now and May on access to the single market, on access to staff and the freedom of movement that we have become used to, moving through to regulation, EU funding and business support. If I could just give one sneak preview, it is that probably one of the biggest issues coming through is access to staff. So business has got used to recruiting in a certain way and there will not be this: if they don't have access to known UK EU nationals then that will be very difficult to fill, that skills gap. We spoke about it earlier. At the moment businesses find it challenging to find staff, so what will happen in the future if that becomes more difficult?

You are right that it is not just about skilled staff. It really isn't. What we are seeing is that sectors, in tourism, hospitality or food production, or those in seasonal economies that recruit in a certain way and are used to it and if they—

Q485 **Chair:** The Scottish Government presented their paper to the UK Government about Scotland's place in Europe, which suggested as its main headline to retain membership of the European single market. Have you come out in support of that? Given it fits exactly with what you are saying, particularly with freedom of movement and the other problems that we have in terms of single market membership, what have you done in order to try to ensure that that has been taken up?

Barry McCulloch: As I said, we have been trying to do our own research on what this means for our members and doing extensive stakeholder engagement with businesses to come to a more reasoned view. What we didn't want to do early on is make a snap, knee jerk reaction. We want to understand the facts and the evidence.

Chair: So you have not said anything or done anything—

Barry McCulloch: What we are trying to do is be mindful of the constitutional issues that are in play and try to advise—

Q486 **Chair:** Is this not the time to come out quite clearly? If this is so significant and important for your sector, shouldn't you be saying this louder and making sure this is in the face of Government? Here is a paper which suggests practically everything that you want but you are not prepared to sign up to it.

Barry McCulloch: As an organisation, the FSB takes no view on constitutional change because that would require quite a fundamental alteration to how we operate as an organisation. We are apolitical. We don't take—

Q487 **Chair:** Would the Institute of Directors be braver when it comes to these issues then?

David Watt: To be fair, the Institute of Directors in Scotland is part of a UK organisation who believes in the UK as a joined up entity from an HQ perspective. While we all want to see the best trade arrangement we can have for all our member companies in Scotland as well—and there might be an argument for it—we simply cannot see how Scotland can remain part of the EU or the free trade part of the EU while it is part of the United Kingdom. It just doesn't seem to fit together.

In principle, absolutely, it is what our members would want and those who trade into Europe. It is 42% of our exporting market. We get that. We would like to continue that but it doesn't seem it is practical.

Q488 **Chair:** You can quite clearly see where we are going in terms of Brexit. I think it is characterised as a hard Brexit, even single market. Are you quite prepared to see Scotland go off what has been described as a cliff edge in all this, so you are not going to get involved in constitutional politics?

David Watt: No, that is not what I am saying at all. What I am saying is that the IoD across the UK is fighting as hard as it can to do the point that you are talking about, which is to make sure that we don't go blindly for a hard Brexit. That we go for a Brexit that actually reflects well in the economy. At the moment the Scottish economy is part of the UK economy. If you are sitting here in five years' time and Scotland wasn't it might be quite a different discussion. There might we welcome differentiations to it but we cannot see how Scotland is going to retain that free trade ability while it is part of the UK. It is not something that wouldn't be brilliant but I personally and organisationally see how it is feasible.

Q489 **Anna Soubry:** Mr Watt, Mr McCulloch, I agree with you completely, however, could you do this? Could you make the case for the free movement of labour because at the moment, would you agree with me, nobody in business with a national voice—whether it is north or south of the border or, indeed, in Wales—is making the positive case for the free movement of labour?

David Watt: I think your point is valid. In fact, the last time I sat in front of this Committee I made that point as well, that particularly Scotland has massive demographic challenges. Barry has just mentioned a number of industries who have spoken to me and others. The Scottish Tourism Alliance, you speak to any business organisation and they will all tell you, they are seriously concerned. The number one thing about Brexit, funnily enough, is not the single market, although that is very important, it is the future of their labour force. That is absolutely right. If I am honest, yes, across the UK business has not been clever enough. I will try not to make a political point. The—

Q490 **Anna Soubry:** You can make be political without being party political.

David Watt: Exactly. I think the immigration argument during the Brexit debate was pretty limited and business probably should have stood up more and said, "You don't quite understand what immigration does". As I am trying to say, somebody said it beautifully over the weekend: we don't seem to want immigrants but we are quite happy to have them working in the health service or the fishing industry or the farming industry. If you look at the evidence of where you meet people who are immigrants to this country, they are daily supporting our economy. We certainly don't see a downside to it at all.

Q491 **Chair:** On that, we should probably leave this alone. Thank you for your very candid comments on this as always, Mr Watt.

We are coming to the end of this session and we are very grateful for both your contributions, but are there any specific changes that you think either the Scottish Government or the Westminster Government could offer to help you, in terms of the issues that we will be facing when it comes to sustainable employment and supporting employers to work within your sectors sustainably?

David Watt: I am very supportive of the work that Scottish Enterprise and CDS are doing within that as well. I think HIE similarly do a lot to support companies and their employees as well. For me at least, I would go to the more general structural points I made about how both Governments need to focus on the economy. I think the industrial strategy is a step along that road and, as I say, I hope the Scottish Government buy into that and it is co-ordinated.

That is also true of local authorities. For example, as I mentioned before, affordable housing is very closely linked to employment. If we want to change models of employment, it is where we build houses and people can live there. A fact that has been well said in the past, for example, this city could have done with a lot more affordable housing during the boom years. I think we should have built a longer more sustainable economy and a place for people to live. People perhaps from some parts of the west of Scotland would have moved here, could they have afforded to, to take some of the attractive jobs that were available. Not quite so much now.

It is that interlinking that is important. I don't think you can detach sustainable employment and how businesses behave from other things like infrastructure, like transport, like broadband supply that the Government really can do to facilitate. Absolutely businesses that do not perform properly as far as treating their employees, should be taken to task, should end up in court, of course they should, absolutely. But we should be more positive and encouraging. The Government should do what it can to facilitate it in terms of infrastructure, broadband, and so on. We as an organisation should make sure the directors in the boardrooms behave better and we should all work together to do that. That is my short summary.

Chair: Thank you. Mr McCulloch.

Barry McCulloch: I would return to that fault line, which I described earlier, between those who characterise the economy and labour market that we have in negative terms and those who are perhaps a bit more positive. In Scotland we don't really have the evidence to make the objective judgments that certainly the FSB would like to make. For some time we have been calling for a review in terms of standards of self-employment and there have been two reviews at a UK Government level: the Deane Review and the Mone Review, trying to understand why business thrives in certain areas. We would encourage the Scottish Government and everyone, in fact, to really better understand the changes that the labour market is going through.

There is one part of that change that David alluded to earlier, which was digital disruption. I know that has been a common theme in previous sessions. The threats and opportunities of digitisation and what that means for the Scottish economy, you have some projections that state that the labour market will reduce by a third. I think how we get ahead of those challenges and how we enable the businesses we have to exploit the commercial advantages of being more digital because I think, as things stand, they are struggling to adapt to a varied, changing market. That is currently not being helped by the business support system because it is not co-ordinated and business focused enough. So that would be how I would draw things to an end.

Chair: We are grateful. Thank you both so much again for attending this session with your usual candour, and almost at the point of getting involved in some political debate with us. I think we managed to avoid that. Thank you ever so much for coming today.