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INVESTING WITH PURPOSE:

SCOTLAND'S GLOBAL CAPITAL INVESTMENT PLAN

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MINISTERIAL FOREWORD

WE CAN AND SHOULD LOOK TO THE FUTURE AS WE TRANSITION TOWARDS A NET ZERO, VALUES-LED ECONOMY

As we emerge from this extraordinary global pandemic I am fully alive to the difficulties that citizens and businesses have been facing with real courage and resilience. If we have learned anything, it is that we must use difficulty to build resilience and opportunity. We can and should look to the future as we transition towards a Net Zero, values-led economy.

That concerns all of us, and will need the efforts of both public and private sectors. This global capital investment plan, the first of its kind in Scotland, is very clear that there are areas of our society that can, should and will remain funded solely by public sector investment, but it also recognises that public sector investment alone will not be enough to respond to the challenges of the 21st Century. It sets out the best opportunities for private capital investment to support that transition and how best to address historic under-investment in Scotland's businesses, and private sector real estate and infrastructure. It complements our earlier work on export and inward investment, and implements the principles in our Trade Vision.

Private capital can increase productivity through better quality infrastructure, company growth and competition impacts. It can build companies, jobs and places and is essential for the shift to a Net Zero, wellbeing-led economy. It is a complex topic, with many distinct factors for different types of investment.

This plan seeks to:

1. Increase the effective supply of capital, by better understanding and targeting different sources of funding.

2. Put forward our best "market ready" opportunities, using the strongest internationalised areas in the economy to create demand for investment.

3. Bridge the gap – taking action to increase the viability and fit of what private capital markets want to invest in and the attractiveness of our investment propositions.

In the plan we have taken care to lead with our strengths and opportunities as we compete for investment on the global stage. Through detailed data analysis we have identified sectors where Scotland is punching above its weight, in renewable technology, life sciences, digital and IT; and we have assessed where these sectors match with global demand for investment. These strengths form the basis for making companies, clusters, towns and cities more viable for global investment. We are putting the combined power of government and all its agencies behind generating projects that meet market standards, and making new market connections that meet Scotland's investment needs. We have taken on the views of industry experts. And we have identified Scotland's strengths and opportunities as a leader in the global movement towards investment which is socially and environmentally responsible.

As Minister for Trade, Innovation and Public Finance, I am grateful for the input from industry and our public sector partners to developing this strategy, and I am positive that our shared ambition will deliver results that will benefit all citizens of Scotland.

Ivan McKee MSP
Minister for Trade, Innovation and Public Finance

EXECUTIVE SUMMARY

WHY CAPITAL INVESTMENT IS IMPORTANT

As we move beyond the pandemic and face the future Scotland's economy faces significant challenges. The imperatives of the just transition to Net Zero are critical, and demographic shifts place greater demand on public resources while reducing the working age population. Challenges which are only made worse by the unnecessary disruption of EU Exit. We recognise that meeting these challenges requires an investment-led recovery. Our strengths in skills, academic excellence, research and innovation, advanced technologies and natural resources give us the tools to do the job. But to mobilise these assets, and build a wellbeing economy with fair work and inclusive growth at its heart requires significant increases in the levels of capital investment in our economy.

Guided by our Vision for Trade, the Global Capital Investment Plan is the final of our three pillars focused on internationalising the Scottish economy. Following on from our Inward Investment Plan and Export Growth Plan, it sets out how we will attract productive forms of private capital investment, in sufficient volumes, focused on creating the market conditions for an investment-led recovery; and doing so in a way that is consistent with our values of Net Zero, inclusive growth and fair work.

We are also clear about what this plan is not. We draw clear distinctions between those investments which seek private capital investment and those which are required to be undertaken solely by the public sector. This is not a plan to lever private investment into core public services but rather to increase the flow of private capital into supporting the wider economy. It seeks to align our efforts to attract private capital with the investment needs of our most competitive global sectors. This will ensure that start-up and scale-up businesses are well placed to benefit from investment to power their growth and create good, green jobs and with the needs set out specifically for private investment in the Infrastructure Investment Plan, the Climate Change Plan and Housing 2040. In doing so, the Plan draws on the recommendations and response to the Advisory Group on Economic Recovery report for an investment-led recovery which leverages public spend to increase private investment, and aligns with the actions in the Logan Review on building Scotland's tech sector and in the Financing the Recovery report on Scotland's business support needs.

PRIVATE CAPITAL INVESTMENT IN THE ECONOMY

This plan defines private capital investment as the deployment of an external source of internationally mobile finance into a project or business in Scotland. This differs from Inward Investment (or FDI) which seeks to attract foreign-owned companies to directly set-up or expand operations in Scotland. Private capital investment is a different market from FDI and as such requires a different investment strategy.

Capital investment can have a range of potential impacts on immediate economic outcomes, which then impact the Scottish economy in the longer term. The supply of private capital can help businesses realise their growth ambitions by removing key financial, and knowledge, barriers to expansion. This impacts on productivity through better quality infrastructure as well as through companies growing and having competition or demonstrator impacts on their sector. And there are further impacts from venture-backed company investment through supply chains and wider economic activity. Scotland, like the UK, has suffered from historic under-investment, which is seen as a key driver of slow productivity growth over past decades.

The Plan is broad, covering as it does investment into business growth, infrastructure and real estate. This, combined with the on-going economic uncertainty, makes it difficult to give an exact figure of the benefits to the economy of implementing the actions in it. However, internal modelling suggests that the longer term benefits to the economy can be both substantial and persistent. The direct impact of increasing private sector business investment to the overall level among OECD countries (as a percentage of GDP) and the potential indirect impacts of higher levels of productivity, could permanently increase the level of GDP by around 1.9% by 2030 (around £3.1 billion a year in 2019 prices). This could also increase average earnings in Scotland by 4.9%, around an additional £1,400 a year to the average Scottish employee in today's prices and is in addition to supporting our Net Zero and wellbeing economy ambitions.

Not all capital investment achieves these positive impacts. The choices set out in this plan explicitly seek to focus effort on attracting investment that generates wider spill-over benefits, and aligns with our values around good global citizenship, tackling climate change and increasing wellbeing.

BASELINE PERFORMANCE

The plan begins by baselining our current performance. Scotland outperforms other regions in the UK in attracting inward investment. However, compared to other OECD countries, there is scope to improve our performance in attracting global capital investment into business growth, infrastructure and commercial property.

Business investment – Scotland's companies attract £34.8 billion in investment annually and this is gradually rising. Much of this is due to past success in creating a strong business angels network, but this is heavily focused on early stage investment. Investment around company growth and scaling is limited by a small market with few players, in which Scottish companies can be under-valued when they do attract equity, or have to leave Scotland entirely in order to gain investment. It is also limited by the number of companies seeking investment – we will need to work hard to increase ambition and financial awareness.

Infrastructure investment performance is more difficult to ascertain through data. However, much of Scotland's success here can be linked to investments in onshore and offshore wind, and in particular to the regulatory and pricing certainty offered by UK schemes such as Contract for Difference (CFD). Our investment needs to deliver Net Zero and our digital ambitions are very substantial. Whilst we need to vastly increase the scale and type of infrastructure investment to meet Net Zero obligations, we do not have the regulatory levers, nor clarity on the UK government's appetite for extending a CFD-style approach to sectors such as heat or hydrogen. We also need to address issues around the scale of projects in these sectors.

Scotland's performance in attracting **commercial property** investment has been flat, and below par at about 4% of UK levels. It has been tilted in favour of standing stock (existing assets changing hands) rather than development capital (which builds new assets). With COVID-19 and EU Exit, the first half of 2020 saw total commercial investment volumes decrease by 73% from the same period last year. We will need to encourage investment into re-purposing under-utilised assets in town and city centres and to expand industrial real estate capacity to support business growth, in particular around our clusters in our key target sectors.

Given tough market conditions, marshalling an investment-led recovery will require us to understand and engage with what makes a project, business, or location viable in the eyes of the market. Investment is constrained by uncertainty, and that uncertainty is currently being accentuated by COVID-19 and the UK's exit from the EU. Under these circumstances, we must be realistic about timescales, and prioritisation to engage with the right investment markets with the right solutions for particular economic needs.

The plan sets out three main pillars to address this challenge: these act as both filters to assess project suitability for private capital investment; and as levers to increase our chances of success for prospects we do take to market.

1. Increasing the effective supply of capital, by better understanding and targeting different sources of funding.

2. Presenting our best "market ready" opportunities, using the strongest internationalised areas in the economy to create demand for investment.

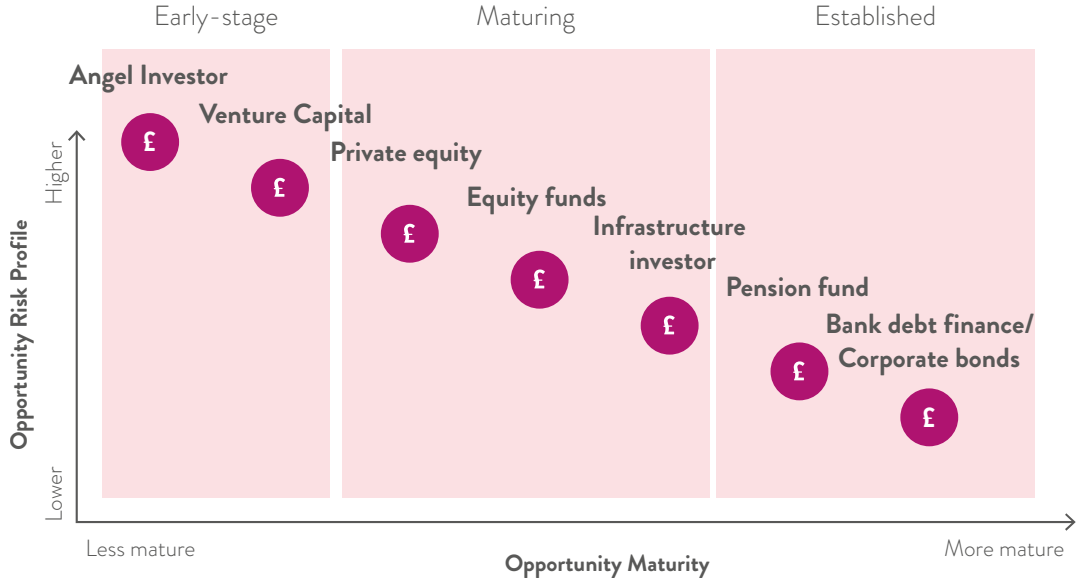
3. Bridging the gap – taking action to increase the viability and fit of what private capital markets want to invest in and the attractiveness of our investment propositions.

SCOTLAND OUTPERFORMS OTHER REGIONS IN THE UK IN ATTRACTING INWARD INVESTMENT. HOWEVER, COMPARED TO OTHER OECD COUNTRIES, THERE IS SCOPE TO IMPROVE OUR PERFORMANCE IN ATTRACTING GLOBAL CAPITAL INVESTMENT INTO BUSINESS GROWTH, INFRASTRUCTURE AND COMMERCIAL PROPERTY

THE SUPPLY OF CAPITAL

The plan begins the work of mapping the global investor landscape, although recognising that this is an area in which Scotland needs to develop capability. There is a wide range of investor types, and within each type a wide offer of individual investors, each with their own risk and reward preferences, timescales, and investment mandates for individual funds. Our aim over time is to deepen our understanding of the needs of those different investors, in order to offer better tactical and strategic matches to individual projects. An overview of the spectrum of private investment capital is outlined in Figure 0.1.

Figure 0.1: Spectrum of risk / reward for capital investment categories.



We also aim to build up better long-term partnerships with investors, as many initial investors in Scotland go on to be repeat-investors. As market and investor preferences evolve over time, this better intelligence and insight will also help us judge when we can nudge some investors towards greater risk appetite in Scotland and ultimately higher economic impact; and when for others we are more likely to gain a first investment by showing an investor a safer or lower risk route into Scotland.

Capital investors exist all over the world, but they do tend to concentrate in relatively few global centres. Again, a better understanding of the investors in each location will lead to better targeting of those partnerships we want to build by intelligent deployment of our global network, including Scottish Government overseas offices, Scottish Development International and our Trade Envoys and Global Scots.

Global investors frequently seek a local investor partner, which both gives assurance and helps overcome information asymmetries. We must not underestimate the emerging importance of the Scottish National Investment Bank in this space, or of making much stronger connections with the investment sector based in Scotland, which already manages £590 billion of assets.

Globally, there is a strong move towards responsible investing, variously called Impact Investment, Ethical Investment or Environmental, Social & Governance (ESG) investment. ESG criteria can play a decisive role in investment decisions: 91% of investors surveyed say that non-financial performance has played a pivotal role in their investment decision-making over the past 12 months either "frequently" or "occasionally".[1] In 2020, ESG-focused funds broke through $1 trillion in assets under management. Despite still being a

1 EY (2020) How will ESG performance shape your future? Why investors are making ESG an imperative for COVID-19 and beyond. Climate Change and Sustainability Services (CCaSS): Fifth global institutional investor survey ey-global-institutional-investor-survey-2020.pdf.

relatively small segment of the market, the direction of travel is clear, and has even seen acceleration during the COVID-19 pandemic. In the UK as a whole, more new money was invested in ESG funds in the second quarter of 2020 than in the previous five years combined, and global estimates show flows into ESG funds comprising between a third and half of all global fund sales over the past year.

Scotland is already in a strong position to pivot towards Impact/ESG investment. Research by the Ethical Finance Hub found that Scotland-based investment funds manage 11% of the UK's responsible investing market, compared to a 7% share of the conventional market; and that this had formed a significant part of the sector's strong growth in recent decades. The areas Scotland needs investment in are attractive to investors looking to increase their exposure in responsible investing. These include the Scottish growth sectors which offer strong ethics (data, digital and health), Net Zero and a business environment in Scotland focused on fair work and equalities.

SETTING OUR STRATEGY: LEADING WITH SCOTLAND'S BEST OPPORTUNITIES

Our Inward Investment Plan has already identified the sectors in Scotland's economy which are globally competitive, crisis-resilient and likely to offer growth which benefits the broader economy and society as well as the business itself. New analysis for this Plan finds the strongest deal flows in the same sectors, underscoring them as the best opportunity we have to use the global economy to build our domestic strengths. The Plan summarises these sectoral opportunities into **four sectoral themes**: low carbon transition, health and life sciences, digital, and high value manufacturing.

These four sectors are the most likely drivers of future economic demand in the economy. They are broad, and that is deliberate. Whilst the focus has to be on those sectors which can drive growth and recovery precisely because they are already strong, this approach leaves space for different sub-sectors to develop and come to the fore, for particular regional clusters of expertise to be brought out, and for the broader macro-economic and regulatory frameworks to change (e.g. around nature-based technologies and solutions to climate change).

OUR COMMITMENT TO NET ZERO MUST UNDERPIN ALL THAT WE DO

These sectors are located across Scotland and already tend to cluster, which in turn means that they are more attractive for development and investment capital in commercial property. Focusing on these sectors, and in particular focusing on the space and infrastructure they need to grow, will enable us to generate and originate a series of both place and sector oriented investment propositions which maximise their strategic attractiveness to investors by aligning infrastructure, business growth and real estate opportunities in a coherent fashion.

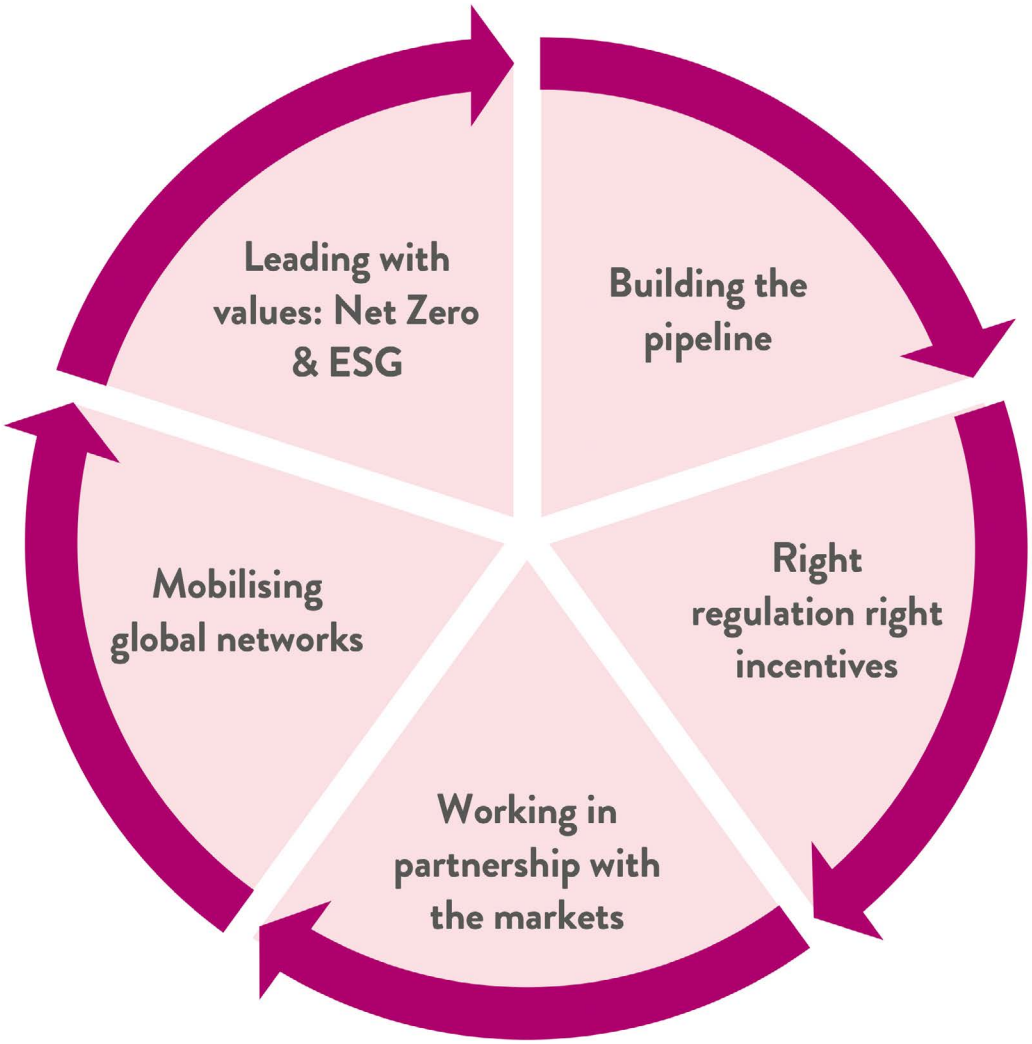
We have set out from the beginning to align with and help deliver the private capital element of the investment needs identified in the Infrastructure Investment Plan, Climate Change Plan and Housing to 2040. Leading with our strongest sectors, and their spill-over into the space and talent they need, in turn drives the viability of city and town centres near them, for housing and commercial property. In line with our Place Principle, we want this to include bringing investment into re-purposing under-utilised assets in town and city centres as part of the direct response to COVID-19. With an approach linking to the strengths and future demand in the economy, it will also be possible to seek investment in modernising construction techniques, including offsite construction, and alternative housing models to support independent living.

Finally, our commitment to Net Zero must underpin all that we do. We should simply no longer be putting public resource into originating, structuring and promoting investments in Scotland which are not aiming at Net Zero. By focusing on our priority sectors and employing a Net Zero and place focus, we will be able to start to build markets instead of individual investment opportunities. We should therefore build on and expand initiatives like the Green Investment Portfolio, and the cross-organisational work to define projects for carbon capture and storage, heating, hydrogen and natural capital, and seek to systematically turn these into opportunities which are both commercially sound, and structured as investments in a way which support a Just Transition. We are doing this at precisely the right time, as global investment markets shift towards ESG and investment in the transition to Net Zero.

BRIDGING THE GAP: TAKING ACTION TO MEET SCOTLAND'S INVESTMENT NEEDS

Public sector efforts to support private capital investment attraction in the past have been relatively fragmented, with the relevant skills spread across a number of directorates, agencies and local authorities. That system itself is evolving with the launch of the Scottish National Investment Bank as both an investor and, over time, a centre of expertise for investment. We now have the opportunity to **coordinate, reprioritise** and **focus** the work across the public sector. Figure 0.2 shows the framework which guides the action plan that sets outs a series of actions that will help us deliver on our ambition.

Figure 0.2: Actions to deliver our ambition.



Action	Leading with our Values: Net Zero and ESG
1	We will **make Scotland's values a core part of our National Prospectus and our engagement with investors**, making it clear that valuing our people, communities, and environment are core to our economic ambitions.
2	Investment opportunities that we promote to market will be **benchmarked against ESG investment criteria.** We will enable the companies and projects we support to report climate-related disclosures in a standardised and transparent way with flows of ESG monitored via a new metric which will cover **environmental and social impacts**.
3	We will use COP26 as a platform to showcase our investment opportunities such as our **Green investment Portfolio**.
4	We will build on existing ESG investment activity and work with Scotland's investment management industry, using events such as the Ethical Finance Summit to make **Scotland a leading globally established hub for ESG investment.**
5	We will **proactively engage with ESG investors** and with **sources of capital new to Scotland**, such as green bonds, to help us achieve our Net Zero and Wellbeing ambitions.

Action	Building an Investment Ready Pipeline
6	We will identify and prioritise **place-based opportunities** or clusters e.g. low-carbon heating or hydrogen, and accelerate their investment-readiness for both company and infrastructure investment.
7	We will work with the private sector to identify and secure the private capital investment needed to develop **internationally recognised clusters of excellence** in our identified sectoral themes (Low Carbon, Digital, Health and Life Sciences, High Value Manufacturing) and build investment solutions for their business ecosystems.
8	We will **build demand for private capital investment for the growth companies** working in our key sectoral themes, for whom engagement with private capital markets is a viable and useful route to growth.
9	We will **build capacity to structure major projects and programmes** for financing focused on the Just Transition to Net Zero, building digital capacity to support data movement, and housing needs.
10	We will co-ordinate the wider public and private sector landscapes to **aggregate opportunities of scale** that will be of interest to institutional investors.
11	We will **act as cornerstone investors** in emerging sectors and technologies where Scotland has genuine potential to lead on the international stage.
12	We will **establish a 'route-map' from project inception to promotion** to ensure investment opportunities are investment ready and attractive to markets, and that the route to support is clear to candidates. The route-map will denote criteria for when a project is ready for development and will be considered 'market ready'.

Action	Building an Investment Ready Pipeline
13	We will take a Team Scotland approach to **disseminate learning and best practice** from across the public sector and private sector ecosystems. This will involve coordinating government and agencies with the private sector to **accelerate the development of investment opportunities**, using co-investment models for example.
14	We will benchmark how our investment propositions that we present to market compare with international standards to **ensure our propositions are best-in-class**.

Action	Right Regulations, Right Incentives
15	We will **establish relationships with UK financial services and pension regulators** to influence and support the coordination of future regulations around reporting standards and our Net Zero aims.
16	We will **align our suite of available incentives to help stimulate investment** in our sectoral themes, places and Net Zero, whilst always seeking to understand and mitigate market distortions.
17	We will engage with the UK and international bodies to **influence the design of market-creating financial and pricing solutions** (e.g. Contract for Difference and carbon pricing), working constructively to remove barriers to investment.

Action	Working in Partnership with the Markets
18	For each category of investor we will **develop an investor relationship strategy** to increase our level of understanding, engagement and partnership with the market.
19	To support business growth investment, and in line with the Logan Review recommendations, we will **seek to fill the gaps in the Scottish equity market** by: • Developing a new Series A fund with a focus on the Scottish ecosystem • Investing outside of Scotland to build a reciprocal relationship with funds that will in return, invest in Scotland • Recapitalising and reorienting existing funds where this will support greater investment • Ensuring that investment is fairly distributed through investment vehicles focused on female and minority founders • Intensifying appropriate support for these companies, such as development, networking, contact building opportunities, leadership, peer to peer support and pitching masterclasses
20	We will **increase connections with institutional investors** who may not be familiar with what Scotland has to offer, starting with ESG investors and thematic funds.
21	We will **build relationships with the most active developers and intermediaries in similar regions in the UK**, linked to the sectors and opportunities we want more investment in.

Action	Working in Partnership with the Markets
22	We will **work closely with local government pension funds** to identify appropriate means of increasing investment in Scottish propositions.
23	We will use data and analysis to **respond quickly to shifts in the market.**
24	We will **develop a service standard on investor experience**, aligned with the Inward Investment Plan, to ensure we are providing investors with a rapid professional and comprehensive service to encourage them to commit to further investment in Scotland.
25	We will **establish an investment panel** to form a partnership with government, drawing on their expertise to provide industry insight on the structuring and financing of the large scale investments required for the transition to Net Zero.
26	We will put in place a process to **track private capital investment into Scotland and to measure performance** going forward.

Action	Mobilising our Global Networks
27	Through our combined networks and relationships, we will continue to **promote Scotland's broad and diverse capital investment offer to investors globally**.
28	We will develop and deliver a **programme of domestic and international events** and activities to support the development and promotion of the pipeline of private capital investment opportunities, providing a platform to access new investor relationships.
29	We will **increase our global capital investment resource in target international markets and make best use of use our international networks** to provide insights, intelligence, introductions and advocacy focused on building investor relations and promoting investment opportunities in Scotland. Such networks include: • SDI's network of overseas field offices • Scottish Government's eight international offices based in private capital investment global capitals including London, Berlin and Paris • Scottish Government Trade Envoys • The GlobalScots Network • The international footprint of our universities and colleges • Private sector business networks that promote Scotland
30	We will **further invest to develop the capital investment strand of 'Scotland Is Now'** and utilise this as a key channel to communicate our messaging and propositions.

1 WHY CAPITAL INVESTMENT IS IMPORTANT

1.1 WHY DO WE NEED A GLOBAL CAPITAL INVESTMENT PLAN?

Scotland's economy faces a number of challenges, both short and long-term. The economic impacts of the COVID-19 pandemic and of the UK's exit from the EU are yet to be fully seen, but are likely to be with us for some time. Scotland, along with the rest of the UK, has a long-acknowledged issue around under-investment and slow productivity growth. The imperatives of the transition to Net Zero are critical, and demographic shifts place greater demand on public resources while reducing the working age population. Change is both necessary and inevitable, and the need to 'build back better' is a challenge we share with other advanced economies.

Our strengths in skills, academic excellence, research and innovation, advanced technologies and natural resources give us the tools to do the job. However, to mobilise these assets, and build a wellbeing economy with fair work and inclusive growth at its heart, requires capital investment at levels significantly higher than at present.

The report from the Advisory Group on Economic Recovery, and the Scottish Government's response to it, highlight the need for an investment-led recovery to upgrade infrastructure and support business growth. It also recognises that while much of this capital investment will come from the public purse, the role of private sector investment is critical in achieving pace and scale – either directly into businesses and projects in Scotland, through partnership with public sector investment, or through public sector borrowing on capital markets.

1.2 WHAT THIS PLAN SEEKS TO DO

This **Global Capital Investment Plan** is the third of our three strategies setting out how we will enhance Scotland's position on the international stage as a dynamic, innovative nation with an outward facing economy. Following on from our Inward Investment Plan and Export Growth Plan, it sets out how we will attract productive forms of private capital investment, in sufficient volumes, focused on creating the market conditions for an investment-led recovery in a way that is consistent with our values. For the purposes of this analysis we consider private capital investment as being distinct from inward or foreign direct investment. Inward investment involves a company or institution headquartered outside of Scotland establishing or expanding operations within Scotland. Private capital investment, by contrast, involves debt or equity financing in a business, project, or development.

As important as what this plan is for, is what it is not for. We draw clear distinctions between those investments that are required to be undertaken solely by the public sector. This is not a plan to lever private investment into core public services but rather to increase the flow of private capital into areas where it is already present, or where the Scottish Government's vision for infrastructure, as set out in our Infrastructure Investment Plan, has identified that private capital can support Scotland's resilience and enable inclusive, Net Zero, and sustainable growth. And whilst markets which already function in Scotland, such as that for wind energy, are noted here, this is not a plan to intervene where there are already good and useful levels of market activity.

It is also not a plan to consider or enact how we work with banks to support all businesses out of post-crisis debt. That is covered in 'Financing the Recovery', and our work to ensure that crisis and recovery schemes contribute broadly to the recovery of Scotland's company base. It is a closely related agenda, but this plan is focused only on those companies and sectors for whom investment markets are a realistic and suitable route to growth and scaling.

Through segmentation and analysis of current capital flows, the plan sets out Scotland's best offer to capital markets. Our strategy for capital investment seeks to maximise the alignment between the investment needs we have in Scotland and the supply of internationally mobile capital, by raising the demand and viability of projects for investment, and by creating a strong enabling environment.

OUR STRATEGY FOR CAPITAL INVESTMENT SEEKS TO MAXIMISE THE ALIGNMENT BETWEEN THE INVESTMENT NEEDS WE HAVE IN SCOTLAND AND THE SUPPLY OF INTERNATIONALLY MOBILE CAPITAL

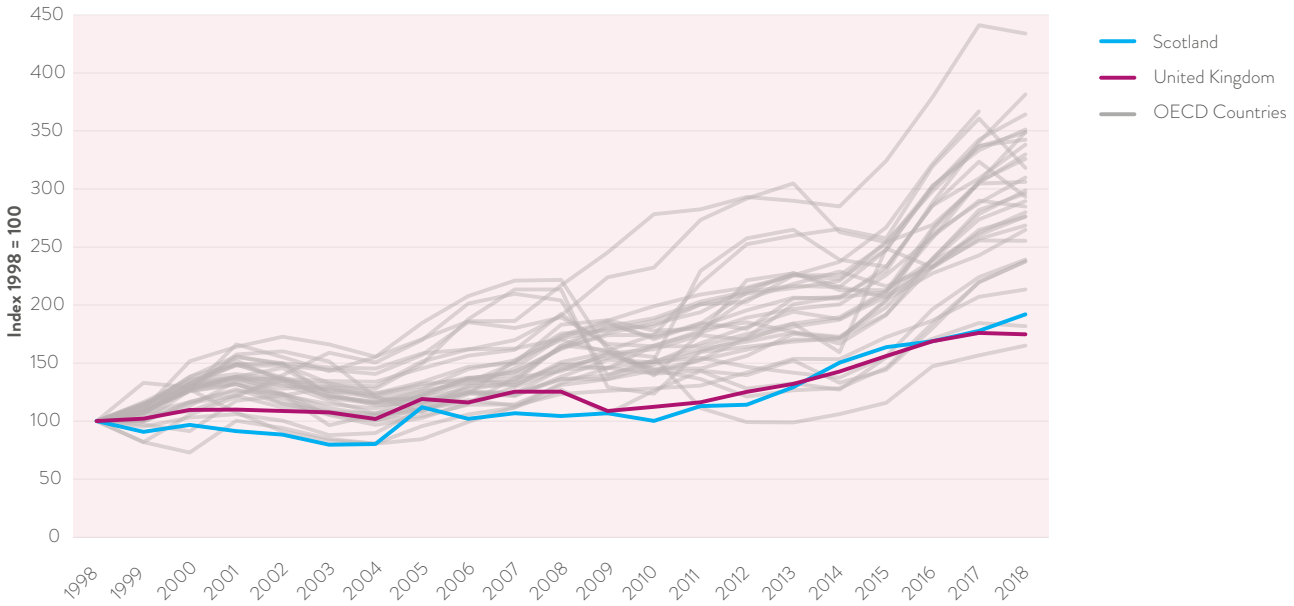
This plan outlines how the wider investment ecosystem in Scotland – including the mission driven approach of the Scottish National Investment Bank – align to support an economic recovery with fair work, inclusive growth and Net Zero emissions at its heart.

1.3 THE ROLE AND IMPACT OF CAPITAL INVESTMENT IN THE ECONOMY

Investment is a key driver of economic growth. Along with consumption, government spending and net exports, it is one of the drivers of aggregate demand in an economy. Increasing investment (both public and private) should increase growth in the short-term, particularly in times of weak economic conditions, as is likely in a post-COVID-19 economy. In the long-term, the more significant role of investment is to boost growth through increasing productive capacity and productivity.

Scotland has seen the gap with overall UK investment close in recent years; however, the UK as a whole suffers from relatively low levels of investment. Business investment in Scotland is generally recognised to be a factor in economic underperformance and it can be seen clearly from Figure 1.1 that growth in this investment has been lower than in most OECD countries.

Figure 1.1: Business capital investment, comparing Scotland with the UK and other OECD countries (index 1998 = 100)

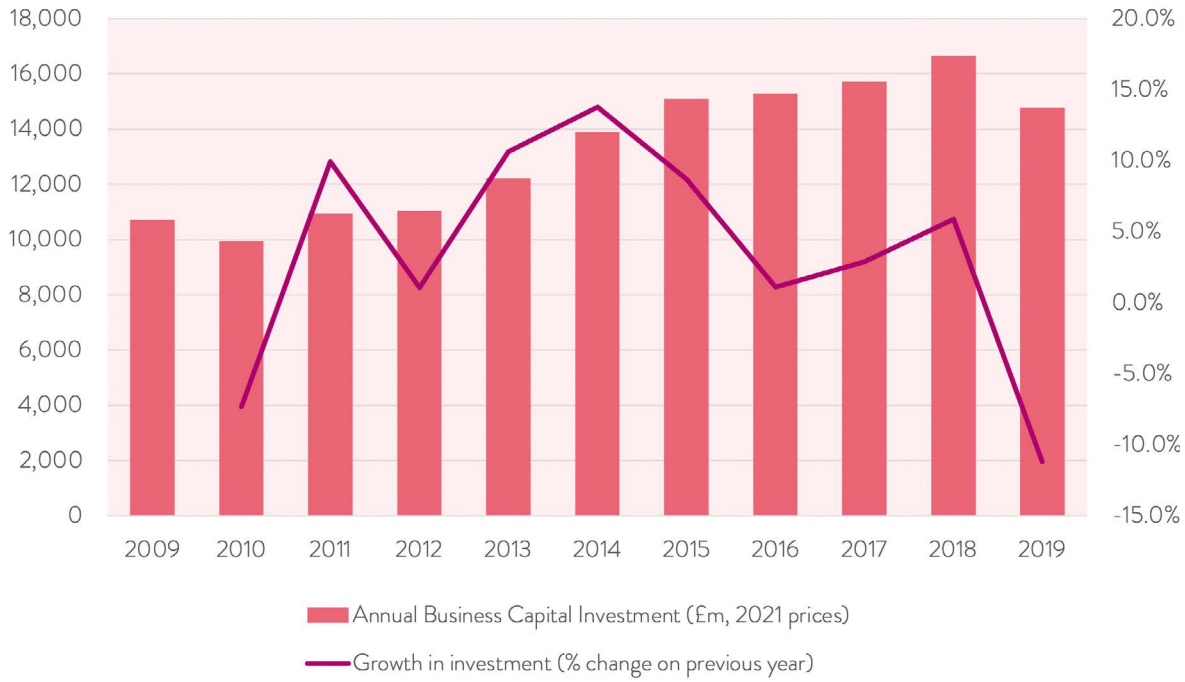


Source: Scotland (Quarterly National Accounts Scotland), UK (ONS), OECD countries (OECD). Note "business capital investment" based on national accounts measure gross fixed capital formation.

INVESTMENT IS A KEY DRIVER OF ECONOMIC GROWTH. ALONG WITH CONSUMPTION, GOVERNMENT SPENDING AND NET EXPORTS, IT IS ONE OF THE DRIVERS OF AGGREGATE DEMAND IN AN ECONOMY

Recent levels and growth in business investment, as measured by the technical term, gross fixed capital formation in the Scottish Government Quarterly National Accounts, are shown in Figure 1.2. The average annual growth figure over the most recent ten years for which data is available is 3.3%. However, this is volatile from year to year – over this period in Scotland it has ranged from -11% to 14% in real terms – reflecting the influence of large investments, for example in renewable energy, which may land in some years but not others.

Figure 1.2: Business investment in gross fixed capital formation in Scotland

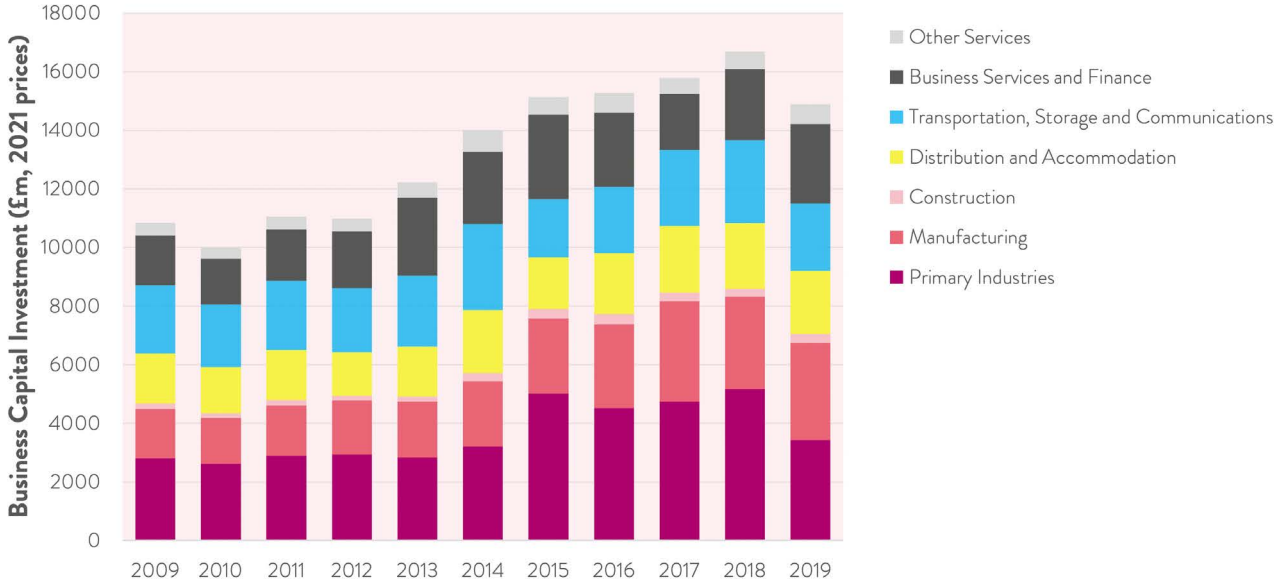


Source: Quarterly National Accounts Scotland (converted to 2021 prices)

THE AVERAGE ANNUAL GROWTH FIGURE OVER THE MOST RECENT TEN YEARS FOR WHICH DATA IS AVAILABLE IS 3.3%

Figure 1.3 shows Scotland's overall business investment split by sector. Overall business investment has been driven by growth in most sectors in recent years, with particular increases in primary industries, manufacturing, business services and accommodation/distribution. Production sectors (manufacturing and primary industries) accounted for a disproportionately large share of business investment in 2019 (45%) compared to their share of Scotland's overall gross value added (19%), reflecting the capital intensive nature of these sectors.[2] Services sectors accounted for 53% of business investment in 2019, compared to 75% of Scotland's overall gross value added.

Figure 1.3: Business investment in gross fixed capital formation in Scotland, by sector



Source: Quarterly National Accounts Scotland (converted to 2021 prices)

DEFINITION – BUSINESS CAPITAL INVESTMENT VS PRIVATE CAPITAL INVESTMENT

It is important to distinguish between the two definitions of private or business capital investment. The economic definition focuses on investment in new long-term assets (such as new office buildings, wind farms or business machinery) which help produce more output in future and relates to the figures shown above. The financial definition centres around flows of funding into a business or project to help realise its goals (such as providing finance to an innovative business to help it grow). While there is a large degree of overlap, there are important differences between these definitions. In particular, some investment under the financial definition may not necessarily yield wider economic value, but rather represent changing ownership of existing assets. Our focus in this plan is on private capital investment which drives increased economic activity, rather than financial transactions (for example that relate solely to changes of asset ownership) that don't generate wider economic value.

2 Quarterly National Accounts Scotland

To maximise the positive contribution of private capital investment to our wider economic goals, it is important to have a clear understanding of different types of financial investors, how they invest and the impacts of their investment activity – both directly and the wider spill-over benefits to society and our environment. This is particularly true if we are to support financial investment as a means to achieving wider economic impact and supporting recovery – bringing the financial definition to bear on the economic one. This is set out in the framework in Figure 1.4 and outlined in more detail in the following sections.

Figure 1.4: Framework setting out how capital investment impacts upon the economy

Investors	What do investors do?	Impact on business/project	Impact on wider economy	Impact on inclusive growth and wellbeing
• Angel investors • Venture capital • Private equity • Corporate • Institutional • Sovereign Wealth Funds • Debt	• Raise funds • Invest in businesses/ projects • Provide expertise and management knowhow	• Business growth and employment • Build/regenerate infrastructure and real estate • Knowledge transfer between investor/investee • Increase R&D	• Firm spill-over impacts • Project spill-over impacts • Increase the capital stock • Higher wages and/or employment	• Productivity and growth • Innovation • Wellbeing (e.g. net zero, regeneration, health innovation)

TO MAXIMISE THE POSITIVE CONTRIBUTION OF PRIVATE CAPITAL INVESTMENT TO OUR WIDER ECONOMIC GOALS, IT IS IMPORTANT TO HAVE A CLEAR UNDERSTANDING OF DIFFERENT TYPES OF FINANCIAL INVESTORS, HOW THEY INVEST AND THE IMPACTS OF THEIR INVESTMENT ACTIVITY – BOTH DIRECTLY AND THE WIDER SPILL-OVER BENEFITS TO SOCIETY AND OUR ENVIRONMENT

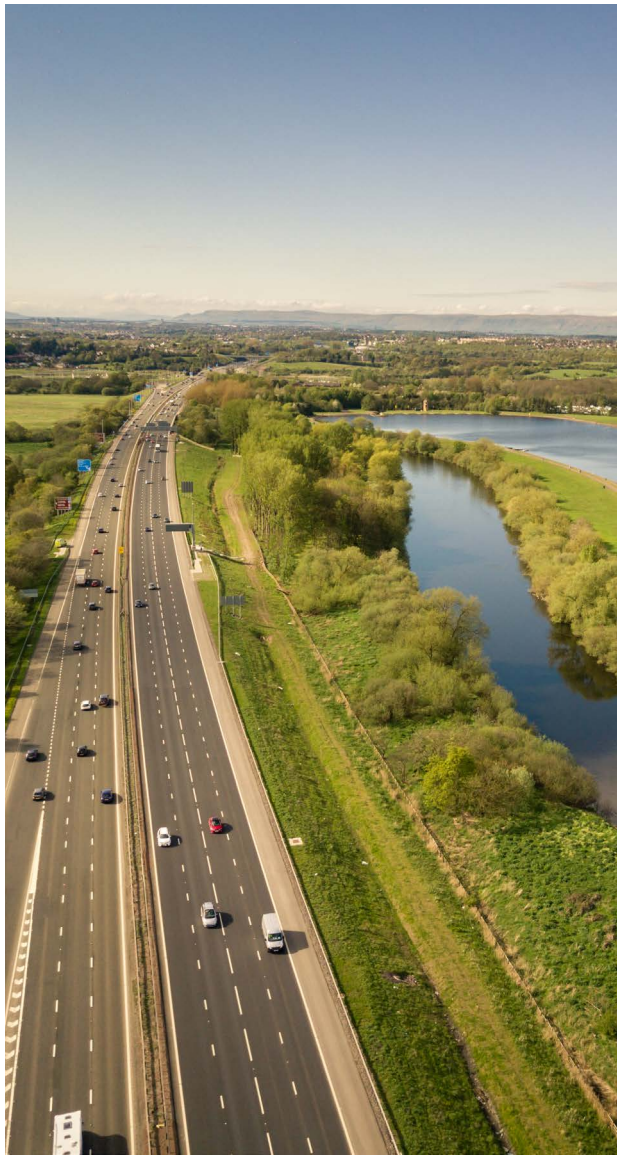
1.3.1 The impact of capital investment on businesses and projects

Private capital investment promotes the creation of new businesses and helps businesses to realise their growth ambitions by removing a key barrier to expansion. Investors who bring market experience or industry knowledge can have a positive impact on the operating performance of investee companies and projects in terms of profitability and growth. Investing in research and development for new products and processes boosts innovation, as does supporting start-ups and early stage companies. Investment in companies to implement restructuring measures can enhance their productivity and thus help them to survive. Government may have a role here in specific cases, but the vast majority of private sector business investment does, and always will, come from private investors.

High quality infrastructure and quality of place are essential for businesses to operate efficiently, increase productivity and attract talent. Infrastructure and real estate projects also create economic activity through project construction and ongoing asset management. Investment may restore and regenerate unproductive assets, such as derelict buildings, for a new purpose, providing wider benefits to communities.

1.3.2 The impact of capital investment on the wider economy

Capital investment can have spill-over benefits on the wider economy, that are enjoyed by unrelated third parties to the investee business or project. For instance, a business growing, becoming more entrepreneurial or innovative has demonstration effects on other firms in the sector that can use the blueprint to improve their activities. There can be 'competition' effects where one business' growth leads other businesses to become more competitive and productive over time. Estimates by Oxford Economics in 2015 found that firms with angel and venture investment backing contributed around £30 billion to UK GDP, with around half accounted for by "indirect" channels such as supply chain impacts.[3] The Scottish Government's modelling for delivering our National Infrastructure Mission also reveals strong evidence of the link between infrastructure spending and improved economic growth. An investment-led stimulus has both a short-term demand effect but also a longer term supply effect by increasing the long-term productive capacity of the economy, enhancing productivity and wages and/or employment.



PRIVATE CAPITAL INVESTMENT PROMOTES THE CREATION OF NEW BUSINESSES AND HELPS BUSINESSES TO REALISE THEIR GROWTH AMBITIONS BY REMOVING A KEY BARRIER TO EXPANSION

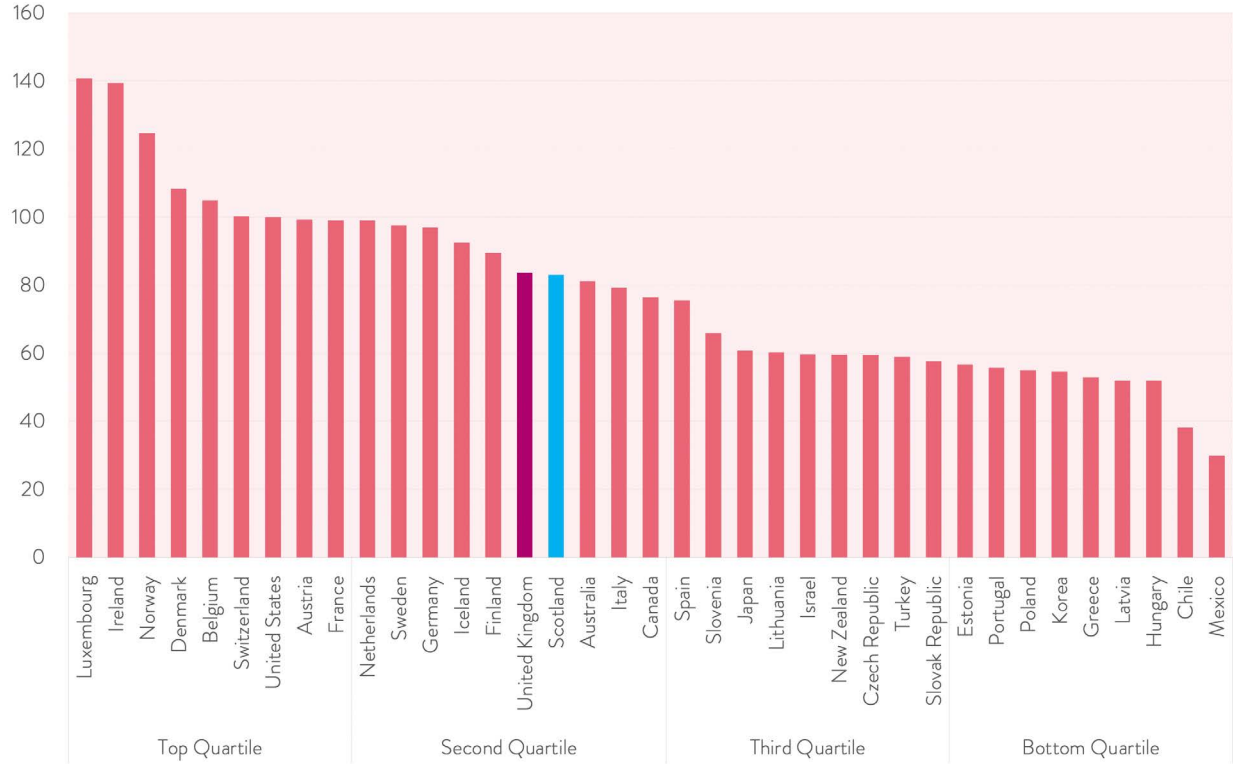
3 Oxford Economics (2017) The Contribution to the UK Economy of Firms using Venture Capital and Business Angel Finance. April 2017 PowerPoint Presentation (bvca.co.uk).

1.3.3 The impact of capital investment on productivity

Productivity performance is the most important determinant over time of growth in living standards. As Paul Krugman set out in his famous quote, "Productivity isn't everything, but in the long run it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise its output per worker".[4] Analysis of productivity drivers show that while Scotland performs well in relative terms with respect to inputs such as skills, there is a case to be made that lower levels of capital investment – in businesses and infrastructure – is one of the reasons why Scotland, and the UK, lag behind other economies in terms of productivity growth.

Scotland currently ranks in the 2nd quartile of OECD nations for GDP per hour worked, a key indicator of productivity (Figure 1.4). Scotland's productivity growth, while higher than that of the UK in recent years, lags behind international competitors. In nearly every OECD country where productivity is above the Scottish level, annual average wages are also higher. On average for every 1% increase in productivity, annual wages increase by around 0.8% across OECD countries. If Scotland's productivity matched that of the OECD top quartile, annual wages could be almost £3,850 or 10% higher.[5]

Figure 1.5: OECD productivity quartiles, GDP per hour worked (USA = 100), 2018



Source: Scottish Government

1.3.4 The impact of capital investment on wellbeing

Investment can create high quality jobs, which supports our inclusive growth ambitions and improves wellbeing. Private investment in innovative businesses and infrastructure can have an impact on wider social goals by, for example, improving digital connectivity and supporting health innovation. Increasing, directing and sustaining investment in the low carbon economy now will accelerate the transition to Net Zero. Not only will this reduce the impacts of climate change, it will also serve to create new industries, and improve air quality and health outcomes. The spill-over impacts may deliver greater wellbeing or community impact. Figure 1.5 demonstrates the wider economic and social benefits from private capital investment.

4 Krugman, P. *The Age of Diminished Expectations*. 1990.
5 Richmond, K and Turnbull, J. *Scotland's Productivity Performance: latest data and insights*. Fraser of Allander Economic Commentary Vol. 39, No. 2, 11.2015, p. 77-90

Figure 1.6: Global Capital Investment Plan

POLICY	PRODUCTIVITY	WELLBEING
Global Capital Investment Plan	Increasing investment	Transition to Net Zero
	Diffusion of innovation	Investing in regeneration
	Improve infrastructure	Improving health

1.4 A GROWING NEED FOR INVESTMENT

Increasing private capital in an economy can be highly beneficial, and can bring with it a series of other impacts. The inverse though can also be true. Persistent low levels of investment mean foregoing not just the direct funding impact, but also the availability of know-how and expertise; and demonstration effects from successful companies and projects.

Turning to recovery from a comparatively low level of investment is a challenge, particularly in simultaneously redirecting investment into new and developing areas, but it is also undeniably a big opportunity. Recent Scottish Government plans demonstrate a real strategic coherence around our investment opportunities that we can build on.

The Climate Change Plan updated in December 2020[6], sets out the Scottish Government's policies that put Scotland on a pathway to achieving the ambitious annual climate change targets to 2032, established in law in Scotland, and, ultimately, to achieving Net Zero climate emissions by 2045. It provides a comprehensive route-map for decarbonisation across the Scottish economy and across the major sources of climate change emissions in Scotland. In doing so, the plan provides clear guidance over future government policy, regulations, and the path of public investment, enabling investment to take place in the low carbon economy confidently, with clear direction about where and how low-carbon markets in Scotland will grow.

The Infrastructure Investment Plan delivers the National Infrastructure Mission, with £33 billion of Scottish Government investment over the course of the next Parliamentary term. It also sets a long-term vision of infrastructure supporting an inclusive, Net Zero carbon economy in Scotland.

The Housing to 2040 Strategy will set out how we will deliver good quality, energy efficient, Net Zero carbon housing with access to outdoor space, transport links, digital connectivity and community services.

Our Inward Investment Plan identified Scotland's best global opportunities for securing inward investment across nine opportunity areas. While focusing primarily on creating or expanding operations, it will in itself create demand for capital investment.

These plans will also all be closely linked with a long-term spatial strategy for Scotland, to be set out in the **National Planning Framework 4.**

Each of those plans acknowledges and sets out the role of private sector investment as distinct from public sector investment. The Infrastructure Investment Plan is clear about the assets we want government to build and maintain, but also identifies needs for private sector investment, for example around digital and emerging technologies in the energy sector. Housing is already largely delivered by the private sector, with the primary role for the public sector around social housing or social rental accommodation. The Climate Change plan requires such a pace and scale of change that it is openly acknowledged that the private sector will take a role in funding and delivering new infrastructure, energy efficiency measures and power generation.

RECENT SCOTTISH GOVERNMENT PLANS DEMONSTRATE A REAL STRATEGIC COHERENCE AROUND OUR INVESTMENT OPPORTUNITIES THAT WE CAN BUILD ON

We have already demonstrated in the **Inward Investment Plan** that Scotland has global-level strengths in particular sectors and sub-sectors. Financing the Recovery now points to the need to help businesses transition out of debt and into growth finance to aid recovery. We will show later in this plan that the same sectoral lens as in the Inward Investment Plan can also be applied to private capital, and indeed that it can help support the transitions needed around infrastructure and climate change.

6 Scottish Government (2020) Securing a green recovery on a path to Net Zero: climate change plan 2018–2032 - update - gov.scot (www.gov.scot). Published 16 December 2020.

1.5 ILLUSTRATING THE IMPACTS OF INCREASING GLOBAL CAPITAL INVESTMENT

The Global Capital Investment Plan covers a broad range of different forms of investment, including investment into business through equity, infrastructure and real estate. Robust evidence on the economic impacts of government action in these different areas is varied and often not available. Combined with the on-going economic uncertainty caused by the pandemic and EU exit, this makes it difficult to provide an estimate of the benefits to the economy of implementing the Global Capital Investment Plan.

However Scottish Government internal analysis[7] shows that the direct impact of increasing private sector business investment by 30%, to match the overall level among OECD countries (as a percentage of GDP), would increase the level of GDP by around 1.1% by 2030 (£1.8 billion per year). In addition to these direct impacts, an increase in investment would also be expected to have a productivity benefit for the Scottish economy, though we do not have evidence of the exact relationship between the two. Assuming the 30% increase in investment also increased the level of productivity in the Scottish economy by an illustrative 2%, then this would increase the GDP impact of investment to around 1.9% by 2030 (around £3.1 billion a year in 2019 prices). This could also increase average earnings in Scotland by 4.9%, around an additional £1,400 a year to the average Scottish employee. Increasing investment as set out in this plan will also support wider outcomes relating to Scotland's Net Zero and wellbeing economy ambitions.

More information on the modelling and the assumptions used can be found in the Analytical Methodology Note.

1.6 A MISSION-LED APPROACH: USING OUR VALUES TO GUIDE PRIVATE INVESTMENT IN THE ECONOMY

Capital investment does not always lead to wider positive economic, social and environmental benefits. It is equally possible for it to extract value from the economy, to privatise gains and socialise costs, and to increase inequality. Governments face a real choice in what kinds of investment to support and welcome.

Societies stand and fall on equality and wellbeing as much as they do on economic growth. In our work as part of the Wellbeing Economy Governments we recognise the ways in which inequality negatively impacts our economy as well as society, by limiting human resources, inventiveness and productivity, and increasing the cost of public interventions in health, education, housing and justice. Inclusive growth is stabilising for the economy, and for democratic, open societies.

Alongside this, we must consider the urgent challenge of transitioning the Scottish economy to Net Zero carbon emissions by 2045. Ending Scotland's contribution is both an opportunity and a moral imperative, and must also form part of a Just Transition.

The 21st century is being increasingly defined by the need to respond to major social, environmental, and economic challenges.[8] These challenges do not have straightforward, single solutions; instead they are "complex, systemic, interconnected and urgent".[9] Our approach to harnessing private capital in support of our inclusive growth ambitions means that we are seeking to work with investors who share our aim to address the 'grand challenges' that we face in Scotland and internationally, and to do so in a way which is fair and which distributes benefits.

The Scottish National Investment Bank, the UK's first mission-led development bank, focusing on Net Zero, Place and People missions, begins to build the institutional architecture that will stand Scotland in good stead for the future. A similar mission-based approach is being used in the Infrastructure Investment Plan and the National Planning Framework.

The Global Capital Investment Plan supports this mission based approach to attracting the right kind of capital for the economic impact we want. Our Vision for Trade sets out how our trade principles underpin the trading and investment relationships we want Scotland to have now and in the future. These principles guide the implementation of our three cornerstone international economy plans on exports, inward investment and now on global private capital.

WE ARE SEEKING TO WORK WITH INVESTORS WHO SHARE OUR AIM TO ADDRESS THE 'GRAND CHALLENGES' THAT WE FACE IN SCOTLAND AND INTERNATIONALLY

7 All estimates in this section are produced using the Scottish Government's Global Econometric Model (SGGEM). More details are available in the analytical methodology note.
8 Mazzucato, M. (2018) Mission-oriented innovation policies: challenges and opportunities, Industrial and Corporate Change, Volume 27, Issue 5, October 2018, Pages 803–815.
9 ibid

2 HOW WELL DOES SCOTLAND DO CURRENTLY IN ATTRACTING GLOBAL CAPITAL INVESTMENT?

Scotland is an advanced economy and already benefits from significant flows of private capital investment, into businesses, infrastructure and real estate. However, the challenge in linking private investment to policy plans lies in turning the investment needs into genuine commercial opportunities. This chapter assesses the current flows, and the gaps in the market that Scotland would need to address in order to achieve this.

2.1 CURRENT INVESTMENT MARKETS AND GAPS IN SCOTLAND

In this section we consider in turn the current investment markets and gaps in Scotland across each of our three areas of focus – business investment, infrastructure investment and real estate investment.

2.1.1 Business Investment

Investment into Scottish businesses across all types of investment activity (angel, venture capital, private equity, mergers and acquisitions, IPOs) was around £34.8 billion in 2020.[10] Performance has held up during the pandemic – the value of investment increased by around 40% in 2020, though deal numbers were down by around 21% compared to 2019 (Figure 2.1).

Figure 2.1: Capital investment into Scotland's enterprises, number of deals and value, Scotland 2010 – 2020.

Source: Pitchbook. Figures covers all deal types.

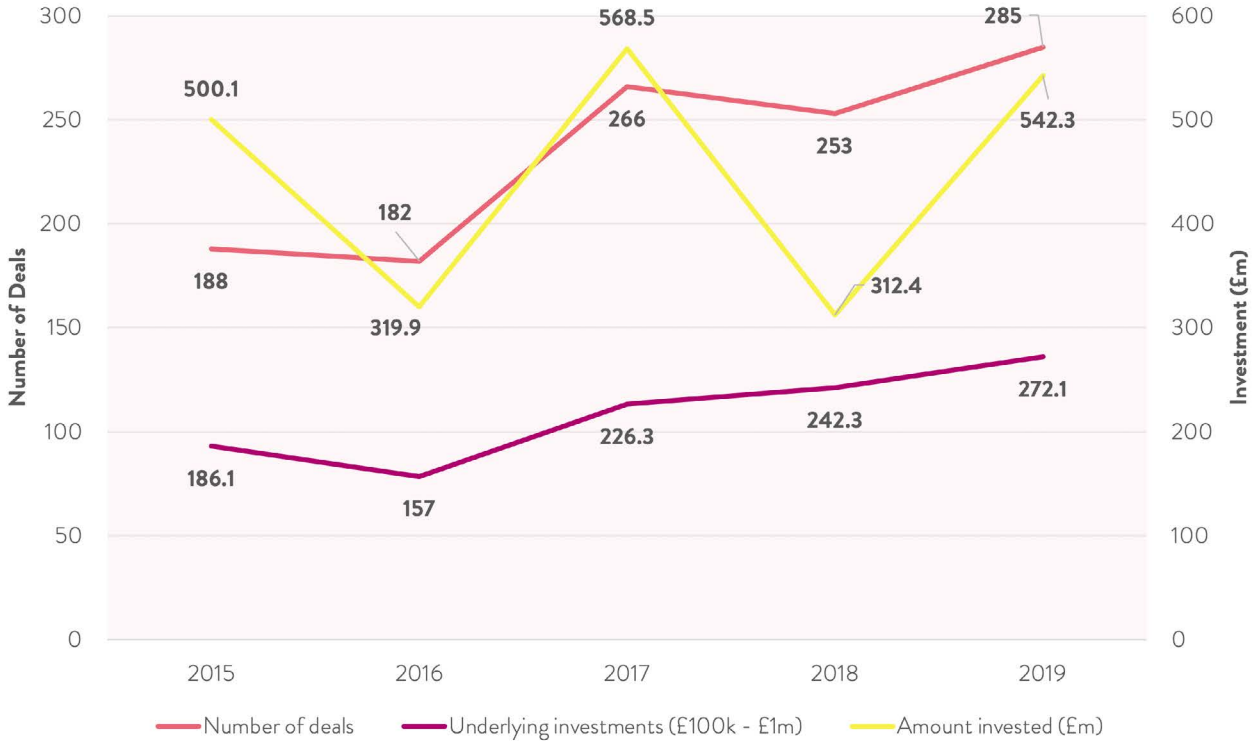
The broad measure used above is a good barometer of overall investment activity in Scotland across business growth, new assets, and in changes of ownership. A more targeted measure of investments into high growth businesses in Scotland is provided by looking at the 'risk capital' market. This risk capital measure includes only investment that is targeted at high growth and high potential businesses, and reflects to a lesser extent changes in ownership.

10 Pitchbook data.

HOW WELL DOES SCOTLAND DO CURRENTLY IN ATTRACTING GLOBAL CAPITAL INVESTMENT?

Scotland performs relatively well in the risk capital market (Figure 2.2). In 2019, Scotland recorded the highest number of deals on record (285 deals), an increase of 13% on the previous year. These deals were worth a combined £542 million in investment.[11] While the value of equity investment deals varies significantly by year, it is usually dependent on a few large investments. The value of the underlying market (in which 99% of deals took place) has grown steadily over time with a 12% increase in total investment between 2018 and 2019. Scottish investment is dominated by digital, IT and life sciences, accounting for half of Scottish deals in 2019 (Figure 2.3).

Figure 2.2: Risk capital investment 2015-2019, deal numbers and investment £m, Scotland.

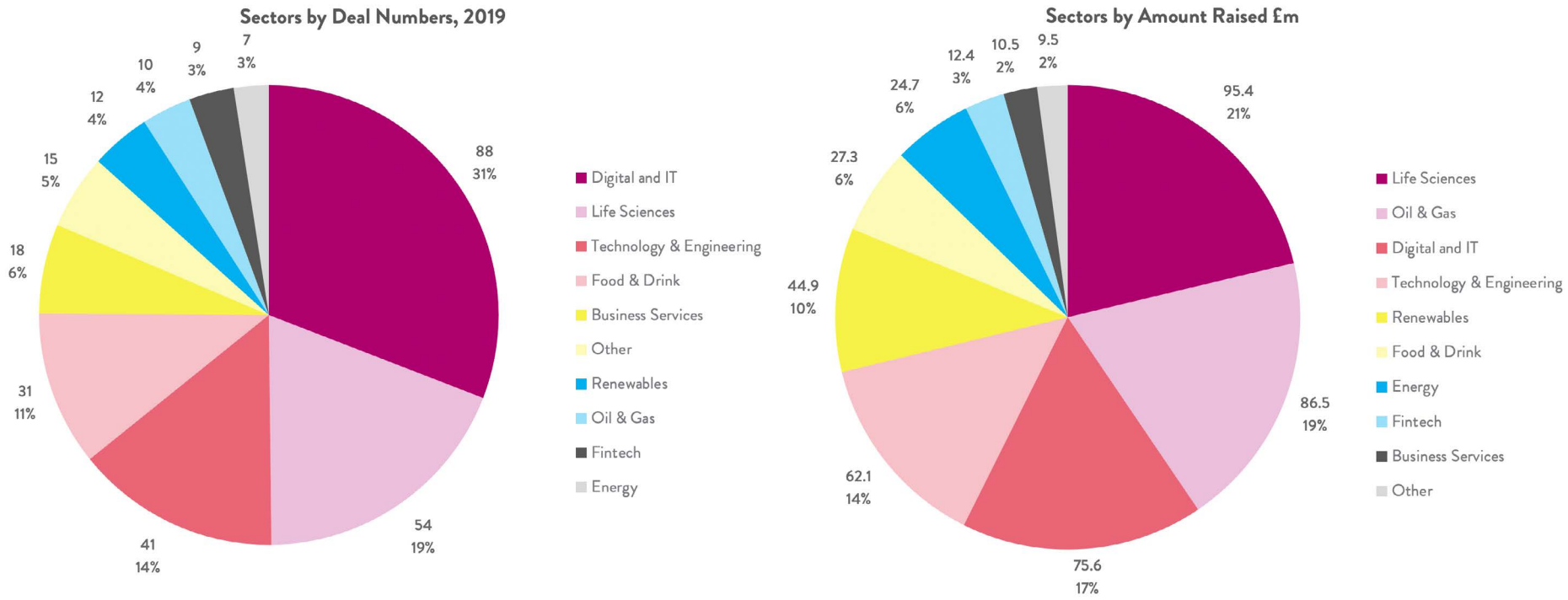


Source: Scottish Enterprise Risk Capital Market in Scotland (unpublished)

Scotland has a particularly strong angel investment market. High levels of angel activity are due to 'the Scottish model' of business angel syndicates investing alongside public sector funds. Scottish Enterprise (SE) works with companies with ambition to scale and those with potential to scale that are strategically important to our economy. SE catalyses investment into the early stage risk capital market by sharing the risks (and rewards) with investors. In 2019/20, this investment activity amounted to £76.2m, leveraging £272m of private sector investment, with over £75m from international investors.

11 Source: Scottish Enterprise Risk Capital Market Report 2019 (Unpublished). Note these figures are based on equity investment only, excluding private debt investment.

Figure 2.3: Investment by sector, deals and amount raised, 2019



Source: Scottish Enterprise Risk Capital Market in Scotland (unpublished)

THERE ARE KEY SECTORS IN SCOTLAND THAT STAND OUT FOR ATTRACTING HIGH LEVELS OF PRIVATE INVESTMENT

The UK's equity markets are highly concentrated in the 'golden triangle' of London and the South East of England which accounted for 72% of all deals, and 79% of all investment in 2018 whereas Scotland secured 7% of all UK deals but only 3% of value (Figure 2.4). This highlights that investment deals in Scotland tend to be lower on average compared to the UK average.

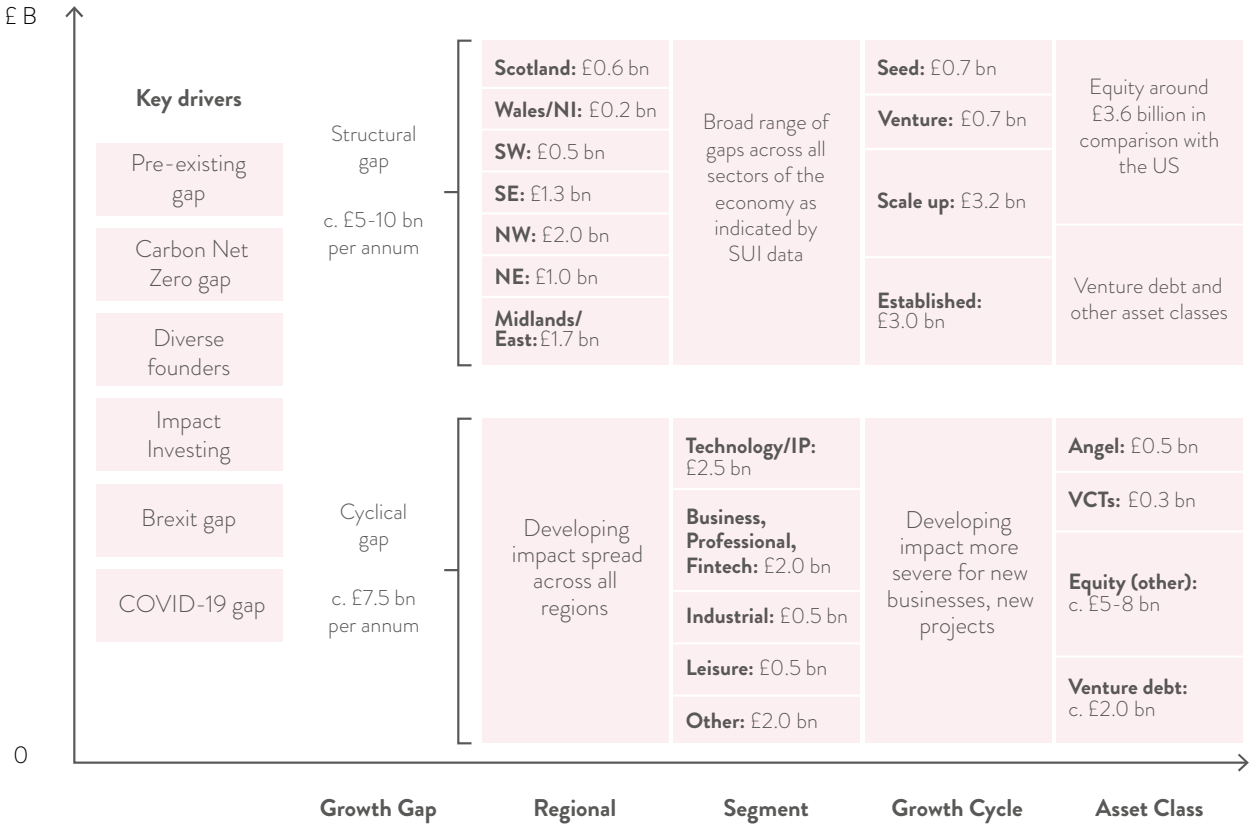
Figure 2.4: Number of deals and value, Scotland and UK Regions, 2018.

	Number of Deals	% of total deals	Value of deals (£m)	% of value
London	2002	52%	5877	57%
South East	483	12%	1232	12%
East of England	288	7%	1078	10%
Scotland	253	7%	312	3%
North West	188	5%	348	3%
South West	180	5%	408	4%
West Midlands	106	3%	338	3%
Yorkshire and Humber	105	3%	222	2%
Wales	88	2%	105	1%
North East	70	2%	283	3%
East Midlands	62	2%	83	1%
Northern Ireland	43	1%	33	0%

Source: Scottish Enterprise Investment Benchmarking Analysis (2019)

According to the Scale Up Institute, Scotland has a "structural finance gap" of around £0.6 billion for high growth businesses each year.[12] In addition to this structural gap, it is estimated that a UK-wide "cyclical" finance gap of around £7.5 billion has developed as a result of COVID-19, EU Exit and wider economic uncertainty.[13] These gaps in finance exist across different regions and nations of the UK across a broad range of sectors and asset classes as outlined in Figure 2.5.

Figure 2.5: Key drivers and dimensions of the growth gap, UK



Source: Scale Up Institute (2020)

Two recent reports in this area are worth considering as to why Scotland's performance is at its current level. The Scottish Technology Ecosystem Review[14] (STER; also known as the Logan Review) provides analysis of the relative strengths and weaknesses of the Scottish investment market for early stage businesses. It argues that the Scottish equity market reflects the immaturity of the overall start-up ecosystem, observing that investment is dominated by an excellent angel investment network, and public sector initiatives such as SE's co-investment model. Whilst these funding mechanisms are well developed and have contributed to Scotland's growing reputation as a promising early stage hub, the report highlights that funding gaps remain for scaling companies pursuing Series A level (£10m+) funding rounds, and for early seed companies seeking investment smaller than the sums favoured by angel syndicates.

For early seed companies, the Logan Review suggests that the problem is chiefly one of discoverability and can be addressed through improved coordination to connect companies to individual investors. The gap in larger scale Series A investment is more complex, but can principally be explained by the absence of venture capital funds (VCs), both domestic and external, that are focused on scouting the Scottish ecosystem for deals. It is argued that in large part this is a problem of adequate deal flow. In developing ecosystems such as Scotland, there is a lower density of investable propositions meaning that VCs often consider their efforts better spent in larger ecosystems where many interesting prospects can be explored in a single day.

12 Scale Up Institute
13 IBID
14 Logan, M. (2020) Scottish Technology Ecosystem: Review

A key focus of the Logan Review is therefore to increase the volume of quality Scottish start-ups. Other challenges include the pitching expertise of start-ups, the prohibitive costs of regular travel to London to develop relationships with VCs and complex ownership models that include large numbers of passive angels and public sector investment, and are viewed as difficult to buy out. The Review recommends a range of solutions to these problems which are reflected in section 6 of this plan, reinforcing Ministers' earlier commitment to full implementation of the recommendations made in the Logan Review.

Benny Higgins' report on Financing Scotland's Recovery largely echoes the analysis presented in the Logan Review. It further highlights anecdotal evidence which suggests there may be a risk of Scottish companies relocating in order to access growth and scaling finance – that is, they leave at precisely the point when they would otherwise begin to generate significant economic and labour market benefits for Scotland. These two reports suggests a need to develop an investment-focused approach for all stages and ages of business maturity; and to broaden out the market in available funding for companies.

There is a recognition that there is not a one size fits all pathway for meeting investment needs for scaling companies. A more diverse, well balanced funding environment means that we are more likely to meet the needs of a greater range of businesses. Where we can meet these needs, companies will not only stay in Scotland, but we will be able to attract early stage businesses from other ecosystems, increasing the density of our innovative clusters. In practice, this is a significant shift in policy direction, from business-level (micro) intervention into a market-level (macro) intervention to ensure the effective functioning of the equity market for all business investment. Figure 2.6 highlights in more detail the differences between emerging ecosystems such as Scotland and more mature, 'post-tipping point' ecosystems.

Figure 2.6: Comparison of the characteristics of mature and Scottish equity markets.

Characteristics of Mature Investment Markets	Characteristics of the Scottish Market
Mostly VC capital	Mostly angel capital
Full range of investments from small to very large	Mostly small investments
High discoverability of prospects i.e. VCs actively scout companies the ecosystem 'deal flow'	Poor discoverability of prospects – many companies have to go searching for VC.
Lower friction for investors: high volume of investable prospects on their doorstep.	Higher friction for investors – cap tables in Scotland are unusual and lower density of investable companies makes ecosystem less attractive for VC.
High pitching expertise among founders	Low pitching expertise among founders
Low-level of government funding	High-level of government funding

Source: Scottish Technology Ecosystem Review (2020)

2.1.2 Infrastructure Investment

The Scottish Government recognises that public sector investment in infrastructure plays an important role in supporting resilience and enabling inclusive, Net Zero and sustainable economic growth. In 2018, we committed to a National Infrastructure Mission to increase annual public sector infrastructure investment by £1.5 billion annually. This will deliver total value of over £33 billion of public capital investment in the next five years.

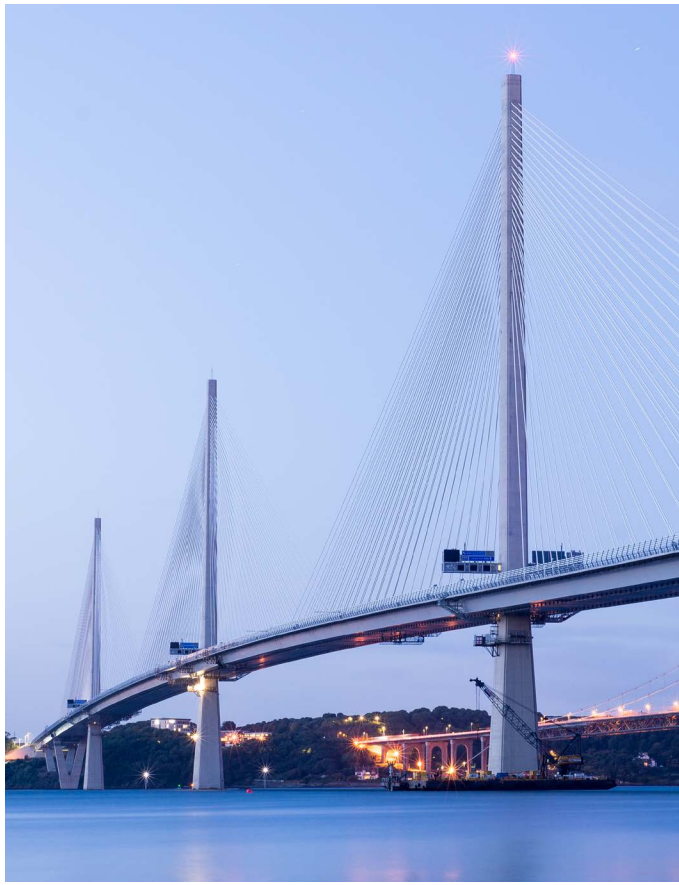
Our recently published Capital Spending Review and Infrastructure Investment Plan set out the priority areas of spending to support our national outcomes, such as Health, Justice, Education, Housing, Transport and Digital. Our capital spending plans will be complemented by spending by UK Government in areas of reserved competence and by Local Authorities.

It is clear that public sector investment in infrastructure does not meet all investment requirements across all infrastructure classes, either because assets are in private ownership, or the responsibility lies with other administrations or is subject to UK regulation such as energy and communications networks. We must therefore consider how best to attract global capital into key sectors of Scotland's economy to complement our ambitious plans.

While establishing the size of the private infrastructure market can be difficult, estimates provided by the Investment Association suggest that its members managed around £45 billion in UK infrastructure assets in 2019, up from £35 billion in 2018.[15] **The ONS estimate that private investment into constructing new UK economic infrastructure reached £10.3 billion in 2016, 68% of which (£7 billion) was accounted for by the energy industry.**[16] This investment has also increased significantly over time (Figure 2.7).

IN 2018, WE COMMITTED TO A NATIONAL INFRASTRUCTURE MISSION TO INCREASE ANNUAL PUBLIC SECTOR INFRASTRUCTURE INVESTMENT BY £1.5 BILLION ANNUALLY

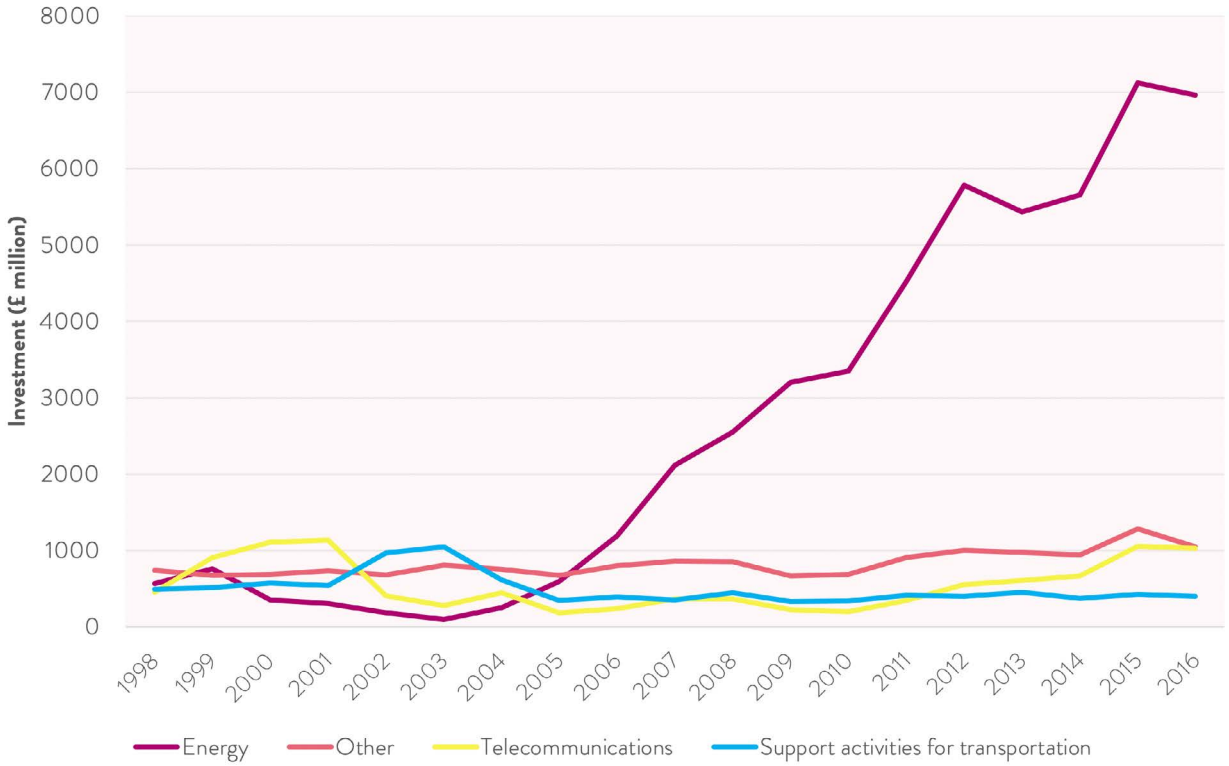
Private investment into infrastructure in Scotland is dominated by investment in renewable technologies. Major investments include the £580 million Viking Offshore Wind Farm on Shetland and the £630 million subsea power cable connecting the island to the Scottish mainland. The forthcoming Scotwind round will add considerably to this, estimated to be as much as £8 billion.



15 The Investment Association (2020) Investment Management in the UK, 2019-2020. The Investment Association Annual Survey, September 2020 20200924-imsfullreport.pdf (theia.org)

16 Developing new statistics of infrastructure - Office for National Statistics (ons.gov.uk). Covers investment in private economic infrastructure only (excludes public spending on schools, hospitals, etc). ONS exclude oil and gas investments from figures.

Figure 2.7: Estimates of market sector investment in infrastructure, selected sectors, current prices. UK, 1998 to 2016.



Source: Office of National Statistics. Note chart excludes sectors that are publicly funded in Scotland (such as water supply) which are publicly funded in Scotland.

Mobilising significant private investment is crucial for transitioning to a low carbon economy and meeting our Net Zero commitments, and is crucial for delivering a Just Transition and meeting our challenging annual emissions targets. However, it is currently very concentrated in sectors where a combination of pricing certainty and regulation have been largely resolved. The dominance of private investment in wind, in particular, can be ascribed to UK-level regulatory interventions around Contract For Difference (CfD). CfDs incentivise investment in renewable energy by providing developers of projects which have high upfront costs and long lifetimes with direct protection from volatile wholesale prices, and they protect consumers from paying increased support costs when electricity prices are high.

SCOTLAND'S INVESTMENT NEEDS: A JUST TRANSITION AND DIGITAL INFRASTRUCTURE

The transition to a Net Zero carbon emissions economy will require significant upfront investment in modernised infrastructure, capital projects, preserving and restoring Scotland's natural capital, and modernising our building stock. Petrol and diesel vehicles will be replaced with zero emission alternatives, buildings will be made more energy efficient and have their heat systems replaced, our renewable electricity generation capacity will significantly expand, our energy networks will be strengthened, and significant changes will occur in how we use our land.

Economic transformation on this scale will be challenging, but will create a wealth of new opportunities for businesses, investors and citizens. Seizing these opportunities will mean researching new technologies, but also developing innovative ways to bring them to market at scale. Many of these low-carbon technologies will have higher upfront investment costs than the technologies they replace, but the lower ongoing running costs and more efficient use of resources will provide a reliable source of returns.

Estimating the additional investment required to reach Net Zero is challenging, as many aspects of the transition pathway will depend on developments in technology, markets and international action beyond any reasonable forecast horizon. The UK's Climate Change Committee (CCC) has produced a range of indicative scenarios to try and address this, and estimate how much additional investment may be required to reach Net Zero, against a counterfactual of taking no further action against climate change. Under their central scenario, the CCC estimate Scotland will need to increase its investment to support the transition five-fold in real terms over the 2020s, from around £1 billion per annum this year to a steady state of around £5 billion by 2030.[17] While this estimate does not account for shifting investment from carbon-intensive industries, or for the savings generated by more efficient low-carbon alternatives, it provides an indication of the scale of the challenge and the direction of travel.

Rapidly ramping up investment in Net Zero over the 2020s will not only set Scotland on the path to ending our contribution to climate change, but will help establish leadership positions in key markets as the world moves towards decarbonisation.

We also know that significant investment is required to continue to develop our digital infrastructure. There is substantial commercial investment planned to develop full-fibre broadband and 5G networks – and the fibre being delivered through our R100 Programme which will also help extend high bandwidth connectivity services across rural Scotland – but some gaps remain in Scotland's digital services and infrastructure, notably the lack of international fibre connectivity and datacentres, both of which are key to maximising the economic impact of data-driven innovation that will increasingly drive the wider digital economy.

Analysis produced for the UK National Infrastructure Commission estimates that, over a 30 year period, building and maintaining a full-fibre network across the UK would cost £33.4 billion.[18] This investment is absolutely necessary for, at a minimum, keeping pace with other advanced economies, and this is only one area of priority infrastructure identified within our Infrastructure Investment Plan.

17 Climate Change Committee (2020) Sixth Carbon Budget - Climate Change Committee (theccc.org.uk). Estimates are in real 2019 £s, under the Balanced Pathway scenario.
18 National Infrastructure Commission (2018) National Infrastructure Assessment. July 2018, National Infrastructure Assessment (nic.org.uk)

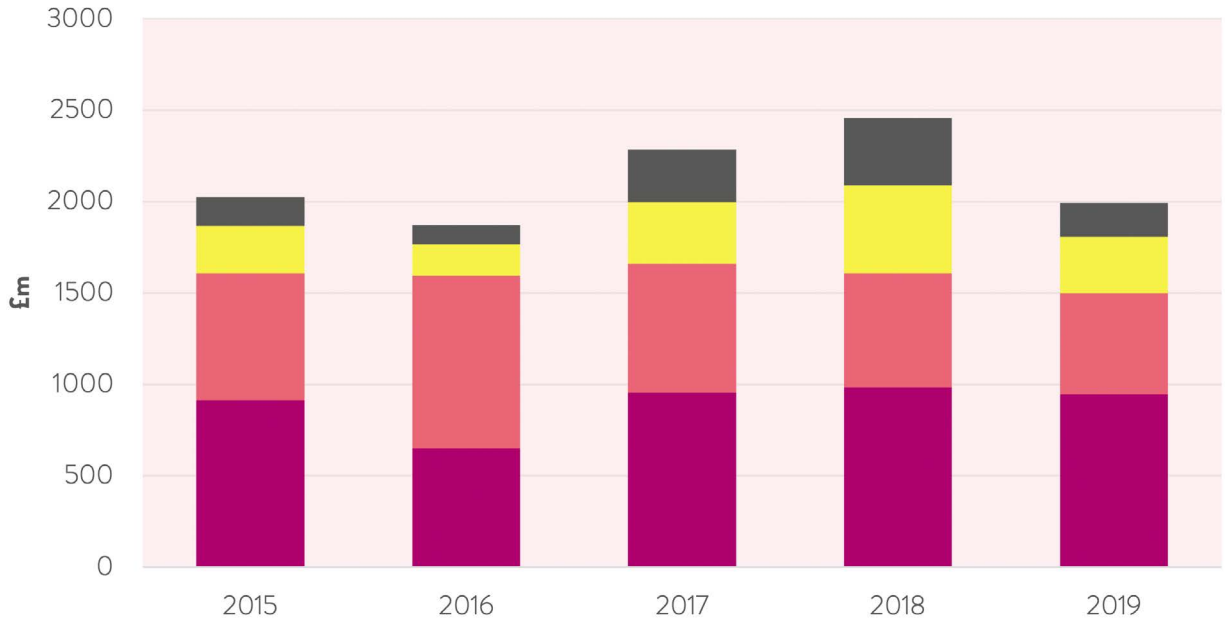
2.1.3 Real Estate Investment

In 2019, the commercial real estate market in Scotland was worth £1.99 billion (approximately 4% of UK market)[19] with almost all of it concentrated in Edinburgh, Glasgow and to a lesser extent Aberdeen. Office real estate accounted for the largest component (48%) of overall commercial real estate investment, followed by retail (28%). 'Alternatives' refers to non-traditional real estate investment such as student accommodation and hotels. Growth in commercial real estate has been broadly flat over recent years (Figure 2.8).

SCOTLAND REQUIRES A MODERN SUPPLY OF INDUSTRIAL ACCOMMODATION TO CATER FOR MODERN MANUFACTURING PRACTICES

A significant proportion of this investment in Scotland is into 'standing stock', essentially ownership of existing assets changing hands. However, there may also be value-creating investment in standing stock through office refurbishment, for example. Whilst this is an important part of the funding market, without which risk and development capital cannot function, it is not the primary part of the investment cycle that drives other economic activity, e.g. in construction jobs or supply chain impacts. Between 2010-2019, Scotland attracted just 6.5% of the UK total for development investment, which is below our pro-rata share.

Figure 2.8: Commercial real estate investment, Scotland, 2015-2019



Source: CBRE

Scotland's (and the UK's) commercial real estate investment market has been heavily affected by the COVID-19 pandemic. Investment in Scottish commercial property dropped to £1.2 billion in 2020, down 42% from 2019 lockdown measures and economic uncertainty hit. More positively, through Scotland was the most popular UK destination for overseas investment outside London and the South East.[20]

It is not yet clear how recovery and transition will affect city and town centres, the underlying rent and return models in the UK, or the appetite for speculative and new developments. Other asset classes, including industrial and logistics, are more resilient, but there is no certainty that these will hold up; and without some government action, these may end up servicing consumer demand (essentially warehousing) without linking to broader economic opportunities and ultimately supporting higher value jobs.

Scotland also has an ageing industrial building stock which presents challenges from a physical, functional perspective and risks obsolescence.[21] Scotland requires a modern supply of industrial accommodation to cater for modern manufacturing practices in line with Industry 4.0, to serve our strategic opportunity growth areas and deliver sustainable inclusive economic growth aligned to our Net Zero ambition.

19 CBRE (2020)
20 Co-Star Report, 2020
21 The Scottish Government (2016) A manufacturing future for Scotland

2.2 STRUCTURAL CHALLENGES IN THE SCOTTISH INVESTMENT MARKET

While there are significant strengths in Scotland's economy, our market performance reflects some challenging underlying conditions: lack of diversity of actors, maturity and scale of markets, and the global lack of certainty around future direction.

Lack of demand shouldn't be under-estimated as a factor in explaining Scotland's investment landscape. Scotland has long-standing challenges around the structure, and more intangibly, the culture and growth ambitions of the business base. While Scotland is successful at encouraging early stage business growth, these businesses often lose momentum at later stages of the growth, limiting their potential.[22] More widely, Scottish SMEs are often reluctant to use finance to grow and expand. According to the Scottish SME Access to Finance Survey 2019, only around 2% of Scottish businesses use equity capital for growth, preferring otherwise to use self-funding or bank debt.[23] However, as noted in the 'Financing Scotland's Recovery' report, the tendency for businesses to use traditional debt may restrict growth in the future given the increased use of debt during the pandemic. The proportion of UK businesses using finance increased sharply during the pandemic from 28% in the three months to May 2020 to 40% in Q3.[24] Different forms of finance beyond traditional debt could help businesses restructure towards growth in future. Even seemingly small shifts in business views on the opportunities presented by different forms of finance would represent a significant shift from historical trends.

There is already significant work underway to stimulate demand for investment. Our enterprise agencies work with partners including Business Gateway, Scottish EDGE, accelerators, intermediaries and investors, and innovation centres to identify and support companies with scale-up potential. This includes entrepreneurship programmes, support to develop investible propositions, and direct investment. Lack of demand from businesses for private capital investment does, however, remain an issue.

OUR ENTERPRISE AGENCIES WORK WITH PARTNERS TO IDENTIFY AND SUPPORT COMPANIES WITH SCALE-UP POTENTIAL

Lack of demand is reflected also in infrastructure and property. The pool of developers and project promoters is relatively limited, compared to similar UK markets, and scale is often an issue for institutional investors or wealth funds, who regard the transaction costs of smaller deals as unattractive. The Scottish Government has put substantial effort into this, through initiatives like the Low Carbon Infrastructure Transition Fund that crowd in private investment, and latterly through the quality assurance processes around property and green investment portfolios. Scottish Futures Trust also collaborates closely with the Scottish Government, the wider public sector and the private sector to develop and deliver innovative financing mechanisms, many of which include a focus on attracting global capital. Nonetheless, lack of demand, diversity of players, and scale of projects remain issues to address in building a mature market.

This is likely to be all the more so on rolling out the technology to deal with climate change, where we also have **co-ordination failure.** This occurs where investment is needed in more than one element of a project to make any single element investable. An example of this is the relationship between the roll out of electric vehicle charging infrastructure network, renewable energy and electric vehicles. Coordination failure is also apparent in for example the combination of energy production, hydrogen and heating infrastructure. Public sector intervention is required to convene around most of the climate change related investment needs of the future. This is reflected in the sectoral plans being produced alongside our Climate Change Plan, and we will need to build investability and coordination into these from the beginning.

This in turn will require careful structuring of projects as **the social costs and benefits** of capital investment (e.g. supply chain or social impacts) may not be fully realised by the investor, and so will not be priced in to an investment decision. For example, a business producing renewable energy technologies may contribute towards reducing carbon emissions, or investment in digital infrastructure may create new technologies that help improve broadband access for local businesses and residents. One estimate puts the total social benefit of meeting Net Zero by 2050 at around £80 billion for the UK (through improved air quality, flood prevention and better health).[25] We will therefore need to consider market signals and mechanisms that encourage these benefits to be priced in, as well as considering the role of the public sector as a co-investor in projects that generate positive spill-overs.

22 Scottish Enterprise (2019) Mid-Sized Businesses in Scotland 2018-2019
23 The Scottish Government (2020) SME Access To Finance Survey: 2019 - gov.scot (www.gov.scot)
24 BVA-BDRC (2020) SME Finance Monitor 2020 Q3
25 Vivid Economics (2020) Keeping us competitive: An investment strategy for Net Zero, February 2020, Vivid Economics Report prepared for WWF UK Keepingus_competitive.pdf (wwf.org.uk).

Finally, in global terms Scotland is a relatively small market for capital investors and, as with other aspects of international trade, gravity matters. The further away from major centres of investment activity, the harder it is to overcome **information asymmetry** whereby companies and projects in Scotland are unaware of how to approach the market; and global market players are unaware of what Scotland might have to offer. Awareness raising, and more intelligent targeting of markets and investors, are required to help Scottish companies better engage with the larger investment hubs, but we also need to make more of our nearby markets – Edinburgh and London.

Public sector efforts to support investment in Scotland have shown individual successes. They have also been relatively fragmented, with the relevant skills spread across a number of directorates in Scottish Government, agencies and local authorities. That system itself is shifting with the launch of the Scottish National Investment Bank as both an investor and, over time, a centre of expertise for investment. There is much greater policy coordination, and enterprise agencies have undergone a process of focusing and democratising their business support to target companies and projects with the biggest economic and social impacts. We need to use the need for recovery and transition as a spur to coordinate, reprioritise and focus the work across the public sector. The intention is therefore for the actions proposed in this plan to be delivered jointly – in partnership across the public sector, with each organisation playing to its strengths, and in partnership with the private sector.

2.3 MAXIMISING THE FIT BETWEEN SCOTLAND'S INVESTMENT NEEDS AND MARKET DRIVERS

Marshalling an investment-led recovery is only partly about the clarity of what we need and want investment for. Alongside that, it requires us to understand and engage with what makes a project or business location viable in the eyes of the market, and monitoring changing market conditions and preferences.

THIS PLAN SHIFTS OUR APPROACH FROM SEEKING INVESTMENT IN PARTICULAR CLASSES OF ASSETS – TO CREATING FUNCTIONAL, VIABLE MARKETS FOR ALL TYPES OF INVESTMENT IN SCOTLAND

This will not be a short-term project. Investment is constrained by uncertainty, and that uncertainty is currently being stimulated by the COVID-19 pandemic, by the UK's exit from the EU, and by the anticipation of further impacts from both. Under these circumstances, we must be realistic about timescales, and about the extent to which engaging with investment markets is the right solution for particular development and economic needs.

This plan shifts our approach from seeking investment in particular classes of assets - to creating functional, viable markets for all types of investment in Scotland, creating opportunities for projects and companies which do not need government support as well as for those that do. There are three main factors in this shift, which act as filters (Figure 2.9) – to answer the question 'is this the right project to engage the market on?'; and as levers – to assess how can we increase chances of success for prospects we do take to market.

These three factors are:

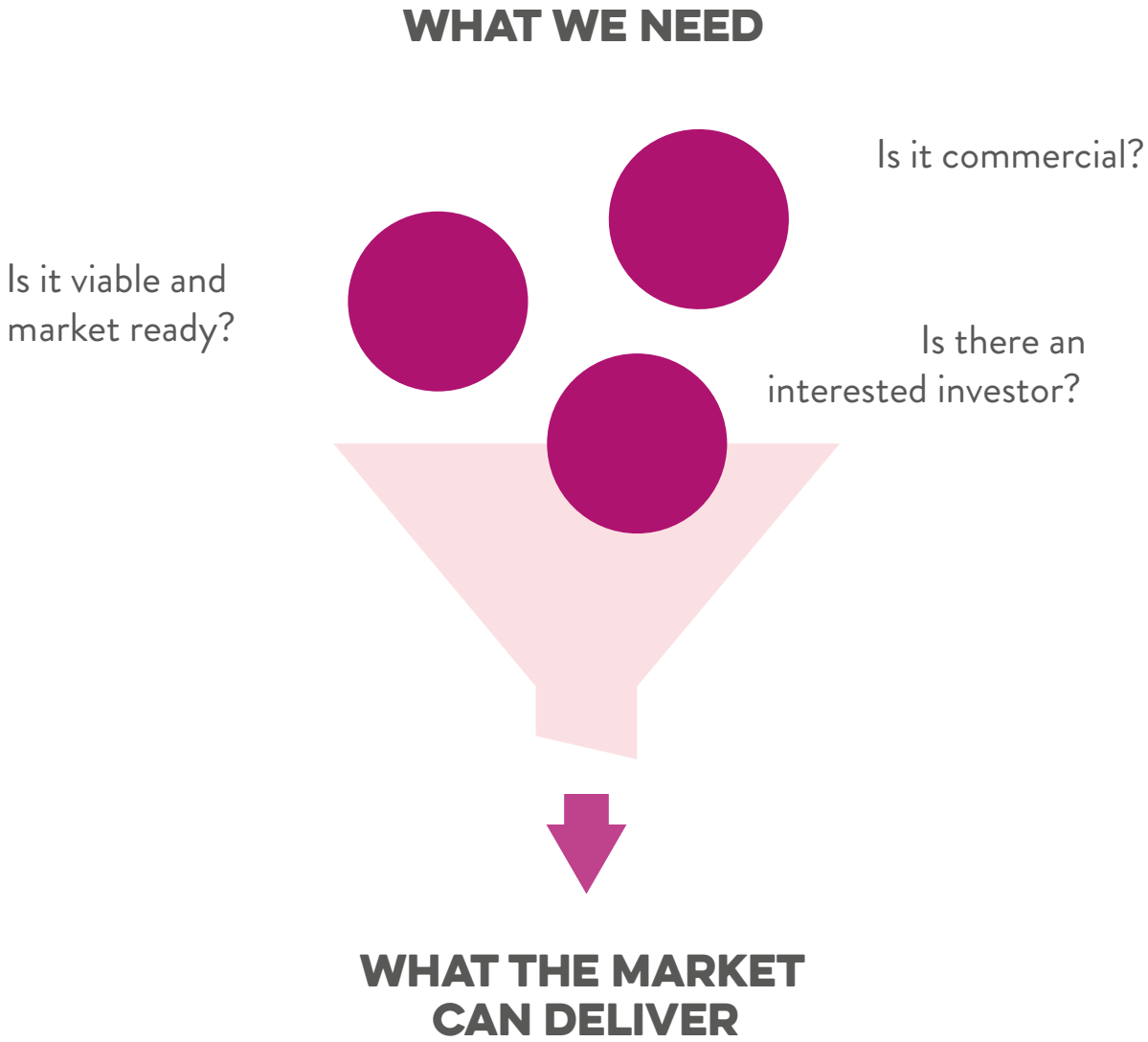
1. INCREASING THE **OPPORTUNITY FOR INVESTMENT**, BY LINKING INVESTMENT NEEDS WITH THE STRONGEST AREAS OF SCOTLAND'S INTERNATIONAL ECONOMY AND CERTAINTY OF FUTURE DEVELOPMENT.

2. INCREASING **VIABILITY OF INVESTMENTS**, SUPPORTING COMPANIES AND PROJECTS BECOME READY FOR MARKET, AND MATCHING THE INCENTIVES AND REGULATION CLOSELY TO THE POLICY OUTCOMES WE WANT TO ACHIEVE.

3. INCREASING **SUPPLY OF CAPITAL**, BY BETTER UNDERSTANDING AND TARGETING DIFFERENT SOURCES OF FUNDING.

In **Chapter 3** we focus on the supply of private capital by reviewing the global investment landscape, the types of investors that exist, which ones we should increase engagement with, and what they are looking for. **Chapter 4** focuses on increasing the opportunity and demand for capital, and the viability of projects, as we articulate Scotland's strengths – what we have to offer investors – and the types of investment we need to build our economy. In **Chapter 5** we bring these together to identify the best fit between Supply, Demand and Viability – with a focus on five areas to guide our actions.

Figure 2.9: Demonstrating the 'Strategic Fit' where the flow of capital is aligned to deliver maximum impact on the economy

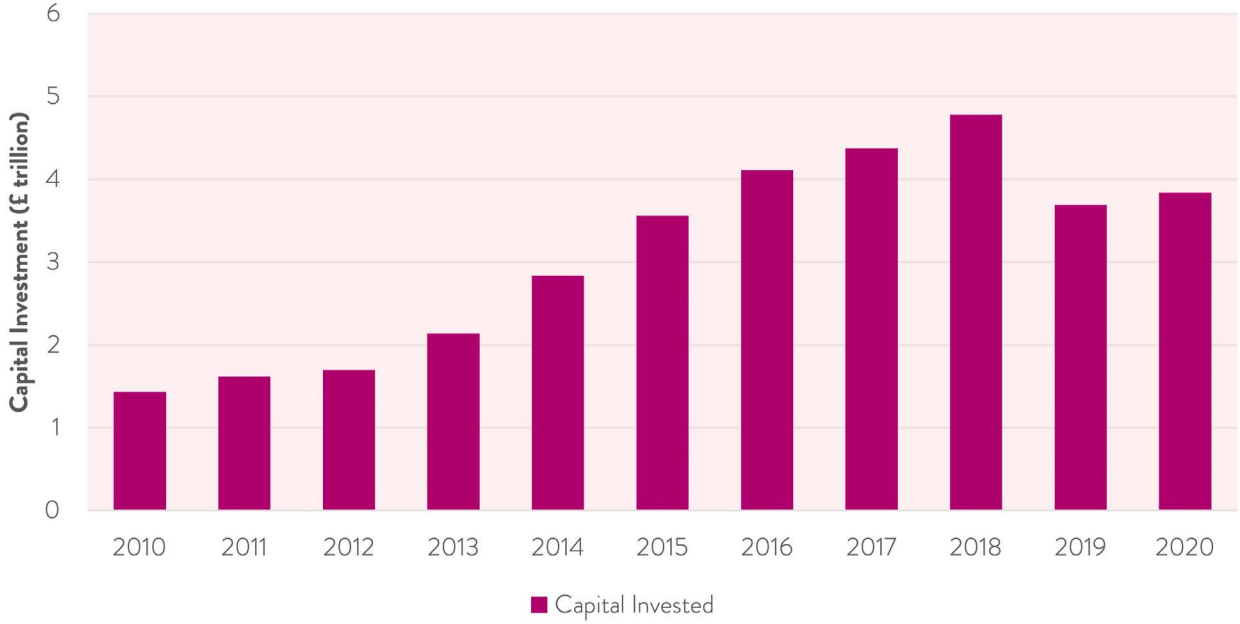


3.1 GLOBAL CAPITAL FLOWS: INTERNATIONALLY MOBILE CAPITAL SEEKING OPPORTUNITY

Global private capital investment has grown robustly over time, both in terms of the number of deals taking place and the value of those deals. Recently, however, investment values have fallen due to a dip in activity in 2019 and the impact of the pandemic in 2020. Data from Pitchbook, which predominantly covers business investment transactions, highlights this global trend (Figure 3.1).[26] Around £3.8 trillion of capital was invested in 2020, slightly up on 2019 (£3.7 trillion) but below the 2018 peak (£4.8 trillion).[27]

Of particular importance within the overall market is "growth capital". These deals, involving venture capital and private equity firms, are among those with the most productive potential. The global growth capital market remained resilient in 2020, with £1.08 trillion of capital invested, an increase in investment on the previous year (£1.02 trillion).[28]

Figure 3.1: Global private capital investment, number of deals and value, 2010-2020



Source: Pitchbook. Overall capital covers all deal types.

26 Pitchbook data covers mostly business investment transactions, as well as partial coverage of some infrastructure and real estate deals.
27 IBID
28 Pitchbook data. "Growth capital" definition in the data is based on private equity and venture capital deals. I.e. excluding mergers, acquisitions, IPOs.

Total global investment is spread across world regions, with the United States, UK and the rest of Europe accounting for a large proportion of capital inflows. In 2020, the US was the destination for around 48% of investment, while Europe attracted around 26%. £343 billion was invested in UK deals in 2020, accounting for around 9% of the world total (Figure 3.2). The US and Europe account for a notably large share of total global investment, though the large US element may be partly due to higher deal-making there. It is important to note that there are significant investment markets in other countries, such as China, which may not show up in the data due to the greater role of public investment and which may also be under-represented in the global investment data used here.

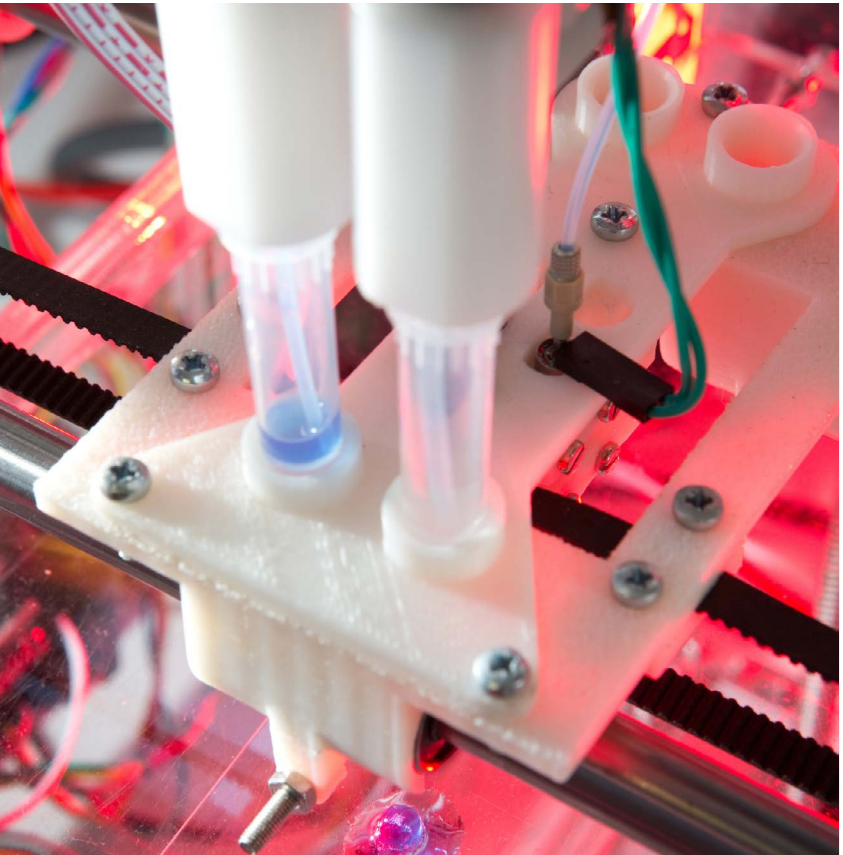
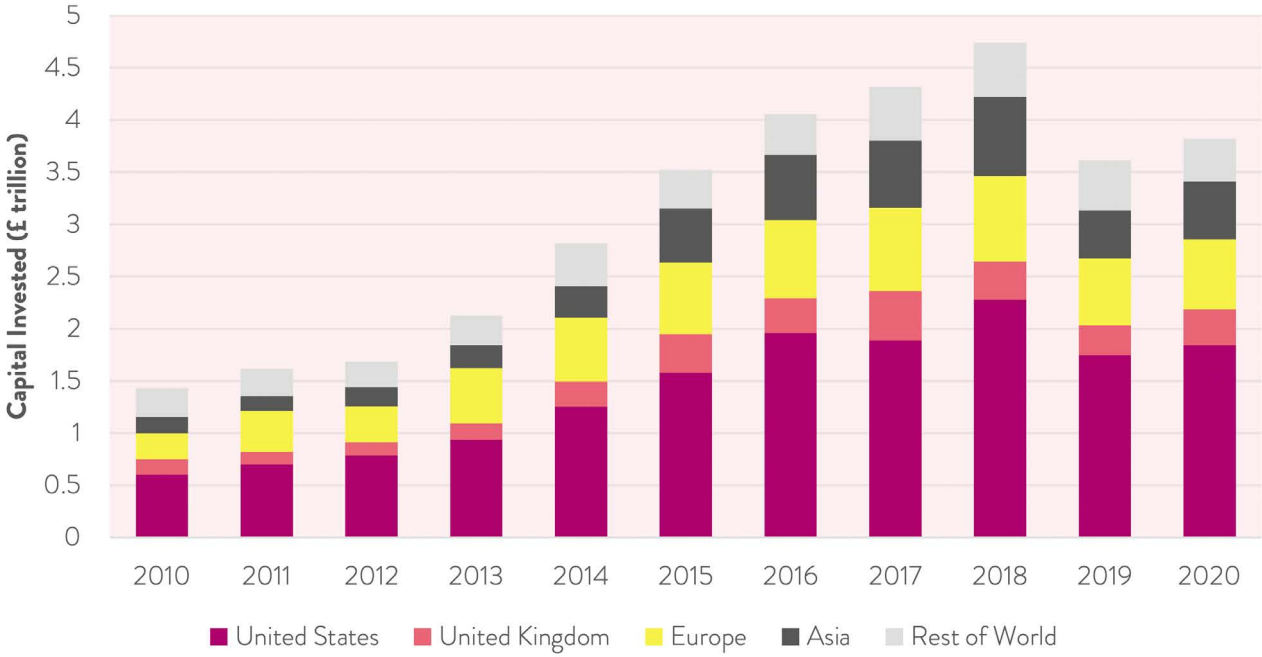


Figure 3.2: Total value of deals by World region, 2010 – 2020.

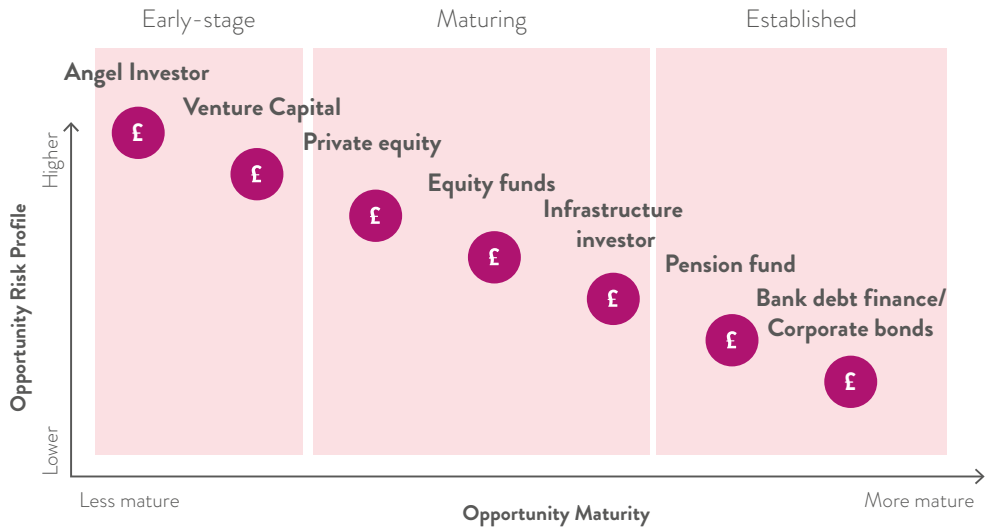


Source: Pitchbook. Overall capital covers all deal types

£343 BILLION WAS INVESTED IN UK DEALS IN 2020, ACCOUNTING FOR AROUND 9% OF THE WORLD TOTAL

3.2 TYPES OF INVESTORS AND INVESTOR BEHAVIOURS

Figure 3.3: Example of Capital Investment categories by risk profile and opportunity maturity. This shows in which part of the market each investor operates, not be read as an 'investment continuum'.



The global market for investment can be differentiated by the risk-reward appetites of different investor groups as detailed in Figure 3.3 - although it is important to note that there is **significant variability across sectors and within segments**. Investor decisions are also influenced by macroeconomic policy (e.g. interest rates, economic stability) and factors such as location, skills, and availability of opportunities. Some categories of investors also tend to choose projects closer to home (particularly early stage investors where discoverability of new deals is frequently linked to information symmetry – the company and investor need to be geographically close to find each other).

Angel Investors are affluent individuals who inject capital into start-ups at an early stage of investment, in exchange for ownership equity or convertible debt, with risk mitigated in part by the availability of tax incentives. Angels frequently syndicate, or pool together, to share risk, and unlike other sources of capital are mostly directly deploying their own money.[29] The personal nature of investment means that they are a good source of financing for high-risk start-ups: Angel investors' decisions to invest are often based on how they perceive the business owners as well as the business plan.[30] They provide access to networks and usually patient capital. While around 70% of angel investments in the UK result in a loss to the investor the average annual rate of return (IRR) is still 22%.[31] This indicates the high risk – high reward nature of angel investment. In the UK the median initial investment is £25,000, and the median follow-on investment from individual angel investors is £7,500.[32]

Scotland's angel market has grown substantially over the past decade and has added a rich and increasingly sophisticated source of finance for early stage companies. It has benefited from passive government co-investment, therefore the average individual investment will likely be lower than the UK figures above. It is also different to other parts of the UK and markets such as the US, where individual angels typically come together on a deal-by-deal basis and more often co-invest with seed stage VC funds.

Venture Capital (VC) funds provide capital to small and medium-sized businesses, start-ups, and seed-stage opportunities with high growth potential. The financing is typically in the form of equity or with occasional use of convertible debt, and provides an equity stake to the investor relying on company growth over time to provide a return. The average size of a UK Venture Capital fund is £48 million.[33] VC funds managers are highly motivated to achieve positive returns because their ability to raise their next fund is entirely dependent on demonstrating an extensive history of well-performing investments.

It is a common misconception that angels and VCs are part of an investment continuum or 'ladder', with angels passing the torch to VCs as the need for scale-up funding grows. This is actually fairly uncommon as VCs frequently invest at the same time as angels or angel syndicates, or may even invest at an earlier stage.

29 Investopedia (2020) Angel Investor Definition (investopedia.com)
30 British Business Bank (2018) The UK Business Angels market report (british-business-bank.co.uk)
31 Angel Resource Institute (2016) Angel Returns Study.
32 British Business Bank (2018) The UK Business Angels market report (british-business-bank.co.uk)
33 BVCA (2019) Report on investment activity

Indeed, a company with investment from an angel syndicate may often find that this is a disincentive for VCs, who view this ownership model as cluttered and overly complex to buy out. VC funds often specialise in particular stages, sectors, or forms of technology, and will invest in pre-seed and seed rounds as well as much larger amounts per funding round than business angel syndicates. Many have exceptional experience of advising and developing companies to successful exits.

68% of UK and European funds are focused on seed funding, and often do not have the finances available to follow on from their initial investment. The US has approximately eight times as much growth-stage capital available in comparison to UK and European VCs, so many start-ups and scale ups often turn to American markets to raise growth rounds. This risks companies re-locating outside of Scotland at the point of growth.[34]

Private equity investors differ from Venture Capital funds in their investment objectives. They tend to mainly invest in stocks and liquid assets, categorised by country or region as well as by sector. Where they do invest in companies, private equity ranges from Growth equity investors who invest from a few million up to large Buyout funds who invest over £75m. Private equity funds focus on companies that are well established, with a view to executing a 'buy and build' or turnaround strategy and selling on at profit after a few years. Venture capital funds invest at the start-up stage and growth stages and typically acquire less than 50% of the equity in a company.[35]

DEFINITION – SERIES A, B AND C FUNDING

Series A, B and C funding refers to successive rounds of venture and equity funding which finances the growth of a business from start-up (Series A), through to expansion (Series B) and then to scale-up (Series C). Monies invested in each round will reflect the amount required to finance those growth ambitions, from £2m-£10m for Series A, £10m-£25m for Series B, and over £25m for Series C, though there can be some overlap in funding amounts and Series. Pre-seed is usually funded by a combination of grants, friends and family, 'bootstrapping', and business angel/ syndicate monies.

Equity funds draw together the resources of a large number of investors, often investing smaller volumes of capital. The scale and options for various risk/return ratios is correspondingly broad. Equity Funds are managed by institutional investors, who manage capital on behalf of others.

Other classes of institutional investors such as pension funds and insurance funds look for long-term stable investments that prioritise reliability and a need to meet their legal/fiduciary duties, over the rate of return on investment. These include pension funds, which can contain vast sums of capital. Evidence from the sixth round of the Wealth and Assets Survey (April 2016 – March 2018) demonstrated that aggregate private pension wealth in Great Britain totalled £6.1 trillion. This equates to 42% of total wealth, up from £3.6 trillion (34% of total wealth) in July 2006 to June 2008, after adjusting for inflation.[36] Infrastructure as an asset class provides the right conditions for pension fund investment with stable and reliable returns. As well as infrastructure, pension funds make investments in stocks and bonds. The specific pension policy may make stipulations as to what can be invested in. It is therefore important to consider investment needs and the varying fund or sub-fund options available.

THE US HAS APPROXIMATELY EIGHT TIMES AS MUCH GROWTH-STAGE CAPITAL AVAILABLE IN COMPARISON TO UK AND EUROPEAN VCS, SO MANY START-UPS AND SCALE UPS OFTEN TURN TO AMERICAN MARKETS TO RAISE GROWTH ROUNDS

Sovereign Wealth Funds (SWF) are state-owned investment funds, accrued from a country's surplus capital, e.g. surplus from foreign reserves, revenue from natural resources, budgeting surpluses, and bank reserves. For the purposes of this plan, we consider SWFs to be private, internationally mobile capital. The majority of countries with SWFs depend on a small number of commodities as their primary revenue stream. A 'Reserve Investment Fund' is a part of a Sovereign Wealth Fund where investments are sought to generate returns. Some countries may have more than one Sovereign Wealth Fund, with differing objectives.

34 Kumar, B. (2018) Structural differences in EU vs UK vs US - Challenge Advisory
35 Investopedia (2020) Private Equity vs. Venture Capital: Understanding the Difference (investopedia.com)
36 Office for National Statistics (2019) Pension wealth in Great Britain - Office for National Statistics (ons.gov.uk)

The largest sovereign wealth fund is the Norwegian Government's Pension Fund which owns more than $1 trillion USD in assets. The fund was established in 1990 and generated the majority of its revenue from taxation of its oil sector. Revenue from oil and gas is still transferred to the fund, however, this now accounts for less than half of its value with returns on investment making up the bulk of the fund. Sovereign Wealth Funds have the potential to supply vast sums of capital investment, however unlocking the investment can require a commitment to engage at the most senior levels in a nation to build a long-term mutually beneficial relationship. Any engagement would be in line with our principles set out in our Vision for Trade.

There are clearly a diverse range of motivations among investors that shape their behaviour, decision making, and ultimately what they invest in. Investors expect fair returns for their investment, linked to risk, and in the next chapter we set out how we will support building a pipeline of these propositions.

3.3 STRATEGIC FACTORS INFLUENCING SUPPLY OF CAPITAL: WHAT DO INVESTORS WANT?

In addition to risk, return on investment and locational factors that can influence the supply of capital, there are also strategic factors to be aware of. In PWC's Global Investor Survey of 2019 investment professionals were surveyed on their perceived threats to company growth prospects. The top five threats were:

- Geopolitical uncertainty (85%)
- Protectionism (78%)
- Future of the Eurozone (77%)
- Social instability (73%)
- Cyber threats (73%)

Beyond geo-political risk, capital investors are attracted by many of the same factors in an economy that work for inward investors: stable and predictable taxation, fair legal frameworks, good infrastructure, and global opportunities driven by skills and specialisation. For the past seven years, the EY Attractiveness Survey has named Scotland as the most attractive location for inward investment in the UK, outside of London. Whilst that is a different group of investors, it is a reasonable proxy for the health of Scotland's investment environment, and worth noting that inward investors have named the liquidity of financial markets and availability of capital as their top priority for the UK Government to improve the UK's attractiveness in the future – that is, improving the attractiveness for one group of investors acts to improve it for others.

A major factor for attracting investment is getting the shape of enabling regulation right. Effective horizontal regulation can help to enable the innovation and deployment cycle, and supports the market. Attractive markets are not those with zero, or low, regulation or intervention, but rather an intelligent series of interlinking enablers. This might start with, for example, a good climate and support for innovation and underlying technologies, move into market mechanisms and support, and finish with a series of incentives for uptake and adaptation. This can help overcome coordination failures in markets, and to both support the development of and create baseload demand for new technologies that would otherwise be too risky for investment. Good examples include hydrogen in Canada, where British Columbia has mandated a set percentage of hydrogen in its heat networks, and we have already mentioned Contract for Difference for wind energy generation in the UK, which built on both technical innovation and the availability of natural capital.

It is also important to strike the right balance in implementation. For example, the UK regime around national security and investment as set out in the National Security and Investment Bill covers many of Scotland's high-potential opportunities. Our approach to implementation should send positive market signals about our openness to investment in those sectors by responsible actors.

Market preferences, the need for investment and the factors needed to bridge them through regulation or incentives will shift over time. The public sector doesn't currently have the full capability to track this across the investment categories we have an interest in, and we need to develop it.

3.4 SCOTLAND'S INVESTMENT INDUSTRY

Scotland's investment management sector supports 7200 jobs directly and 6500 jobs indirectly.[37] 20% of UK assets are managed by firms with headquarters in Scotland, with Edinburgh the key hub of asset management activity. Scotland is home to a number of asset management companies of global importance, including Aberdeen Standard Investments, Baillie Gifford and Scottish Widows, and has regional offices for key global companies including BlackRock. A number of these have recently committed to divestment from fossil fuels, moved into ethical investment, or launched specific Net Zero or Paris Agreement linked investment products. £590 billion in assets are managed from Scotland, equating to 7% of the UK total. In relative terms this figure is unchanged from 2018 but represents a £60 billion increase in nominal terms.

The Scottish Local Government Pension Scheme (SLGPS) is a single statutory scheme administered by 11 different administering authorities. Between them, the Funds hold assets of around £48 billion with about 10% being invested into infrastructure. SLGPS Funds also contribute to the economy, by paying pensions totalling over £800 million annually.

The strength of the investment management sector in Scotland is important, as global investors will frequently look for a local partner to invest with. These arrangements help overcome information asymmetry, and act to provide reassurance in placing assets far from home that the investment is considered good by someone closer to it. Providing better investment opportunities to investors close to home can therefore act to bring in further funding diversity to the market. These businesses and institutions are, by the dictates of their business, at the forefront of market developments. Working in partnership with the sector on our doorstep to better understand that market, and to shape it, should be a first step.

The Scottish National Investment Bank, has the ability and mandate to act as a cornerstone investor, to help provide the reassurance that global funds will need when first becoming active in Scotland. In addition to the economic impact of its mission-led investments, the Scottish National Investment Bank will also develop into a centre of knowledge on investment within the Scottish institutional landscape, adding power and depth to the expertise we can draw on. We also have strong global networks and a global brand through which we can promote Scotland as an investment destination and to gather intelligence about shifts and preferences in major capital market centres.

37 The Investment Association (2020) Investment Management in the UK, 2019-2020. The Investment Association Annual Survey, September 2020 20200924-imsfullreport.pdf (theia.org)

3.5 ESG (ENVIRONMENTAL, SOCIAL AND GOVERNANCE) CRITERIA

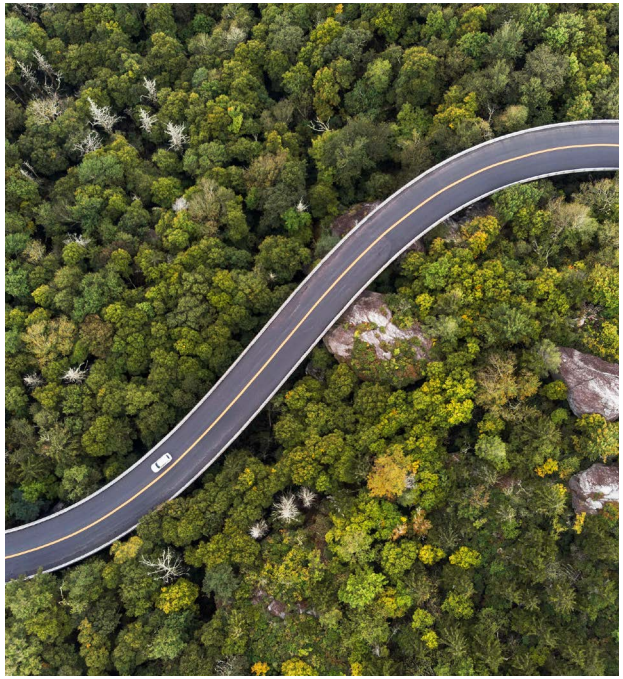
Figure 3.4: ESG investment

Globally, there is a move towards ESG investment (explained in Figure 3.4), ranging from investors taking an interest in social outcomes through to impact investment, where the purpose is to deliver social and environmental benefits as well as there being a financial return. Driven by Environmental and Social outcomes, ESG information can play a decisive role in investment decisions. In EY's Climate Change and Sustainability Services global survey on ESG Performance, 91% of investors surveyed said that non-financial performance has played a pivotal role in their investment decision-making over the past 12 months either "frequently" or "occasionally". The proportion of investors that say this happens frequently has jumped to 43% in 2020 from 34% in 2018.[38]

Scotland is already in a strong position to pivot towards ESG investment. Research by the Ethical Finance Hub found that Scotland-based investment funds manage 11% of the UK's responsible investing market, compared to a 7% share of the conventional market; and that this has formed a significant part of the sector's strong growth in recent decades. In 2020, for the first time ESG-focused funds hit $1 trillion in assets under management globally. Despite still being a relatively small segment of the market, the direction of travel is clear, and has even seen acceleration during the COVID-19 pandemic. In the UK as a whole, more new money was invested in ESG funds in the second quarter of 2020 than in the previous five years combined, and global estimates show flows into ESG funds comprising between a third and half of all global fund sales over the past year.

SCOTLAND IS ALREADY IN A STRONG POSITION TO PIVOT TOWARDS ESG INVESTMENT

The areas Scotland needs investment in – particularly the sectors in growth which require a robust ethical framework (data, digital and health) and the shift towards Net Zero – and the strong business environment in Scotland focused on fair work and equalities, would be good sources of projects for investors looking to make first or further moves into ESG and impact investing.



38 EY (2020) How will ESG performance shape your future? ey-global-institutional-investor-survey-2020.pdf

3.6 TARGET MARKETS

Private capital can be found in any market, but there are places with very high concentrations of funds. London and New York have very dense, mixed equity and institutional markets; Boston and Silicon Valley host a plethora of venture and equity funds; Frankfurt, Berlin, Paris, and Sydney have a strong presence of relatively patient institutional investors; and Hong Kong and Singapore are both mixed and act as the gateway to major Asian fund markets. In addition, Sovereign Wealth Funds are heavily concentrated in the Middle East, but also present in Norway, Singapore and China (Figure 3.5). As we begin to build up our capability and resources to engage with capital markets, these are natural places to start, alongside mobilising Scotland's home market for investment.

Figure 3.5: Global capitals of finance

We demonstrated in Chapter 2 that Scotland has particular priorities around attracting and working with a greater diversity of funders in the venture and equity categories. This includes using the venture funds in which Scottish Government or its agencies have active and direct control to make some out of territory investments, which will generate reciprocal investments in Scottish companies from external investors. We should seek to target markets both close to home and those particularly dense in venture and equity funds with an interest in the sectors where Scotland has particular strengths.

We must also build relationships with institutional investors including Sovereign Wealth Funds that share the same long-term strategic goals as us, but engagement needs to be opportunity-led. Pension funds – in particularly Scottish based funds such as the Scottish Local Government Pension Scheme are actively seeking viable opportunities to invest in Scotland and have the real potential to unlock investment opportunities for other institutions as co-investors. Our work with institutional investors should also seek to understand their risk perception, as this will be critical in getting the regulatory framework to enable new markets right.

The sectoral dimension to our target markets is covered in Chapter 4. Above all, with this breadth and range of markets, we have a choice in the type of investment we dedicate public resources to attracting. In supporting economic recovery, we will remain flexible enough to accommodate relatively short-term investment that creates jobs. However, our ambitions and values should guide us increasingly towards ethical and long-term investment pitches and partnerships, where public investment can unlock greatest additionality from private sources of capital and positive spill-over benefits.

WITH THIS BREADTH AND RANGE OF MARKETS, WE HAVE A CHOICE IN THE TYPE OF INVESTMENT WE DEDICATE PUBLIC RESOURCES TO ATTRACTING

LEADING WITH OPPORTUNITY: ATTRACTING GLOBAL CAPITAL INVESTMENT

4.1 INTRODUCTION

We set out in Chapter 2 our ambition to maximise capital investment flows into Scotland and identified the three levers for doing so – increasing demand for capital, increasing supply of capital and increasing viability. In Chapter 3 we examined the sources of private capital and highlighted specific categories of investors that are of interest to Scotland. We have looked at what makes an attractive investment environment and highlighted what investors look for when making their investment decisions. In this chapter, we set out Scotland's best offer to private capital markets.

4.2 SCOTLAND'S INVESTMENT ENVIRONMENT

Scotland is a stable, safe and secure location with a transparent government and robust legal institutions with coherent regulatory practices, making it a safe and attractive investment destination. Our integrated, agile approach allows us to work with investors in support of their capital investment activities in Scotland, ensuring greater attraction and retention of capital flows into our economy.

Scotland offers a well-developed legal, advisory and professional framework, and easy access to finance. To ensure that this economic environment translates easily into capital investment flows, the Scottish Government has developed a highly competitive package of support to encourage and de-risk investment. Measures include rental guarantees, business rate exemptions, innovative funding schemes, and planning reforms that all catalyse development. We have made major investment ourselves, into our infrastructure (over £20 billion in the past ten years) and our people through our education system. The level of coordination that is possible in a small jurisdiction like Scotland is an attractor in itself. We will now turn to how we leverage these strengths to our advantage.

4.3 SCOTLAND'S PROPOSITION: TURNING STRENGTH TO OUR ADVANTAGE

In addition to a good and maturing investment environment, Scotland's economy has some real strengths which drive demand for investment.

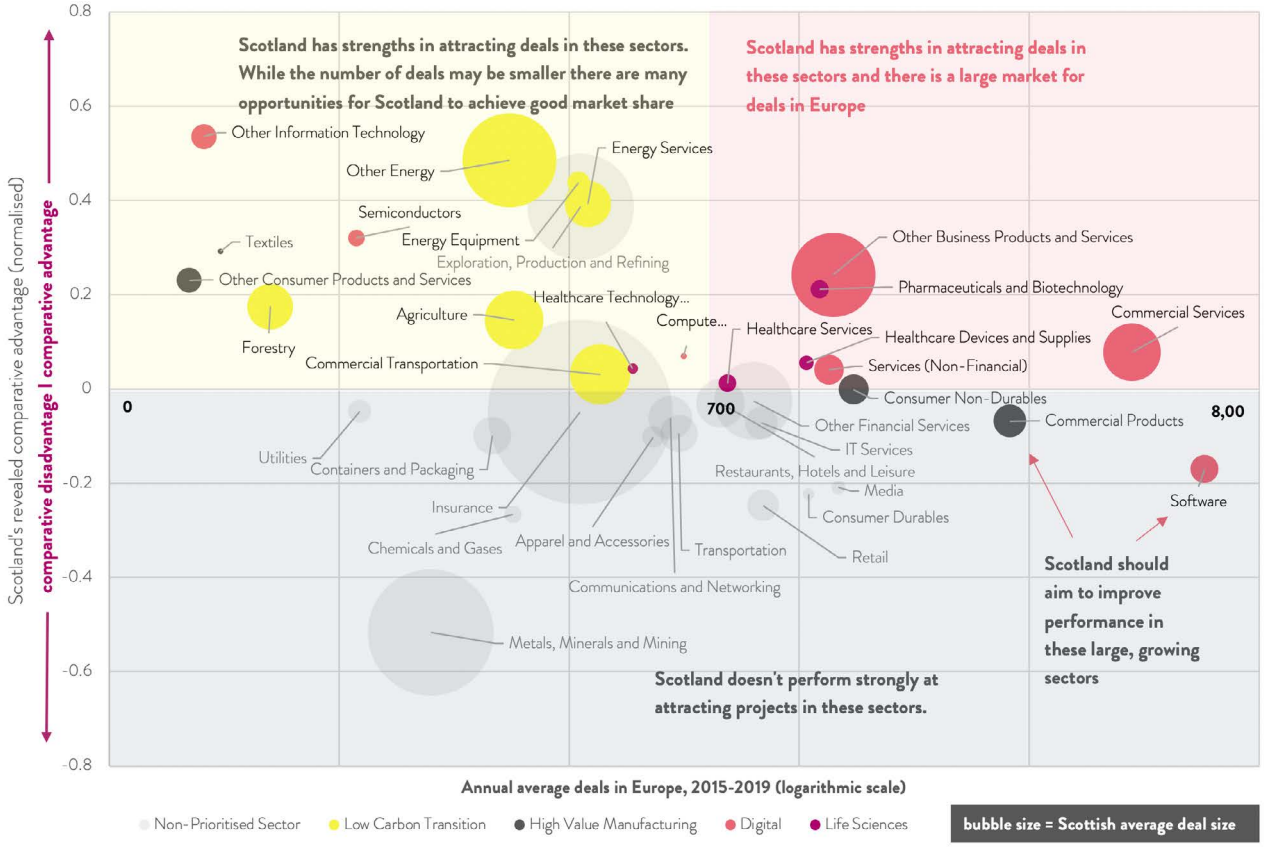
Shaping Scotland's Economy: Scotland's Inward Investment Plan has already identified the sectors in Scotland's economy which are globally competitive, crisis-resilient and likely to offer growth which benefits the broader economy and society as well as the business itself.

OUR INTEGRATED, AGILE APPROACH ALLOWS US TO WORK WITH INVESTORS IN SUPPORT OF THEIR CAPITAL INVESTMENT ACTIVITIES IN SCOTLAND

Using the same analytical approach, in we have identified those global capital investment flows which are strongest in terms of deal numbers and value, and matched them to globally competitive sectors in Scotland's economy. This is summarised in Figure 4.1.[39]

- The sectors in the top right quadrant are those which the analysis identifies as strengths for Scotland, and where there is also a large market for deals
- The top left quadrant are sectors where Scotland again has strengths and, while they may not have such a large market for deals, there is the opportunity for Scotland to achieve significant market share in the sector
- The sectors in the bottom half of the chart are generally not prioritised as they are not identified as substantial enough strengths to compete in international markets. However, there are some exceptions for 'commercial products' and 'software' sectors, both of which are very large and where Scotland has some particular strengths in underlying subsectors

Figure 4.1: Scotland's strengths and sectoral themes for capital investment



Source: Office of the Chief Economic Adviser analysis of Pitchbook data

39 The chart uses data from Pitchbook on the number and size of deals in Scotland and Europe. This data covers all types of enterprise capital flows, from venture capital and private equity deals to M&A and IPOs. For more information on the data and methodology behind the chart please see the Technical Methodology note published alongside this plan.

This analysis finds the strongest deal flows in the same sectors, underscoring them as the best opportunity we have to use the global economy to build on our domestic strengths.

These opportunities can be grouped into four sectors:

- Low carbon transition
- Health and life sciences
- Digital
- High value manufacturing

These four sectors are the most likely drivers of future economic demand in the economy. They are broad, and that is deliberate. Whilst the focus has to be on those sectors which can drive growth and recovery precisely because they are already strong, this approach leaves space for different sub-sectors to develop and come to the fore, for particular regional clusters of expertise to be brought out, and for the broader macro-economic and regulatory frameworks to change (e.g. around nature based technologies and solutions to climate change).

4.4 TURNING NEED INTO MARKET DEMAND: SUPPORTING PLACE AND NET ZERO AMBITIONS

We have identified Scotland's strongest opportunities for engaging with international markets, and a significant focus will therefore be on stimulating and supporting the pipeline of investable propositions within those sectors. This isn't only a plan to attract company investment. We have set out from the beginning to align with and help deliver the private capital element of the investment needs identified in the Infrastructure Investment Plan, Climate Change Plan and Housing to 2040. We want to use the strengths of these sectors to deliver the broader spill-over impacts in the economy we set out in Chapter 1.

Firstly, our commitment to Net Zero must underpin all that we do. We should simply no longer be putting public resource into originating, structuring and promoting investments in Scotland which are not aiming at Net Zero. The combination of strong sectors and place has the potential to act to create baseloads markets and offtakes for new Net Zero infrastructure.

OUR COMMITMENT TO NET ZERO MUST UNDERPIN ALL THAT WE DO

We should therefore be looking to build on and expand initiatives like the Green Investment Portfolio, and the cross-organisational work to define projects for carbon capture and storage, heat, hydrogen and natural capital, and seek to systematically turn these into opportunities which are both commercially sound, and structured as investments in a way which support a Just Transition. We are doing this at the right time: ESG investments supporting a transition to Net Zero, aligns precisely with the requirements that both end-users and occupiers, and the investor markets, are shifting towards too.

We also want the benefits to be felt across Scotland. Shaping Scotland's economy: Scotland's inward investment plan sets out where the key growth assets and clusters are located in Scotland. These should form the basis of higher quality place-based propositions to capital markets for business space, backed and supported by stronger company propositions for investment. They should also form the basis of investment opportunities for international connectivity infrastructure, as these are the sectors and locations are where we are most likely to find viable, commercially-attractive propositions.

Successful place-making requires economic, physical, and networking assets to be high quality and well-integrated. Our ambition is to create places where people and businesses want to move to and stay in because they support their needs, reflect their values, and enable their aspirations. Great places to live and work are powerful attractors for economic activity, creating a clustering effect, where different types of investment impact positively on each other.[40] Leading with our strongest sectors, and their spill-over into the space and talent they need, in turn drives the viability of city and town centres near them. In this way, attracting capital investment can contribute to a very broad range of policy objectives, including:

- 'Mission Clyde' identifies how the area's natural, physical and intangible assets can make it attractive to investors and scaling companies
- In recent years, we have stepped up our efforts to attract private investment into housing provision. Successful initiatives have included using government guarantees and financial transactions funding (including the Building Scotland Fund) in creative housing-led mechanisms to unlock place developments and expand provision of private-rented homes including homes for mid-market rent. This has attracted substantial additional investment from institutional investors including pension funds. The challenges ahead mean that we need to accelerate private investment in housing programmes and projects and in the transition to decarbonised heat
- Supporting tourism and the regeneration of our towns and cities post COVID-19

40 ScaleUp Institute (2020)

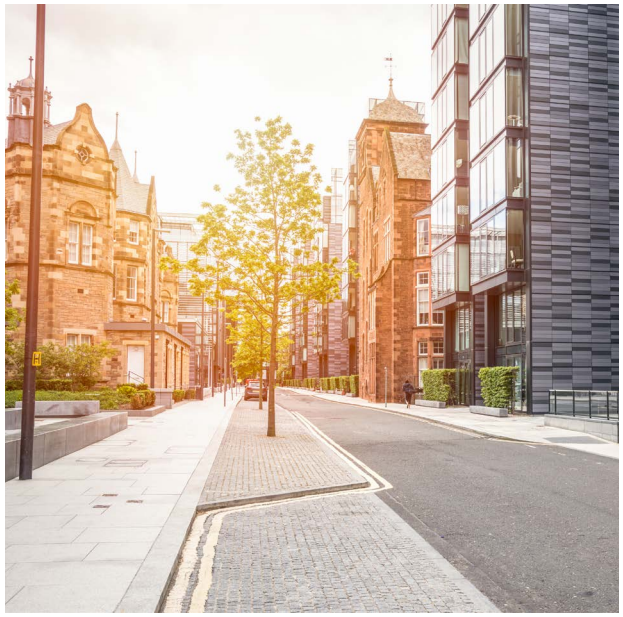
The globalised nature of COVID-19 has accelerated trends already underway, and is likely to fundamentally transform the way we think of and use our city and town centres. The Town Centre Action Plan Review points to a radical shift away from the existing retail and commercial dominant model, and towards 'local and connected'. There is a positive role that capital investment can play here, in bringing under-utilised assets into different productive use, oriented specifically around business space for future economic opportunities, and the conversion of assets for housing, leisure or tourism.

Investment needs to be supported by a flexible, forward looking planning system that anticipates new business models and enables the types of retail and commercial development that will be needed, and which there will be demand for. We will publish a draft National Planning Framework in 2021 that looks ahead to guide the long-term geography of investment, and is supported by clear, consistent and enabling national planning policies. The Scottish Government's National Planning Framework 4 (NPF4) will guide development and investment in a way that improves our places and helps to deliver on our wider objectives including Net Zero.

CASE STUDY – BUILD TO RENT (BTR)

Build to Rent (BTR) is the provision of purpose-built private rented sector (PRS) homes by investors and developers, and has an increasingly important role in helping to redress the gaps in new housing provision and contributes significantly to mixed-use place-making. BTR is a means of providing good quality homes in the private rent sector that are well-designed, and can be delivered quickly at scale.

The Scottish Government has worked closely with industry to develop and launch a well-received package of enabling measures to stimulate growth and private investment in the BTR sector. This package covered planning advice, taxation, tenancy reform, a Rental Income Guarantee Scheme (RIGS) – developed with industry - and a promotional prospectus to investors. Rettie's analysis of the pipeline for BTR units progressing through our planning system shows highly positive signs of health with almost 9,800 units of accommodation currently being advanced, but with a particular focus in our two major cities, with around 22 separate individual schemes presently being brought forward in Glasgow (12) and Edinburgh (10).



GREAT PLACES TO LIVE AND WORK ARE POWERFUL ATTRACTORS FOR ECONOMIC ACTIVITY, CREATING A CLUSTERING EFFECT, WHERE DIFFERENT TYPES OF INVESTMENT IMPACT POSITIVELY ON EACH OTHER

4.5 OPPORTUNITIES, GAPS AND FOCUS

The following section sets out opportunity-based plans for each of our four sectoral themes, and the wider place-based and Net Zero benefits we believe they can drive. Each of these sectors requires a blend of capital options to support recovery, growth and transition; and each requires a mix of interventions and actions to strengthen demand and viability in parallel with supply of capital. The plans set out here are initial outlines of the investment opportunities, gaps and therefore targets and actions we will take.

Sector 1 – Low Carbon Transition	
Investment context	Our landmark Climate Change Act is one of the most ambitious legislative frameworks in the world – committing Scotland to Net Zero by 2045. The commitments of the Scottish Government, and governments around the world, mean that despite the risks inherent in new and emerging technologies there are guaranteed markets and opportunities for investors as part of the low carbon transition. COP 26, in Glasgow in November 2021, sets the global direction for decarbonisation, raising the profile of what Scotland has to offer and demonstrates where there are opportunities for investment on the international stage.
Scottish Government support	The Climate Change Plan Update, 2020 sets out clear steps for decarbonisation. This is supported by a Heat in Buildings Strategy (2021) and a Hydrogen Strategy (2021). Scotland's 2020-21 Programme for Government set out an initial tranche of £1.6 billion from the Low Carbon Fund, with a further £400 million set out in the recent Climate Change Plan update – providing an additional £2 billion of public investment in Net Zero across 2021-2026. Alongside wider capital commitments, over this five year period the Scottish Government will invest nearly £1.6 billion to transform heat and energy efficiency of our buildings; £60 million to support the industrial and manufacturing sectors during a green economic recovery; over £550 million in Active Travel; £500 million in bus priority infrastructure; £120 million for Zero Emission Buses; and a £180 million Emerging Energy Technologies Fund to support the development of hydrogen and Carbon Capture and Storage (CCS). The Infrastructure Investment Plan delivers the National Infrastructure Mission, with £33 billion of Scottish Government investment over the course of 2021=26. The plan covers projects that the Scottish Government or its Agencies and Non-Departmental Public Bodies deliver directly and sets a long-term vision of infrastructure supporting an inclusive, Net Zero carbon economy in Scotland. Scotland's Green Investment Portfolio will present £3 billion of green commercial projects to market by 2022. The portfolio sets out low carbon propositions which can deliver returns for investors, while supporting Scotland's transition to Net Zero. The first projects – worth more than £1 billion in total – were launched in September 2020 and include opportunities to invest in property, energy and innovative companies. It is expected that the portfolio will also include heat decarbonisation, hydrogen, battery storage, carbon capture, and green transport opportunities for investment. We need to continue to build on the Green Investment Portfolio to make sure that our opportunities for investment in Scotland have an international profile and showcase the innovation and ambition that we have to offer. To further increase investment we will establish a forum of investors who want a deep level of partnership with government, aligned to the transition to Net Zero. The Scottish National Investment Bank opened for business in November 2020 as a mission-led development bank providing patient capital to build a stronger, fairer, more sustainable Scotland. The Bank's primary mission, set in December 2020, will be to support a Just Transition to Net Zero by 2045. The Scottish Government has committed to capitalising the Bank with £2 billion over 10 years. SEPA, NatureScot and Marine Scotland have specific sectoral interests and are developing new ways to harness private capital to support policy ambitions relating to natural capital which will help to support the rural economy.

Sector 1 – Low Carbon Transition	
Key growth subsectors	In Scotland, there are particular opportunities for capital investment in relation to: • low carbon transportation – including electric vehicle charging technology and infrastructure • heat decarbonisation – including city-level heat network projects deploying zero emissions heat solutions • carbon capture, utilisation and storage – both to reduce emissions in key sectors directly and to remove CO2 through negative emissions technologies to balance emissions that are challenging for certain sectors to avoid • hydrogen – applying this zero-carbon fuel in various settings such as heat, transport, and energy systems management • emerging energy generation technologies – such as marine
Business investment opportunities	Maximising the economic benefits of the Net Zero transition will require significant capital investment into scaling businesses that will accelerate the development and delivery of new and emerging low carbon technologies across the economy. Scotland benefits from a strong pipeline of innovative businesses in this space, supported by our Universities and Innovation Centres.
Infrastructure investment opportunities	Increased capital flows will be required into low carbon infrastructure projects where established technologies can be scaled beyond existing levels e.g. for heat and electric vehicles. There is already a well-established pipeline for low carbon infrastructure investment, however, the scale of what is needed to meet our 2045 commitment means that there is a role for government to support more private capital investment. For example, the Climate Change Plan signals a major expansion of renewable electricity generation, including the development of 8 to 11GW of new offshore wind capacity before 2030. There are also globally significant opportunities for carbon capture and storage (CCS) deployment available as a result of Scotland's access to the North Sea.
Real estate investment opportunities	The real estate sector is a large generator of carbon emissions, and decarbonising the built environment will in itself lead to significant investment opportunities. The transformation of our existing building stock as set out in the Climate Change Plan Update (published December 2020) includes a commitment for 50% of buildings to have low or zero carbon heat systems by 2030, in addition to the continued expansion of energy efficiency measures. This will further drive opportunity, reflecting that as well as supporting our Net Zero targets there is a clear economic benefit. According to BNP Paribas[41], "green properties improve returns and future-proof the value of real estate investments. These types of properties have lower operating expenses and voids, and can generate higher rents. Green properties are also more liquid and more resilient to technical and operational obsolescence." National Planning Framework 4 will set out a spatial plan to enable national policies to focus on our commitment to Net Zero.
Target investors	For infrastructure opportunities of scale, the full spectrum of infrastructure debt and equity investors should be targeted. This includes global project finance banks, infrastructure funds, pension funds, sovereign wealth funds, utilities and large development companies. Venture capital and private equity funds with a focus on low carbon and ESG assets would be potential target investors for company investment. There is global and growing investor appetite to invest in suitable low carbon opportunities. Early engagement should include building relationships between Scotland and the City of London, as well as leveraging our global resources (through SDI as an example) to develop relationships with investors globally.

41 BNP Paribas (2018) Sustainable investment: the future of real estate | BNP Paribas Real Estate

LOW CARBON TRANSITION

LOW CARBON TRANSITION KEY CLUSTERS

ISLANDS
- BIG-HIT – HYDROGEN DEMONSTRATION PROJECT
- MEYGEN TIDAL ENERGY PROJECT, PENTLAND FIRTH (WORLD'S LARGEST TIDAL ENERGY PLANT)**
- ORKNEY MARINE RENEWABLES ENERGY CLUSTER
- EUROPEAN MARINE ENERGY CENTRE, ORKNEY
- SURF N' TURF, ORKNEY
- VIKING ONSHORE WINDFARM

ABERDEENSHIRE
- EUROPE'S LARGEST HYDROGEN BUS FLEET
- ABERDEEN HYDROGEN PROGRAMME (ABERDEEN CITY COUNCIL)*
- INVERURIE ENERGY PARK - AGILE ENERGY RECOVERY*
- ACORN CARBON CAPTURE AND STORAGE (PALE BLUE DOT ENERGY)

LANARKSHIRE
- ILI GROUP (9 BATTERY STORAGE DEVELOPMENT PROJECTS ACROSS SCOTLAND)*
- MOSSEND INTERNATIONAL RAILFREIGHT PARK*
- POWER NETWORKS DEMONSTRATION CENTRE, CUMBERNAULD

TAY CITIES REGION
- MICHELIN SCOTLAND INNOVATION PARC*
- UK'S LARGEST ELECTRIC TAXI FLEET
- PI POLYMER RECYCLING - LARGE RIGID PLASTIC RECYCLING – PERTHSHIRE (BINN GROUP)*
- FIFE HYDROGEN DEMONSTRATION PROJECT/METHIL ENERGY PARK

GLASGOW CITY REGION
- CLYDE GATEWAY – GREEN REGENERATION & INNOVATION DISTRICT*
- WHITELEE ONSHORE WINDFARM (2ND LARGEST IN EUROPE)

EDINBURGH & SOUTH EAST SCOTLAND CITY REGION
- MITSUBUSHI HEAT-PUMP FACTORY, LIVINGSTON
- SUNAMP HEAT BATTERIES, EAST LOTHIAN
- FOREV (EV TECHNOLOGY ACROSS SCOTLAND)
- EDINBURGH CENTRE FOR CARBON INNOVATION

AYRSHIRE
- HUNTERSTON PORT AND RESOURCE CENTRE (PEEL PORTS)*

*INVESTMENT OPPORTUNITY WITHIN THE GREEN INVESTMENT PORTFOLIO
**UNDER DEVELOPMENT

Sector 2 – Health and Life Sciences	
Investment context	The Health and Life Sciences sector involves a wide range of activity in animal health, human health, agricultural, aquaculture and marine biotechnology. It includes the discovery, research, development and manufacture of therapeutics; diagnostics; medical devices and platform technologies as well as the specialist suppliers of products and services necessary for these organisations to function. The sector is fast growing in Scotland: since 2010 we have seen on average just under 10% year on year growth in turnover. Over 40,000 people are employed in life sciences in over 750 organisations. Some of the largest global companies in the sector have a presence in Scotland.
Scottish Government support	In 2017 the Life Sciences sector published The Life Sciences Strategy for Scotland: 2025 Vision (2017). This key strategy set a target to grow the life sciences sector to reach £8 billion in turnover by 2025. We also have three complimentary strategies for developing related sectors: Life and Chemical Sciences Manufacturing Strategy (2015) Aquaculture Growth to 2030 (2016) Scotland's Digital Health and Care Strategy (2018) In addition, healthtech is one of 9 priority areas identified in our Inward Investment Plan. Life and chemical sciences are key sectors in our Export Growth Plan. Scottish Enterprise has identified innovative medicines and advanced therapies as an area of strategic focus. In 2020, the Scottish Life Sciences COVID-19 Strategic Response Plan was created by the Life Science Industry Leadership Group (ILG) to set out how we can work with the life sciences sector in Scotland in response to the pandemic. Our policy approach forges the vital close working relationship between industry, the NHS and academia (the 'triple helix'). We have invested in developing centres of excellence in order to keep making those ground-breaking discoveries in medical treatments and attracting world class researchers who see Scotland as a choice location for collaborative research. There have also been significant investments in city deals in Glasgow, Edinburgh, Inverness, Aberdeen and Dundee to support the sector. Scotland also offers a range of funded opportunities for industry to work on pre-commercial innovation in Test Beds. This is mainly via the application of experimental development characterised by prototyping, demonstrating, piloting, testing and validation inside Test Beds.
Key growth subsectors	Drug discovery, biotechnology and diagnostics top Scotland's investment portfolio with over 20% of new capital going into life sciences. The Scottish sector is strong in healthtech, pharmaceuticals, advanced therapies, medtech, precision medicine, and animal health, agritech and aquaculture (AAA). Agricultural biotech, environmental biotech and industrial biotech are also expanding subsectors. With nearly a third of all start-ups in these fields in 2019, Scotland is emerging as the leading centre in the UK.
Business investment opportunities	A key focus of the ILG is on growing Health Technology companies beyond the existing 8% growth rate. The sector has a particularly active risk capital market – capital being invested in high growth/high potential businesses, reflecting strong start up activity. Since 2013, the life sciences sector accounted for 22% of all Scottish deals (343) and 24% of investment (£504 million) according to the Scottish Investment Bank Risk Capital Market Report.

Sector 2 – Health and Life Sciences	
Infrastructure investment opportunities	The ILG has identified advanced therapeutics and diagnostics, health data and digital, and pharmaceutical supply chain capability as a key priority for further developing the sector. Growing health and life science supply chains, as well as direct sales to the NHS, is a core component of driving innovation. A government-wide programme is underway with scope to convert pandemic infrastructure investments in manufacturing into key growth areas. We will develop an Investment Strategy for NHS Scotland and Life Science industries that is globally connected and locally rooted to protect and grow this vital sector. This will build on the success of the sector in supporting NHS Scotland's response to COVID-19 and continue to strengthen local supply chains moving forward. With a renewed strategic focus on retaining strengths and supply chains in health related sectors, this will be the first of our roadmaps to investment for each of our sectoral themes, and will serve as a model.
Real estate investment opportunities	Real estate related to the health and life sciences sector has seen significant investment during the COVID-19 pandemic due to the centrality of the sector in developing and producing a vaccine for COVID-19.[42] The sector is already rapidly expanding in Scotland and around the world in response to demographic changes, and innovation and advancements in biology that have fuelled demand. Clusters representing the 'triple helix' of industry, health and social care providers, and academic research are developing at pace across Scotland, presenting a range of opportunities for investment. There is evidence of growing institutional investment seeking representation in this emerging but high growth asset class (for example the EG/AXA IM acquisition of Kadans Science Partners and Bruntwood SciTech – a Joint Venture between Bruntwood and Legal & General).
Target investors	The fallout of the COVID-19 pandemic has led to an increase in investor interest in the health and life sciences sector. There are a number of specialist life science investment funds as well as broad-focused investors, and large industry players (e.g. pharma companies) that invest into life science companies, with many specialising at the sub-sectoral level or drug/treatment level. Whilst there is a renewed global interest in investing in life sciences companies, our focus on investor relations focus will initially be in US and European markets.

42 JLL (2020) Why investors are shifting focus to life sciences real estate

HEALTH AND LIFE SCIENCES

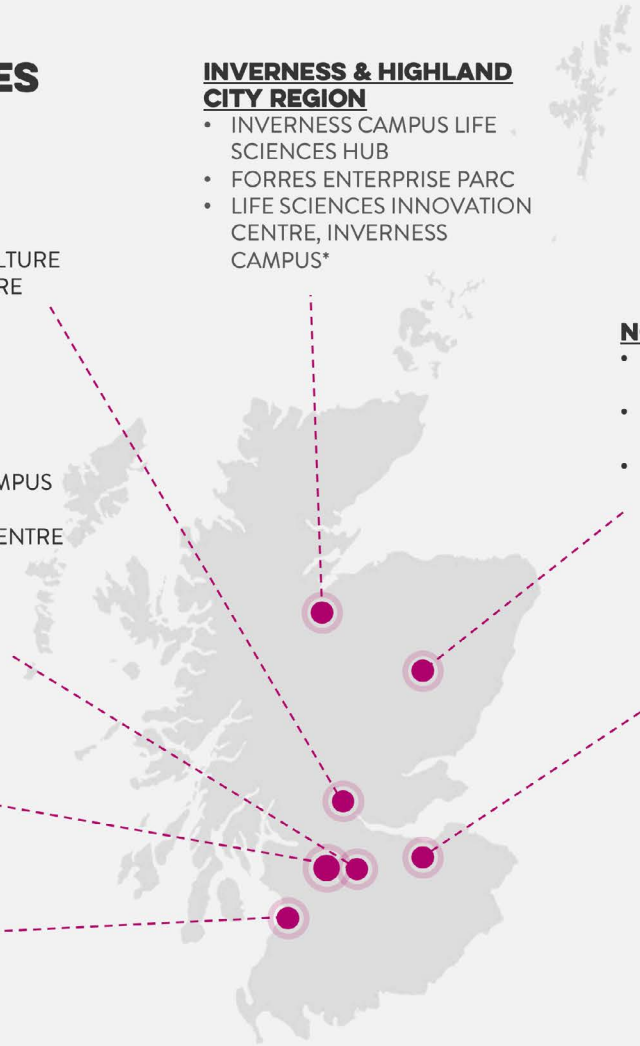
HEALTH AND LIFE SCIENCES KEY CLUSTERS

INVERNESS & HIGHLAND CITY REGION
- INVERNESS CAMPUS LIFE SCIENCES HUB
- FORRES ENTERPRISE PARC
- LIFE SCIENCES INNOVATION CENTRE, INVERNESS CAMPUS*

STIRLINGSHIRE
- SCOTTISH AQUACULTURE INNOVATION CENTRE

NORTH EAST
- ABERDEEN BIO-THERAPEUTICS HUB FOR INNOVATION (BIOHUB)
- TAY CITIES DEAL FOCUS ON HEALTHTECH SECTOR GROWTH
- TAY CITIES BIOMEDICAL CLUSTER

GLASGOW CITY REGION
- DIGITAL HEALTH & CARE INSTITUTE (DHCI)
  - "FUTUREQUIPPED" PROJECT
- QUEEN ELIZABETH UNIVERSITY HOSPITAL CAMPUS
  - IMAGING CENTRE OF EXCELLENCE
  - PRECISION MEDICINE INNOVATION CENTRE
  - CLINICAL INNOVATION ZONE
  - ICAIRD
- GLASGOW UNIVERSITY
  - PRECISION MEDICINE LIVING LAB



EDINBURGH & SOUTH EAST SCOTLAND CITY REGION
- EDINBURGH BIOQUARTER
- MIDLOTHIAN BIOCAMPUS
- SCOTTISH HEALTH TECHNOLOGIES GROUP, HEALTH TECHNOLOGY ASSESSMENT
- DATA CENTRE OF EXCELLENCE

NORTH LANARKSHIRE
- BIOCITY - MEDICITY

AYRSHIRE
- IRVINE LIFE SCIENCES ENTERPRISE AREA

*UNDER DEVELOPMENT

Sector 3 – (High Value) Manufacturing	
Investment context	Manufacturing is a diverse sector and vital to Scotland's economy. It is responsible for over half of Scotland's exports and employs more than 169,000 people across 13,270 enterprises in communities all over Scotland.
Scottish Government support	Our ambition is to support the sector to maximise the opportunities from the Industry 4.0 revolution and the transition to Net Zero to become global leaders in advanced and high value manufacturing. Working with industry and academia, the Scottish Government has established the Making Scotland's Future Programme to bring together our partners in Scotland to deliver a more collaborative and joined up approach to supporting the sector. The £75 million National Manufacturing Institute Scotland (NMIS) is a central part of this programme. In response to the pandemic, the Programme has pivoted to adapt to the impacts of COVID-19 and develop a Manufacturing Recovery Plan (MRP). High value manufacturing a key focus within the Inward Investment Plan and is relevant to all of the nine opportunity areas. Engineering services & advanced manufacturing is also a key sector within our Export Growth Plan.
Key growth subsectors	Our manufacturing businesses are embracing innovation and moving into markets that are increasingly advanced and high value. Our particular growth sectors include medicines, low carbon transport, chemical industries, space and satellites, healthtech and food and drink innovation.
Business investment opportunities	To drive growth in high value manufacturing, we will work to target capital flows into manufacturing businesses, with a focus on SMEs and supporting the development of established clusters of manufacturing activity. Investment is needed to unlock progress with product development, process efficiency, digitisation, automation and carbon reduction. There is a need for early stage risk capital to enable start-ups and scaling, recognising that innovative new manufacturing companies often have large capital costs to bear in the early stages. The acceleration and financing needs of manufacturing start-ups involved in the manufacturing of 'hardware' are also distinct from technology companies involved in the development of software. We will support delivery of the *Making Scotland's Future Manufacturing Recovery Plan* by helping to enable increased levels of investment in manufacturing companies, especially through the stimulation of demand for investment from SMEs, and by supporting wider efforts to address the early stage funding needs of medium and high growth manufacturing start-ups.
Infrastructure investment opportunities	We anticipate the need for enhanced capital investment flows into plant and equipment as manufacturing companies modernise and adopt Industry 4.0 best practice.
Real estate investment opportunities	Manufacturing companies are found in almost every community in Scotland. Commercial real estate investment is a key element in a strategy to increase capital investment flows into advanced manufacturing through the provision of modern, efficient accommodation. The Advanced Manufacturing Innovation District Scotland is Scotland's flagship initiative to attract more capital investment for the provision of next generation manufacturing facilities. A number of strategically aligned high value manufacturing investment opportunities are already being presented to market as part of the Green Investment Portfolio. Propositions will continue to be of a scale to appeal to both UK and international investors.
Target investors	Investment into advanced manufacturing includes a broad range of sources as the sector includes elements of low carbon, life sciences and digital as well as more traditional manufacturing that is high value. The target investors for this sector will be highly dependent on the nature of the opportunity and the specialism. Venture capital, private equity investors, as well as large multi-national corporations, will be our main targets for engaging with investors.

HIGH VALUE MANUFACTURING

HIGH VALUE MANUFACTURING KEY CLUSTERS

HIGHLANDS
- EDRINGTON MACALLAN DISTILLERY
- ORBEX (AEROSPACE)

GLASGOW CITY REGION
- ADVANCED MANUFACTURING INNOVATION DISTRICT SCOTLAND*
- MEDICINES MANUFACTURING INNOVATION CENTRE
- NATIONAL MANUFACTURING INSTITUTE SCOTLAND
  - ADVANCED FORMING RESEARCH CENTRE
  - LIGHTWEIGHT MANUFACTURING CENTRE
- AAC CLYDE SPACE
- SPIRE GLOBAL DATA & ANALYTICS
- COHERENT TECHNOLOGIES
- M SQUARED
- FRAUNHOFER CENTRE FOR APPLIED PHOTONICS
- SMALL SATELLITE MANUFACTURING CLUSTER

STIRLINGSHIRE
- INDUSTRIAL BIOTECHNOLOGY CLUSTER, GRANGEMOUTH
  - INDUSTRIAL BIOTECHNOLOGY INNOVATION CENTRE

NORTH SEA
- BEATRICE OFFSHORE WINDFARM (WORLD'S 4TH LARGEST)

ABERDEENSHIRE
- SUBSEA ENGINEERING CLUSTER (INC):
  - TECHNIPFMC
  - AKER SOLUTIONS
  - GE OIL & GAS
  - SUBSEA 7
  - BOSKALIS

TAY CITIES REGION
- ROSYTH ADVANCED MANUFACTURING PARK

AYRSHIRE
- AEROSPACE CLUSTER (INC):
  - SPIRIT AEROSYSTEMS
  - CHEVRON AIRCRAFT MAINTENANCE
  - BAE SYSTEMS REGIONAL AIRCRAFT
  - COLLINS AEROSPACE

EDINBURGH & SOUTH EAST SCOTLAND CITY REGION
- MEDICAL DEVICES MANUFACTURING CENTRE, HERIOT WATT UNIVERSITY (OFFSHOOTS IN GLASGOW & ABERDEEN)
- ADVANCED THERAPIES MANUFACTURING CLUSTER

*INVESTMENT OPPORTUNITY WITHIN THE GREEN INVESTMENT PORTFOLIO
**UNDER DEVELOPMENT

Sector 4 – Digital	
Investment context	Scotland's digital technology sector is one of the biggest contributors to the economy, and one of the most underpinning, including for the other sectoral themes. The sector is forecast to grow at twice the rate of the rest of the economy, and with businesses that have embraced new technology outperforming those that have not. The benefits of a digital economy will only be fully realised and retained in Scotland if we have a digital infrastructure that enables the seamless and cost effective movement of data and the real-time data processing and computing capability that is central to the development of machine learning, AI and other drivers of future growth. On average, every £1 of risk capital invested in the tech sector generates £6 for the economy.
Scottish Government support	Over £1 billion has been invested in recent years in programmes such as Digital Scotland Superfast Broadband (DSSB), Reaching 100% (R100) and Scottish 4G Infill (S4GI). This investment, alongside substantial commercial investment, has greatly extended the reach and capacity of fibre networks across Scotland. The Scottish Government published a 5G Strategy for Scotland in 2019 and a new strategy for Renewing Scotland's Full Potential in a Digital World will be published in 2021. Our policy priorities are informed by a study undertaken by Deloitte: Scotland's Digital Potential with Enhanced 4G and 5G Capability: Final Report for the Scottish Futures Trust (2019); and an independent review by Mark Logan of Skyscanner on the Scottish Technology Ecosystem (2020).
Key growth subsectors	Fintech, software development, data science, AI, digital health, sensors and connectivity.
Business investment opportunities	Growth in Scotland's digital technology sector will be driven by the presence of high potential business enterprises. As these businesses scale, access to growth capital will be critical to their success. Our focus will be on supporting businesses to scale, and facilitating investment to deliver growth in Scotland.

Sector 4 – Digital	
Infrastructure investment opportunities	Both the Infrastructure Commission for Scotland and the Scottish Government Advisory Group for Economic Recovery (AGER) identified that significant investment in fibre connectivity is required to strengthen digital connectivity resilience and increase Scotland's international competitiveness. The Infrastructure Commission also recommended that the Scottish Government prioritise support for an indigenous data centre market to underpin the development of the data and digital technology sector. With the appropriate support, interventions and investment, Scotland can generate significant new economic growth from data storage, management and innovation. The long-term and capital-intensive nature of digital infrastructure projects provide opportunities for largescale capital deployment. Our Town Centre Action Plan Review recommends that project demonstrators for digital towns are carried out working in partnership with capital investors. The Scottish Government is working with Scottish Futures Trust and industry partners on a vision and action plan for datacentres and international connectivity. Renewable technology is important here. This work will identify and map out future digital connectivity investment opportunities. We will also support the development of business cases for private, public or partnership investment in new international subsea cable routes and terrestrial wholesale fibre connectivity as a priority for improving Scotland's critical national infrastructure.
Real estate investment opportunities	Digital disruption is having and will continue to have a profound impact across all asset classes in the commercial real estate sector. It is changing the nature of demand for office space, meanwhile retail is experiencing a structural shift online. And it is increasingly important that industrial assets are digitally enabled for high value manufacturing and high-tech operations. This is equally the case for non-commercial and community owned property. The Town Centre Action Plan Review (2021) makes a recommendation for project demonstrators around digital towns, to harness the benefits of new technology as part of revitalising towns.
Target investors	Increased demand for digital infrastructure, in response to Scottish Government's connectivity commitments, will continue to attract both debt and equity infrastructure investors in the form of, for example, project finance banks, infrastructure funds and telecom companies. In relation to company investment opportunities, the COVID-19 pandemic has demonstrated the relative attractiveness of digital technology investment opportunities across a range of sectors including communication, entertainment, healthcare and AI. As a result, investors have increased their focus on the digital tech sector. Depending on the maturing of the specific opportunity, we would expect to engage with a broad range of investors including early venture capital investors, private equity investors and multi-national corporations.

DIGITAL

DIGITAL KEY CLUSTERS

ABERDEENSHIRE
- DATA LAB, ABERDEEN
- DIGITAL INCUBATOR, ROBERT GORDON UNIVERSITY

GLASGOW CITY REGION
- UNIVERSITY OF GLASGOW, QUANTIC – QUANTUM TECH HUB
- CENSIS CENTRE FOR SENSING, IMAGING & INTERNET OF THINGS TECH
- THE SCOTLAND 5G CENTRE
- FRAUNHOFER CENTRE FOR APPLIED PHOTONICS
- DATA LAB, GLASGOW

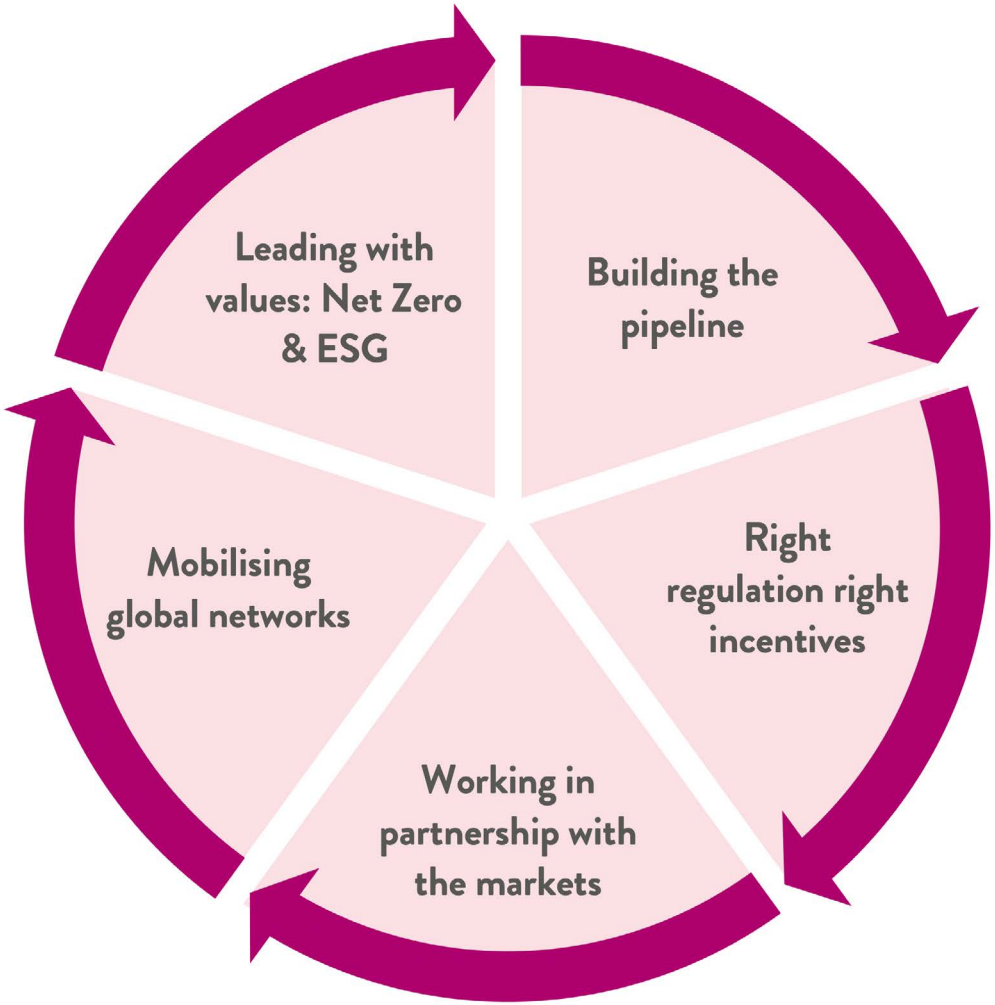
EDINBURGH & SOUTH EAST SCOTLAND CITY REGION
- EDINBURGH UNIVERSITY, BLOCKCHAIN TECHNOLOGY LAB & SCHOOL OF INFORMATICS
- THE DATA LAB INNOVATION CENTRE
- THE NATIONAL ROBOTARIUM, HERIOT WATT UNIVERSITY
- CODEBASE
- DATA LAB, EDINBURGH
- CODECLAN DIGITAL SKILLS & CODING ACADEMY
- BAYES CENTRE, UNIVERSITY OF EDINBURGH

5.1 INTRODUCTION

We set out at the start of this plan that we want to create and expand markets; focus on our recovery and transition by building on our strengths; and do this in a manner which is compatible with our values. We have identified the three levers for doing so: increasing opportunity (demand) for investment; increasing the viability of investment opportunities; and through those, increasing the supply of investment. We have begun the work of identifying our target markets, and here we set out our strategy towards opportunity-led investment.

To bring this together, we now present an ambitious agenda over the short to medium term, under five broad areas outlined in Figure 5.1. These areas address the factors highlighted throughout this plan around: leading with our values and pivoting towards ESG investment; building an investment-ready pipeline; market maturity and diversity of funding sources; the importance of underlying market conditions and regulations; the role of the public sector as a convening and coordinating force working in partnership with markets; and of course letting the world know what Scotland has to offer through our global networks.

Figure 5.1: Actions to help us deliver on our ambition



5.2 LEADING WITH VALUES: NET ZERO AND ESG

Scotland has a clear focus on building an economy that values people, place and planet. The Climate Change Plan, the mission focus of the Scottish National Investment Bank, our Vision for Trade, and the Infrastructure Investment Plan are key building blocks for this approach. Building on Scotland's existing strengths as a responsible investing hub will increase access to finance for Scottish businesses, creating a deeper pool of expertise and talent to help firms bring sustainable projects to market, as well as securing high quality jobs in Scotland's financial centres.

Scotland is not alone in looking to expand access to ESG investment. In November 2020, the UK Government made several significant announcements designed to demonstrate regulatory and policy leadership on green finance, and these should complement our focus on sustainable investment. The Treasury, Bank of England, and other major regulators have published a roadmap for making climate-related financial disclosures (referred to as 'the TCFD recommendations' for shorthand) mandatory across the UK economy by 2025 at the latest.[43] Requiring comprehensive climate-related disclosures will allow investors to better price these risks, which should drive investment towards more sustainable projects.

This will be complemented by a new UK 'green taxonomy' which will classify investments according to their compliance with the Net Zero objective. The taxonomy is expected to be largely based on its EU equivalent, and the objective again is to tilt the investment landscape away from 'brown' investments and towards 'green' ones by increasing transparency. To build and enhance our ESG capability:

- We will **make Scotland's values a core part of our National Prospectus and our engagement with investors**, making it clear that valuing our people, communities, and environment are core to our economic ambitions
- Investment opportunities that we promote to market will be **benchmarked against ESG investment criteria.** We will enable the companies and projects we support to report climate-related disclosures in a standardised and transparent way with flows of ESG monitored via a new metric which will cover **environmental and social impacts**
- We will use COP26 as a platform to showcase our investment opportunities such as our **Green investment Portfolio**
- We will build on existing ESG investment activity and work with Scotland's investment management industry, using events such as the Ethical Finance Summit to make **Scotland a leading globally established hub for ESG investment**
- We will **proactively engage with ESG investors** and with **sources of capital new to Scotland**, such as green bonds, to help us achieve our Net Zero and Wellbeing ambitions

43 The Taskforce on Climate-related Financial Disclosures (TCFD) is an international body that was tasked by the Financial Stability Board to recommend a set of common disclosure standards for the financial sector and major NFCs. The recommendations were published in 2017, and focused on governance, strategy, risk management, and metrics and targets.

5.3 DEMAND STIMULATION: BUILDING THE PIPELINE

Scotland has a lot to offer investors, but to increase the supply of investment, we need to provide investors with a pipeline of market-ready propositions to invest in, linked to strong economic performance, viability and attractiveness to private capital flows.

Companies: Increasing growth and scaling

To have sustained and consistent flows of finance into companies which anchor and develop Scotland's economy, we need to build-up our capability to host developing businesses from pre-commercial stage through to commercial. This means that we need a rich flow of companies that will provide investment opportunities at each stage of company growth. This requires the system we already have for economic development to ensure a broad pool of possible options, and within it a tight focus on those companies and projects which have the best chance of benefiting from market engagement.

This is a critical theme in Mark Logan's Scottish Technology Ecosystem Review. By creating a higher volume of quality early stage companies we create a virtuous circle through which we can attract new capital, and this capital in turns boosts the growth and maturity of the talent pipeline. As recommended in Financing the Recovery, this should be a joint effort by the public sector and partners. The development offer we make to companies should be open to those recommended by others in partnership, whether by centres of expertise, industry groupings, business advisors or banks.

Infrastructure and place: Systematic origination and quality control of investable projects

Scotland's public sector has been working together for a number of years on improving the quality of major projects we take to market. For example we have developed the Scottish Green Investment Portfolio. This approach needs to be both focused and augmented. It needs to focus in on the themes selected in this plan, and on the places and infrastructure to support them; and augmented through better coordination and use of the expertise that sits in the public sector to source and structure major projects to market projects to market readiness.

Again, this must build on the capabilities we already have, including the expertise in our Enterprise Agencies, Scottish Futures Trust and in local authorities. The advent of the Scottish National Investment Bank is intended to grow and develop into a centre of expertise on investment within the Scottish institutional landscape. It has arrived at the time we need it most, to help think through the implications and possibilities around coordinated, multi-sector and multi-project government supported efforts at tackling climate change.

THE ADVENT OF THE SCOTTISH NATIONAL INVESTMENT BANK IS INTENDED TO GROW AND DEVELOP INTO A CENTRE OF EXPERTISE ON INVESTMENT WITHIN THE SCOTTISH INSTITUTIONAL LANDSCAPE

In Chapter 1 we set out that not all capital investment is equal, or equally beneficial for the broader economy it acts in. This is a critical distinction when it comes to delivering Scotland's objectives for a Just Transition to Net Zero greenhouse gas emissions by 2045. The transition to Net Zero will transform our economy and society. It will bring huge opportunities and benefits but there are also risks that these will not be shared equally or fairly. The Climate Change Committee's latest analysis finds that the costs of transition are affordable, but the distribution of those costs may not be. This emphasises the need for governments to prioritise that impacts on people, communities and sectors are taken into account in decisions and investments we make. This will be important as we structure major investments in heat, transport, energy efficiency, hydrogen, energy and land use.

SCOTLAND'S PUBLIC SECTOR HAS BEEN WORKING TOGETHER FOR A NUMBER OF YEARS ON IMPROVING THE QUALITY OF MAJOR PROJECTS WE TAKE TO MARKET

Whilst we will make many investments directly, as set out in the Infrastructure Investment Plan, it will also be important that we work with investors investing in Net Zero projects so that they understand the benefits of a Just Transition to their investments and to ensure we are able to consider the distributional impacts of the transition. To build a strong pipeline of strategic investable opportunities to take to global investors:

- We will identify and prioritise **place-based opportunities** or clusters e.g. low-carbon heating or hydrogen, and accelerate their investment-readiness for both company and infrastructure investment
- We will work with the private sector to identify and secure the private capital investment needed to develop **internationally recognised clusters of excellence** in our identified sectoral themes (Low Carbon, Digital, Health and Life Sciences, High Value Manufacturing) and build investment solutions for their business ecosystems
- We will **build demand for private capital investment for the growth companies** working in our key sectoral themes, for whom engagement with private capital markets is a viable and useful route to growth
- We will **build capacity to structure major projects and programmes** for financing focused on the Just Transition to Net Zero, building digital capacity to support data movement, and housing needs
- We will co-ordinate the wider public and private sector landscapes to **aggregate opportunities of scale** that will be of interest to institutional investors
- We will **act as cornerstone investors** in emerging sectors and technologies where Scotland has genuine potential to lead on the international stage
- We will **establish a 'route-map' from project inception to promotion** to ensure investment opportunities are investment ready and attractive to markets, and that the route to support is clear to candidates. The route-map will denote criteria for when a project is ready for development and will be considered 'market ready'
- We will take a Team Scotland approach to **disseminate learning and best practice** from across the public sector and private sector ecosystems. This will involve coordinating government and agencies with the private sector to **accelerate the development of investment opportunities,** using co-investment models for example
- We will benchmark how our investment propositions that we present to market compare with international standards to **ensure our propositions are best-in-class**

5.4 RIGHT REGULATION, RIGHT INCENTIVES

Improving regulatory frameworks

Scotland already has a very strong investment environment, underpinned by sound and predictable legal and planning systems, and benefiting from the availability of financing and development partners available within Scotland and the UK. Now, though, that system needs to evolve in line with emerging priorities, in particular in relation to Net Zero.

We have already seen how the introduction of Contract for Difference in effect created an investment market for wind power. The scale and pace of the transition to Net Zero means we need to see the development of long-term market frameworks to create the demand certainty that is necessary to drive investment appetite in heat decarbonisation, hydrogen and more. There are recent positive signals from the UK Government on hydrogen in particular, and we need to engage fully to ensure these frameworks emerge as fit for purpose for investments in Scotland.

We also need to investigate the expansion and use of existing models that work. The Scottish Government will establish a Green Heat Finance Taskforce in early 2021 to forge a new collaboration between the Scottish public sector, heat decarbonisation experts and the financial sector to explore how existing models could work alongside innovative financing mechanisms to fund both at-scale heat infrastructure and individual level investment.

The needs of Net Zero will require significant sustained investment in our electricity and gas networks across the coming decades to enable the rapid growth in renewable and low carbon energy that will be needed to decarbonise our heat and transport systems, and meet industrial demand. Although energy regulation is reserved, the Scottish Government is closely engaged with the regulator, Ofgem, on these matters, as well as Scotland's energy network owners. The UK Government Energy White Paper, Powering our Net Zero Future, published in December 2020 commits to consulting on how to align Ofgem's remit and strategy to support delivery of our Net Zero commitments.

Incentives that target and drive behaviour

The incentives package Scotland offers investors has previously largely been targeted at commercial property and housing. This includes a competitive non-domestic rates (NDR) system, with the lowest poundage in the UK, delivering a lower rate of tax in Scotland for over 95% of properties than anywhere else in the UK; and a package of NDR reliefs to encourage investment including the unique Business Growth Accelerator relief for new builds and building improvements, which from 1 April 2021 is available even where there has been a change of use of property alongside an improvement; the unique Fresh Start relief for long-term empty properties when they are reoccupied; and the most generous relief thresholds for small businesses as well as reliefs for renewables anywhere in the UK. Recognising the timescales involved in investing, the Scottish Government has committed to making the Telecommunications New Fibre Infrastructure relief available until 2029, and the existing Hydro and District Heating reliefs available until 2032.

There is an opportunity to align incentives to the broader set of priorities we want to create markets for. The Green Growth Accelerator Model has already started this, with enabling infrastructure grant support predicated on creating Net Zero outcomes from a new development. The Scottish Government holds many of the levers which would allow us to adjust incentives such as rates relief towards repurposing and redevelopment of assets. To ensure we have the right set of regulations and incentives:

- We will **establish relationships with UK financial services and pension regulators** to influence and support the coordination of future regulations around reporting standards and our Net Zero aims
- We will **align our suite of available incentives to help stimulate investment** in our sectoral themes, places and Net Zero, whilst always seeking to understand and mitigate market distortions
- We will engage with the UK and international bodies to **influence the design of market-creating financial and pricing solutions** (e.g. Contract for Difference and carbon pricing), working constructively to remove barriers to investment

5.5 WORKING IN PARTNERSHIP WITH MARKETS

Increasing the size and diversity of equity and growth finance markets

The best investment ecosystems turn on the availability of talent, capital and infrastructure. Having more diverse sources of capital will attract the attention of other investors, entrepreneurs, corporates looking to acquire innovative companies, and the wider community of advisors who can direct clients towards emerging ecosystems. Combining this with the world-class support for companies proposed in the Logan Review would make Scotland an attractive hub for entrepreneurship and investment which goes well beyond the digital sector. With both Scottish Enterprise and the Scottish National Investment Bank engaged, we can target both on a deal-by-deal and early-stage basis, and on a multi-deal and fund structure basis.

Given that diversity of funding sources is our objective, we need to help and encourage Scottish companies to go out and access the best and most appropriate investors regardless of location. Experience suggests that once an out of territory investor makes their first investment in a new location the probability of making further investments increases significantly. We should therefore first take action to have a large and diverse range of new investors make their first investment in Scotland. Over time, a subset of investors will emerge from this group who are particularly well aligned with what Scotland has to offer. Some of this group of very regular investors in Scottish companies will go on to set up a presence in Scotland based on need and fit.

Testing the approach

Scotland has a significant opportunity in health and life sciences, but we also have a number of companies leaving Scotland in order to find growth capital. With a renewed strategic focus on retaining strengths and supply chains in health related sectors, we need to reverse this. This will be the first of our roadmaps to investment for each of our four sectoral themes, and will serve as a model.

WE RECOGNISE THAT THERE IS A SET OF INVESTORS FOR WHOM A DEEPLY COORDINATED AND SUPPORTED SYSTEM OF PROJECT STRUCTURING, PRE-COMMERCIAL SUPPORT AND DEVELOPMENT, AS WELL AS A MATCH WITH THEIR OWN VALUES AND FUTURE DIRECTION, WILL MAKE INVESTING IN SCOTLAND A NATURAL FIT

Meeting the market at their level

In our response to the report from the Advisory Group on Economic Recovery, the Scottish Government committed to working closely with business to support and grow the economy. In this plan, we set out clearly the kinds of investments we want to see made in Scotland, and how these will benefit people, businesses and supply chains, as well as investors. We recognise that in setting out this approach, there will be investors who want to be a part of it, with whom we will seek to build strategic relationships. There will also be investors who prefer a more transactional approach to making their investments. Scotland is still open to those investors. However, we also recognise that there is a set of investors for whom a deeply coordinated and supported system of project structuring, pre-commercial support and development, as well as a match with their own values and future direction, will make investing in Scotland a natural fit.

The offer we will make to work with business and investors will operate at different levels, with appropriate levels of partnership and cooperation for each type of investor to find common goals and values.

- **Tactical introductions to Scotland,** developing our understanding of specific investor 'asks' and how best to encourage companies to engage with them. The aim here is to increase the number and scale of new 'out of territory' repeat investors active in Scotland
- **Increasing opportunities in Scotland** for those investors and intermediaries who are already active here and seeking further opportunities
- **Strategic relationships,** forming long-term partnerships with a set of investors who share interests and aims around long-term transitions, and aiming to create a sense of shared ownership of those changes

For our first goal, we will build on the success of the Scottish Growth Scheme equity funds in attracting new repeat investors to Scotland. Both the Scottish National Investment Bank and Scottish Enterprise are building strong teams around investor relations and understanding both markets and the propositions we have which might match them. We need to ensure that there is good communication between agencies at national and local level, and a seamless, timely and professional service for investors.

For the deeper strategic relationships envisaged here, we want to target investors who share a commitment to ESG investment and to long-term transitions. We want Scotland to feel like home to these investors: a place where they will find a ready pipeline of projects and companies that are a natural fit for their objectives, where projects have been scoped and checked for compliance with reporting requirements, and where the convening power of government and its agencies can help structure them to create a long-term fit with their funding options. In turn, we will ask for patience and a genuine desire to create shared value for Scotland through their investments. We want to see these projects, central to the places and infrastructure Scotland needs for the future, use Scottish suppliers and technology, and crowd in more positive economic and jobs impacts through attracting suppliers to Scotland.

Building our capacity in market intelligence

Chapter 3 of this plan has begun the work of better understanding and therefore being able to offer different market players what they are seeking. As we noted, this will continue to be a shifting picture, and one at which no one part of the Scottish public sector system currently has extensive and in-depth knowledge. Without this, it is not meaningful to establish target markets or investors beyond a very general level. We therefore need to commit to building this knowledge base, focusing first on acknowledged market gaps in Scotland:

- **Venture capital funds** – identifying and targeting these by sector and geography, and understanding the funds which are likely to take more patient positions which favour growth and expansion over rapid exits. As above, we should then seek initial deals and partnerships with a view to long-term location in Scotland
- **Institutional investors** – institutional investors have multiple funds and structures, so here the challenge is to understand the sub-components, and which aspects and stages of projects are most relevant to which fund. In parallel, these funds often seek scale in projects, and we will need to map what that means to different fund managers. We should start local – in Scotland and in London
- **Sovereign Wealth Funds** – like institutional investors these look for scale, but frequently also benefit from government-to-government relationships. We should seek specialist advice on these fund structures and their requirements in deciding where we may have something to offer, and what other arrangements are acceptable alongside investment
- **ESG investors** – this category spans the risk and investor categories, with for example most institutional investors now beginning to operate some ESG funds within their overall structures. Understanding **ESG funds** will therefore act as an overlay, and we should additionally investigate opportunities in the **green bond market**

WE WANT TO TARGET INVESTORS WHO SHARE A COMMITMENT TO ESG INVESTMENT AND TO LONG-TERM TRANSITIONS. WE WANT SCOTLAND TO FEEL LIKE HOME TO THESE INVESTORS: A PLACE WHERE THEY WILL FIND A READY PIPELINE OF PROJECTS AND COMPANIES THAT ARE A NATURAL FIT FOR THEIR OBJECTIVES

- For each category of investor we will **develop an investor relationship strategy** to increase our level of understanding, engagement and partnership with the market
- To support business growth investment, and in line with the Logan Review recommendations, we will **seek to fill the gaps in the Scottish equity market** by:
  - Developing a new Series A fund with a focus on the Scottish ecosystem
  - Investing outside of Scotland to build a reciprocal relationship with funds that will in return, invest in Scotland
  - Recapitalising and reorienting existing funds where this will support greater investment
  - Ensuring that investment is fairly distributed through investment vehicles focused on female and minority founders
  - Intensifying appropriate support for these companies, such as development, networking, contact building opportunities, leadership, peer to peer support and pitching masterclasses
- We will **increase connections with institutional investors** who may not be familiar with what Scotland has to offer, starting with ESG investors and thematic funds
- We will **build relationships with the most active developers and intermediaries in similar regions in the UK**, linked to the sectors and opportunities we want more investment in
- We will **work closely with local government pension funds** to identify appropriate means of increasing investment in Scottish propositions
- We will **develop a service standard on investor experience**, aligned with the Inward Investment Plan, to ensure we are providing investors with a rapid professional and comprehensive service to encourage them to commit to further investment in Scotland
- We will **establish an investment panel** to form a partnership with government, drawing on their expertise to provide industry insight on the structuring and financing of the large scale investments required for the transition to Net Zero
- We will put in place a process to **track private capital investment into Scotland and to measure performance** going forward

5.6 MOBILISING OUR GLOBAL NETWORKS

Scotland is the proposition: promoting quality, coordination and values

We have already built a stronger Scottish brand and presence in investment markets, including through our global footprint, and are increasingly targeting events at investors with a known interest in either Scotland, the UK, or the specific project, company and investment opportunities which are available in Scotland.

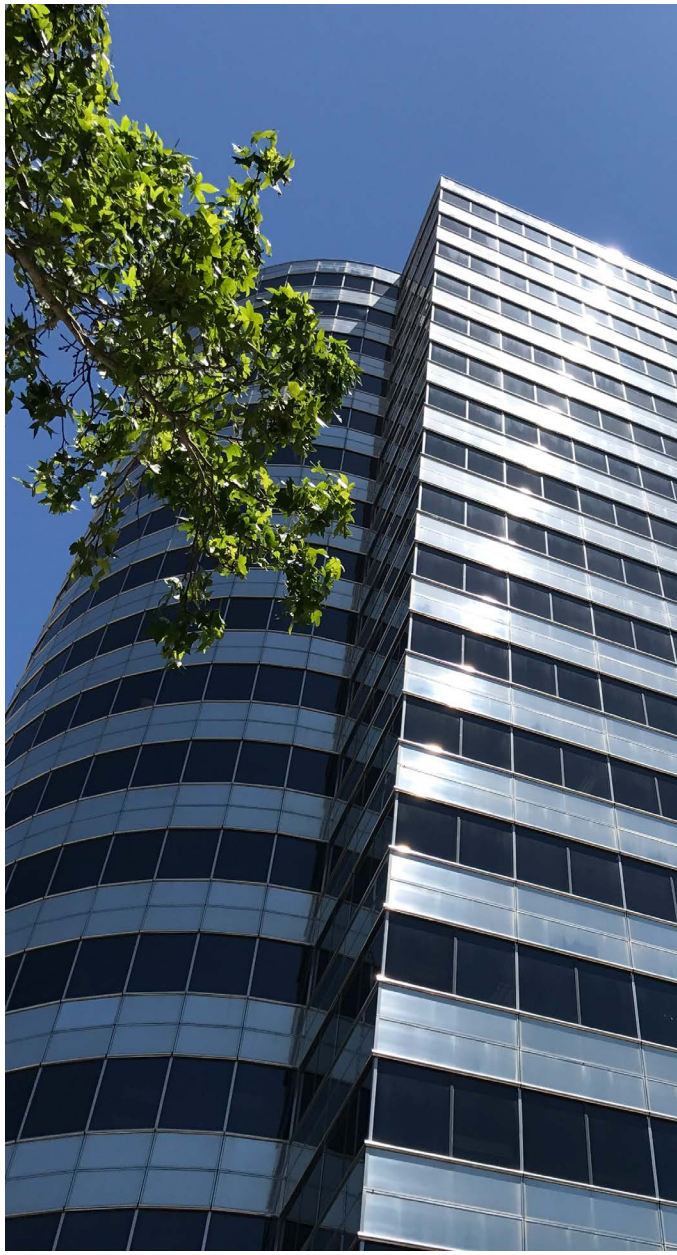
The Scottish Government and public sector partners have also established a well-regarded quality control system over the past three years, aimed at increasing the market readiness of any propositions we take to market. This is open to all local authorities and areas of Scotland. We already have a presence in over 30 markets via Scottish Development International's overseas field offices and the eight Scottish Government international offices (Figure 5.2).

Figure 5.2: Making the most use of our international networks

GlobalScots is a volunteer network administered by Scottish Enterprise that comprises senior business people around the world who have a connection to Scotland and are keen to support Scottish businesses to further their international growth ambitions. GlobalScots provide, on a volunteer basis, informal advice and introductions to Scottish companies and also act as advisors and advocates in promoting Scotland as a place to live, work, invest and study. We are scaling up the GlobalScot network, expanding from 600 to 2000 business people in key markets, with clearer "asks" and "offers" of support from a revamped SDI support platform.

The Scottish Government Trade Envoy network comprises six individuals covering Indonesia, Poland, Spain, UAE, Singapore and a higher education sectoral envoy. We can make more and better use of this network and we will also keep our marketing materials updated, relevant and credible, making sure that investors are seeing new opportunities when we speak to them. Increasingly, we are experiencing that our values are part of our pitch. Our values protect our strongest assets (our people and natural capital), and that makes Scotland attractive for the long-term. We should not be shy about this, and so we will both start and end with values: We have previously committed to developing a National Prospectus for Scotland, and this Plan will build capital investment into that. Here we set out how we will make improvements in this key area:

- Through our combined networks and relationships, we will continue to **promote Scotland's broad and diverse capital investment offer to investors globally**
- We will develop and deliver a **programme of domestic and international events** and activities to support the development and promotion of the pipeline of private capital investment opportunities, providing a platform to access new investor relationships
- We will **increase our global capital investment resource in target international markets and make best use of use our international networks** to provide insights, intelligence, introductions and advocacy focused on building investor relations and promoting investment opportunities in Scotland. Such networks include:
  - SDI's network of overseas field offices
  - Scottish Government's eight international offices based in private capital investment global capitals including London, Berlin and Paris
  - Scottish Government Trade Envoys
  - The GlobalScots Network
  - The international footprint of our universities and colleges
  - Private sector business networks that promote Scotland
- We will further invest to develop **the capital investment strand of 'Scotland Is Now'** and utilise this as a key channel to communicate our messaging and propositions



5.7 SHIFTING OUR APPROACH TO DELIVERY

To be even more effective in attracting internationally mobile private capital we must make a shift and change our delivery. The ecosystem that we have in place performs well with the enterprise agencies including Scottish Development International, Scottish Futures Trust and local authorities all playing a strong role currently in leveraging in investment. Until now though, we have not had a national strategy that will help us to mobilise the public and private sector ecosystems and use our resources and levers where we can have the biggest impact. Figure 5.3 summarises what we will do differently.

Figure 5.3: How we will change our approach to our target markets

Current delivery	What will feel different
We build companies: We pitch companies to individual funds for investment.	We build markets: We pitch Scotland to funds for repeat investing and create diversity and ecosystems.
We give equal attention to all potential investors.	We target our efforts at our best opportunities and at investors who want the same long-term outcomes as us.
Investors find the Scottish system difficult to navigate.	We work across the Scottish public sector ecosystem to have a seamless and joined up system which is based on a one-point of entry concept. This is more relevant for infrastructure investment than venture capital.
There are no sectoral priorities for investment.	We target our efforts on the sectoral themes identified where Scotland's strengths match international demand.
There are no geographic priorities for investment attraction.	We work in partnership with Scottish-based investors recognising the necessity for local investors to leverage in foreign capital investment, and focus our foreign engagement in the global financial centres such as London, Boston, New York, Silicon Valley, Berlin, Frankfurt and Singapore.

TO BE EVEN MORE EFFECTIVE IN ATTRACTING INTERNATIONALLY MOBILE PRIVATE CAPITAL WE MUST MAKE A SHIFT AND CHANGE OUR DELIVERY

THE ACTIONS IN SUMMARY

SCOTLAND'S GLOBAL CAPITAL INVESTMENT PLAN – SHORT TO MEDIUM TERM ACTION PLAN

The Actions are set out under the five strands that have been identified in Chapter 5 as areas of focus. We have brought together an ambitious set of actions that will take time to embed. We therefore present a short to medium term Action Plan to help us address the challenges and realise the real opportunities that we have to leverage in private capital investment that will help us achieve build our future economy.

Action	Leading with our Values: Net Zero and ESG
1	We will **make Scotland's values a core part of our National Prospectus and our engagement with investors**, making it clear that valuing our people, communities, and environment are core to our economic ambitions.
2	Investment opportunities that we promote to market will be **benchmarked against ESG investment criteria.** We will enable the companies and projects we support to report climate-related disclosures in a standardised and transparent way with flows of ESG monitored via a new metric which will cover **environmental and social impacts**.
3	We will use COP26 as a platform to showcase our investment opportunities such as our **Green investment Portfolio**.
4	We will build on existing ESG investment activity and work with Scotland's investment management industry, using events such as the Ethical Finance Summit to make **Scotland a leading globally established hub for ESG investment.**
5	We will **proactively engage with ESG investors** and with **sources of capital new to Scotland**, such as green bonds, to help us achieve our Net Zero and Wellbeing ambitions.

Action	Building an Investment Ready Pipeline
6	We will identify and prioritise **place-based opportunities** or clusters e.g. low-carbon heating or hydrogen, and accelerate their investment-readiness for both company and infrastructure investment.
7	We will work with the private sector to identify and secure the private capital investment needed to develop **internationally recognised clusters of excellence** in our identified sectoral themes (Low Carbon, Digital, Health and Life Sciences, High Value Manufacturing) and build investment solutions for their business ecosystems.
8	We will **build demand for private capital investment for the growth companies** working in our key sectoral themes, for whom engagement with private capital markets is a viable and useful route to growth.
9	We will **build capacity to structure major projects and programmes** for financing focused on the Just Transition to Net Zero, building digital capacity to support data movement, and housing needs.

Action	Building an Investment Ready Pipeline
10	We will co-ordinate the wider public and private sector landscapes to **aggregate opportunities of scale** that will be of interest to institutional investors.
11	We will **act as cornerstone investors** in emerging sectors and technologies where Scotland has genuine potential to lead on the international stage.
12	We will **establish a 'route-map' from project inception to promotion** to ensure investment opportunities are investment ready and attractive to markets, and that the route to support is clear to candidates. The route-map will denote criteria for when a project is ready for development and will be considered 'market ready'.
13	We will take a Team Scotland approach to **disseminate learning and best practice** from across the public sector and private sector ecosystems. This will involve coordinating government and agencies with the private sector to **accelerate the development of investment opportunities**, using co-investment models for example.
14	We will benchmark how our investment propositions that we present to market compare with international standards to **ensure our propositions are best-in-class**.

Action	Right Regulations, Right Incentives
15	We will **establish relationships with UK financial services and pension regulators** to influence and support the coordination of future regulations around reporting standards and our Net Zero aims.
16	We will **align our suite of available incentives to help stimulate investment** in our sectoral themes, places and Net Zero, whilst always seeking to understand and mitigate market distortions.
17	We will engage with the UK and international bodies to **influence the design of market-creating financial and pricing solutions** (e.g. Contract for Difference and carbon pricing), working constructively to remove barriers to investment.

Action	Mobilising our Global Networks
18	For each category of investor we will **develop an investor relationship strategy** to increase our level of understanding, engagement and partnership with the market.
19	To support business growth investment, and in line with the Logan Review recommendations, we will **seek to fill the gaps in the Scottish equity market** by: • Developing a new Series A fund with a focus on the Scottish ecosystem • Investing outside of Scotland to build a reciprocal relationship with funds that will in return, invest in Scotland • Recapitalising and reorienting existing funds where this will support greater investment • Ensuring that investment is fairly distributed through investment vehicles focussed on female and minority founders • Intensifying appropriate support for these companies, such as development, networking, contact building opportunities, leadership, peer to peer support and pitching masterclasses
20	We will **increase connections with institutional investors** who may not be familiar with what Scotland has to offer, starting with ESG investors and thematic funds.
21	We will **build relationships with the most active developers and intermediaries in similar regions in the UK**, linked to the sectors and opportunities we want more investment in.
22	We will **work closely with local government pension funds** to identify appropriate means of increasing investment in Scottish propositions.
23	We will use data and analysis to **respond quickly to shifts in the market.**
24	We will **develop a service standard on investor experience**, aligned with the Inward Investment Plan, to ensure we are providing investors with a rapid professional and comprehensive service to encourage them to commit to further investment in Scotland.
25	We will **establish an investment panel** to form a partnership with government, drawing on their expertise to provide industry insight on the structuring and financing of the large scale investments required for the transition to Net Zero.
26	We will put in place a process to **track private capital investment into Scotland and to measure performance** going forward.

Action	Working in Partnership with the Markets
27	Through our combined networks and relationships, we will continue to **promote Scotland's broad and diverse capital investment offer to investors globally**.
28	We will develop and deliver a **programme of domestic and international events** and activities to support the development and promotion of the pipeline of private capital investment opportunities, providing a platform to access new investor relationships.
29	We will **increase our global capital investment resource in target international markets and make best use of use our international networks** to provide insights, intelligence, introductions and advocacy focussed on building investor relations and promoting investment opportunities in Scotland. Such networks include: • SDI's network of overseas field offices • Scottish Government's eight international offices based in private capital investment global capitals including London, Berlin and Paris • Scottish Government Trade Envoys • The GlobalScots Network • The international footprint of our universities and colleges • Private sector business networks that promote Scotland
30	We will **further invest to develop the capital investment strand of 'Scotland Is Now'** and utilise this as a key channel to communicate our messaging and propositions.

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