

An IWA report | February 2021

# A better balance

Business support policy for  
the foundational economy

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## About the author

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## About us

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For more information about the IWA, its policy work, and how to join, as either an individual or corporate supporter, contact:

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## Foreword

The 2020s are shaping up to be an era, much like the 1940s or the 1970s, in which economic policy pivots in a new direction. Just as before, global crises are exposing local weaknesses that have built up over decades, and there is a political imperative to find new ways of managing the economy. There is now widespread agreement that we need to reduce our environmental impact, redress significant inequalities, both between places and between people, and do far more to ensure that work and public services enhance people's well-being. COVID-19 has made this even more urgent.

As in previous eras, politicians must be open to new ideas and be prepared to try something new. The foundational economy is an important contribution in this regard. Research, analysis and discussion over the past decade has illustrated that everyday essentials such as food, care, transport and construction have been under-invested in, leaving many people reliant on systems that have been stripped to the bone.

Nowhere has this analysis found more supporters than in Wales, where weaknesses in basic infrastructure are compounded by the challenge of a 'missing middle' of vibrant but rooted Welsh businesses, able to play a leading role in their communities. The foundational economy has rapidly risen up the policy agenda, with expressions of support from across the political spectrum for the task of supporting these vital sectors and businesses.

The IWA has partnered with CREW to build on this interest by exploring how policy makers in Wales can use their powers to achieve the goals of a stronger foundational economy and a more resilient base of Welsh firms. We are focusing on the ways in which governments can help businesses to stabilise and grow, by investing in skills and innovation, by managing the regulatory burden and, as this report sets out, by providing finance, information, advice and guidance.

Our findings provide more evidence that policy has focussed on the largest employers, the most glamorous industries and the shortest route to creating jobs without considering the quality or sustainability of those jobs. A lot of the best outcomes of the last few decades in the Welsh economy have been fleeting, with too little attention paid to building a resilient economy that can support people's wellbeing in the face of an uncertain future. With this report, we are calling on the next Welsh Government to conduct economic policy in a more open, transparent and accessible way which touches every corner of the nation and ensures that Wales' future is everyone's business.



**Auriol Miller**  
Director of the IWA

## Introduction

This report was produced as part of the IWA's collaborative project with CREW to look at the foundational economy as a policy agenda in Wales. This project aims to identify new opportunities for policy makers to strengthen the foundational economy in Wales, boosting the position of grounded Welsh firms and ensuring that citizens have access to high quality everyday goods and services.

Our project is aiming to build on existing research and policy development that has been undertaken in Wales and elsewhere by academic researchers, community development practitioners and local and devolved governments. This has illustrated the potential impact of social and public spending and procurement, as well as the need for experimentation and innovation.

We intend to build on this existing work by looking at the range of powers available to Welsh policy makers, whether in the Welsh Government, local government, health authorities or city and growth deal regions. Despite this emphasis on public bodies, we recognise that the strength of the foundational economy is determined by the private and third sectors, and our project will focus on the ways in which these different sectors relate to each other. We hope that our conclusions and recommendations will form the basis for a future discussion on the direction and the overall aims of economic policy in Wales, starting with the 2021 Senedd elections.

This first report focuses on the support that is provided by Welsh agencies, both in terms of information, advice and guidance and in terms of finance and investment. The report has been informed by a review of research literature, policy literature, evaluations, evidence presented to the Senedd, as well as extensive discussions with a range of stakeholders including supporters of the foundational economy agenda, business support providers and a small number of businesses themselves.

Our project has also benefited from the generous support and input of an advisory group bringing together academic and practical expertise on the Welsh economy, policy making and community development, and we would like to thank them here for their contributions.

Dr Rhys ap Gwilym	Senior Lecturer in Economics, Bangor University
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Glenn Bowen	Director for Enterprise, Wales Co-operative Centre
Dr Rachel Bowen	Director of Policy and Public Affairs, Colegau Cymru
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# Part 1: Context

## What is business support?

Governments provide support for businesses for a variety of reasons, including<sup>1</sup>:

- To create employment opportunities
- To raise productivity in specific sectors of strategic importance
- To facilitate the creation of successful firms, which can in turn contribute to economic performance and tax revenue.

The approaches that governments take to support businesses have changed over time, often in line with changes in political and economic conditions. Looking at the Welsh experience, there are a few historical trends that continue to inform how business support and economic development is seen today:

- **Post-war consensus, 1940s - 1970s.**

This era saw pro-active industrial policy in which governments invested heavily in selected firms, often in strategically important sectors such as coal and steel, including through equity stakes and nationalisation, and provided significant advantages for these firms through trade policy and labour market policy

- **Regional development agencies, 1970s - 2010s.**

In an increasingly global economy, regional development agencies marketed regions to foreign investors, providing subsidies and influencing skills provision

- **Generic improvements in the business environment, 1980s - 90s.**

Following criticism of the market-distorting effects of proactive industrial policy in the post-war era, there was a trend towards more 'light-touch' generic support for new firms and entrepreneurs<sup>2</sup>, encompassing information, advice and guidance, enterprise allowance and enterprise zones, accompanied by deregulation of key markets, including for labour and finance

- **Targeting high-growth firms and sectors, post 2008-9.**

Since the financial crisis, governments have sought to address sluggish growth by targeting investment and support at potential high-growth sectors and firms, using innovation policy, funding and support for research and development, targeted skills programmes and use of clustering and 'hubs'<sup>3</sup>

1 Warwick, K. (2013). "Beyond Industrial Policy: Emerging Issues and New Trends", OECD Science, Technology and Industry Policy Papers, No. 2. OECD Publishing

2 See Brown, R. & Mason, C. (2012). Raising the batting average: Re-orientating regional industrial policy to generate more high-growth firms. *Local Economy*. 27. 33-49; and Shane, S. (2009) Why encouraging more people to become entrepreneurs is bad public policy. *Small Bus Econ* 33, 141-149

3 Coad, A., Daunfeldt, S., Hözl, W., Johansson, D. & Nightingale, P., (2014) High-growth firms: introduction to the special section, *Industrial and Corporate Change*, Volume 23, Issue 1, February 2014, Pages 91-112

In practice, the business support that is offered today combines aspects of all of these approaches. Governments have sought to combine generic or ‘horizontal’ support (which creates a better environment for all businesses) with more selective or ‘vertical’ support (which targets particular sectors and firms)<sup>4</sup>. Nonetheless, it is generally accepted that contemporary support remains more ‘light touch’ than that seen in the post-war era, with governments being less interventionist, in some cases due to restrictions on the use of state aid as part of various international trading agreements<sup>5</sup>.

In Wales, provision of business support has generally followed these trends. Prior to devolution, firms in Wales were supported by UK government programmes and policy. The interventionist approach of the post-war era had a positive effect on the Welsh economy, boosting large industries such as coal and steel<sup>6</sup>, and the creation of the Welsh Development Agency (WDA) in the 1970s provided a distinct regional approach that was well regarded at home and internationally<sup>7</sup>. Since devolution the Welsh Government has gradually reformed its provision so that as of 2020 the majority of support for businesses is delivered through three bodies:

<b>Business Wales</b>	<b>The Development Bank of Wales</b>	<b>Welsh Government direct investment</b>
<p>A ‘one-stop-shop’ service providing tiered support to businesses across Wales.</p> <p>Business Wales is predominantly funded through European Structural Investments (ESI) and is organised in line with both those funds’ strategic priorities and economic development priorities of the Welsh Government.</p> <p>The Business Wales ‘brand’ encompasses a number of programmes, and most of the delivery is contracted to private sector providers. Much of the delivery is focussed on information, advice and guidance, with the degree of specialisation increasing for firms with specific aims or issues.</p>	<p>The Development Bank of Wales was established in 2017 in response to recognised market failures in the provision of business finance in Wales, resulting from restrictions on lending after 2008-9 and biases in private sector investment that negatively affected Welsh SMEs<sup>8</sup>.</p>	<p>Since the dissolution of the Welsh Development Agency in 2010, the Welsh Government has provided direct financial support both to Welsh firms and to foreign firms looking to invest in Wales, typically providing support at a level that would not be appropriate for the Development Bank (often through non-repayable finance)<sup>9</sup>.</p> <p>Many of the Welsh Government’s programmes of investment are specific to sectors or policy aims, such as the Valleys Taskforce and the Tech Valleys programme.</p>

4 [Warwick, 2013](#)

5 [Brown & Mason, 2012](#)

6 [Industrial Strategy Council, \(2020\) UK Regional Productivity Differences: An Evidence Review](#)

7 [Cardiff Business School and Cardiff Business Partnership, \(2012\) Selling Wales: The problems and potential for attracting financial and professional services investment to Wales](#)

8 [Development Bank of Wales Task and Finish Group, \(2015\) A feasibility study into the creation of a development bank for Wales](#)

9 [Evidence provided by Giles Thorley, Chief Executive of the Development Bank of Wales, to the Welsh Parliament Public Accounts Committee, 17/06/2019](#)

## Impacts of business support in Wales

### Performance

The impacts of business support programmes in Wales have typically been measured in terms of numbers of jobs created or supported. This reflects the value that both policy makers and citizens place on employment, particularly in the context of the transition from historical reliance on heavy industry. Successive Welsh Governments have seen reducing worklessness as the principal mechanism for reducing poverty<sup>10</sup>. As a result, business support has often been targeted at those firms who offer the opportunity to create or support large numbers of jobs.

In terms of the support offered directly by the Welsh Government, the approach taken has largely followed that which was set out by the WDA before 2010, in particular by attracting investment by foreign manufacturing firms through a mix of marketing and international strategy, subsidies for land, rent and taxes, and through other forms of non-repayable finance (often in the form of grants). There is evidence that this approach has had some historical success in achieving its aim of encouraging investment, as in both in the 1990s<sup>11</sup> and since 2015<sup>12</sup> Wales has captured a relatively high proportion of total UK foreign investment. This investment has supported a large number of jobs, and evidence suggests that this contributed to a significant narrowing of the employment gap between Wales and the UK average<sup>13</sup>.

However, more recently, concerns have been raised about the transparency of the Welsh Government's investment decisions, and about the wider impacts of these investments in terms of the Welsh economy and society<sup>14</sup>. A lack of strategic planning and data collection has made formal evaluation of impact difficult, and it has been suggested that a lack of certainty about investment priorities has discouraged firms from engaging with the business support offer<sup>15</sup>. Analysis of individual supported projects suggests variability in cost-per-job<sup>16</sup>, with high costs associated with many of the Welsh Government's investments. In addition, there have been high-profile examples of firms revising their commitment to Wales despite receiving significant public investment<sup>17</sup>.

In terms of the support offered by Business Wales, there is stronger evidence of success against many of its targets, with the Core and Growth programme (which represents the largest component of the most recent delivery programme achieving 141 percent of its target for employment and 117 percent of its target for increases in exports<sup>18</sup>. This achievement also represents significant improvement on the performance of the

10 See Welsh Government, (2012), *Tackling Poverty Action Plan*, Cardiff: Welsh Government

11 Welsh Affairs Committee, 2012, *Eighth Report - Inward Investment in Wales*

12 Barry, S. (2015) *Wales turns in best inward investment performance for a decade*, in *Wales Online*, 28/05/15

13 Resolution Foundation, (2020) *From locking down to levelling up: The past, present and future of Welsh living standards*

14 See in particular the reports of inquiries held by the Senedd's Public Accounts Committee into *The Welsh Government's Funding of Kancoat Ltd (2016)*, *The Welsh Government's initial funding of the Circuit of Wales project (2018)* and *The Welsh Government's relationship with Pinewood (2018)*

15 *Audit Wales*, (2018) *Welsh Government financial support for business*

16 *Federation of Small Businesses*, (2018), *Supporting success: Business support beyond 2020*

17 This has included *Ineos* (<https://www.bbc.co.uk/news/uk-wales-53317740>), *Pinewood Studios* (<https://seneddresearch.blog/2019/04/29/assembly-to-debate-the-welsh-governments-relationship-with-pinewood/>) and *Ford* (<https://www.bbc.co.uk/news/uk-wales-48738537>)

18 Zaidi, A; Shah, P. and Beadle, S (2018). *Evaluation of Business Support Services in Wales: a report for the Welsh Government*. Cardiff: Welsh Government, GSR report number 67/2018



previous 2007-2013 programme<sup>19</sup>, suggesting that the Business Wales model has become well established and has effective mechanisms for supporting firms.

There is evidence that Business Wales support reaches only a small minority of Welsh firms, with the most recent programme meeting only 37% of its targets for firms supported. In part this can be associated with a trend towards greater selectivity over time. The strategic policy change beginning with the publication of Economic Renewal in 2010 led to a purposeful change in the way that the 2007-2013 Business Wales programme was delivered. Partly in response to the ongoing effects of the 2008-9 financial crisis, the Welsh Government proposed greater targeting at 'high potential start ups' as well moving approximately 45m Euros of ERDF funding from medium to higher priority firms<sup>20</sup>. In the subsequent 2014-2020 programme, Business Wales has targeted its Accelerated Growth Programme (AGP) at businesses and start-ups with the potential for high-growth (defined as a 20% increase in turnover year on year for five years).

In terms of the Development Bank of Wales, there is evidence that it has achieved its purpose of plugging a gap in business finance in Wales, having successfully achieved its target of investing £80m per annum by 2020<sup>21</sup>. The Bank has also been successful in leveraging more private investment into Wales, continuing a pattern established by both Finance Wales and the Welsh Government in pairing with private investors. Private Sector Leverage by the Development Bank has grown from around £40m in 2017/18 to nearly £250m in 2019/20, addressing a recognised weakness in access to business finance in Wales<sup>22</sup>. Nonetheless, it has been noted by observers and by staff of the Bank that it could do more in terms of making its offer more widely accessible to Welsh firms, and in particular to small and medium-sized enterprises (SMEs) and to microbusinesses.

## Limitations

Despite the successes documented above in terms of attracting and securing investment, supporting jobs and growing exports, there remain widely-recognised weaknesses in the Welsh economy, including:

- Low productivity measured by GVA per worker, both compared with UK nations and regions<sup>23</sup> and compared with regions across the western nations of the European Union<sup>24</sup>
- High levels of poverty, associated with low pay<sup>25</sup>
- Gaps in terms of basic infrastructure, including rail<sup>26</sup> and telecommunications<sup>27</sup>

<sup>19</sup> Old Bell 3 Ltd. and Cardiff University, (2012) Mid-Term Evaluation of the Customer Engagement EU Project. Final Report, Cardiff: Welsh Government

<sup>20</sup> Old bell 3, (2012)

<sup>21</sup> Development Bank of Wales, (2020), Annual report and financial statement

<sup>22</sup> See [evidence provided to the Welsh Parliament Public Accounts Committee, 17/06/2020](#); and also, for a reflection of investment in Wales within the UK context, Wilson, N., Kacer, M & Wright, M. (2019) [Equity Finance and the UK Regions: Understanding Regional Variations in the Supply and Demand of Equity and Growth Finance for Business](#). BEIS Research Paper Number 2019/012

<sup>23</sup> Price, J., (2018) [Welsh Government Budget 2018: Chief Economist's report](#), Cardiff: Welsh Government

<sup>24</sup> Eurostat, (2019) [News release: Regional GDP per capita ranged from 31% to 626% of the EU average in 2017](#)

<sup>25</sup> [Lloyd, C., \(2017\), An exploration of low pay sectors, and measures to improve pay of low-paid workers such as the living wage; Ways to increase the security of work in Wales](#), Equality, Local Government and Communities Committee ELGC(5)-21-17 Papur 5/ Paper 5

<sup>26</sup> [Barry, M., \(2018\) Wales' Rail Network: The case for investment](#)

<sup>27</sup> [BT, \(2019\) Smart rural: The utilisation of digital infrastructure by the agricultural and tourism sectors in rural Wales](#)

This raises important questions about the impact of business support programmes in Wales. While programmes can demonstrate achievement against targets, these achievements have not had transformative impacts in the economy as a whole. There are a number of contextual factors that help to explain this.

Firstly, the period of devolution has been marked by significant changes in **macroeconomic conditions**, particularly since 2008-9. This has included the UK-wide experience of relatively sluggish economic growth and of a ‘productivity puzzle’ in which low unemployment is coupled with low productivity per worker<sup>28</sup>. The ability of both the UK and Welsh Governments to address this through policy has been limited by significant cuts in public spending (which in turn have a greater impact on wages in Wales than across the UK as a whole due in part to a relatively higher proportion of workers employed in the public sector). In addition, Europe-wide analysis has highlighted that, due to the importance of foreign investment and relatively low levels of skills and productivity, Wales is highly exposed to globalisation and to the effect of shocks from elsewhere in the global economy, such as the 2008-9 recession as well as the 2001 Asian financial crisis<sup>29</sup>.

Another related limitation comes from the challenge of delivering policy at **scale**. At around 6% of its annual budget, the Welsh Government spends less on economic development, including business support, than nearly all OECD nation states, and less than many sub-national regions<sup>30</sup>. Despite some success in supporting jobs, Business Wales and the Development Bank of Wales reach only a small minority of firms. A key question for policy makers in Wales is how to increase the level of investment within a tightly constrained budget and in light of an ongoing economic slowdown due to COVID-19.

Perhaps a more fundamental problem arises from the increasing **challenges of capturing the benefits of growth**. A combination of a variety of trends in how high-growth firms operate has created difficulties for governments in capturing the benefits of economic growth through wages and tax, with many benefits accruing to higher earners and being regionally concentrated<sup>31</sup>, firms becoming more mobile<sup>32</sup>, and governments subsequently facing difficulties in extracting greater social value out of those firms<sup>33</sup> (what Welsh Government has called a ‘something-for-something’ agenda). Whereas challenges of macroeconomic conditions and scale can be addressed through existing policy levers (albeit primarily at the UK level), this last challenge is perhaps more difficult to address, requiring entirely new approaches.

In view of these challenges and limitations, it is unrealistic to expect business support and economic development policy in Wales to affect transformational change in the overall productivity of the Welsh economy in the short term. Several authors have concluded that the long-stated aim of closing the gap between Gross Value Added (GVA) per worker in Wales and the UK average is unlikely to be achieved by the Welsh Government under the current devolution settlement<sup>34,35</sup>. Despite these well-evidenced observations, GVA remains one of the Welsh Government’s key indicators, forming part of the national Well-Being Indicators. In the context of business support programmes, this indicator appears to be particularly influential, linked to the long-term focus of these programmes on the numbers of jobs created and supported.

28 [ONS, \(2015\) What is the productivity puzzle?](#)

29 [Directorate General for Regional Policy, \(2009\) Regions 2020: Globalisation challenges for European Regions, Brussels: Commission of the European Communities](#)

30 [OECD, \(2019\) The future of regional development and public investment in Wales, Paris: OECD](#)

31 [Healy, A. \(2020\) Strengthening economic resilience, Cardiff: Wales Centre for Public Policy](#)

32 [OECD, \(2018\) Policy Note: Multination enterprises in the global economy, Paris: OECD](#)

33 Coad et al., 2015

34 [Ifan, G., Sion, C. and Poole, E.G., \(2019\) Wales fiscal future: A path to sustainability?, Cardiff: Cardiff University](#)

35 [Bristow, G. \(2018\). Reflections on the Welsh economy: remanence, resilience and resourcefulness. \*Welsh Economic Review\* 26, pp. 13-20](#)

The selective approach is strongly associated with the UK's high regional inequalities. There is evidence that policy makers have attempted to address regional disparity not through business support and investment but through redistribution, or through the assumption that the benefits of productive firms and regions will 'trickle down' to less productive firms and to struggling regions. Decades of experience have demonstrated that this is not the case, with increasing inter- and intra-regional inequalities. Whilst these inequalities may have been tolerated in the past, there is now extensive evidence from across Europe that inequality between places has driven the rise of populism and anti-system politics, with damaging effects on national politics<sup>36</sup>.

## The importance of the foundational economy

### What is the foundational economy?

The foundational economy as a policy agenda is an important contribution to debates about how Wales should respond to the problems outlined above. It comes at a time when long-held views about economic development and its social effects are being questioned, largely in response to an extended period of stagnation dating back to the economic crisis of 2008-9. It is now widely observed that the foundational economy describes those sectors of the economy that are often essential in everyday life, but which are often under-represented in policy-making and in public investment.

The complexity of economic activity, and in particular the complexity of supply chains in a globally integrated economy such as Wales', make it difficult to produce a definition typography for foundational goods and services, but in the research and policy literature there is agreement around a core set of characteristics for the foundational economy:

1. It incorporates goods and services that satisfy fundamental human needs – housing, utilities such as heat and power, health and social care, food, as well as aspects of education.
2. It represents between 40 and 50 percent of economic activity and employment in most development economies.
3. It is, particularly in relation to services, non-tradeable. Everyday essentials such as social care and child care, maintenance of utilities and the distribution and sale of food (if not its production) cannot be exported or imported – they must be developed and 'produced' in the same place where they are consumed.
4. In many cases, foundational goods and services overlap with the concept of public goods, particularly in relation to utilities and healthcare.

The foundational economy as a policy agenda essentially focuses on two broad, complementary policy aims:

1. Improving the quality of the provision of foundational goods and services, in order to improve citizens' quality of life.
2. Influencing who provides these goods and services to ensure this provision creates additional benefit for society, for instance through creating higher-quality employment opportunities and through the recycling of any profit or surplus into activities that are socially valuable.

### What could business support do for the foundational economy?

The current Welsh Government has incorporated the foundational economy into its economic policy making by including foundational sectors in its priorities within the 2016 Economic Action Plan:

*'... sectors such care, tourism, food, and retail are the backbones of many local economies. By developing new models of support and partnerships in these areas, we can help small and often fragile enterprises embedded in local communities increase their productivity, encourage skills progression and develop more sustainable business models.'*<sup>37</sup>

This quote is illustrative of the Welsh Government's approach to the foundational economy and of a challenge that faces all policy makers hoping to improve the foundational economy. It demonstrates a recognition that many of the firms that operate in the foundational economy, firms which provide value above and beyond their provision of goods and services, face significant challenges that make their futures uncertain.

The foundational economy literature associates these challenges with a shift in the balance between small, locally-grounded businesses and larger, mobile and often highly-financialised businesses who compete in the same markets. This is evident in the experience of independent retailers in competition with supermarkets, who use their scale and financial resources to control supply chains and cross-subsidise products, enabling them greater competitive advantage. A similar situation has been documented in the provision of social care, where private equity firms invest in care homes as a property investment, collecting rents from social care providers, often at levels which make the provision of high quality care unprofitable.

The concept of a 'missing middle' (a comparative lack of medium-sized firms compared to the large numbers of micro-firms and small number of highly influential large firms) in Wales' business base in Wales has also gained acceptance by a wide variety of stakeholders. The concept is addressed in both the foundational economy literature and in emerging policy discussion in Wales. It has been accepted, albeit with different conclusions, through the Hodge Foundation's research programme looking at the Welsh economy and has been explored by the Economic Intelligence Wales unit as part of the Development Bank of Wales<sup>38</sup>. Medium-sized firms are considered important as an illustration of dynamism and also as a key player in maximising

<sup>37</sup> <https://gov.wales/sites/default/files/publications/2019-02/prosperity-for-all-economic-action-plan.pdf>

<sup>38</sup> See:

- Brill L., Cowie, L., Folkman, P., Froud, J., Johal, S., Leaver, A., Moran, M. and Williams, K. (2015) What Wales Could Be, CRESC and FSB Wales;
- Federation of Small Businesses (2020) Foundational Economy 2.0;
- Holtham, G., (2018), The Future of Wales; Julian Hodge Institute of Applied Macroeconomics Annual Lecture 2018
- Kapatsinis, N., Munday, M. & Roberts, A., (2019) Medium-sized businesses and Welsh business structure, Wrexham; Economic Intelligence Wales

positive social impacts from economic activity. They are associated with a degree of groundedness, meaning their commitment to and investment in a local area, through the quality and range of employment opportunities that they offer and their investment in the skills of their workforces.

The problem of the 'missing middle' in Wales is associated with both a lack of Welsh-owned firms and a lack of dynamism that would see firms grow from microbusinesses (making up the vast majority of Welsh businesses) into medium sized. Several features of Wales' economic history have influenced this, including a long-term reliance on a small number of very large firms for a high proportion of Welsh employment, but also relatively low levels of entrepreneurship, and in particular, less business dynamism, with fewer firms transitioning from microbusiness to medium-sized business<sup>39</sup>. At the same time, with a high level of economic integration, markets in Wales are accessible to a wide range of firms, including many outside of Wales. This has created a situation in which, in many different markets, consumers in Wales are reliant on firms from outside to provide key goods and services.

To date, much of the policy discussion surrounding the foundational economy, and related concepts such as the 'Preston Model'<sup>40</sup>, relational procurement<sup>41</sup> and Community Wealth Building<sup>42</sup>, has focused on public procurement as a way of addressing the 'missing middle'. In identifying the capacity that the public sector has as a purchaser of foundational goods and services, proposals have been put forward for how public procurement could provide greater emphasis on the social value that suppliers contribute to.

We believe that, to date, too little attention has been paid to the other side of this equation: the breadth and capacity of grounded firms in Wales to provide foundational goods and services to the standards required by public procurement. If policy makers want to create the circumstances in which the balance shifts between mobile firms and grounded firms, it will not be sufficient to control access to markets. Concerted action is needed to boost the capacity of Welsh firms to compete on merit. By doing this, these firms will not only gain a foothold in important markets and contribute to social value by recycling more investment back into Wales, they will also improve what they do, enabling them to develop new products and innovations and enter new markets.

Business support is an important piece of the puzzle, in terms of linking this work together. It represents a key point of contact between government and the private sector, through which long-term strategic aims can be communicated and shared between sectors. However, to achieve a transformational impact in Wales' business demography, business support needs to reach a wider range of firms than it currently does. Targets, and the subsequent design of programmes, have been focussed on the numbers of jobs that they both create and support. In order to realise longer-term impacts, business support needs to be open to firms that are at different places in their own journeys, and across a wider range of sectors than are currently represented.

<sup>39</sup> Department for Business, Energy and Industrial Strategy (2016) *Growth ambitions among SMEs*, BEIS: London

<sup>40</sup> [Preston City Council website](#)

<sup>41</sup> Waters, L., (2020) *'It's time to focus on the everyday economy'*, IWA: Cardiff

<sup>42</sup> CLES, (n.d.) *'What is community wealth building?'*

# Part 2: Recommendations

## Smarter sector policy

In Wales as elsewhere, economic development policy has often targeted specific sectors. However, sector policy has not been consistent. Since the introduction of priority sectors in 2004, an initial seven sectors were revised to six in the Welsh Government's 'Economic Renewal' strategy in 2010, while a further three priority sectors were identified two years later, before a decision in 2016 to move away from explicit sector policy, while still emphasising investment in 'industries of the future' and the foundational sectors of care and tourism.

Unsurprisingly, delivery of business support has not been able to keep pace with these policy changes. Whilst the Welsh Government established sector teams to lead on delivery, there is evidence that these have often worked in a reactive way, working across their defined sectors and responding to proposals from businesses rather than setting out clarity about what they aim to support<sup>43</sup>. In lieu of well defined strategic priorities, Business Wales, the Development Bank of Wales and more recently the various city and growth deals as well as regional skills partnerships, have taken their own approaches to identifying sectors, often through specific programmes and strategic plans that do not always align with the Welsh Government's priorities or time frames.

The more recent move away from explicit sectors is a response to the complexity of the contemporary Welsh economy and the potential for growth to arise from almost anywhere. However, in practice, the lack of a clear vision and of well-defined and sector-specific targets creates a risk that practitioners will pursue a more ad hoc approach. There is some evidence that this has occurred, with continued emphasis on high-tech manufacturing being reflected through significant investment in the Tech Valleys programme.



## The Tech Valleys programme<sup>44</sup>

The Tech Valleys programme encompasses the Welsh Government's support for a proposed automotive technology park in Blaenau Gwent. The high-level vision for the programme is:

**to seize an opportunity from the fourth industrial age and to address a need that is founded in the demise of traditional industries in many of the South Wales Valleys, and in particular, those of Blaenau Gwent<sup>45</sup>.**

This is a substantial programme with a proposed spend of £100m over ten years. For 2020-21 the budget for the programme (£10m) was nearly twice that of the revenue budget allocated directly to Business Wales (£5.57m).

There is much to be welcomed in the Welsh Government making ambitious, long term investments in areas that need it. But, as with other examples of sector-based policy in Wales, it is not clear how ambitions are going to be realised. The emphasis of the Tech Valleys Vision and Strategic Plan documents is clearly on the potential impacts it could have if successful, rather than the existing assets in the region which could make it a reality. A number of key questions go answered:

- Manufacturing remains a large employer in Blaenau Gwent, but the programme outlines an ambitious transformation to a technological frontier. This will require either significant inward investment, with commitment by foreign or UK-wide firms to create jobs higher up the value chain than recent history suggests, or alternatively will require ambitious Welsh firms to engage with these opportunities. The strategy is not clear about the relative balance of these options that will be sought.
- There is a headline target for the whole of the Tech Valleys programme of creating 1,500 jobs. The proposed investment by automotive manufacturer TVR (of whom the Welsh Government have purchased a three per cent stake) is anticipated to create 200 jobs once production begins. Besides this, it is not clear how the figure of 1,500 has been identified (though reference is made to the capacity of the various properties in which the Welsh Government has committed to invest), nor how it will be achieved.

In terms of the delivery mechanisms for business support, this programme rests within the Welsh Government. This is broadly in line with the stated principles for the different roles of business support organisations, with significant, often non-repayable investments being made by the Welsh Government<sup>46</sup>. Nonetheless, the Strategic Plan for the programme makes no mention of Business Wales or the Development Bank of Wales, despite stated aims that the investment should encourage impacts in wider supply chains and an apparent need to engage with business and promote new opportunities. In identifying potential investors to complement TVR's commitment, it is striking that these existing bodies are not playing a greater role.

<sup>44</sup> Images from <http://www.blaenau-gwent-business-hub.co.uk/documents/EVEZ%20transition%20to%20Tech%20Valleys.pdf>

<sup>45</sup> Welsh Government, (2018) Tech Valleys Strategic Plan, Cardiff: Welsh Government

<sup>46</sup> See [evidence given to the Welsh Parliament Public Accounts Committee, 24/06/19](#)



On the basis that a lack of sector policy can result in a less systematic approach, but also by virtue of a recognition of Wales' particular economic circumstances, there is an argument for better sector policy, rather than no sector policy at all. Achieving better sector policy requires a more data-driven approach to identifying priorities, but with the opportunity for different targets and expectations for different sectors.

At present, it is difficult to scrutinise the methodology that the Welsh Government and other bodies have used to identify priorities, as very little of this decision making has been made public. The Cardiff Capital Region has indicated that its own sector policy has been based on analysis of the geographical concentration of firms from particular sectors (through location quotients)<sup>47</sup>, but there are concerns that this provides a relatively shallow understanding of the real depth of impacts of a sector within the Welsh economy<sup>48</sup>.

Ultimately, a lack of transparency in picking sectors creates risks in a context where there have already been a number of high profile failures in government investment. This lack of transparency creates conditions in which priorities might be chosen due to the strength of lobbying rather than the growth potential of an industry or sector. Perhaps more importantly, where sector policy is decided behind closed doors, it will always be owned by policy makers and by the specific sector bodies that have influenced it – the wide variety of stakeholders that are required to make a success of sector policy, such as educators, SMEs and local authorities – are only given a reactive role, waiting for each new government to give them a new set of priorities to fulfil.

<sup>47</sup> [Evidence from Kellie Beirne, Director of Cardiff Capital Region City Deal, to Welsh Parliament Economy, Infrastructure and Skills Committee, 23/01/2020](#)

<sup>48</sup> [Crawley A, Munday M. \(2017\) Priority sectors in city regions? Some issues from a study of the Cardiff Capital Region. \*Local Economy\*. 2017;32\(6\):576-589](#)

## A research-oriented approach to identifying priorities

Identifying sectors should instead be informed by a mixed-methods research approach that identifies industries that could have a broad, sustained impact on the Welsh economy, and that could benefit from public support.

In the past, sector policy has combined sectors where Wales has strengths and weaknesses without sufficient rationale for doing so, or for what kinds of impacts policy is expected to have. To help design appropriate interventions, research should aim to distinguish between different groups of potential priority sectors:

1. Sectors which are strong and embedded, in which multiple aspects of the supply chain and higher value activities take place within Wales - this includes features of the foundational economy such as aspects of food production, wood and timber, construction and infrastructure.
2. Sectors which have recognised weaknesses or limitations in Wales, but which provide benefits to other firms and are essential to the operation of key systems and supply chains - this includes digital technologies, transport and logistics, business-to-business services.

Much of this can be achieved by investing in quality economic data on productivity and supply chains, surveys and engagement with firms, but also through more experimental measures such as the identification of 'generative businesses', something that the IWA and the Centre for Local Economic Strategies have explored through the IWA's Understanding Welsh Places project by analysing legal and ownership structures<sup>49</sup>. The creation of Economic Intelligence Wales as part of the Development Bank of Wales is a welcome step to addressing a recognised lack of economic analysis<sup>50</sup>. Crucially, identification of sectors should be undertaken with recognition of limitations in the data - in particular industry classification and the scope for emerging industries, or specific subsets of wider industries, to fall through the cracks of the analysis.

49 <http://www.understandingwelshplaces.wales/en/methodology/#interrelationship>

50 See Jones, J., (2014) *Why Wales needs to up its game in terms of economic data*. Cardiff: IWA; and Crawley A, Munday M, Roberts A. *How serious is a devolved data deficit? A Welsh perspective*. *Local Economy*. 2018;33(8):862-876

## The evidence base in Greater Manchester

The Manchester Independent Economic Review (MIER)<sup>51</sup> was a Commission established in the mid 2000s, including prominent economists and business leaders with a policy advisory board including representation from relevant civil society organisations. MIER commissioned a series of high quality evidence-based thematic reviews of aspects of the economy of Greater Manchester in 2009.

The core aim of MIER was to create a shared set of resources and an accessible evidence base to inform economic development over the coming decades. The scope of the review was strongly informed by consultation and engagement, and findings were presented in a transparent, user-friendly way.

The MIER drew on high quality research support from the region's universities and the National Endowment for Science Technology and the Arts (NESTA). In addition, it drew in international expertise, from Goldman Sachs' Head of Global Economic Research Jim O'Neill and Professor Edward Glaeser, Professor of Economics at Harvard University, an influential theorist of city economies. This approach of bringing in outside expertise and insight has been replicated by the updated Greater Manchester Independent Prosperity Review in 2018, which assembled a panel with highly respected economists representing a range of perspectives and research interests, including Professor Diane Coyle, Professor Mariana Mazzucato, Professor Henry Overman and Stephanie Flanders<sup>52</sup>.

In doing so, these reviews sought to combine accessibility to local partners with a strong conceptual framework and robust methods. As a result, the outputs of the reviews have contributed to a greater degree of consensus amongst various partners involved in economic development in the region. While debates have continued about the emphasis on agglomeration and challenged the assumption about the impacts of growth for equity<sup>53</sup>, the MIER and the subsequent Independent Prosperity review have contributed to wide-ranging partnership working, as many of their findings became widely accepted as the basis for future strategy.

The broad focus of this approach to evidence gathering has allowed for a holistic approach to economic development. The MIER focused on themes that each contribute to the productivity of the region, such as labour market and skills, agglomeration, sustainable communities, investment and trade and connectivity. This allowed for recommendations to be made across a range of policy areas, having had particularly impacts on approaches to transport, housing and spatial planning and governance structures. The findings have also demonstrated that a robust, well-supported case can gain support and investment from central government and have a wider influence across the UK, particularly shaping the development of the UK Government's city region agenda (which has found its way into Wales).

In contrast to the Greater Manchester experience, there is no existing programme or set of outputs in Wales that achieves the same kinds of broad engagement and long-term emphasis. Whilst there is a substantial and growing body of research and analysis on the Welsh economy, much of this is undertaken for distinct purposes, relating for instance to specific and topical policy interests. Despite a wide range of advisory bodies to the Welsh Government and to the various city and growth deal bodies in Wales, the breadth of engagement with different types of firms and civil society organisations is mixed. The difference in the scope of the evidence base is striking considering the range of economic policy tools available to the Welsh Government in comparison with the combined authority of Greater Manchester.

51 <http://www.manchester-review.org.uk/aboutus.html>

52 See page 25, UK Government, (2019) *Greater Manchester Local Industrial Strategy*

53 Nolan, A (2011) *Manchester Independent Economic Review: Lessons for informing better policy decision making*, Centre for Local Economic Strategies (CLES) briefing issue no.95

## Better engagement with small business

In addition to economic analysis, policy makers need to establish better processes for engaging directly with firms. In the past, the Welsh Government has actively cultivated good relationships with so-called ‘anchor-firms’, such as Ford, Tata and Airbus, in recognition of the significant impacts that these firms have for employment and GVA in Wales<sup>54</sup>. However, the closure of the Ford plant in Bridgend in 2020 demonstrates that no amount of relationship building can override these firms’ commercial decision making. Economic policy making is currently informed by a wide range of advisory bodies, and concerns have been raised not only about duplication but about the risk that smaller firms find it harder to engage with these forums<sup>55</sup>. As a result, there is a risk that the experience of the majority of Welsh firms is not being presented to policy makers.

To achieve better engagement, policy makers should make use of both formal and informal networks, including chambers of trade, Business Improvement Districts, sector bodies and informal social networks. This kind of engagement should be treated as a research exercise, with the aim of triangulating examples of the lived experience of business owners with analysis of economic data, in order to identify the strengths, weaknesses, opportunities and threats across the whole of the Welsh economy.

Business service providers such as accountants, local networks such as chambers of trade and BIDs and informal networks or contacts between businesses could all be used to grow the reach of Welsh business support programmes, with programmes setting ambitious targets for how many firms are engaged through these channels.

As we have highlighted, in normal times, business support programmes only engage a small minority of businesses. In the context of COVID-19 and the support offered through the Welsh Government’s Economic Resilience Fund, a much higher number of firms have engaged directly with Business Wales. As of December 2020, 13,000 out of an estimated total of 267,000 (representing 5% of all firms in Wales).

This substantial increase in engagement presents an opportunity to re-shape the relationship between government and Welsh business. Business Wales now holds a large amount of data on these firms, including contact details and basic information about these firms’ sector and products, as well as indications of turnover and the general health of many of these businesses. This can form the basis for a new range of business support services that enable providers to be more proactive in promoting new opportunities, as well as playing a stronger convening role by encouraging links between firms doing complementary work.

Firms that have accessed the Economic Resilience Fund should continue to be targeted for information about how restrictions are likely to change, but also about the potential impacts of Brexit moving through the first years of transition. Business Wales should be funded by the Welsh Government to deliver a specific programme to deliver one-to-one consultations to a wider range of firms, not only to share information but to identify concerns in order to inform future work.

54 [New Economics Foundation, \(2013\) Towards a Welsh industrial strategy, London: NEF](#)

55 [Cottam, B., \(2020\) ‘The next Welsh Parliament needs to prioritise business and the economy’, article for \*the welsh agenda\* online, 26/02/2020](#)

## Using public procurement to inform priorities

Public procurement has been an important part of the policy programme for the foundational economy, and for comparable approaches to economic development such as Community Wealth Building and the 'Preston Model'. In Wales, this agenda has been addressed by the office of the Future Generations Commissioner, who have conducted a detailed analysis and review of principles and practice across Wales, and also by the Welsh Local Government Association, who have invested resources in the development of metrics and tools to inform procurement professionals. In addition, the Economy, Culture and Skills Committee of the Welsh Parliament has conducted an inquiry into procurement for the foundational economy, compiling evidence on barriers to further progress<sup>56</sup>.

This work has highlighted a number of factors which influence whether or not public procurement can successfully instigate change in local or regional economies. Amongst these is the confidence of the procurement profession in departing from long-held expectations, often created by policy makers, that procurement should prioritise value-for-money from public spending. The programme of transforming the aims of procurement ultimately requires a different approach to value, informed by much more detailed evaluation and engagement with suppliers to identify how deep that investment goes within a local economy, tracking its impact within supply chains. Despite its complexity of this goal, there is significant commitment from Welsh Government, Public Service Board, Health Board and Local Authority levels to achieving it.

## Procuring Personal Protective Equipment

COVID-19 presented a significant challenge to the smooth, uninterrupted operation of supply chains for many essential goods. One in particular that attracted public attention early in 2020 was the interruption to the supply of Personal Protective Equipment in the UK and across Europe. With many countries reliant on manufacturing in Asia for PPE, the interruptions to production and additional barriers to international trade brought about by public health measures meant that a rapid increase in demand could not be met, resulting in shortages to front-line staff in health and social care as well as the general public.

Both the National Procurement Service - a collaboration between Welsh public sector agencies - and the Welsh Local Government Association sought to address this gap in supply through proactive engagement with Welsh firms. This engagement highlighted a number of existing producers with the capacity and resources to adapt their offer to supply required forms of PPE.

A separate element of the process saw a similar kind of relationship with suppliers for storage and distribution. Extensive local authority experience of procuring distribution for school supplies meant that a wide range of firms with relevant capacity were included in existing supplier frameworks. This data, followed up by engagement with suppliers, saw the creation of a network able to deliver Welsh-made PPE to relevant settings.

This approach represented a departure from normal procurement practice, in which specific demands are defined by commissioners and put out to market to await responses from bidders. A more pro-active approach allowed for a closing of the gap between demand and supply, and a greater collaboration between the public and private sectors. These examples provide an illustration of how the procurement system can respond to interruptions and build relationships, and provides clear evidence to support the Welsh Government's policy aims using procurement for greater social benefit.

56

See the progress of the Future Generations Commissioner's inquiry at <https://business.senedd.wales/mgIssueHistoryHome.aspx?IIId=25951>  
See details of the WLGA's work on TOMS framework at <https://www.wlga.wales/national-toms-for-wales-regional-stakeholder-consultation-survey>

Developing more ‘relational’ procurement between commissioners, procurement professionals and suppliers will create a vast resource in terms of data and understanding of how particular supply chains and industries work. It is vital that this resource can be drawn upon not just for procurement but for the purpose of setting out a vision and targets for economic development across Wales. In developing national economic strategy and priorities, and in developing its communication with the private sector, the Welsh Government should incorporate procurement data alongside established measures for key sectors, therefore contributing to a wider understanding of the opportunities that will be available to Welsh firms in the future.

Procurement professionals should also be considered as partners in economic development, having expertise and insight into the Welsh economy. The National Procurement Service should be involved in discussions about economic development priorities in order to align future demand from the public sector with the capacity of firms to meet that demand.

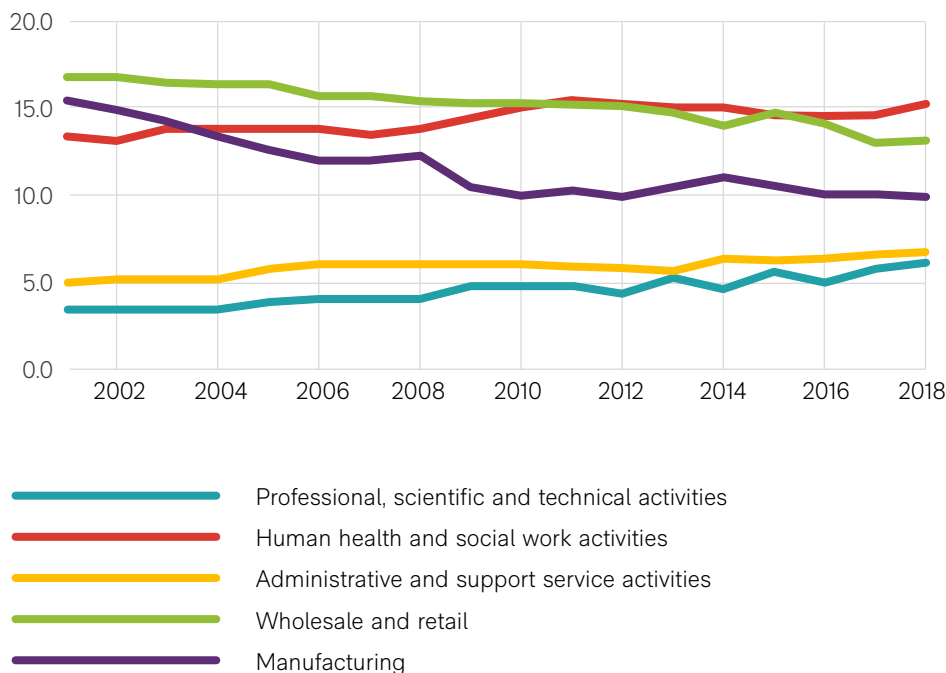
### Setting clear, realistic expectations

As the foundational economy literature has highlighted, many sectors that are prioritised in economic policy, such as ICT and financial services, represent relatively little total employment<sup>57</sup>, yet policy design and target setting has been based on jobs growth. The vast majority of business support programmes and interventions in Wales refer to jobs growth in their own materials, and jobs growth is also referred to in external evaluations as a measure of the success or not of these programmes. However, the sectors and priorities set out by policy makers in Wales do not often come with detailed evidence of where and how they anticipate that jobs will be created - as is the case with the Tech Valleys programme, outlined above.

Looking at longer term trends in employment in Wales, it is difficult to draw clear inferences about their relationship with sector policy. Where there has been jobs growth, it is often in more general industry classifications rather than in defined sectors. This partly reflects long-term changes in the labour market, and particularly the growing importance of services. At the same time, with long term growth in sectors such as health and social care, technical and professional services and administration and support services, it is difficult to identify any link to priority sectors or to the support that sector policy has provided. Similarly, some sectors which have been prioritised by policy makers, such as manufacturing, have seen steady decline in employment.

Figure 1

Percentage of total employment in Wales by selected sectors, 2002-2018<sup>58</sup>



<sup>57</sup> [Bentham, J., Bowman, A., de la Cuesta, M., Engelen, E., Ertürk, I., Folkman, P., Froud, J., Johal, S., Law, J., Leaver, A., Moran, M. & Williams, K., \(2013\) Manifesto for the foundational economy, CRESC Working Paper no. 131](#)

<sup>58</sup> Source: Stats Wales

As well as looking at the numbers of jobs created, it is illustrative to consider productivity per job, which contributes to another key aim of Welsh economic policy as well as being associated in part with job quality. Looking at the recent examples of priority sectors, and considering the productivity of these sectors in Wales against UK averages, there are examples where Wales has strengths, such as manufacturing, as well as those where Wales has evident weaknesses, such as digital technologies (See Table 2 below). Within this variety, policy aims and targets are often not clearly distinguished, resulting in sometimes unrealistic expectations that Wales can become a ‘world leader’ in sectors where it barely keeps pace with the rest of the UK<sup>59</sup>.

**Table 2**  
Productivity per job in Wales by sector, 2018<sup>60</sup>

Sector	Productivity per job in Wales, variation from UK average
Accommodation and service activities	26.4
Human health and social work activities	18.5
Public administration and defence	16.8
Other, Households	13.2
Transportation and storage	10.8
Manufacturing	9.2
Administrative and support service activities	3.2
Wholesale and retail trade	-2.2
Construction	-4.6
Education	-5.2
Finance and Insurance	-13.5
Arts, entertainment and recreation	-16
Professional, scientific, and technical activities	-20.6
Information and communication	-32.2
Non-Manufacturing Production & Agriculture	-33.2

This suggests that a much more granular approach is required, in which policy makers set targets for each priority sector that recognise its specific needs and capacity. Sector policy needs to be guided by a dashboard approach that identifies specific measures of performance, as well as establishing baselines that indicate where policy can make an impact, whether by boosting skills and work-based learning, creating incentives for private sector investment, by improving the way that markets function locally and across Wales to ensure accessibility for new entrants, or by looking across the whole of a supply chain to identify new opportunities.

<sup>59</sup> High profile examples were found in the experience of Techniums in the 2000s, and also in the experience of Enterprise Zones after 2013, among which there are multiple examples of failure to meet targets and accusations of a lack of local insight - see – Pugh, R., MacKenzie, N.G. & Jones-Evans, D., (2018) From ‘Techniums’ to ‘emptiums’: the failure of a flagship innovation policy in Wales, *Regional Studies, Taylor & Francis Journals*, vol. 52(7), pages 1009-1020, July; and – Welsh Parliament Economy, Infrastructure and Skills Committee, (2018) *Enterprise Zones: Boldly Going?*, Cardiff: Welsh Parliament

<sup>60</sup> Source: Stats Wales



One way that policy makers can do this is to consider how the value of particular jobs are multiplied within local economies and within wider supply chains, rather than targeting the creation of numbers of jobs across Wales as a whole. Using the examples of Wales' shellfish economy, a relatively small number of directly-employed people have a greater impact within local economies in regions such as the Menai straits, and many have invested in capital and skills that would not be easily recycled if businesses failed. These businesses support employment in local business-to-business services such as accountants and legal services, as well as creating demand for high-value processing and distribution that both contributes to exports and provides opportunities to grow the sector as a whole. These strengths can be found in many industries in Wales that slip through the cracks of sector policy at present.

## The Welsh shellfish sector

The shellfish industry provides an example of a sector where Wales has potential strengths that are not being realised. Wales has extensive coastline with large tidal range, which industry bodies have described as a representing strong conditions for aquaculture and shellfish harvesting. The industry is relatively long-standing in coastal areas, representing a heritage food 'brand' that can be easily marketed. As a result, all aspects of the supply chain for shellfish can currently be found in Wales, including producers, processors and distributors. Much of the work is high skilled and specialised, and a majority of the catch is exported.

The Welsh Government has recognised the sector as a potential economic strength, having set an ambitious target of doubling the catch by 2025<sup>61</sup>. However, since the publication of this target the catch has in fact declined. Sector bodies have highlighted how Welsh agencies have poor licensing processes, with unclear criteria and unclear time frames, with some applications taking years to be processed. Delays and uncertainty cause significant problems in a sector that requires extensive forward planning, not just to finance expensive equipment but to prepare areas and seed shellfish years in advance of harvesting, and regulatory impact is noted by fisherman as a significant barrier to growth<sup>62</sup>.

Brexit has posed a fundamental challenge, with the sector being cut off from by far its largest export market. Ensuring survival, let alone growth, is going to require the kinds of proactive policy intervention that is typically directed at high tech sectors, but there are clear opportunities for the Welsh Government to help the sector to transition, without requiring the same kind of capital investment seen in the Tech Valleys programme. Building on existing collaboration with fishery order bodies and academic researchers, Welsh Government should seek to streamline its application and licensing procedures to provide greater certainty and to proactively communicate its intentions. Public agencies collect data for regulatory purposes which sector bodies have suggested could be used to inform smart monitoring across the supply chain, enabling producers to shorten the time between catch and sale<sup>63</sup>. As part of the Brexit process, there is also a need for the Welsh Government to ensure that the concerns of the sector are heard by the UK Government, including by keeping the door open to future negotiation with the European Union. Recognising these opportunities and coordinating policy making and regulatory processes requires commitment from the centre of government, a strong feature of sector policy.

<sup>61</sup> [Welsh Government, \(2013\) Wales Marine and Fisheries Strategic Action Plan, Cardiff: Welsh Government](#)

<sup>62</sup> [Shellfish Centre, \(2018\) Shellfish production in Wales: Opportunities, constraints and research needs, Bangor University](#)

<sup>63</sup> [CamNesa Consulting, \(2016\) Understanding the Welsh seafood supply chain, Seafish/Milford Haven Port Authority](#)

With the ongoing work of the city and growth deal regions and the incorporation of them into the Welsh Government's Regional Investment Framework, as Corporate Joint Committees, there is now an established regional geography and governance mechanism below the Welsh Government level. This should be an important feature of identifying sectors and delivering support in the future.

Ultimately, this means departing from such an explicit focus on job creation and job support. This may prove politically difficult in the short term, but can be justified where policy makers, political opponents, industry and the public share a long-term vision for the direction of the economy - something that we discuss later in this report. Investments that strengthen supply chains, boost business acumen and help firms to diversify and innovate are all likely to contribute over time to the creation of high quality jobs that are grounded in Wales, are more productive and are more likely to create spin-off benefits, even if they don't directly support job creation now.

## Rethinking 'productivity' for social benefit

Business support programmes, and policy interventions to boost productivity more generally, have become more selective over time, largely in response to evidence about where the greatest impact could be gained. As a result, non-tradeables and local services have seen relatively little investment and support, partly due to the fixed size of their markets and the lack of international competition to drive innovation<sup>64</sup>.

There are good reasons for policy makers, particularly in Wales, to target improvements in productivity. In the Welsh context, productivity per worker is often associated low wages, or more accurately with a lack of high wage earners<sup>65</sup>. Despite recognised weaknesses in how policy makers target improvements in productivity, few people would be happy to see productivity decline. However, standard measures based on output and pricing have less merit when thinking about the foundational economy, and a different approach to thinking about productivity is required. Ultimately this requires thinking about quality and about complex systems which rely on a variety of different actors in order to function.

Despite a lack of investment, improvements in the functioning of foundational sectors is likely to have significant positive impacts for Wales. The foundational sectors of care, food, transport and energy benefit everyone when they function well, and hold everyone back when they function badly. Measures of productivity typically ignore the economic impacts of these sectors, contributing to artificial conceptual barriers between tax-generating private sector and a tax-dependent public sector. This ignores the huge contribution of both public services and foundational systems more generally to the everyday functioning of the economy, as well ignoring the capacity of these sectors to innovate and explore new opportunities in an entrepreneurial way, whilst remaining grounded in place<sup>66</sup>. Improvements in these systems are likely to result in greater accessibility and higher quality delivery, and will contribute to improved well-being and quality of life, reducing the need for later intervention and making life in Wales more enjoyable and affordable.

This reframing of 'productivity' as 'quality' makes improving productivity in the foundational economy a social challenge, as much as an economic one. However, analysis of how foundational systems work underscores the importance of the private sector, creating a significant role for the instruments of economic policy such as business support. A large number of private sector firms - including taxi drivers, caterers, cleaners, carers and engineers - are essential to the successful operation of larger public sector bodies such as schools and hospitals. At present, these firms fall into a gap between several government priorities and funding streams. On one hand, business support is largely targeted at potential high-growth firms in high tech, export-oriented sectors. On the other, significant investment in public service improvement, through Public Service Boards and the future generations framework as well as programmes like Invest To Save<sup>67</sup>, does not reach much beyond the public sector. Making business support programmes and investment available to these firms will help them to adapt their offer to make use of new technologies and processes, but more importantly, to get better use out of their existing resources.

<sup>64</sup> McDonald, R., (2018) *The 12 urban myths of Christmas: Myth 6 - We should focus on the 'long tail' to solve the UK's productivity problem*. Centre for Cities website, 18 December 2018

<sup>65</sup> McCurdy, C., (2020) *From locking down to levelling up: The past, present and future of Welsh living standards*. Resolution Foundation

<sup>66</sup> Thompson, M., Nowak, V., Southern, A., Davies, J. & Furmedge, P., (2020) *Re-grounding the city with Polanyi: From urban entrepreneurialism to entrepreneurial municipalism*. *Environment and Planning A: Economy and Space*, 52 (6), 1171 - 1194.

<sup>67</sup> For more information on the Invest to Save programme see <https://gov.wales/invest-save-2019-2020>

### A focus on 'challenges'

One way of developing a business support offer that is valued by businesses is to focus on a series of challenges that we know are likely to impact both business, government and wider society. There is particular scope to use business support programmes to raise awareness and promote responses to climate change. Decarbonisation is the greatest public policy challenge of the contemporary era. To date, international debate has identified a number of key tools for policy makers<sup>68</sup>:

- Economic approaches that require government intervention to reflect environmental costs in pricing (such as carbon taxes and emissions trading);
- Technological solutions that will both mitigate the impact of existing damage (carbon capture) and replace carbon-intensive technologies (electric vehicles);
- Behavioural change that will discourage consumption of particularly impactful goods and services.

Focussing on the foundational economy provides an opportunity to utilise all three of these tools, creating new supply chains to replace more impactful ones and disseminating new technologies among a wider range of firms. SMEs and firms in foundational sectors make up a large part of the Welsh economy and their commitment to decarbonisation will be absolutely essential to making it happen.

However, there are significant barriers to achieving this. As noted throughout this report, many firms in the foundational economy have limited engagement with government agencies and business networks. There is significant evidence that these firms are also less likely to adopt new technologies, even where they present new business opportunities. Evidence from the Superfast Broadband Rollout Scheme in Wales has indicated that foundational economy firms were less likely to develop new products and services to make use of access to broadband, and less likely to possess the skills required to do so<sup>69</sup>. Across the EU, only 25% of SMEs work on green products and services, and only 17% have successfully integrated digital technologies, compared to 54% of large companies<sup>70</sup>. This pattern of disengagement from the cutting edge of technology is replicated in other aspects of business planning, such as preparedness for Brexit<sup>71</sup> and flood defence<sup>72</sup>.

<sup>68</sup> [S. Niggol Seo, \(2017\) The Behavioral Economics of Climate Change, Adaptation behaviours, global public goods, breakthrough technologies and policy making, Elsevier Inc.](#)

<sup>69</sup> Reynolds, et al., 2018

<sup>70</sup> [European Commission, \(2020\) Unleashing the full potential of European SMEs, Brussels: European Commission](#)

<sup>71</sup> [Mal, N., \(2020\) More than a quarter of Welsh businesses 'unclear on Brexit readiness', Wales Online, 12/12/2020](#)

<sup>72</sup> [Ingirige, B., & Wedawatta, G. \(2014\). Putting policy initiatives into practice: Adopting an "honest broker" approach to adapting small businesses against flooding. Structural Survey, 32\(2\).](#)

The evidence suggests that it is not sufficient to make new processes and technologies available to firms - governments need to play a conscious role to engage, incentivise and promote uptake. In the context of superfast broadband, failure to do so will result in lost productivity and potentially in business closures, but in the context of decarbonisation could result in significant and avoidable environmental impact, with carbon-intensive technologies being used for decades after safer alternatives have been developed. Decarbonisation is therefore a policy area in which neither market solutions nor selective support will be sufficient.

The Welsh Government and business support providers can support firms to adapt to decarbonisation by:

- Convening ‘knowledge producers’ such as higher education institutions and knowledge-intensive firms on one hand and SMEs in the foundational economy on the other, to enable greater distribution of technologies and processes throughout the foundational economy;
- The development of innovation vouchers that promote collaboration and skills partnerships;
- Providing incentives through low-interest loans through the Development Bank of Wales to promote the adoption of new technological and process solutions to support decarbonisation; and
- Building on the growing interest in Challenge Funding in Wales to encourage and reward innovation, and making sure that this plays a greater role alongside other forms of repayable and non-repayable financial support.

The recognition of foundational sectors within the Economic Action Plan, and in both the Welsh Government’s Foundational Economy Challenge Fund and the Cardiff Capital Region investment framework, provide opportunities to invest in everyday services that are provided in the private sector. It will be important going forward to keep these funding streams, and their strategic aims, distinct from programmes which target growth. Doing so will avoid creating implicit orders of value in which the potential for high-growth, and the ability to demonstrate immediate and direct impact (i.e. in jobs growth), become primary concerns. Evidence from the 2014-2020 Business Wales programme suggests that even where high-growth sectors are not specified in the offer of support, the characteristics of certain sectors make them more likely to gain support.

### Dispersing technology and innovation

Digital technology offers an opportunity to overcome some of Wales’ well-documented structural challenges, in terms of physical connectivity, information sharing and market access. Many successful regions are associated with connectivity and agglomeration, but digital technologies, when combined with good relationships, offer an opportunity to replicate some of the benefits of agglomeration without its associated costs - congestion, carbon emissions, higher costs of living, lower quality of life, and greater regional imbalances. COVID-19 has rapidly accelerated existing trends in terms of remote-working and e-commerce. If these new ways of working are going to reach wider into the Welsh economy, policy makers need to play a proactive role in analysing and presenting opportunities to firms who are furthest away from the technological frontier.

The Welsh Government has invested heavily in partnership with the private sector in expanding access to superfast broadband in Wales, and has had some success. However, this is only part of the work that is required to create a truly digital economy. Foundational economy firms have been recognised as less likely to adapt their processes as a result of superfast broadband, with self-identified weaknesses in digital skills and

capacity<sup>73</sup>. Within the wider population, surveys have indicated that Wales has the weakest digital skills of the UK nations and regions, with 73% of people able to perform basic digital tasks (compared to an average of 84%)<sup>74</sup>. Concerns have been raised that policy to address this problem to date has been focussed on the public sector, leaving Wales' SMEs behind<sup>75</sup>.

We echo the conclusions of the 2019 Review of Digital Innovation for the Economy and the Future of Work in Wales - future governments need to make explicit commitments to the task of 'mainstreaming' digital technologies so that they become the norm for all citizens and firms. There is little precedent in terms of the scale of this upskilling and the requirement to reach the whole population. This will require experimental funding for local projects, along a challenge fund model, to explore what works in bringing together citizens, community organisations, firms and other stakeholders to ensure that no one is left behind. There is a particular role for Business Wales to play in proactively engaging with as many firms as possible to make clear the importance of upskilling and provide easily accessible information and material to support them to do so.

The IWA will contribute to this objective by undertaking a targeted review of innovation and the foundational economy. We will look at existing delivery mechanisms for skills, work-based learning, continuing professional development, research & development and innovation as well as engaging with firms in foundational sectors, and develop recommendations for how to improve reach and accessibility.

### Foresight for the Welsh economy

Engagement with firms and the reach of government-sponsored business support programmes are often limited by long-standing issues of trust, with many firms being highly sceptical of the ability of government to appreciate and improve their commercial understanding or to provide information and advice that will positive impact their business<sup>76</sup>. This lack of trust can be overcome by engaging with firms in a way that emphasises the things that government does well - convening, strategising and identifying longer-term trends.

Through Future Trends Wales, the Welsh Government has invested in a programme of identifying potentially significant impacts of ongoing trends in technology and international politics. There is widespread evidence that firms, and SMEs in particular, struggle with the capacity to undertake this kind of analysis themselves. Research conducted in 2019 identified that only 37% of a representative sample of Welsh firms had a long-term business plan<sup>77</sup>, heightening the risk to those firms in cases of economic shocks such as COVID-19 or Brexit.

Business support programmes, and Business Wales in particular, should play a role in pro-actively distributing foresight information to firms, making clear where opportunities and threats lie and how firms may need to adapt in order to survive. In the context of COVID-19 and Brexit, this activity should reflect the Welsh Government's role in setting policy (for example on public health measures) and their capacity to identify and model the potential effects of policy change.

<sup>73</sup> Reynolds, L., Henderson, D. and Roche, N., (2018) Superfast Broadband Business Exploitation Project Horizon Scanning Report: Digital technologies and future opportunities for the foundational economy in Wales, Cardiff: Cardiff University

<sup>74</sup> Lloyds Bank (2020) Lloyd Bank UK Consumer Digital Index 2020

<sup>75</sup> Evidence given by Prof Dylan Jones-Evans, to the Welsh Parliament Economy, Infrastructure and Skills Committee, 16/09/2020

<sup>76</sup> Department for Business, Energy and Industrial Strategy, (2019) Business Basics: Attitudes to adoption; Understanding the barriers and enablers to the adoption of best practice technologies and management practice by small and medium-sized enterprises, London: BEIS

<sup>77</sup> Morgan, B., Holtham, G., Morgan, S., Huggins, R., Clifton, N., Davies, J., Kyaw, S. & Walpole, G., (2020) Managing productivity in Welsh firms: Final report 2020, Hodge Foundation/Cardiff Metropolitan University

## Supporting entrepreneurial eco-systems

Business support policy, in Wales and elsewhere, has typically focussed on achieving direct outputs, often in terms of jobs growth. In a context of reduced public spending, policy makers have shifted resources towards targeting sectors and firms where growth is likely to be high. Partly in response to the ongoing effects of the 2008-9 financial crisis, the Welsh Government proposed greater targeting at 'high potential start ups' as well moving approximately 45m Euros of ERDF funding from medium to higher priority firms<sup>78</sup>. In the subsequent 2014-2020 programme, Business Wales has targeted its Accelerated Growth Programme (AGP) at businesses and start-ups with the potential for high-growth (defined as a 20% increase in turnover year on year for five years)<sup>79</sup>.

### Steady-state microbusinesses

As part of this review we spoke with a small number of business owners and business organisations to discuss experiences of using business support services in Wales. One experience in particular is illustrative of the effects of targeting of support at high-growth firms.

We spoke to the owner-manager of a micro-business employing just themself. The business provides communications services primarily to other businesses as well as to some public sector bodies. This business owner recalled their experience contacting Business Wales. They had recognised the opportunities available to employees in large organisations to take advantage of periodic training and professional development, for example covering day-to-day business skills, health and safety and other areas. They recognised that this was a gap in terms of the experience of running a microbusiness, and contacted Business Wales to explore potential options for support with accessing training. They were up-front about their business aims and that they had no explicit plans to take on more employees, and were advised that support was targeted at jobs growth, so would not be available to them.

In this instance, as across most Business Wales programmes, attempts to target support are based almost exclusively on a single metric - jobs growth. This approach does not allow scope to recognise, for instance, that where a firm provides services to other firms within a supply chain, any improvement in skills is likely to have wider effects. This is particularly problematic given Wales' recognised lagging behind other nations and regions of the UK in terms of entrepreneurship, and emphasises the potential benefits of remaining an employee rather than starting a business.

<sup>78</sup> Old Bell 3 Ltd. and Cardiff University, (2012) Mid-Term Evaluation of the Customer Engagement EU Project. Final Report.

<sup>79</sup> [Zaidi et al., 2018](#)

This has created a situation where policy and investment tends to flow towards those firms who offer the highest numbers of jobs in the immediate term. As we have argued in the earlier sections of this report, there have been limitations on the longer term impacts that this approach has had for resilience and productivity in the Welsh economy. There is a growing recognition that high-growth firms are often unpredictable, experiencing bursts of growth that are not replicated over time, and arising in sectors that policy makers are unable to anticipate<sup>80</sup>. Similarly, there is recognition that existing firms are often ignored in favour of start ups, despite evidence that high-growth often occurs amongst long-standing firms<sup>81</sup>.

We believe that an approach which focuses so heavily on numbers of jobs created or supported misses opportunities to create the conditions for a more resilient, sustainable form of growth. By focusing on jobs growth, policy has paid too little attention to the impacts of so-called 'steady-state' firms, many of which make up grounded provision in the foundational economy. These kinds of firms are often excluded from support, but provide benefits in terms of their contribution to the entrepreneurial eco-system:

- Contributing to the spread of knowledge and experience within a community of businesses, often providing informal and trusted support and advice and contributing to business organisations and chambers of trade;
- Providing important goods and services within the supply chains of other firms, often contributing to and benefiting from introductions of new processes and technologies;
- Contributing to the functioning of important everyday systems that allow everyday life and economic activity to continue, often in innovative ways and in collaboration with public services<sup>82</sup>;
- Having an outsized influence within their local area, providing medium- to high-skilled jobs that are not easily replicated once lost;
- By providing business-to-business services, microbusinesses can contribute to the strength of knowledge-intensive sectors. Microbusiness play a particularly strong role in some of the high-value sectors that have been prioritised in Wales in the past, such as the creative industries, construction and financial services<sup>83</sup>.

There is international evidence that firm dynamism can have spillover effects, as business knowledge and experience can be recycled, both through new ventures, through proximity of complementary firms, and through information, advice, guidance and mentoring between firms<sup>84</sup>. However, in Wales there is a recognised lack of firms which transition smoothly between being small and medium size, and suggestions that the role of medium sized firms is comparably weaker than in other countries such as Germany: the so-called 'missing middle'. Wales has been recognised amongst the UK nations as having lower levels of entrepreneurial ambition, largely driven by differences in how potential opportunities are perceived by non-entrepreneurs<sup>85</sup>. This situation may get worse in the future due to the age profile of business owners in Wales.

<sup>80</sup> Coad et al., 2015

<sup>81</sup> Brown & Mason, 2012

<sup>82</sup> Thompson, et al., 2020

<sup>83</sup> [Welsh Government, \(2016\) Priority Sector statistics, Cardiff:Welsh Government](#)

<sup>84</sup> [Mason, C. & Brown, R., \(2014\) Entrepreneurial eco-systems and growth-oriented entrepreneurship, Paris: OECD](#)

<sup>85</sup> [Bonner, K., Hart, M., Heery, L., Prashar, N. and Levie, J. \(2018\) GEM UK: Wales Report 2018](#)



Business support which focuses on potential high growth firms will do little to address the specific problem of firm dynamism across the whole economy, and may miss areas of potential growth that are hard to predict. In addition, many of the types of high growth firms that policy makers have targeted in Wales and elsewhere are short lived, often with rapid growth coming in short bursts that are not repeated. Many of Wales' successful high growth firms have been sold after periods of growth, with ownership and management moving outside of Wales, recreating the branch-plant pattern that has been a feature of FDI.

The foundational economy offers an opportunity for policy makers to support entrepreneurship. Foundational sectors include an extensive range of stable, often long-established firms and a set of markets with consistent demand, spread relatively evenly across Wales. Support to boost entrepreneurship and encourage better succession planning in the foundational economy can result in some of these firms growing, taking on new employees, moving into new markets. But also, by strengthening the position of more stable firms and micro businesses, policy can raise the profile of entrepreneurship and increase the strength of the entrepreneurial ecosystem while maintaining a focus on accessible markets and realistic opportunities. It can raise skill levels and contribute to the sustainability and quality of business services in every area of Wales, facilitating strong ecosystems through which people and ideas can both be recycled over time.

Doing so will require a different set of interventions than those used to promote high-growth firms. The problems of foundational firms and of encouraging firm dynamism do not require large capital investments, and the distributed nature of markets for foundational goods and services means that clustering is likely to have little appeal for firms. The problems that firms in the foundational economy face instead relate to;

- capacity for planning and foresight
- ability to innovate (related in part to capacity, but also distance from centres of knowledge generation)
- opportunities for collaboration with other firms
- the availability of business finance that is patient, affordable and does not require changes in governance or control
- Building on current provision in terms of succession planning, acting on the recommendations of the 2018 review of succession issues by boosting that size of the Development Bank's succession fund and providing one-to-one sessions for workforces on employee-ownership<sup>86</sup>

## A business-support voucher scheme

Provision of information, advice and guidance through government bodies or organisations helps to ensure consistency and a good use of public money. However, there is evidence that many firms are sceptical of the ability of government bodies to teach them about successful business practice<sup>87</sup>. Even where many supported firms are positive about the support that they receive, as is the case with Business Wales, it is difficult for government to overcome this perception.

However, by contrast, there is evidence that firms place greater trust in information, advice and guidance provided to them by other firms. This is partly informed by their status as business owners and their obvious shared experience, but also because these relationships between firms not only result in the sharing of specialist knowledge and practice, they facilitate new and unpredictable collaboration and innovations as part of entrepreneurial ecosystems<sup>88</sup>.

Business support programmes could promote these kinds of relationships by shifting some provision out of public agencies to the private sector through the use of voucher schemes, funding supported firms to access specialist support from accredited providers within their industries. Both Innovate UK and Invest Northern Ireland deliver schemes in which firms can apply for a voucher of up to £5,000 to be used to fund collaboration with 'knowledge providers' such as universities, colleges and research institutions. An evaluation of the Invest Northern Ireland programme highlighted positive impacts on new products and services in over half of cases<sup>89</sup>. Both programmes respond to a recognised need in supporting SMEs, who face challenges investing time and resource into innovation while maintaining their focus on core business activities<sup>90</sup>.

As well as engagement with 'knowledge providers', there are also examples of voucher schemes that promote collaboration between businesses. The European Commission has funded a voucher scheme for specialist ICT support through which governments provide vouchers to be used with accredited suppliers of consultancy and advice services, enabling supported firms to build, for example, customer relationship management tools, improve their ability to buy and sell online, and streamline business processes<sup>91</sup>. In doing so, firms have been able to access highly specialised support, beyond the capacity of public bodies to be able to provide. Since 2018, the Scottish Government has delivered one such programme, with the express aim of improving cyber security of Scottish firms, a specialist skill set that is beyond the capacity of government to provide<sup>92</sup>.

<sup>87</sup> Department for Business, Energy and Industrial Strategy, (2019)

<sup>88</sup> Mason & Brown, 2014

<sup>89</sup> SQW Ltd., (2019), [Evaluation of the Innovation Vouchers Programme: Report to Invest Northern Ireland](#)

<sup>90</sup> [Innovate UK \(2014\) Innovation vouchers for all smaller businesses, GOV.UK website, 21/10/2014](#)

<sup>91</sup> [European Commission, \(2020\) ICT innovation vouchers in action, European Commission website, 29/10/2020](#)

<sup>92</sup> [Cyber essentials \(n.d.\) £1000 Cyber Security Voucher available for Scottish businesses, Cyber Essentials website](#)

### A more accessible microfinance offer

The foundational economy literature has highlighted that many grounded firms are rightly sceptical of taking on debt in the private sector. Often this is due to the steady state of their firm's growth over time (and therefore the potential challenges of meeting the repayment terms of business banking that is largely geared towards high-growth firms), but also reflects concerns about how debt will alter their way of running the business. A net result of this is that many firms who have the capability to do more than they are currently doing are put off by the risks that finance would bring.

Patient finance, and development banks in particular, have been highlighted as an alternative that can encourage businesses to invest and, subsequently, to innovate and improve their productivity. The Development Bank of Wales was formed in response to this recognised lack of accessibility in business finance. In its first few years it has responded strongly to the regional dimension of accessibility and by identifying biases against investment in Wales and, working to encourage the private sector through matched investment, it has plugged an important gap. However, compared with many European banks (where the practice of development banks is more established), it does less to compensate for other gaps in business finance, particularly around microfinance. Microfinance makes up 58% of the Development Bank of Wales total number of loans but in terms of the size of its funds, the Wales Micro Loans Fund represents £30 million of a total of nearly £1.2 billion. The definition of microfinance used by the Bank (£50,000 or under) is considerably higher than the definition used by the European Commission (approx £27,000 or under)<sup>93</sup>. The former Chair of the Task Force established for the creation of the Bank has suggested that both the amounts offered and securities required are out of the reach of many microbusinesses<sup>94</sup>.

This is something that the Bank has itself recognised, and it has indicated that lending smaller amounts with more patient terms is likely to be an important component of its work going forward<sup>95</sup>. If transformative impacts in the Welsh economy are to be realised, all relevant public bodies will need to work to encourage firms that are sceptical about loans to see them as an opportunity and not a threat.

<sup>93</sup> [European Commission, \(2003\) Microcredit for small businesses and business creation: Bridging a market gap, European Commission](#)

<sup>94</sup> [Evidence given by Prof Dylan Jones-Evans to the Welsh Parliament Public Accounts Committee, 13/05/19](#)

<sup>95</sup> [Evidence from Giles Thorley, Chief Executive of Development Bank of Wales to the Welsh Parliament Economy, Infrastructure and Skills Committee, 11/11/2020](#)

## Recycling entrepreneurship

As public health related restrictions begin to be lifted throughout 2021 and into 2022 and beyond, the Welsh economy will undoubtedly require the formation of high numbers of new businesses to fill gaps left by business closures. The UK is recognised as among the top 20 countries in the world for the ease of starting a business<sup>96</sup>, and this ease of doing business may become valuable as part of the medium-term response. Policy makers have a role to play in ensuring that business closures in response to COVID-19 do not undermine the entrepreneurial eco-system, and that important attributes are not lost.

The current package of business support - from information advice and guidance through to patient finance - will need to work efficiently and at greater scale than previously in order to facilitate a quick reallocation of entrepreneurial skills and capabilities into new businesses. This should form a distinct set of policy aims, with ambitious targets to provide follow-on support in the case of business failure, offering one-to-one consultation and support to identify where new opportunities may arise.

In the short term, both the Welsh Government and local authorities should recognise the ways in which they can further facilitate new business start ups over the coming years.

- Repurposing high streets through identifying opportunities for ‘meanwhile’ use with landlords and potential businesses;
- Facilitating the use of public space for socially distanced hospitality - something for which FSB Wales has provided detailed recommendations<sup>97</sup>;
- Expanding the support available through microfinance.

Yet also, as with other proposals in this paper, the foundational economy cannot be ignored in the policy response. A key lesson of COVID-19 is the resilience of foundational sectors, with consistent levels of demand for foundational goods and services and a relatively even geographical spread across Wales. More effort should be made through entrepreneurship support to promote opportunities for business development in these sectors, encouraging a form of entrepreneurship that can build from stable foundations.

<sup>96</sup> The World Bank publishes an ‘ease of doing business’ ranking that compares countries of a range of measures including various regulations and access to finance - <https://www.doingbusiness.org/en/rankings>

<sup>97</sup> [Federation of Small Businesses. \(2020\) Open for Business: Repurposing public spaces for economic recovery](#), FSB

## Getting the structures right

It is widely recognised that the Welsh Government does not have the powers or budget to provide short-term economic boosts, but it does have a range of powers that can contribute over the long term to a strengthened economy<sup>98</sup>. If these long term benefits are to be achieved, policy needs to be much better coordinated to ensure that all of the relevant pieces are in place.

The current picture of economic policy making in Wales is complex. It has had to align with the strategic aims of the European Commission, the UK Government, and the Welsh Government as well as local and regional bodies. A business looking for support in Wales today still faces a number of options that is likely to differ in each individual case, including Business Wales and the Development Bank of Wales, but also local government, city and growth deals, enterprise zones, and from UK-wide providers, particularly if they require support relating to innovation or R&D<sup>99</sup>. To overcome this complexity, significant effort has been undertaken to make Business Wales a 'one-stop-shop' providing signposting and advice. This approach to delivery needs to be replicated in terms of how policy is made, with a role for greater coordination.

## Secure funding for economic development after Brexit

Brexit poses a number of significant challenges for Wales. In terms of trade, Welsh producers need to quickly reorient themselves towards new regulatory regimes and identify new markets - in the case of industries such as shellfish, there is a strong rationale for government support with this. However, funding this support, and indeed the Welsh Government's wider economic policy capacity, represents a potentially even bigger challenge.

European structural investment represented a significant portion of the Welsh Government's Economy & Transport budget. It is highly unlikely that the loss of these investments will be compensated over the longer term by the UK government. Despite political commitment that investment will be 'not a penny less', the relevant geographies and needs-based formulas for the Shared Prosperity Fund in particular are not clear and the Institute for Fiscal Studies have questioned the fairness of continuing to fund Wales at current levels<sup>100</sup>. There is strong indication that the Fund will see no formal role for the Welsh Government, instead seeing local authorities as key delivery partners<sup>101</sup>.

Wales needs to prepare for a post-Brexit regional development framework that is more competitive, with closer alignment to immediate political priorities in Westminster and with potential distinct focuses on sectors and funding streams, such as the UK Government's Industrial Strategy Challenge Funds.

As noted in a recent review of R&D funding in the UK, devolution provides the opportunity for a powerful voice in advocating for what a region needs, but to date there is relatively little evidence that devolution in Wales has had this effect<sup>102</sup>. The Reid Review of R&D funding in Wales highlights that Welsh HEIs and other partners have typically struggled to access more competitive sources of funding<sup>103</sup>.

**98** Price, (2018)

**99** Centre for Cities, (2013) Support for growing businesses - Policy briefing, Centre for Cities website

**100** Centre Davenport, A., North, S. & Phillips, D., (2020) Sharing prosperity? Options and issues for the UK Shared Prosperity Fund, Institute for Fiscal Studies

**101** See comments made by Robert Jenrick MP, communities secretary in the UK government, to the English Local Government Association <https://www.lgcplus.com/finance/breaking-councils-in-driving-seat-over-shared-prosperity-fund-jenrick-insists-22-01-2021/>

**102** Forth, T. and Jones, R., (2020) The missing £4 billion: Making R&D work for the whole UK, NESTA

**103** Reid., G. (2018) Review of Government Funded Research and Innovation in Wales, Cardiff: Welsh Government

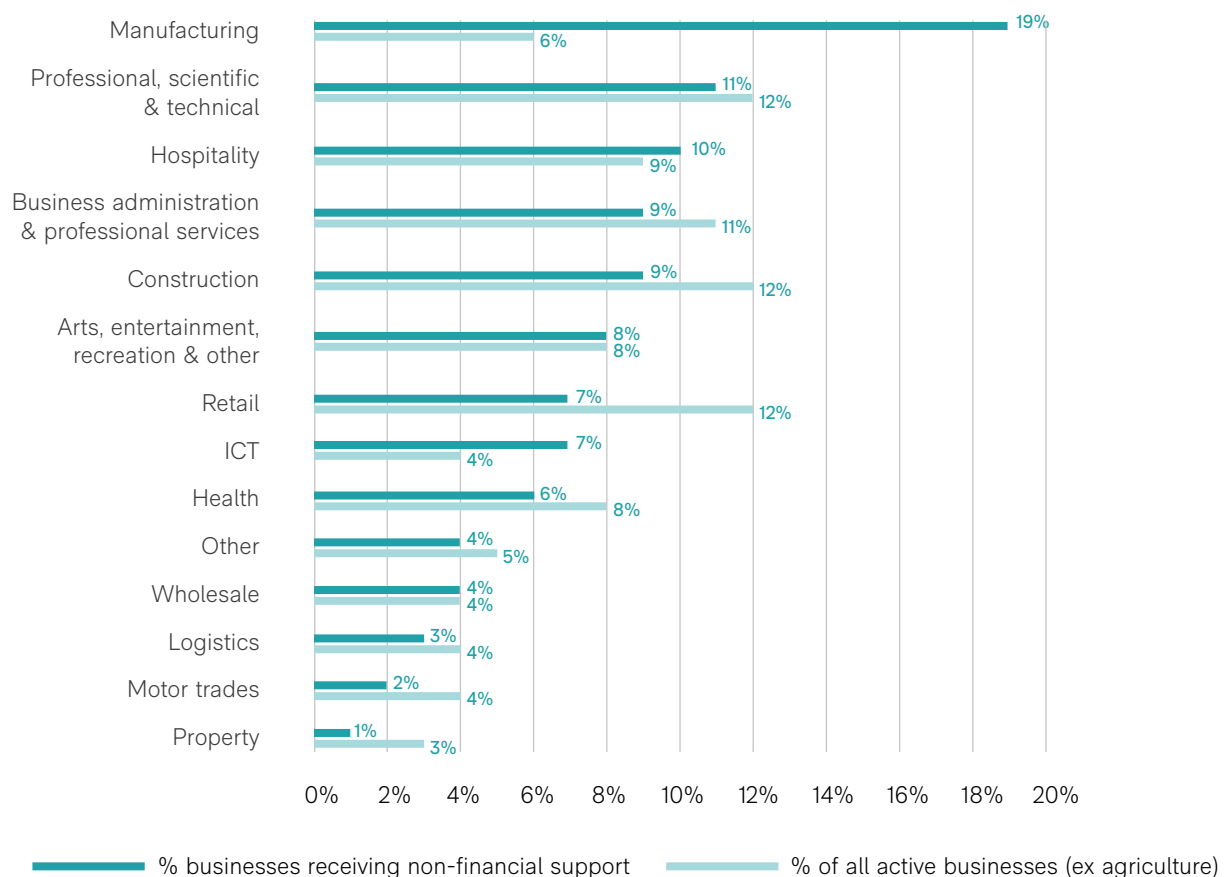
Nonetheless, the stability of the devolution settlement in Wales, particularly compared with arrangements in England, could present an opportunity to challenge successfully for access to funding. If this is to happen, the Welsh Government needs to work to convene local partners, including local authorities but also employers and social partners, to facilitate the creation of a shared vision leading to the development of robust, evidence-based and well-argued bids. While there remain certain structural biases in how funding is distributed, with long-standing emphasis on London and the south east of England, this is unlikely to be overcome without a powerful voice from the nations and regions to challenge these biases.

### Keeping Business Wales at the heart of the business support offer

Business Wales represents a feature of Welsh policy making that has become widely recognised by the business community and by the wider public. Evidence from a series of evaluations demonstrates that firms who receive support from Business Wales are likely to grow in terms of their staff and in terms of sales value and exports. The ‘one-stop-shop’ approach has clearly contributed to a recognisable entry-point, and improvements in cross-referral, particularly with the Development Bank of Wales, have avoided the proliferation of business support structures that has been seen elsewhere. There is also some evidence that Business Wales reaches a wide variety of sectors, with hospitality, construction and retail being well represented among supported firms, illustrating both its responsiveness and its relative accessibility to SMEs.

**Figure 2.**

Proportion of Business Wales beneficiaries receiving non-financial support by sector, 2016-2018<sup>104</sup>



However, continuation of Business Wales in its current guise beyond 2022 is uncertain due to the loss of access to European structural investments, which provide the bulk of its £5m annual budget. Current proposals for the UK Government's Shared Prosperity Fund suggest a more local focus, raising serious questions about whether or not this funding could be used to support an all-Wales programme such as Business Wales..

The Welsh Government has the capacity within its economy and transport budget to reallocate some of the funding that is currently used for its direct investment and business support to enable Business Wales to be sustainable in the longer term. There is evidence that doing so would represent good value for money. Analysis by FSB Wales has suggested that, particularly compared with the support offered by the Welsh Government, Business Wales represents good value for money in terms of cost-per-job<sup>105</sup>. However, that same analysis notes that Business Wales' budget represents only one tenth of that used by the Welsh Government in supporting businesses.

A Business Wales programme with a sustainable funding settlement should be at the heart of future economic development policy in Wales. It represents a recognised and trusted brand that delivers support which is valued by businesses, and has scope to be scaled up relatively easily. European funding has enabled it to be influenced but not determined by political priorities, while multi-annual funding has taken it out of political timeframes. These elements of the Business Wales model should be replicated going forward.

A post-Brexit Business Wales will require new approaches to monitoring and evaluation. European structural investments have long been associated with complex monitoring regimes, in which outputs are mapped against an array of strategic priorities, further complicated in Wales by the distinction between programmes delivered in the NUTS2 regions of East Wales and West Wales and the Valleys. Whilst Business Wales has seen two high quality evaluations (cited throughout this report), the Annual Implementation reports for ERDF and ESF are difficult for stakeholders outside of government to engage with. Going forward, the future Business Wales should produce annual reports that present the data breakdowns included in the most recent (2018) evaluation, including by sector and by programme. Doing so will help to draw attention to which firms are engaging and will also enable easier scrutiny.

## Create an office at the heart of government

In instances of complex social problems with long term solutions, there is often a temptation to create, revise and dissolve institutions in the hope of finding better ways to align delivery across a wide range of policy areas<sup>106</sup>. This has been evident in Wales with the creation, dissolution and often recreation of QUANGOs, non-departmental bodies and sponsored bodies performing government functions. In relation to economic policy, this has informed a long-running debate about the role of independent economic development agencies. Recent reflections suggest that the anticipated benefits of bringing the work of the WDA into the Welsh Government have been missed, partly due to funding restrictions and partly due to consistent shifting of priorities under different Ministers<sup>107</sup>.

Our view is that much greater coordination is needed, whilst seeking to avoid 'reform fatigue'. There is evidence from the experiences of WDA<sup>108</sup>, and from Business Wales<sup>109</sup> and the Development Bank of Wales that establishing new organisations carries a cost in terms of lost organisational knowledge, poor communication and cross-referral and general misunderstanding by target groups<sup>110</sup>. It is also not clear that arms-length bodies attract popular support, with bodies such as England's Regional Development Agencies and Local Enterprise Partnerships<sup>111</sup> and city and growth deals across the UK<sup>112</sup> facing criticism from across the political spectrum for their lack of local control and accountability. There may be value in establishing arms length bodies which can detach economic development from electoral timescales and political priorities, but this detachment would require robust governance and evaluation.

One of the contributions of the discussion of the foundational economy to policy in Wales has also been to highlight ways in which other departmental budgets might be used in support of economic development. In particular, public procurement is seen as a potential vehicle for boosting demand for grounded firms that are embedded in Wales. However, there are recognised difficulties in achieving this aim in a context where commissioners across policy areas are not engaged in economic policy making, or aware of their own potential role in delivery.

Building on the OECD's recent review of regional development policy in Wales, we believe that there is scope for the Welsh Government to achieve this coordination through the creation of an Office for Economic Development within government, attached to the First Minister. Currently, economic policy is represented at Cabinet level by the Minister for the Economy, Transport and North Wales and by the Deputy Minister for Economy and Transport. This structure provides clarity in terms of accountability and delivery. However, in terms of the Welsh Government's overall budget, the activities directly overseen by these Ministers represent around 6 percent of total spending (for comparison, the Health and Social Care budget represents around 50 percent of annual spending). An office at the centre of government would have the capability to engage across departments, align policy objectives and identify opportunities to incorporate economic development into the broader activities of government.

<sup>106</sup> Guy Peters, B. (2018) *The challenge of policy coordination*, *Policy Design and Practice*, 1:1, pp. 1-11

<sup>107</sup> OECD, (2020)

<sup>108</sup> Cardiff Business School and Cardiff Business Partnership, (2012)

<sup>109</sup> Zaidi et al., (2018)

<sup>110</sup> See evidence presented by Rhian Elston to the Welsh Parliament Public Accounts Committee, 17/06/2019

<sup>111</sup> Sandford, M., (2011) *The abolition of regional government*, Research Briefing SN/PC/05842, London: TSO

<sup>112</sup> House of Commons Committee of Public Accounts, (2015) *Devolving responsibilities to cities in England: Wave 1 City Deals*, London TSO



## Invest time in developing a long-term approach

The success of the Welsh Development Agency, and the reason why it is still discussed today, was made possible due to its long-term focus on how Wales could transition away from heavy industry, gain advantages in specific industries and do so outside of political timeframes, as well by having the consistency required to build a brand that was recognised in the private sector<sup>113</sup>. Broadly speaking, it set out an understanding of the Welsh economy and its place in the world that remains influential today, because it engaged with historical circumstances at a time of upheaval.

Since the Welsh Government moved those regional development functions ‘in-house’, the strategic approach to economic development has seen a period of almost constant change, with priorities emerging and disappearing often in a way that reflects individual Ministerial interests, even though one party has been consistently represented in government<sup>114</sup>. This has left firms unsure about what will be supported<sup>115</sup> and being faced with a ‘cliff edge’ of support as priorities change between, and even within, periods of government<sup>116</sup>. As the Institute for Government has noted with in relation to the UK context, successful industrial policy needs to outlast the politicians who design it<sup>117</sup>.

There is a strong argument to suggest that as of 2020 we are seeing the rapid acceleration of economic change in a way that may have similar impacts on Wales as deindustrialisation. This requires asking some very fundamental questions about the Welsh economy that should shape policy making over the coming decades as much as the coming years. Such questions include:

- What are Wales’ key economic strengths and weaknesses?
- What do the Welsh public want from the economy?
- How much will Wales be disrupted by automation and the fourth industrial revolution?

At present, these big questions about the future direction of Wales are addressed in sector- or policy-specific strategies and reviews. Examples such as the Review of Digital Innovation for the Economy and the Future of Work in Wales<sup>118</sup>, the International Strategy<sup>119</sup>, the Donaldson Review of curriculum<sup>120</sup> and the working draft of the National Development Framework 2040<sup>121</sup> all articulate their own visions of what the future holds, with certain common characteristics, such as automation, the knowledge economy, decarbonisation and technological innovation. Nonetheless, these visions exist largely in siloes, with relatively little coordination between them by government.

<sup>113</sup> Cardiff Business School and Cardiff Business Partnership, (2012)

<sup>114</sup> OECD, (2020)

<sup>115</sup> Audit Wales, (2018)

<sup>116</sup> [Morgan, B., Holtham, G., Morgan, S., Huggins, R., Clifton, N., Davies, J., Kyaw, S. & Walpole, G., \(2020\) Managing productivity in Welsh firms: Final report 2020, Hodge Foundation/Cardiff Metropolitan University](#)

<sup>117</sup> Wilkes, G., (2020), How to design a successful industrial strategy, London: Institute for Government

<sup>118</sup> [Brown, P. \(2019\) Wales 4.0 Delivering Economic Transformation for a Better Future of Work, Cardiff: Welsh Government](#)

<sup>119</sup> [Welsh Government, \(2020\) International strategy for Wales, Cardiff: Welsh Government](#)

<sup>120</sup> [Donaldson, G., \(2015\) Successful Futures: Independent Review of Curriculum and Assessment Arrangements in Wales](#)

<sup>121</sup> [Welsh Government, \(2020\) Future Wales: The National Plan 2040, Working Draft National Development Framework Document: September 2020 Version, Cardiff: Welsh Government](#)

The project of creating a vision, comprising a set of commonly recognised trends and a set of idealised outcomes, is particularly important in the context of losing access to European structural investment. The European Union not only provided significant investment in the Welsh economy, it provided a methodology and a model for regional development, focused on inclusion in labour markets, enterprise, infrastructure and skills. With the loss of the funding, there is also a lack of clarity as to the extent or vision of the UK government's proposed Shared Prosperity Fund, though commentary suggests that funding will be decided centrally, focus on infrastructure, be awarded on a competitive basis, that regions will be smaller and that overall funding for Wales in particular will be lower<sup>122</sup>. If this is to be the case, the Welsh Government will not only need to be prepared to fight for what it needs, it will need to establish a clear, consistent, evidence-based approach that is attractive to everyone, in Wales and elsewhere, who shares the aim of improving the Welsh economy.

The Welsh Government should use its strong ability to convene stakeholders to develop and embed a consensual vision of the long-term future of the Welsh economy, including an outline of how future priorities can be identified. The aim of this exercise should be to gain a degree of consensus support, politically and in civil society - it is vital that all stakeholders have ownership of the agenda, and that successive governments do not attempt to radically re-write the national vision.

There is strong evidence that this vision should be informed directly by citizens. However, there is widespread indication that economic policy is considered impenetrable and complex, and as being alien from the concerns of everyday life<sup>123</sup>. Recent public frustration with politics has arisen in parallel with a period of widespread economic stagnation, but the relationship between these two trends is clearly complex, with political cleavages emerging along cultural, rather than economic, lines. To prevent a further rise in anti-system politics, and to ensure that political dissatisfaction remains constructive, there is a need for a much deeper understanding of the public's relationship with the economy. The Welsh Government is well-placed to seek to understand these views, engaging with existing community organisations but also through the development of assemblies, surveys and consultation.

There is also merit in the next Welsh Government exploring a more statutory footing for economic development, to embed a consensus vision into a set of principles and define the responsibilities of key institutions. We welcome the FSB's proposal for a wide-ranging Economic Development Bill to be developed in the next Senedd. All parties who are interested in being represented in the Senedd should be prepared to state their principles and priorities for economic development, making clear the evidence they are informed by and being prepared to collaborate proactively across party lines. This would create an impetus for a timely debate in the Senedd on Wales' economic future during a period of transition, with new powers available to the Welsh Government and accelerating changes in the economy.

<sup>122</sup> Williams, J., (2020) *Action plea on Wales' post-Brexit aid replacement*, BBC Wales News, 29/11/2020

<sup>123</sup> Earle, J., Moran, C. & Ward-Perkins, Z., (2017), *The Econocracy: The Perils of Leaving Economics to the Experts*, Manchester: Manchester University Press

## Concluding remarks

Much of the evidence presented in this report supports the findings of previous research into the foundational economy – in particular, that economic development policy, and business support as a branch of that, have been increasingly targeted at a narrow range of firms and sectors, and have largely overlooked foundational sectors, non-tradables and everyday local goods and services. It is clear why this has been attractive to policy makers in the past, with the potential rewards of high-growth firms in terms of high-skilled jobs and a boosted tax base, but our review of the wider literature has illustrated the challenges of capturing these benefits.

In looking to an alternative approach, we have not suggested radical changes but called on policy makers to build on the successes of existing programmes and structures by making their support much more widely accessible. By doing so, government can recalibrate its relationships with the private sector, building greater trust both ways, recognising that in many activities, not least in the foundational economy, both parties share the same aims of making sure that everyday essentials reach more people in Wales.

The theme of collaboration and relationship building is common throughout our recommendations. The diversity of Wales and the Welsh economy cannot be captured in the vision of a single group, and the structures through which economic policy is delivered cannot be open only to a narrow range of participants. As we have stated throughout the report, the Welsh Government is in a good position to build these kinds of relationships – it has the scope and capacity to connect across localities, and the influence and convening power to bring together different interest groups. This is where devolved government has a chance to shine and to really demonstrate its value, but it is not clear that it has done so in the past.

Over the next year we will be working to ensure that the messages of this report are at the top of the agenda for the next period of government in Wales. There is an appetite for a different approach, and the next Welsh Government will have significant powers, as well as funding challenges. To make the impact of the former outweigh the latter, the next Welsh Government will have to be creative and innovative, ready to provide an example of how these attributes can make a difference in Wales.

