Brexit and Scottish Business
Final Report

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Recent years have seen tumultuous change worldwide. The UK and Scotland have not been immune from this, evidenced by the result of the UK Referendum on exiting the European Union in June 2016.

Another measure of this change has been the dramatic impact upon the assumptions of the past in economics and politics – assumptions which have been unable to withstand the flow of events.

Amidst this there is a need to approach research and consultancy work with change being at its heart. Hence the creation of our new Scottish company with international ambitions. 'Momentous Change Ltd', a niche consultancy, will help address and use change to seek progress for business, organisations and wider society.

Michelle Thomson, Founding Director

With a background in financial services, IT, property and the creative sector, Michelle has a breadth of experience in private business. She was a key member of parliament serving on the Business, Energy & Industrial Strategy Select Committee, leading on a range of inquiries which achieved national prominence. Since stepping down from parliament in 2017 she has been appointed as Ambassador for the All Party Parliamentary Group for Fair Business Banking.

Roger Mullin, Founding Director

Roger has over 30 years' experience in leading research and consultancy companies. He is Honorary Professor at the University of Stirling's Management School and before entering parliament, he undertook 27 international assignment for UN agencies, the World Bank and Asian Development Bank. Since leaving parliament in 2017 he has been appointed Special Envoy for the All Party Parliamentary Group on Explosive Threats.

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EXECUTIVE SUMMARY

Brexit presents both uncertainty and complexity to businesses in Scotland.

There is an unrealistic yearning for certainty amongst some business leaders.

Planning and preparations for Brexit are currently weak amongst many Scottish businesses.

Businesses should be addressing their exposure to different types of risk by conducting the equivalent of stress tests.

The ability to access suitable labour and skills is the greatest concern businesses have about the post Brexit future.

There are significant economic concerns surrounding Brexit. These include in areas such as barriers to trade, and worsening general economic conditions.

There is a strong desire amongst business leaders for an extended transition period as the UK exits the European Union.

There is considerable uncertainty about the plans of banks for business lending post Brexit.

There remain problems in the relations between banks and business customers, which is adding to concerns around Brexit.

There has been a marked decline in net bank lending to businesses over the last year.

There is little effective guidance being provided by government that enables businesses to plan for Brexit.

There is a concern that the impact of Brexit will weaken the attractiveness of Scotland as a place to do business.

Our recommendations are that –

Businesses should undertake planning and preparations for Brexit including in those areas proposed in our report.

The Scottish Government should provide financial support to SMEs on a similar basis to the initiative in Ireland to enable expert assistance to be accessed in preparing for Brexit.

The Scottish Government should commission a review of its skills strategy.

The Scottish Government should commission a series of business briefings in preparation for Brexit.

The Scottish Government should seek to intensify its engagement with business in relation to Brexit.

The UK Government should make clear its position regarding the implications of Brexit for devolved powers.

The UK Government should urgently engage with the Scottish Government to construct a joint examination of inward migration with a particular focus on ensuring easy access to skills and expertise for Scottish businesses from the remaining member countries of the EU.

The UK Government should provide special funds to the devolved administrations for Brexit preparations.

The UK and Scottish Governments should actively monitor the availability of funds for business, and for SMEs in particular. This should include assessing how additional funding streams could be made available.

PREAMBLE

> Cultures and societies that are shaped by fear... will without doubt not get a grip on the future.
>
> Angela Merkel

> Men often act knowingly against their interest.
>
> David Hume

PREAMBLE

In early 2017, we (Michelle Thomson and Roger Mullin) were Members of Parliament. We had different but related roles: one as a member of the Business, Energy and Industrial Strategy Select Committee (formerly called Business, Innovation & Skills Select Committee) and the other as a Treasury spokesperson, and member of the Regulatory Reform Select Committee.

Political context

We were becoming increasingly concerned at the lack of clear focus on the needs of business in relation to exiting the European Union, or Brexit as it had become known. In particular, we were very conscious of the supremely political nature of the debate to such an extent that we feared a number of key matters, including the threats, opportunities and uncertainties for business, were getting lost from view within parliament.

Had the General Election not occurred, we had been planning to establish a research capability based in Westminster to help us develop a clearer understanding of business related issues. But, typical of the modern world, significant change was just around the corner and by June 2017 we were no longer MPs.

Momentous Change Ltd

Following a period of post-election reflection, we eventually agreed to establish Momentous Change Ltd, and to set about conducting our own independent research into Brexit and Scottish Business.

We have done so in the hope of highlighting the need for a much stronger focus on how to secure a successful future.

We note here that, regardless of whether business leaders supported, opposed or were neutral towards Brexit, no one denies we will be facing a very different future trading context. In such a context, how business leaders set about making decisions and planning for the future should be of particular concern.

Uncertainty

Much discussion around Brexit has dwelt on a desire from business for much greater certainty and facts about what awaits in terms of future trading, regulatory, labour market and general economic arrangements. This is very understandable. But in our view such desire may be taken too far and obscures the fact that there is rarely, if ever, certainty in business. Even without Brexit we live in a world of constant change and Brexit should not become an excuse for inaction.

Stability

In his famous Reith lecture of 1970 on Change and Industrial Society and subsequent book *Beyond the Stable State* (1973)[1], Donald Schön argued there remains in modern society a deeply ingrained and pervasive illusion of the possibility of stability. It is a

“belief in the....attainability of constancy”.

He argued it serves to

"protect us from apprehension of the threats inherent in change".

Such apprehension can be seen in the desire for definitive facts about Brexit before choosing to make decisions or to act. But businesses, like individuals, cannot reasonably expect comprehensive exactness or definitive knowledge in the face of uncertainty. Searching for such an illusion too often becomes the cause of doing nothing.

Pace of change

Since 1970, change in social, political and economic affairs has become ever faster and more pervasive. Yet the illusion of the possibility of constancy and stability remains in many quarters.

Our assumption in undertaking this study into Brexit and Business in Scotland is that for business and institutions of various types to do nothing, to fail to plan in the face of uncertainty surrounding Brexit, is not a rational option.

Preparing for Brexit

As we set out in this study, we were aware that some sectors, such as banking, were embarking on very detailed scenario planning. However, we also had strong suspicions that many other types of business were showing much less inclination to attempt to plan for the future.

The challenge

Our challenge has been how best to identify meaningful information that may guide future endeavours under the uncertain conditions currently being faced. This has led us to capture the views of business leaders spanning a broad range of sectors and representing businesses of varying scale from SMEs to some of the largest businesses in Scotland.

We detail our research approach and responses later in this report. We recognise that in some respects we have only scratched the surface. We hope that further research will be commissioned with some urgency to ensure Scotland and her business community do not go into the future unprepared for the challenges that lie ahead.

INTRODUCTION

Some of our findings have surprised us. Indeed we are pleased they have done so. A willingness to be surprised is to us an essential trait for anyone conducting research.

"The only thing that makes life possible is permanent, intolerable uncertainty; not knowing what comes next."

Ursula K. Le Guin

"In the varied topography of professional practice, there is a high, hard ground where practitioners can make effective use of research-based theory and technique, and there is a swampy lowland where situations are confusing "messes" incapable of technical solution. The difficulty is that the problems of the high ground, however great their technical interest, are often relatively unimportant to clients or to the larger society, while in the swamp are the problems of the greatest human concern."

Donald A. Schön

Only fools profess to know precisely what is going to happen as a result of the UK leaving the European Union. We make no claims to having a crystal ball. The more the uncertainty, the more we cannot accurately predict the future. We are, to repeat Donald A. Schön's words above "in the swamp" facing a problem of great interest, but where uncertainty abounds.

Listening to business

This report is born out of an interest in how business in Scotland is facing the prospect of leaving the European Union, what actions are being taken, and what perceptions are guiding action. It is based not on any econometric modeling, but on speaking to people in leading positions in business and trying to understand how they are coming to terms with the uncertain consequences of leaving the European Union. As Deirdre McCloskey, the distinguished economist, put it,

"Asking is not part of the official rhetoric of economics. Yes, it sounds insane. Why wouldn't you go and ask business people what they think they are doing?! It's part of the evidence, surely."

Some of our findings have surprised us. Indeed we are pleased they have done so. A willingness to be surprised is to us an essential trait for anyone conducting research.

Politics

Although recently we were both Members of Parliament we believe political discourse is, in the main, proving a barrier to understanding rather than a light on the future. Too much political rhetoric is framed in a false certainty regardless of whether people support or are against leaving the EU.

We admit to having much to learn on many issues, and that is as it should be.

Uncertainty

Our study has been undertaken over a period of some months using a variety of investigative methods. We make no claims to having achieved certainty; rather we believe that admitting to great uncertainty is a necessary starting point.

Much, much more needs doing in our opinion to reach the depth of understanding needed for both governments and business to effectively chart the most effective way forward. This study is a small contribution. If it generates debate and criticism it will in our judgment have served a useful purpose.

Themes and sectors

In our interim report, we suggested our final report would focus on sectors. However, having reflected on this, we have taken a different approach. Rather than writing what would become very repetitive sectoral chapters, we think it best to focus on a few key themes. Thus, we have chapters on Labour and Skills, Innovation and Research and so on. We still draw upon sector specific insights, but within a thematic structure.

Questioning

We hope this report helps generate more testing questions for business and government alike – for it is only by asking the hard questions are we likely to get the most useful answers.

> **The practice of deep listening is the practice of open inquiry, without assumption or judgement.**
>
> **Sharon Weil**

> **In changing times, question everything you take for granted.**
>
> **Gyan Nagpal**

Classical Assumptions

We have eschewed any attempt at forecasting the likely outcome effects of Brexit. We agree with those from the classical tradition of economics – that mathematical models of the economy beloved of neo-classical economists carry too much sway at the cost of understanding the individual and collective influences that affect the day by day judgments and decisions of economic actors.

Professor David Simpson has explained[2] better than we ever could what is meant by the classical tradition,

"An intellectual tradition that began with Adam Smith, was continued by Marx, Menger and Marshall,

Schumpeter and Hayek and in the present day is represented by theorists of complexity.

The hallmarks of this classical tradition are principally three. The first is the belief that the growth of the economy, rather than relative prices, should be the principal object of analysis. Coupled with that belief, is an understanding of the market economy as a collection of processes of continuing change rather than as a structure, and that the nature of this change is self-organising and evolutionary. Finally there is a conviction that economic activity is rooted in human nature and the interaction of individual human beings."

We trust our methods of inquiry can therefore be understood in this context (as can our frequent references to complexity throughout this report).

Political economy

Our case for dealing with Brexit by shunning quantitative predictions is given added weight by the very recent critique of the inadequacy of the mainstream economic debate at the time of the Scottish Independence referendum. The authors of "Sine praejudicio? Economics and the 2014 Scottish independence referendum."[3] argue that,

"As the consequences of constitutional change for institutions and behaviour are uncertain, an equilibrium framework treats anything beyond calculable prediction as a shock, inducing fear of the unknown. In contrast, a political economy approach is tailored to analysing uncertain developments and encompassing the broader issues relating to values, democracy and power, and is thus better suited to the analysis of constitutional change."

We agree and have studiously avoided calculable prediction in this report.

Triangulation

This study achieved the research requirements of triangulation[4] by utilising the following research methods.

Desk-top review

We have conducted a desk-top review focusing primarily on commentaries relating to business and Brexit within the UK generally and Scotland in particular. Our sources included major newspaper titles, some specialist publications and sector specific reports. In addition, we consulted some academic publications in the fields of business, leadership and change.

Survey

An online questionnaire was designed and piloted. The final version was then distributed to a sample of business leaders across a range of sectors.

METHODS OF INQUIRY

Interviews

We conducted a wide range of individual interviews.

In part, our interviews included elements of Acquisitive Inquiry[5] with the aim of capturing ideas and examples of planning and future opportunities[6].

We also, in both interviews and our survey, invited respondents to reflect-in-action[7]. That is, we encouraged our study participants to reflect on what they are doing and their business related priorities in the face of current uncertainties, and also reflect on what could be done, for example by government, to assist given the nature of the uncertainties.

In other words, in using elements of Acquisitive Inquiry and reflection-in-action our study is based on the belief that more qualitative insights into the challenges faced and actions being taken by businesses are needed.

Informal communication

Throughout our study we benefited from a considerable amount of informal communication from individuals and from discussions at interim briefing events where we presented our interim findings and held open discussions.

Respondents

Excluding those attending interim briefing events, we engaged with 236 business leaders in the course of our study.

Interim report distribution

Our interim report was distributed to approximately 250 individuals on an unrestricted basis, and was used as a basis for a range of recent interviews and events.

Research ethics

We have been particularly conscious of our ethical obligations throughout this study. The general guiding principles of research ethics are beneficence and non-maleficence indicative of a meticulous regard for the rights, autonomy and interests of others whilst carrying out all aspects of research. Non-maleficence is the principle of doing no harm in the broadest sense and beneficence is the prerequisite to serve the interests and well being of others, or doing good in its broadest sense.

In carrying out the study we have, therefore, paid particular regard to the following.

1. Ensuring no individual completing a survey or participating in a research interview can be identified either directly or indirectly.
2. Ensuring the views of individuals are not attributed, unless already recorded in the public domain.

WHAT BREXIT MEANS

> **Brexit means Brexit.**
>
> **Theresa May**

> **Those who think in Britain they can push the Brexit button and not have a bill to pay are seriously mistaken.**
>
> **Charles Michel**

What might a Hard or Soft Brexit mean?

As part of our survey we sought to understand how our business leaders understood the terms 'hard' and 'soft' Brexit.

Although there is no definitive definition, there were only a few of our senior business people who sought to describe degrees of 'hardness' or softness' – most of our respondents simply defined it as being 'in' or 'out' of the Single Market and the Customs Union.

A few responses were irritated by the use of the terminology with one noting curtly that;

"I pay absolutely no attention to this, it is simply media hype and so biased... there is no such thing as a soft Brexit or hard Brexit".

Very few respondents broke down the Single Market into its component four freedoms (people, goods, services and capital).

Even in the definitions given, we noted the sense of concern about the potential loss of free movement of people. The potential limitations on access to skills and labour were mentioned the most frequently. Indeed, some respondents went as far as expressing a fear of a forced repatriation of UK nationals from other EU states.

Consider this response;

"Loss of freedom of movement will impact upon workforce availability and desirability. EU-US Open Skies agreement could impact upon the UK's connectivity within Europe and across transatlantic routes whilst severely impacting aviation-related employment and future investment. An already onerous visa system to live, work and study may be exacerbated thereby reducing the UK's level of attractiveness and reduce competitiveness."

Even those respondents who expressed an understanding of potential future trading arrangements gave limited consideration of the Customs Union and the potentially significant changes in using World Trade Organisation rules.

Some mentioned EU agencies about which they were aware; these included Erasmus +, Horizon 2020, Creative Europe, European Court of Human Rights (ECHR), European Court of Justice (ECJ) and Open Skies.

However, the respondents that included any of these were in the minority.

Some also noted that a softer Brexit could involve some form of EFTA/EEA agreement.

Some differentiated the two options by outlining what they thought it would mean to their own personal future noting the loss of trading relationships as well as a diminution of cultural diversity.

Perhaps the following is the most comprehensive response as it considers both definition and the potential economic and political considerations:

"A "Hard Brexit", in my view, entails leaving the European Union WITHOUT a comprehensive free trade deal (or signed Heads of Agreement thereof) and therefore having to rely on WTO Most Favoured Nation status trading terms with the remaining EU27. I am aware and understand that some commentators take the term

> **It would be very difficult for any UK Government now, or in the near future, to accept a framework which is underpinned by the principle of free movement of people.**

"Hard Brexit" to mean leaving the Single Market and/or Customs Union but my view is that staying in these arrangements was never politically feasible as an alternative to EU membership in the longer term. Norway is often cited as an example to follow by some but the EEA form of Single Market membership which it has was originally intended as a means to facilitate full EU membership as a 'next step' (which was subsequently rejected in a referendum) – the opposite direction in which the UK is travelling.

Furthermore, observing that a desire to see controls on immigration was a key reason for many voters to vote Leave, it would be very difficult for any UK Government now, or in the near future, to accept a framework which is underpinned by the principle of Free Movement of People. The Customs Union, meanwhile, only allows new trade arrangements with third party countries to be negotiated by the European Commission and so would prohibit the UK negotiating its own international trade deals which would, again, go against the basic principles behind the relinquishing of EU membership (in this case, to trade independently of the EU). So in my view, now that we have, by majority, made the decision to leave, staying in the Single Market and/or Customs Union is not a credible, long term position on the 'spectrum' of "Hard Brexit" versus "Soft Brexit". These terms, in my view, should instead reflect divergences in degrees of 'closeness' to/convergence with/ harmonisation with the EU in terms of institutions, laws, regulations and practices, and the existence of agreement, or not, of meaningful treaties and trade arrangements between the two respective jurisdictions following the UK's exit. In my view, not only would a "Hard Brexit" involve exiting without a free trade deal, it would inevitably mean a clear divergence with EU *institutions, laws and regulations from the beginning".*

This response encapsulates the complexity in what initially appears to be a simple question.

Our survey also brought out general concerns that the smaller business voices may find themselves drowned out by the larger voices, and particularly in the charity sector.

Note this response from a small charity:

"I am concerned that it may not allow time for full discussion of the implications. I work with groups that lack power and voice but have found collective strength through collaborating across the globe."

There were a few mentions of a hard border between Northern Ireland and the Republic of Ireland but with no further definition and it should be noted that the questionnaire was completed before the December 2017 agreement with the European Union which included much more reporting around the complexities associated with the Irish border.

Finally, some business leaders sought to express their frustration at Brexit occurring at all even as they sought to define a 'hard' then a 'soft' Brexit. These two replies from the same respondent:

"A 'hard Brexit' – chaos, confusion, isolation, economic downturn, restricted mobility within the EU, loss of ESF funding, catastrophic impact on the marginalised and deprived students we support, retrenchment to Little Britain in the shade (rather than in the sun), distracting political tensions, narrowing of educational opportunity, hardening of extreme attitudes, descent over the proverbial cliff edge to global irrelevance and diminished prosperity."

"A 'soft Brexit' – business as usual, business continuity, relief, maintenance of the status quo, "much ado about nothing", continued prosperity, global relevance, opportunity, "bullet dodged", certainty – fudge".

We also sought to explore the sentiment and depth of concern in our survey.

Depth of Concern

We invited our respondents to rate their concern about Brexit on a scale from 0, indicating no concern, to 100 of extreme concern.

The mean score across all respondents was 68 indicating significant concern.

However, it is instructive to consider the breakdown of responses. While only 10 percent gave a response in the bottom quartile of less than 25, some 54 percent gave a top quartile response of 75 or more.

However, the depth of concern is not significantly associated with either the extent of planning businesses are undertaking, nor the likelihood of having consulted external authorities on Brexit. We can only speculate at present why this is, although some interviews suggest that those who have already undertaken the most detailed planning become no less concerned as a result of it.

> **It seems that while concern about Brexit is high, this concern has not, as yet, fuelled action by way of risk mitigation or planning.**

One CEO of a large business who, having described their very active preparations for the relocation of entire functions noted;

"The bit that may seem counter intuitive is that the concern is high, as we still don't know what sort of deal we are going to have, or what the situation is regarding migration..."

Despite this company's detailed planning, the complexity of the overall situation did not allow for comfort to be drawn from their planning efforts to date. It should be noted that this same company was one of the few that had also consulted extensively with external authorities.

In summary, it seems that while concern about Brexit is high, this concern has not, as yet, fuelled action by way of risk mitigation or planning.

Extent of consultation

Exploring the data further we hypothesised that those who had not consulted may be less concerned about Brexit. However, the results were not as clearly divided as we had expected. Of the 41 percent of respondents who had not consulted at all, the mean score for concern was 63, lower by only 5 points than the 68 overall. Indeed, 45 percent of those who had not consulted at all gave a concerned score in the top quartile (75-100). Therefore, at the time of our study there were significant numbers of business leaders who, while expressing real concern about Brexit had not as yet sought to consult with external bodies or advisers of any type.

Similarly, we hypothesised that those who gave themselves a low score of less than 50 out of 100 for planning would be less concerned about Brexit. However, the results were not significantly divided at all. Of the 46 percent of respondents who gave themselves a low planning score, the mean score for concern was 65, which is not significantly different from the rating of 68 overall.

> A plan is not putting you in a box and forcing you to stay there. A plan is a guide to keep you on course, efficient and safe.
>
> **Amber Hurdle**

> The greatest danger in times of turbulence is not the turbulence – it is to act with yesterday's logic.
>
> **Peter Drucker**

Business exists in a world of permanent change. Brexit poses significant challenges for business and the prospect of significant change in access to labour, funding, markets, regulation and so forth. But our contention is that not facing up to and planning for prospective change, living with yesterday's logic, is a dangerous game to play. We therefore sought to address planning and preparation for Brexit as a key feature of our investigations.

Extent of Planning

We asked our respondents *'Where 0 represents not at all preparing, and 100 fully preparing, where do you rate your business at present in terms of preparing for Brexit?'*

We then asked how each business was undertaking the task of preparing for Brexit.

The mean score in terms of how business rated their own level of preparation was 43 and suggests that our senior business leaders recognised there is much for them to do. Those sectors that have been undertaking the most significant work and preparation are Further & Higher Education and Financial & Business Services.

These sectors are also the most concerned about Brexit, which suggests that, having undertaken more preparation than any other sector they are more, rather than less worried about future prospects.

The Financial & Business Services sector included some of our largest businesses (categorised as those with greater than 1000 employees). At this scale, it is more likely they have entire departments or key resources dedicated to managing the implications of Brexit and one of our respondents simply noted;

"(A) variety of scenarios considered and planned for, including moving functions and staff abroad."

Free movement implications

There is an overwhelming desire to maintain free movement of people, and therefore access to labour was frequently mentioned as a key feature of current planning. However, there was one respondent who noted an opportunity in restricting access:

"Assessing impact on labour market to identify areas of opportunity for providing services hit by a loss of skilled labour".

But this was the only respondent able to outline any likely benefits from ending free movement. Those that were planning saw the challenge of ensuring an appropriate supply of skilled labour into the future as a major problem.

Investment

We found evidence from quite a number of our contributors that they were either pausing or slowing down investment such as;

"Preparations are difficult since no one knows the UK position as yet. However, it is prudent to assume the worst case – either Hard Brexit or No Deal. Therefore we will make few investments or commitments until the situation is clear".

> **We're advisers. We're telling people what they need to be concerned about but we're as much in the dark as anyone else.**

This sentiment has been replicated across most sectors.

Key planning tasks

It is perhaps ironic that the comments provided by smaller businesses often included more lists and detail than that from the larger businesses. Smaller business listed a large range of individual tasks including targeting post-Brexit growth sectors, looking for new EU territories, recruiting fewer EU staff, diversifying, investing in UK based staff, looking for alternative (non-EU) sources of funds, looking to relocate outside the UK and finally limiting financial commitments until they felt they had more clarity.

Some larger businesses made simple comments such as 'moving functions' but without detailing further the considerable effort and cost required, the human resource considerations or the potential impact on business morale and the wider community.

As an example of how detailed some businesses are in preparing for Brexit, one business in the size range 250-299 noted the areas they were evaluating included anticipating new training for staff for customs duties, and VAT and tax implications.

This same business commented sagely,

"We're advisers. We're telling people what they need to be concerned about but we're as much in the dark as anyone else. We've no idea where we're headed but we're fairly sure we wouldn't start from here. "

The Higher & Further Education sectors suggested very specific actions have been taken. The following comments illustrate this but also highlight their attempts to address the two key areas that we found were of concern: notably access to labour and the potential withdrawal of EU funding.

Here is an example:

"Our main concerns lie with the recruitment and retention of European staff, EU students and access to EU funding to support our academic provision and we are looking at the issue from a risk perspective and seeking advice (mostly legal advice) on what we can do to mitigate these risks.... we are also working with UHI and sector agencies who represent the sector's interests with government."

And this:

"We are projecting potential financial impacts and diversifying our income; we are looking at ways of mitigating the risks from the impact of a new post-Brexit immigration regime and its impact on our employees; we are discussing with Scottish Government the potential impact of EU students being excluded from SG funded places in Higher Education."

But these detailed preparations are unfortunately not typical of Scottish business.

Given the low mean score on preparation generally, there were a significant number of comments outlining exactly why business leaders felt it was difficult to prepare. Even those who presented as being in favour of Brexit were not preparing and are waiting to find out what the future operating environment will hold. Note this comment;

"It is difficult to properly plan as, although I welcome the decision to exit the EU, what are the UK Government going to do regarding fisheries? Worrying signs they promised full domestic control of fisheries, but may be willing to compromise on their promise during negotiations."

We have highlighted elsewhere in this report how high the demand is for both the UK Government and the Scottish Government to provide more information, so this cry will resonate with many;

"How can anyone prepare when no one knows what is happening?"

So what then can business do to plan in the face of such uncertainty? There are a number of simple and immediate steps that can be taken, regardless of size of business, product or sector type or whether it imports or exports.

In the area of finance it seems sensible to stress test the business.

Is there any flexibility to build cash reserves?

Can any finance be paid down?

How much flexibility is there in any existing debt obligations?

Could invoice financing be used?

What impact could an increase in interest rates have on the bottom line?

There are too some immediate steps in regard to labour in the business.

What percentage of them are EU nationals?

How many of them have partners who are EU nationals?

Can these staff be assisted in obtaining 'leave to remain'?

For those with a more complex supply chain there should be an audit.

> **Even those who presented as being in favour of Brexit were not preparing and are waiting to find out what the future operating environment will hold.**

Can businesses find better profit margins within the chain?

Are they taking full advantage of any reliefs?

These are just a few examples and there are many considerations that are sector specific.

The above questions are intended to highlight why we respectfully disagree with business leaders who do not consider any form of planning is possible.

Support for Preparations

We were interested in the extent to which there are specific government policies in place to support businesses in their planning for Brexit. The best example came from Intertrade in Northern Ireland which focuses on cross border issues.

A voucher worth €2000/£2000 is being offered to small businesses in Ireland (jointly funded by the Republic of Ireland and Northern Ireland administrations) to spend on preparations for Brexit.

We spoke with the scheme administrators to obtain more detail. They concur with our findings that many small businesses cite a lack of clarity as an impediment and as a result remain underprepared.

Because of this, the governments have set up a proactive scheme that offers support to small business from specialist firms with relevant expertise such as in customs, tax or tariffs. They work with the SME to evaluate the company supply chain and produce a report with recommendations. It's believed the report adds value regardless of the future outcome of Brexit.

This is of course just a start in the process, but a valuable one to get business owners thinking about their potential exposure. The view of Intertrade is that;

"being pro-active in preparation is the best way to combat uncertainty."

We quite agree.

PRIORITIES IN A WORLD OF UNCERTAINTY AND COMPLEXITY

> **For all of its uncertainty, we cannot flee from the future.**
> **Barbara Jordan**

"Too large a proportion of recent "mathematical" economics are mere concoctions, as imprecise as the initial assumptions they rest on, which allow the author to lose sight of the complexities and interdependencies of the real world in a maze of pretentious and unhelpful symbols."
John Maynard Keynes

Much of the commentary about business has emphasised uncertainty as the major cause of concern. We partly agree. But as our interim report argued, we consider complexity to be almost as significant as uncertainty in driving concerns about Brexit.

On complexity

The complexities surrounding Brexit, led us in our interim report to characterise matters as living on "The Edge of Chaos" as some complexity theorists[8] might put it. The edge of chaos is meant to describe a place where order and disorder coexist.

To give a little more context, a system[9] is considered complex when it is composed of many parts that interconnect in intricate ways[10] such that their relationships are imperfectly known. In terms of change[11] it can create dramatically different effects in the short-run compared to the long-run.

Thus, for example, some of our more optimistic respondents see significant short run problems with Brexit but (assuming significant innovation and adaptability) are more confident about the ability to prosper in the long run.

It is because of complexity, in addition to uncertainty, that we are very cautious about reading too much into the many forecasts being made by some think tanks and economic bodies: in our view it is not possible to adequately model in an exact enough manner the combination of uncertainty and complexity inherent in Brexit hence our choice of quote at the opening to this chapter from John Maynard Keynes.

It is clear that from a very practical business leadership context, some of our respondents see the ability to prosper in a context of both uncertainty and complexity by recognising the importance of innovation and novelty in driving purposeful change.

A practical case of complexity

We repeat here a practical example of complexity taken from our interim report. On the issue of customs control, our respondent wrote:

"It is not yet settled on what basis the UK will be trading with the EU after March 2019. The possibilities range from "business as usual", which is unlikely, to WTO terms, which by definition, impose requirements for customs controls. The more the UK diverges from EU standards to WTO and stand-alone, the more customs controls there are likely to be...

In any event, HMRC and Borderforce who are the agency carrying out its physical checks are in the frontline of Brexit with responsibility for security and the revenue capture from levies on imported goods under current and future regimes.

As far as possible HMRC target inspection remote from ports to minimise disruption and rely on declarations from shippers and forwarding agents to direct their activities. HMRC has estimated that this will increase from the current 55million entries (each entry takes around 50 pieces of information) to 255 million entries, which will require up to an additional 5000 staff to handle the administration...

(Furthermore) HMRC is only one of 26 agencies which can intervene in an international transaction with bodies such as Home office (Immigration), Environment Agency (Toxic Waste), Port Health (Contaminated Food) and local authorities all accounting for up to 75% of the inspections which occur at the ports. Each of these agencies will have to scale up activities to ensure "control of our borders" to varying degrees depending on the reliance of each on the current controls in place within Europe."

We believe this potent mix of considerable uncertainty combined with great complexity has been poorly represented to date in the political debate surrounding Brexit.

Priorities

In the midst of this challenging and ever-changing context, we were keen to get a clearer picture of the detailed priorities and concerns of business leaders.

Reviewing a range of business publications we identified some issues that regularly occurred in discussions.

We then summarised these in eight statements as follows:

1. Access to European Funding
2. Access to labour and related labour force issues
3. Market confidence
4. Possible reliance on WTO rules
5. Product standards
6. Regulatory issues
7. Sterling exchange rates
8. Tariffs and quotas

We asked our respondents to do two things. Firstly, to rank order them in terms of priority issues for their business which may be affected by Brexit. Secondly, to explain the reasoning that lay behind their rank order.

The following table lists the rank order of issues across all respondents.

Access to Labour

Not only was access to labour and related labour force issues the number one ranked priority overall, it was very clearly so.

The comments that related to this issue predominantly expressed a concern about the ability to attract workers from EU states. Put another way, the great majority of leaders were concerned about the possible impact of the ending of free movement of labour. As a leading figure in one business organisation put it,

"Across Scotland the largest concern will be labour as companies already struggle to recruit in all sectors and at all levels."

Table 1: Rank order of Priorities (all)

Rank	Issue
1	Access to labour and related labour force issues
2	Market confidence
3	Regulatory issues
4	Access to European Funding
5	Sterling exchange rates
6	Tariffs and quotas
7	Product standards
8	Possible reliance on WTO rules

> **Across Scotland the largest concern will be labour as companies already struggle to recruit in all sectors and at all levels.**

Market confidence

In terms of Market Confidence, its importance was well summarised in the comments;

"Confidence is the single biggest issue. Our business is perceived to be a discretionary spend and so any excuse to delay a decision gives prospective clients and indeed, some existing clients, a reason to not spend with us."

And

"I feel we have not yet seen the shift downward of market confidence. The European & World financial base of London will become seriously down rated as major players relocate..."

Regulatory issues

In terms of regulatory issues, many sectors are potentially affected, and although those that favour Brexit have often claimed a benefit of leaving the EU will be a reduction in "Brussels red tape", others express concern about the future of regulation in very different terms.

The following are quotes from leaders in two very different sectors and differing size of business with very different opinions on regulation; although both see regulation as important. First, from someone highly critical of EU regulation;

"In the construction industry the EU Regulations on tendering are designed for the top end companies not the small builders. The process of PQQ is designed to block the small companies under the EU Ruling. As a country we are inflicting (damage on) the working man's ability to run and manage their businesses"

Next, from someone concerned about exiting EU regulatory frameworks;

"The aviation sector is heavily regulated from UK and Europe; it also relies on bilateral agreements in order to provide free movement of aircraft. Any delay in agreeing regulations or trade agreements could mean that airlines cannot/ do not fly between the UK and Europe. Airlines such as Ryanair have already indicated this is a possibility."

Sector views

These general views relating to priorities overall do, however, mask some variations across sectors.

Focusing on sectors, we can see this effectively displayed in the following table that outlines the top two priority areas from respondents across eight individual sectors, and a ninth "All other sectors" combined.

We advise the reader that as the number of respondents by sector are comparatively small, this table should be read with due caution. That said, there are a small number of areas that predominate as major priorities.

Table 2. Top two concerns from sector leaders.

Sector	Top 2 priority areas
Creative Industries (including digital)	**1.** Access to Labour **2.** Tariffs and quotas
Energy (including renewables)	**1.** Market confidence **2.** Access to Labour
Financial and Business Services	**1.** Market confidence **2.** Access to Labour
Food & Drink (with agriculture and fisheries)	**1.** Tariffs and quotas **2.** Access to Labour
Further and Higher Education	**1.** Access to EU funding **2.** Access to Labour
Life Sciences	**1.** Access to Labour **2.** Regulatory issues
Manufacturing	**1.** Sterling exchange rate **2.** Access to Labour AND Tariffs and quotas
Tourism	**1.** Access to Labour **2.** Market confidence
All other sectors	**1.** Access to Labour **2.** Regulatory issues

As is clear from the above, analysing by sector confirms that concern about access to labour from both beyond the UK and particularly within Europe is noted by all sectors as a key priority. Any restriction on this ability to access labour will be a major concern.

We note too, that even amongst those who support Brexit, there is little enthusiasm for restricting freedom of movement. As one pro-Brexit business leader put it;

"I voted to leave the European Union because I felt that if we did not take a stand, then we would be complicit in what the European regulatory union of unelected officials is becoming. I did not vote this way to reduce migration nor to turn our backs on Europe." (emphasis is ours).

Sectors have different needs and motives regarding access to labour. This ranges from a concern to be able to attract seasonal workers for the soft fruit sector, to attracting the most eminent academics to our universities.

The reliance on attracting professional nurses and doctors to the health sector is dealt with in other studies and reports, but we find such reliance is mirrored in this study in other highly knowledge intensive sectors too, such as life sciences.

It is very clear from our study that business leaders have a strong interest in ensuring that a negative immigration debate does not compromise the ability of business to recruit workers from beyond our shores. Indeed, one of our interviewees argued that since the devolution of income tax powers now meant that all tax payers in Scotland had a unique tax reference; it would make it a much more practical proposition for immigration policy to be devolved to Scotland.

Although access to labour is a common priority, there are other priorities that reflect sector differences.

Further and Higher Education

For example, the Further and Higher Education sector is deeply concerned about the potential loss of both EU funding and the ability to be part of transnational research and education programmes. We have received many examples of this from respondents. The college sector in particular is very vulnerable to loss in funding as the following concerns from a Principal make clear;

"13% of our funding comes through ESF. ERDF has made a significant difference to the College Estate. We employ a significant number of EU nationals. Erasmus + gives an enhanced experience to students and staff. We have a large number of EU students undertaking ESOL courses.

No longer being "European" will create a different atmosphere within the organisation. Many of our partners receive a significant amount of funding through the EU and as their businesses are adversely affected they will be unable to commission work through the College."

More strategically the college sector sees a range of vulnerabilities;

"Access to European funding is essential to supporting Scottish colleges punching above their weight, globally. The sector is respected by European partners and others who are further afield. EU funding programmes have and continue to support many domestic activities and, have frequently substituted for (removal of) UK Government funding that took place in earlier periods...

It is crucial to transnational activities and these have been enhanced by the increasing presence of a global strand to such funding. The sector's outputs and workforce benefits enormously from access to skills and expertise in other countries (this is something which benefits our international partners, too). Sterling exchange rate issues (the value of the pound) have a significant influence on the sector's capacity to operate and recruit internationally. There are a host of European transparency tools regarding academic qualifications which provide confidence and trust in the value of Scottish qualifications and these are susceptible to issues governing standards and regulations. There is anecdotal evidence of declining market confidence as some international partners have expressed some concern about maintaining ongoing relations with us."

Scotland's Universities are no less concerned, with even more vulnerability to potential restrictions on free movement of labour, and with additional concerns relating to research activities. One leading figure in the sector points to the need to maintain engagement in institutions and programmes on a wide range of fronts;

"It will be important in a post-Brexit scenario that Scotland maintains its membership of the European Higher Education Area and continues to contribute to and benefit from relevant European Associations like EURASHE, EUA. Opportunities for inputting to research and publications by Cedefop and Eurydice should be maintained as well as those with OECD, UNESCO, etc."

As one university Principal further emphasised;

"Higher Education is not subject to trade regulation. Our main issues will relate to immigration regimes and/or UK participation in EU funding for research and education and other educational programmes... Participation as an associate member of future EU research and innovation framework is important for UK universities. Above all, our economic interests, our competitiveness and cultural richness will depend on having free movement of labour and to study between the UK and the EU."

It is all a bit of a mess... there will be no deal as good as the UK has and it looks like trade barriers will rise with 27 countries.

Tariffs and Quotas

The issue of tariffs and quotas are of particular concern to Food and Drink (including agriculture and fisheries), the creative sector and manufacturing.

In the food sector, there is a deep concern about the potential impact of tariffs and quotas...

"Tariffs, quotas and regulatory issues are likely to have the greatest direct impact on our business...."

"Tariffs & Quotas will dictate lamb profit margins..."

"Major issue for us is what is going to replace EU quota regime. UK Government worryingly quiet at present..."

"It is all a bit of a mess... there will be no deal as good as the UK has and it looks like trade barriers will rise with 27 countries... I still can't get my head around leaving the calm and solidarity of the 27 neighbouring EU States... despite the EU's shortcomings."

As is well known however, many in the fisheries sector have been extremely critical of the Common Fisheries Policy and strongly believe in the need for a new approach to fisheries management including the much criticised EU quota regime.

Yet within the fisheries sector there are different perspectives. The catching sector is much more likely to have supported Brexit given the way access to fishing rights are managed under the CFP. However, the processing sector is, in contrast, deeply concerned because of its dependence upon recruiting labour from other EU countries and beyond.

In some jurisdictions, such as Shetland, areas of the processing sector depend upon recruiting more than 50 percent of their workers from beyond the shores of the UK.

Creative Sector

A number of leaders in the creative sector rated tariffs and quotas highly, but comments suggest they saw this as a surrogate for more general concerns about international trading, rather than having strong specific issues equivalent to the detailed concerns of the fishing and agriculture communities.

One leader of a major international player put it thus;

"The bottom line is that (our) continued investment in the UK and in Scotland depends entirely on how attractive a place it is to do business in a global and European context... (We) rely on a buoyant, creative SME community as that is an important source of innovation and supply to our business."

The manufacturing sector has concerns too regarding future trading and hence regards both tariffs and quotas and Sterling exchange rates as being very important. As one interviewee put it;

"It seems likely that we will face increased tariffs that will hamper our competitiveness in international trade... which is one of the reasons we are reviewing whether to establish some of our operations in the EU."

She went on to add;

"People don't seem to understand how difficult and complicated negotiating tariffs and quotas can be across such a wide sweep of product areas."

Manufacturing Reflections

One leading figure in the manufacturing sector who is in favour of leaving the European Union, was much more philosophical about the uncertainties and complexities that we face;

"There are no guarantees. Most businesses don't outlive their first product. You must prepare for the worst. The good times take care of themselves..."

"You have to try to be fit and adaptable and be responsive. That's all you can do..."

"There are a lot of unknown unknowns. You have got to look at things more philosophically. There is no necessary symmetry in life. That's something I have learned in business".

Reflections on Priorities

We have not discussed in detail all of the priorities and sectors identified.

We have chosen instead to highlight some examples and opinions demonstrating the complexities that can lie behind apparently straightforward matters.

In conclusion we would add that merely repeating the shibboleths of both leavers and remainers will get us nowhere. Barbara Jordan was right when she said *"We cannot flee from the future"* – we must identify our priorities and do all we can to secure them.

> The recession reminded people, maybe for the first time in their lives or careers what happens when capital markets are frozen. Even though you have a strong balance sheet, you can't refinance your debt. That's a very uncomfortable situation to be in, for an individual, a business, a country or a municipality. The risk averse way is to have no debt, but that's not the way to run a company.
>
> **Bob McDonald**

> All people interested in their work are liable to overrate their vocation. There may be makers of dolls' eyes who wonder how society would go on without them.
>
> **Harriet Martineau**

On banks

A key consideration regarding the economic impact of Brexit has centred around banks. We too shall consider aspects of banking, but not for its own sake, rather for the sake of the economy as a whole.

This is no mere pedantry. We have been increasingly concerned that much of the discussion around banks has been what are they doing for themselves: How they are preparing themselves as a business for Brexit. It is this concern for themselves that attracted us to the quote from Harriet Martineau above. We need to keep in sight the bigger picture.

Banks as businesses

Our research confirms that it is the banking sector that has been undertaking the most detailed examination on the implications of the uncertainties and complexities of exiting the EU.

As a key part of the economy, it should be viewed positively that banks are actively planning for a disorderly Brexit. That does not in any way suggest they assume a chaotic Brexit will definitely occur, rather that it makes sense to plan for a worst case landing.

Even without a worst case, it is still possible there could be further increases in interest rates, a significant fall in asset prices and a general lack of confidence due to uncertainty.

Reports continue to make forecasts, often very variable, about the extent of job losses in the banking and financial sector with March 2018 being cited as the 'drop-dead' date by which time banks must start to enact their contingency plans. It is anticipated there will be a movement of some finance jobs to the continent. If a *'hard Brexit'* comes about, entire functions may be moved out of the UK.

Stress tests

The Bank of England continues to encourage banks to undertake planning for a *'no deal'*[12].
Encouragingly, for the first time since the global financial crisis of 2008 no bank needs to strengthen its capital position as a result of the recent stress tests.

The recent tests were stringent with scenario planning allowing for a 33 percent reduction in the value of house prices, further interest rate rises (up to 4 percent), a drop of up to 4.7 percent of (UK) output all occurring within two years, and a continued fall in the value of sterling. The tests are described as being *"more severe than the global financial crisis"*[13].

Transition issue

Many in the sector, although wanting to see a long transition period, also understand there are significant issues surrounding it. Representatives from one major bank confirmed to us that any transition deal must be legally watertight otherwise they will continue to plan for a "chaotic Brexit".

Enough?

All well and good it seems. Or is it? Missing from all of this planning and stress testing is clarity regarding the range of possible effects on the business customers of the banks. In what way, for example, will the banks various product offerings be altered for their business customers in the scenarios the banks are working on? On this there is silence from most. Indeed when we sent a major bank, at its request, advance notice of the questions we wished to ask regarding its plans for business customers, it changed from wanting to participate in our study, to declining to do so. Fortunately, others have participated.

A key question for us has been to what extent might the banks find themselves in conflict by having to satisfy the requirements of the Bank of England; as well as the needs of their SME customers? Do we face the possibility that some loans could be withdrawn altogether as the banks consider the risk as being too high to their own balance sheets?

One can argue that the increased capital adequacy requirements are now much more stringent than pre the 2008 crisis and that will be effective mitigation against some risks to banks.

However, although protecting banks as businesses in themselves is very valuable, it is not enough. They also need to effectively service the needs of the wider economy and most obviously their business customers.

There is clearly a tension between the various demands that must be met: from the banks to their regulator(s) and from the banks to their customers.

We heard repeatedly from our senior banking contributors about the nature and type of decisions that banks must make.Here from one Board member of a bank;

“Uncertainty is king. As the day gets closer you will see credit commission papers that will have a mandatory ‘Brexit impact’ on that business... it will say the likely impact of Brexit on this customer could be... and the landing will be based on the worst case scenario”.

We recognise that the functioning of an effective banking and financial system is critical for all sectors of the economy. In our interim report we highlighted four areas, namely: lack of engagement with business, preparing for possible relocations, transition requirements and threats to lending. To this we add a fifth, and possibly the most important: The culture of banking.

Banking culture

The risks of future difficulties for business become even more serious when we consider how much still remains to be done after the crisis of 2008. After this a number of banking scandals emerged: from Interest Rate Hedging Products (IRHP), to that at HBOS Reading, to the most recent of RBS Global Restructuring Group (GRG).

On January 18 this year, the RBS GRG issue was debated in Westminster. The debate revealed examples of SMEs undergoing extreme bank induced distress. This included being forced into a default position with a resultant huge impact on employees, families, lives and the wider community.

The debate sought to encourage regulators, parliament and government to undertake an independent inquiry and address the prospect of establishing an independent tribunal system.

However, it is not clear that this will be bold enough to address the systemic issues in our banking system.

At the time of writing, it is anticipated that the unredacted S166 report into RBS will be released into the public domain and will likely trigger a fresh wave of legal cases.

As it stands there is a built-in imbalance of power between SMEs and large banks leaving the small business owner required to take on a mighty bank if a legal dispute arises.

Whilst an effective tribunal system to deal more effectively with SMEs is worthwhile, perhaps a duty of care should be enshrined in banking practice? Maybe even stronger action should be considered such as imposing unlimited liability on directors such as that uniquely practiced by C Hoare & Co?

To us, recent history suggests there needs to be much clearer safeguards for businesses in their dealings with banks. Banks have been unable or unwilling to make adequate reforms and it must be time for government action.

Lack of engagement

We asked our business respondents to indicate with whom they had consulted as part of preparations for Brexit. With the addition of further respondents in this our final report, the mean engagement with banks across all sectors is a mere 10 percent of respondents.

This compares with engagement levels of 32 percent with business groups such as the Confederation of British Industry, Federation of Small Business and Institute of Directors, and the same engagement levels of with Government Agencies. Academics were more consulted at 24 percent.

During our detailed interviews we explored the reasons for this. A lack of trust, a key component of organisational culture, was confirmed repeatedly during our detailed interviews. One senior business leader wryly noted that a business was hardly likely to raise concerns with its bank given their actions after the global financial crisis of 2008. As he put it;

"Given the lower level of trust in the SME community of banks, why would they go to them to offer a concern?"

But the situation is even more severe for other businesses. Some have wanted to discuss concerns but have come up against a brick wall because of changing bank practices. As one respondent explained,

"We cannot even get an appointment with a business manager to discuss our business needs… let alone planning for the

> **The banks are failing small businesses and there is a divide opening up (regarding) who has access to information and support.**

future... Their emails frequently don't work so there is no way to communicate unless you make an official complaint... I'd move banks but they are all the same... I'm only able to have this personal account because I earn more than £100k and my mortgage is more than £300k. The banks are failing small businesses and there is a divide opening up (regarding) who has access to information and support. It's very very wrong."

That said, we also heard from some in the banking sector that some engagement has taken place with business;

"They definitely are – Scotland is actually better than anyone else at doing it. I know for example that <name withheld> was doing this back in September. Literally months after the referendum they were taking soundings, they had listening lunches, they're asking people what are you concerned about so they are in listening mode now. I would be encouraging them to stay engaged".

This was countered by another large bank that indicated they were being contacted only by large corporates and that;

"Business is generally expressing little interest or concern".

Despite the latter limited positive claims, as cited earlier, one of Scotland's largest two banking groups declined to engage with us at all when we approached them to speak about how they were preparing their business customers.

This weakness in engaging with the SME sector, and the lack of a duty of care to business customers seems to reflect negative aspects of current banking culture – which have fundamentally resulted in a lack of trust.

Preparations for relocation

Returning to seeing banks as a business, there has been much speculation in the financial press about the possible relocation of banking and related services post Brexit. This is an area where considerable scenario planning has been taking place. In a report in The Herald of 17 October 2017, it was pointed out that;

"Royal Bank of Scotland for example, has already said it will transfer hundreds of jobs to Amsterdam. In England, insurance giant Lloyd's of London has said it will move its EU base to Dublin."

In the same report, Professor Sir Anton Muscatelli, who advises the Scottish Government on Brexit matters, was quoted as saying,

"British business is quietly, but much more firmly than before, explaining to the UK Government that time is running out."

"For them the cliff-edge is not March 2019, but early 2018 when contingency plans have to be executed.

"Most financial services companies have made these contingency plans, and many tell me that they are stepping these plans up from 'Brexit-min', where they were moving some minimal operations to take advantage of being inside the single market in the case of a 'cliff-edge', to 'Brexit-max', i.e. plans to scale up operations significantly in Frankfurt, Dublin and elsewhere.

"Once gone, these jobs will not come back if, following a cliff-edge Brexit, we seek ex post facto to recover the situation.[14]*"*

Our respondents from the financial world suggest Professor Muscatelli is correct, but it is not nearly as clear-cut in other sectors. We have also found a growing emphasis on finding ways of working with EU partners. For example, one of our respondents explained the preparations of his organisation in the following terms:

"We have performed scenario analyses on the spectrum from hard to soft. We have identified European business partners with whom we are seeking to contract relatively urgently and certainly intend to be live next year. We have "over"-invested executive time and presence in Europe to reassure colleagues that we remain a reliable business partner with a continental and outgoing perspective and a long-term approach to delivering our strategy. We have also taken advice on the regulatory outlook e.g. MiFID2 and Capital Markets Directive".

The trigger points for the wholesale lift and shift of functions are anticipated to be no later than the end of Q1 2018.

We explored this further with Scottish banks and noted that there are confirmed plans for the move of functions.

The issues about passporting which enables services to continue to be sold within the EU is believed to be of less concern for Scottish business given their lower exposure when compared to City-based institutions. This was confirmed by one contributor;

"We are not involved in casino banking so we have no investment banks in Scotland – people like UBS or Goldman Sachs or anybody like that. So our banks are involved in SME lending, corporate, mid-corporate, and large-scale institutional lending – the Royal Bank of Scotland, by way of example".

> **British business is quietly, but much more firmly than before, explaining to the UK Government that time is running out.**

Despite this confidence we were informed of confirmed plans for some functions to be moved elsewhere.

What is also not clear is if or how any domino-effect could materialise. This could manifest itself where economies of scale can be obtained by co-locating other functions elsewhere – something we have seen before in Scotland as functions moved from Edinburgh to London. Only time will tell.

Transition requirements

Our research included attending the Treasury Select Committee on 17 October 2017 at the House of Commons, and listening to the evidence of Dr. Mark Carney, Governor of the Bank of England. Although inevitably careful in his choice of words, he emphasised the importance of securing effective transitional arrangements for the financial sector. Under questioning, his words suggested he foresees a need for transitional arrangement longer than the maximum 2 years that was being proposed by the UK Government cabinet at that time. He noted this was related to the issue of complexity. He put it thus:

"There is a very limited amount of time... between now and the end of March 2019 to transition large, complex financial institutions and activities...If one thinks about the implementation of Basel III, it was agreed back in 2011 and will be implemented fully in 2019.[15]

The possibility of a "cliff edge" Brexit with no transitional arrangements was something he argued should not take place,

"There is a question of what the ultimate arrangement is... I will quote the President of the European Council: a disorderly Brexit is in no one's interests."

From analysis of our detailed responses across all size and sector of business our respondents were adamant that a transition deal must be sought with this being the highest priority at 78 percent of sectors. It was even higher for Financial & Business services with over 90 percent of this sector rating it a priority.

It's also worth re-iterating that banks will not be confident of an agreed transition period unless they perceive it as legally watertight.

Threats to lending

For the SMEs who currently represent around 99 percent of Scottish businesses the concerns are varied.

For a period of time after the financial crash of 2008 there was a well-defined gap in lending to SMEs and it took a range of steps to address for some years afterwards. Even as recently as October 2016 there was an enquiry by the Business, Innovation & Skills Select Committee at Westminster into access to finance for SMEs[16].

One of the threats to lending to businesses has been identified as the issues surrounding those financial institutions domiciled in Europe who conduct business in the UK. As a report in the Guardian of 3 October 2017 put it;

"The Bank of England has warned that lending to businesses could dry up after Brexit because not enough preparations are being made by companies in the EU to keep operating in the UK after March 2019."[17]

In the Bank of England's Inflation report of February 2018, it explained its view of weak business investment in the following terms:

Box 1: Excerpt from BofE Inflation report[18]

Overall, a range of indicators suggests that Brexit-related uncertainty and expectations around lower future sales are, on balance, weighing on business investment growth. Estimates derived from the Bank's Decision Maker Panel (DMP) Survey suggest nominal investment was around 3%–4% lower over the year to 2017 H1 than it would otherwise have been. In view of the impact of the fall in sterling on the cost of investment goods, the impact on real business investment is likely to have been larger. Given the continuing negotiations over the United Kingdom's future trading relationship with the EU, there are risks in both directions to the path for business investment in coming years. If uncertainty persists, the drag on capital expenditure could intensify as businesses delay plans further. By contrast, those deferred plans may be brought forward if businesses gain clarity about future trading arrangements, pushing up aggregate investment growth.

We note this says nothing regarding any impact of movement in bank lending policies.

There is another issue regarding threats to lending that in our judgment requires further examination.

As we commented on earlier, the scenario planning and research banks and others have undertaken in relation to the effect of Brexit on their customers is unclear.

How will they manage their existing business client base if economic turbulence continues for some time after Brexit?

Are businesses that currently hold loans from banks going to find any new flexibility to support them? If there is to be greater flexibility what might it look like?

What role will government play in supporting lending during a period of turbulence?

The recent history of bank behaviour post 2008 – towards SMEs in particular – has shown the vulnerability SMEs can face due to bank policy changes; the obvious if extreme example being RBS's former GRG operation.

The threat to Scottish business is particularly acute given the lack of competition in the banking sector.

A study by the Boston Consulting Group[19] has suggested that a 'hard Brexit' could lead to greater restrictions on access to wholesale banking services, with SMEs potentially the worst affected.

We examined the Bank of England net lending figures to SMEs from after the Brexit vote to the most recent data available which collates net lending across 30 UK banks (at least 75 percent of the UK lending market).

There has been a clear and demonstrable drop in net lending to SMEs (excluding overdrafts) from Q2 2016 onwards which is evidenced in the table below. It should be noted that in this data the Bank of England definition of an SME is *"those businesses with annual debit account turnover on the main business account less than £25 million"*.

Table 3 Net lending to SME's (excluding overdrafts) – Bank of England[20]

Date	Amount (£m)
Q1 2016	1047
Q2 2016 (*Brexit referendum)	1081
Q3 2016	920
Q4 2016	217
Q1 2017	356
Q2 2017	296
Q3 2017	100
Q4 2017	-73

We then compared this lending to the figures made available by Funding Circle which is the only platform that currently provides unsecured SME loans. The comparison is stark.

Comparing tables 3 and 4 suggests a notable collapse in net lending from banks with a significant pick up in net lending from Funding Circle in 2017. We would need further research to draw firm conclusions as to the cause of these movements, but at face value it tells a disturbing tale of bank net lending.

Table 4 Net lending from Funding Circle

Date	Amount (£m)
Q1 2016	99
Q2 2016	58
Q3 2016	74
Q4 2016	167
Q1 2017	173
Q2 2017	145
Q3 2017	124
Q4 2017	156

Bank Lending trend

However, we caution against seeing such movements as a direct consequence solely of the Brexit vote. We note in particular that Bank of England figures show that between 2011 and 2016, the UK's largest banks' combined 'amounts outstanding' (the amount of money currently lent out to small businesses) reduced by 18%. This is a result of consistently low levels of net lending (total minus repayments) since the financial crisis.

Innovation

Innovation, as we point out elsewhere, is an essential component when dealing with complexity and uncertainty. It is therefore encouraging to note that there are alternatives to traditional lending from banks such as Funding Circle. Encouragingly too, there are other initiatives with a specific Scottish focus such as the very recently established Full Circle Partners, the brainchild of Mike Welch, which is specifically aimed at filling the funding gap for Scottish businesses[21]. In addition, we are aware of feasibility studies into the creation of a new type of stock exchange for Scotland. At a time of challenge, it is such innovations that in our judgment hold out positive prospects for the future.

Risk appetite

Another consideration and implication beyond lending is risk appetite and implications for types of business. A recent study by St Andrew University notes that[22];

"Often SMEs are the ones that are taking the risk in innovation, or in developing new technologies – but in times of recession these types of businesses are often turned away by mainstream lenders despite their recognised potential for raising productivity and growing the real economy out of a downturn".

The report further notes,

"The results of our analysis suggest that Brexit-related concerns could result in a range of negative consequences for UK SMEs [small and medium-sized enterprises], especially the impact on reduced capital investment, which critically weakens and undermines their ability to grow and prosper.

"Most worryingly, these perceived negative impacts appear to be foremost in the minds of entrepreneurs and managers located in the types of innovative and export-oriented companies, which are often viewed as the high growth 'superstars' of tomorrow.

"In other words, SMEs thought to

be the most significant for boosting productivity and economic growth may be the most negatively affected by Brexit."

One senior respondent to our study made the additional point that there is a time lag between data being available and action being taken;

"It has to be organised – that's the problem with market forces, there is a flash bang factor... the problem is the lag in the market – the problem around... strategies is about getting ahead of the curve so people can go back into their credit policy units and speak to their risk directors and say 'how do we avoid a situation where we are not being reckless but we don't simply close our appetites down?"

And he notes the complexity around planning;

"It's more complex if you're planning. If you see the right hand side up lending such as crowd funders (funding circles is a big one we have for example here in Edinburgh) i.e. Fintech – so if you have a big bank saying that they have less appetite and then crowd funders can pick up some of that. You may think private equity firms can also take some of it – they could have equity stakes... Also, understanding statistical modelling and then saying that crowdfunding is great but it only picks up 10 percent of the 100 percent gap. So what you plan for has to make up for the 90 percent shortfall."

If banks are stress testing their own businesses: – how then are business customers' stress testing theirs and working out what they should do? If business is often not planning, banks are planning only for themselves and the Bank of England is actively conceding there could be economic pain – what risks lie ahead for business and households? 'Fail to plan – or plan to fail' is the mantra by which all business, regardless of sector or scale must live. For now that could mean stockpiling cash, ensuring credit lines remain secure and so on. Diversification could be considered. Price rises in supply chains could be modelled to assess sustainable levels of profit. There is much that could and should be considered.

This is a time for action particularly for the small, inexperienced or exposed businesses that have the lowest capital reserves. Businesses no less than banks need to be able to cope with a *"disorderly Brexit"*.

The uncertainty and lack of planning in business presents both the UK and the Scottish Government with a major policy challenge. Government, too, must take action to support business. As with business, to do nothing would be to invite failure.

For all of these reasons we note a number of recommendations for both the UK Government and the Scottish Government which are contained in the 'Recommendations' sections.

We agree with the comments from the Chief Secretary to The Treasury (John Glen) who stated in the House of Commons on 18/01/2018:

"Let my final words be these: small businesses and their continued success are critical to the continued growth and improvements in productivity of our economy..."

THEMATIC PRIORITIES: SKILLS AND PEOPLE

> **Our future growth relies on competitiveness and innovation, skills and productivity... and these in turn rely on the education of our people.**
>
> **Julia Gillard**

> **Your workforce is your most valuable asset. The knowledge and skills they have represent the fuel that drives the engine of business - and you can leverage that knowledge.**
>
> **Harvey Mackay**

Given earlier discussions, the reader should be clear that there are considerable general concerns surrounding access to labour and skills. Without the necessary skills, businesses will die. In our judgment, this is one of the most substantial threats to future economic prosperity in Scotland.

Demography and skills

What does a reliance on attracting labour from furth of the UK tell us? Basically, we believe from discussions and our research that there are two overriding factors at play. Firstly, a simple demographic one. Scotland has an ageing population with a diminishing pool of prospective working age labour from amongst its current population. We need to attract the necessary labour to support our economy. Secondly, there is criticism of the rigidity of some aspects of the education and training system, mostly related to vocational skills. These suggest a need for two, very different forms of government intervention.

In terms of demography, our business leaders readily agree that Scotland must retain the ability to access labour from the remaining 27 EU member states. Although most would prefer this was undertaken in a consensual manner led by the UK Government, there is a recognition that Scotland may have to seek its own remedy.

EU Nationals

At the time of writing the UK Government's refusal to guarantee permanent rights to EU nationals who come to live and work here during any transition period, is seen as fundamentally against the interests of Scottish business. Indeed, the Scottish business interest goes far beyond any transition deal: there is a desire born out of need for Scottish business to continue to access skills from outwith the UK for the foreseeable future.

This is the opinion of the vast majority of the 236 Scottish business leaders who have been participating in our research into Brexit and Scottish business.

We have been given numerous examples of differing skill requirements for various sector needs. These examples come from the creative sector, energy, finance, fisheries, food and drink, further and higher education, manufacturing, science based industries, tourism and transport. Access to skills is a major Brexit concern for each and every sector. Indeed, it ranks either as their number one or number two priority as we move towards Brexit.

We cannot stress strongly enough this concern is not a function of whether or not business leaders support or are against leaving the European Union. It is a function of business need. Indeed, some of those business leaders who support leaving the EU are nonetheless concerned that we should not be putting up barriers to accessing labour. We repeat the view of one leader,

"I voted to leave the European Union because I felt that if we did not take a stand, then we would be complicit in what the European regulatory union of unelected

> **It is a serious mistake to think that the types of skills we need to access for Scottish business are confined to a comparatively small range of areas.**

officials is becoming. I did not vote this way to reduce migration nor to turn our backs on Europe."

The need to continue to access skills from outside the UK is mainly a function of demography, but also in some areas because government skills strategy is not functioning as well as it should. There is an urgent need to address national skills strategy in our judgment, but that alone will not be sufficient.

It is a serious mistake to think that the types of skills we need to access for Scottish business are confined to a comparatively small range of areas. Our research confirms it spans everything from attracting leading academics to seasonal fruit pickers, from engineering technicians to fish processors. This says nothing of areas of the public sector we have not encompassed in our study such as the health care sector.

To give further emphasis, here are a small selection of opinions from leaders in different sectors that sometimes do not receive the focus their importance to Scotland deserves.

Tourism:

"I think the assumption that seasonal labour is low-grade is untrue. Look at the quality of those who are coming in to serve the tourism industry here in Scotland. People say they can be replaced from somewhere else – but where is that somewhere else?"

and

"Access to labour is key. Tourism accounts for 9.5% of the Scottish workforce and is even as high as 18.5% in rural areas such as Argyll."

Digital:

"It is important that the Digital industry attracts the best of the best globally. I am very concerned about the impact on our universities, on research funding, on the ability of

some of the best brains in the world being able to remain and work here after concluding their studies for a period of time including EU students."

and

"I am fearful of what Brexit will do to Scotland's academic and business communities, and the impact of reduced migration into Scotland. I also fear that Scotland will suffer culturally from being removed from the EU."

Music:

"I don't think it is generally understood how important EU Nationals are to the actual sound we produce – the benefit is much more than just the cultural mix and applies to many of our musical groups in Scotland and the UK. Take an orchestra for example – many sections can highlight how a particular school of playing from a particular country has influenced their sound – and they can often trace it back to individual teachers. So their contribution has not just made our vocal and orchestral sounds richer and more rounded – it is now a part of our fundamental product that we sell to the world".

Charities

Even some charities that have contributed to our study emphasise the importance of having easy access to EU nationals, not only for the part they play as employees, but as volunteers too. As one charity leader put it in interview

"Almost half our staff are EU Nationals which is very helpful in terms of the language skills they bring."

And a specialist travel agency claimed a concern about 40% of his staff who were EU nationals bringing expertise in different cultures and language.

Scotland still falls short as a multi-lingual society. Indeed one of the criticisms of its education and skills strategy is that it ignores the significance of language. That being the case, there is an increased vulnerability from the loss of multi-lingual groups.

One senior business leader argued that with the advent of Scotland's own tax code for income tax purposes, the mechanism was there to assist in the process of controlling inward migration in such a way as to allow Scotland a continuing "open border" while providing comfort about control to other UK jurisdictions. This is an area we agree is worthy of further investigation.

Vocational skills

In many areas the need to recruit staff from other EU countries is also a function of the lack of suitably qualified staff locally. This includes at higher intermediate skills levels which were at one time a strength of Scotland's economy.

Although Brexit is not a cause of skills weakness, it does bring its importance into sharp relief. If this leads to a much stronger emphasis on skilled development in the future, many business leaders will welcome it.

THEMATIC PRIORITIES: TRADE

> For the only way in which a durable peace can be created is by world-wide restoration of economic activity and international trade.
>
> **James Forrestal**

> you have to understand that comparative advantage is the principle of cooperation, as against competition. The word "advantage" gets us thinking of competition, which is perfectly reasonable – (but) within a… world economy the job is to produce a result in the best way, cooperatively.
>
> **Deirdre McCloskey**

Export import

Not all businesses are involved in direct exporting. This is particularly true of a great many SMEs. Not all businesses are involved in direct importing, and again this is particularly so for SMEs. However, the numbers affected by changes to international trading arrangements will include many businesses whose supply chain includes exporters and importers. As one respondent put it,

"We currently do not trade outside of the UK, however a large proportion of our customers do, therefore this could have a dramatic effect on our business."

Supply chain

This presents a direct issue for many SMEs – to understand their supply chain sufficiently to assess if there is likely to be a significant implication from, for example, the UK leaving the customs union. This is a necessary part of understanding your own business. Indeed, as cited earlier in relation to the initiative to support SMEs in Northern Ireland, the spur of Brexit to look at such matters has wider benefits to business leaders.

Complex trading picture

Sectors vary in their exposure to international trading. For some, like tourism, they benefit in attracting more visitors from overseas as a result of the fall in Sterling, but on the other hand are deeply concerned about the impact of losing free movement of labour, which threatens their ability to employ the people necessary to supply the level of service needed.

The creative sector too has commented on a range of pressures they may face, as in the view of one CEO,

"Increased barriers including quality standards, regulatory issues and exchange rates will all add to the barriers the business will face."

Part of the issue for businesses is that they expect to face not one or two barriers but a complex array of barriers even before the issue of possible tariff barriers to trade is considered.

Tariffs and WTO

Although only a minority of respondents commented on the possibility of exiting the EU and falling back on WTO rules, those that did were wholly negative in their views. Some admitted to not knowing precisely what tariff barriers could be expected, but no additional barriers to trade would be welcomed.

Customs

An added and very unwelcome, burden would be if customs checks were to become more onerous. This is of huge concern in Northern Ireland of course in relation to its border with the Irish Republic, but it is also an issue raised by Scottish businesses. This is an area requiring further research.

"Dear optimist, pessimist, and realist -- while you guys were busy arguing about the glass of wine, I drank it! Sincerely, the opportunist!"

Lori Greiner

"All courses of action are risky, so prudence is not in avoiding danger (it's impossible), but calculating risk and acting decisively."

Nicolo Machiavelli

SWOT and Risk assessment

Many good businesses will take a step back from an impending change to develop a SWOT; an acronym for Strengths, Weaknesses, Opportunities and Threats. The cool business head looks dispassionately at a situation and makes an honest assessment.

Risk (more exactly probability of either a good or bad outcome) is rarely always all downside and opportunity rarely only has an upside.

This short section highlights our findings of where our contributors see opportunities and where they see threats. Our own view is not represented.

It should also be borne in mind that where some see risk, others see opportunity and that this is a function of attitude to risk, which can be affected by many factors.

Opportunities

As part of our detailed interviews, we worked hard to engage with contributors who regarded themselves as strong leavers due to the perception that business was more inclined towards being in favour of remaining in the EU.

Despite this, we have found it hard to obtain any detailed definition of what specific opportunities those who voted to leave saw for their business.

They often spoke in general terms but when questioned some even went as far as to concede that Brexit could harm their business but that they remained committed to it regardless. In other words, supporters of leave and of remain have wider considerations than simply their immediate business interests when deciding on such major constitutional questions.

Opportunity themes

Two general themes, which were perceived as opportunities are:

1. The potential removal of burdensome regulation

2. The opportunity to forge new trade deals with other countries

For the former, it is clear that some EU regulation is burdensome, especially for smaller businesses. However, some business leaders believe that the UK may become a rule-taker to continue to trade with the EU and that the removal of some regulation may be more complex than originally thought.

There appears to be some confusion over what impediments to trade actually exist as a result of being in the EU. Some of our contributors cited more trade with China – and yet there is no insurmountable barrier to increasing trade with China whilst continuing to be part of the EU or remaining within the single market

> **We have found it hard to obtain any detailed definition of what specific opportunities those who voted to leave saw for their business.**

and customs union. Germany remains a huge partner in trade with China. Another example is Belgium, which has extensive trading arrangements with India, again as part of the EU.

Threats

When it comes to threats, business leaders are much more precise than with opportunities.

Free movement of people

The free movement of people which so often is expressed as a concern in obtaining access to the right labour, with the right skills, at the right time is uniformly articulated by every sector and by every size of business as a key threat.

Tariffs

The thought of a no deal and falling back on WTO rules is a major concern. Indeed it is such a concern, some business leaders told us they refuse to believe it is a possibility, hoping a deal preventing trade barriers with the EU will be achieved.

Transition

The need for a transition deal has also been articulated consistently by every sector. However, it is still not clear what form this transition period (or implementation period) will take. Will it simply be pushing the end date for a hard or chaotic Brexit further out? In reality, as we know from our interviews with banks, if the detailed definition of a transition deal is not deemed legally watertight by them with a specific definition they will continue to plan for a no deal.

Cultural impact

Amongst other concerns, some business leaders expressed concern about the negative cultural impact that may result as a result of Brexit. They cited fewer EU nationals willing to come and work in Scotland, a reduction in transnational research and educational opportunities for our young, and a generally more inward looking tone to political debate becoming more acceptable.

Our respondents found it much easier to identify possible threats than opportunities.

> What I'm thinking about more and more these days is simply the importance of transparency.
>
> **Esther Dyson**

> You cannot escape the responsibility of tomorrow by evading it today.
>
> **Abraham Lincoln**

We believe that most business leaders with whom we have spoken would have sympathy with the opening quotes. As we write, there remains a lack of transparency and obfuscation regarding the aims and process of Brexit. This serves us ill from a practical business viewpoint.

To our respondents, the sound and fury of political debate has contributed to the uncertainty and confusion around Brexit. And uncertainty and confusion make the task of business preparations for Brexit much more difficult.

However, we would argue much less political focus has been given to how businesses could be helped now.

A key question for us has been: What types of actions would our business respondents like to see from both the UK and Scottish Governments?

Identifying test options

Following a review of press comment over the course of the weeks following the onset of negotiations, there was a variety of comment in business and political circles related to both the UK and Scottish governments. From such comment, we prepared a list of five options in relation to UK Government and four in relation to the Scottish Government plus a free response item for respondents to add further suggestions.

The options presented in relation to UK Government were:

- Appoint business advisory panels specifically to advise on sector issues.
- Produce guidance and briefing notes for business at regular intervals.
- Establish transition arrangements specifically for business to assist in the process of leaving the European Union and engaging with future legal, regulatory and trading arrangements.
- Make explicit those matters that will be devolved to devolved governments as a consequence of leaving the European Union.
- Increase direct engagement with the business community.
- Other.

In relation to the Scottish Government the options were:

- Appoint Scottish business advisory panels for Exiting the European Union for key sectors of the economy.
- Produce guidance and briefing notes for business at regular intervals.
- Increase direct engagement with the business community.
- Make explicit how it intends developing policy and managing new areas of competence which may be devolved as a result of leaving the European Union.
- Other

> **It's not yet clear what will happen. Given the uncertainty and complexity, it would be wise for business to prepare for a much shorter transition period or indeed none at all.**

UK Government priority asks

By a clear margin the two highest asks by our respondents in relation to the UK Government were firstly to establish transition arrangements specifically geared to assisting businesses (77 percent of respondents asking for this), and secondly to make explicit those matters that will be devolved (76 percent).

However, a great many comments are very critical of the UK Government's capacity and competence in the negotiations to date. A typical included:

"Clearly, the government is disorganised and is not making a good job of things, but I hope it will eventually be a success."

Given the largely critical views of the UK Government's negotiations to date, it is understandable that there are concerns about whether an effective transition deal can be struck.

Indeed, only days before writing this report, the EU chief negotiator Michel Barnier claimed a transition deal was not a given.

The remaining 27 EU states are offering a 21-month transition deal during which the UK would, in effect, remain in the EU and obey EU laws. However, the UK Government wishes those EU citizens who arrive during the transition period to be treated differently to those already here as well as the right to reject any new EU laws. This position is against the wishes of many Scottish business leaders and perhaps may threaten a transition deal altogether

Transition arrangement

A transition arrangement is very strongly favoured, but comments suggest that business would like a longer transition arrangement than the 21 months on offer. As one respondent averred in relation to the UK Government:

"Get their act together in terms of negotiations including seek an open ended or 5 years transitional arrangement."

In large part the call for a lengthy transition arrangement reflects the complexities that many think are involved. Once more we find it is a combination of uncertainty and complexity that is driving future asks.

We also find the call for transition arrangements spans a wide range of sectors, from life sciences to food, from the creative industries to higher education, and from finance to tourism.

It's not yet clear what will happen. Given the uncertainty and complexity, it would be wise for business to prepare for a much shorter transition period or indeed none at all.

Scottish Government priority asks

In relation to the Scottish Government, the key asks were to make explicit how it would seek to use any new devolved powers (80 percent) and to increase direct engagement with the business community (70 percent).

Note that while respondents want the UK Government to clarify what new devolved powers will come to Holyrood, they also want the Scottish Government to be clear on how it intends using such powers. This was true at the time of our interim report, but little clarity has been achieved since.

Devolved powers

We have not found evidence that this pursuit of clarity is a function of political or constitutional preference, but rather it reflects the desire for business to know who they must deal with policy-wise.

To give a simple example, if we are to exit the Common Fisheries Policy, Scotland's fishing industry wants to know who is going to be framing new domestic policy and ideally the direction of travel.

More generally, we believe many would support the following quote from one respondent:

"We recognise the limited role the SG can play in terms of the Brexit negotiations. The SG is consulting the business community around Brexit concerns without necessarily having the power to tackle these concerns. SG would be better placed planning for post Brexit by considering firstly the impact on

> **The Scottish Government could do more to develop helpful policies for the business community. They need to listen more.**

devolved powers and also giving thought to how best to deal with any additional powers that might come post Brexit. SG have not thus far appeared to have been pro-active as to how best deal with Brexit (in the way the CBI are). SG arguably too busy doing the politics of Brexit."

Engaging with business

There is a desire amongst the significant majority of respondents to see the Scottish Government more engaged with the needs of business. This is exemplified in forthright comments such as:

"I'd like to see our own government showing more interest in us."

"(The) Scottish Government could do more to develop helpful policies for the business community. They need to listen more and their rhetoric needs to escape from being overly focused on how to spend money and better balanced with how to grow the economy and encouraging a profitable private sector."

Brexit presents considerable challenges, and our respondents would therefore welcome stronger direct engagement by the Scottish Government with a view to supporting directly whatever transition arrangements may be agreed and to re-profile the type of support needed post-Brexit.

To give but one example. If there is a context of greater restrictions on inward migration, this may lead to the need to revise current higher education and skills strategies. There have been suggestions, for example, that restrictions on migration are likely to lead to requirements for a greater focus on the training and education of those over the age of 24 and in work.

This in turn may well have significant investment implications. This presents a major challenge in terms of policy development for government, but one where they would find support in the business community.

Lending to SMEs

We noted earlier the issue of bank lending to SMEs. This is an area where there may be scope for changing policy to enable more ready supply of funds in the future.

We are grateful to the Funding Circle for agreeing to be cited and to making the suggestions below. We are not in a position to fully evaluate the merit of Funding Circle suggestions, but do think they are of sufficient merit to cite here:

*"**Maintaining access/opt-in to the EIB and enhancing the role of the BBB:** The EIB supported UK small businesses with more than £1.2 billion of investment in 2016 alone... we see a clear benefit to the retention of some form of relationship with the EIB and... we also believe that expanding the capabilities of the BBB would deepen the pools of capital available to small businesses...*

However, current state-aid rules mean that the BBB is prevented from lending more than £100 million through a single platform (such as Funding Circle), significantly capping further investment. It is Funding Circle's view that the UK Government should legislate to release the BBB from state-aid rules post-Brexit...

***Expanding access to BoE schemes to create level playing field:** Funding Circle loans are not currently Central Bank eligible, which means we are unable to participate in schemes such as the Funding for Lending Scheme (FLS – now the Term Funding Scheme) and the Discount Window Facility. Schemes of this kind disproportionately favour traditional high-street banks... Expanding eligibility of these schemes to include alternatives would allow a wider range of investors (to participate)."*

Wider support for business

It is evident however that more than the above needs doing. In our judgment there are ample reasons to justify providing some initial support for SMEs and the Scottish Government should consider an equivalent offer to that available to SMEs in Northern Ireland and referenced earlier in this report.

There are potentially going to be major labour and skills challenges that need addressed, with a more demand led system to enable greater flexibility in the provision of skills training.

More generally, initiatives are needed to ensure business has the information it needs to more effective engage in planning and preparation for Brexit.

It is to these possible forms of intervention we now turn in our recommendations section.

RECOMMENDATIONS

> **The UK Government should urgently engage with the Scottish Government to construct a joint examination of inward migration.**

The wealth of data we are in possession of tempted us to produce a great number of recommendations. However, we recognise that time is limited, as are resources, and therefore we have restricted ourselves to the following. Based on this study we therefore make the following recommendations.

Business

1. Businesses should undertake planning and preparations for Brexit, and should include the following in their approach.

    a. Review their exposure to changes in migration.

    b. Undertake a basic financial "stress test" for their business.

    c. Conduct basic scenario planning.

    d. Where external support is needed for the above, they should assess their eligibility for grant support (including for the initiative outlined in recommendation 4.)

2. Businesses should inform themselves of the emerging practical implications of Brexit, including via briefing initiatives such as those proposed in recommendation 5.

Scottish Government

3. The Scottish Government should provide financial support to SMEs on a similar basis to the initiative in Ireland to enable expert assistance to be accessed in preparing for Brexit.

4. The Scottish Government should commission a review of its skills strategy, with a particular requirement to make recommendations on how the skills strategy can be made more flexible, more business needs driven, more responsive to changing circumstances, and more business user friendly.

5. As part of Scottish government policy development in relation to Brexit and Scottish business, it should review innovations aimed at providing new funding streams, including those referenced in this report.

6. The Scottish Government should commission a series of business briefings in preparation for Brexit. These could involve the higher education sector in partnership with business organisations providing short on-line briefings on Brexit related topics as issues emerge from negotiations.

7. The Scottish Government should seek to intensify its engagement with business in relation to Brexit.

8. The Scottish Government should ensure it has fully reviewed the implications of Brexit for each of its areas of competence.

UK Government

9. The UK Government should take full account of business needs as it negotiates a transition arrangement.

10. The UK Government should make clear its position regarding the implications of Brexit for devolved powers.

11. The UK Government should urgently engage with the Scottish Government to construct a joint examination of inward migration with a particular focus on ensuring easy access to skills and expertise for Scottish businesses from the remaining member countries of the EU.

12. The UK Government should provide special funds to the devolved administrations for Brexit preparations, and specifically for readying government departments for all anticipated changes.

13. The UK Government should implement an active monitoring process for availability of funds for business, and for SMEs in particular. This should include assessing how additional funding streams could be made available, such as considering the potential of peer to peer lending.

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