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Title: Prospects for Welsh business – a presentation by CBI Wales

National Assembly for Wales: Economic Development Committee meeting 28th November
Prospects for Welsh business – a presentation by CBI Wales

About CBI Wales

1. The CBI is the UK's foremost business representative body dealing principally with cross-sectoral issues which affect the business environment in which all companies operate. The CBI's strength lies in its breadth of membership, which includes companies of every size, including over 200 trade associations and academic institutions, and from all sectors of the economy – manufacturing, construction, retailing, financial services, e-commerce, leisure, transport and so on. The CBI represents about 50% of the private sector workforce in Wales.

Purpose of this paper

- Examine the outlook for Welsh business
- Identify priority areas for National Assembly action in support of business survival and growth
- Explode some myths.

Outlook for Welsh business

Global context

1. By the end of August the world economy was already slowing sharply. The terrorist attacks of 11th September took place at a particularly vulnerable time for the world economy, with a synchronised global recession already on the cards.
2. Post 11th September, the feared collapse of **world equity markets** and the inevitable impact on the world economy has not happened – stock markets have recovered to roughly where they were before and early fears of a sharp rise in oil prices have proved unfounded.
3. The **World Trade Organisation** meeting in Doha went well (attended by CBI as a

member of the UK delegation), with the prospects of a successful world trade round looking, if anything, better than they did in the summer.

4. Short-term interest rates have come down in response to the easing of monetary policy and long yields have been supportive of activity.
5. But in the **real economy evidence** is still very limited, although some patterns are emerging. In America, worries have centred on consumers who were single-handedly keeping the US out of recession. There have been sharp falls in consumer confidence and rising unemployment. By contrast, in the Eurozone the impact so far has been on business confidence, which is bound to have a significant impact on growth prospects in economies which are export-led.
6. So far, the UK looks to be encouragingly resilient. Consumer expenditure over the summer has kept the economy moving and the UK policy stance has been more supportive than in previous downturns. The CBI expects a **UK recession to be avoided** (subject to a further unforeseen decline in prospects across the rest of the world or further terrorist/military action).

Welsh context

1. **Lack of demand** remains the primary constraint on Welsh economic growth (exacerbated by contraction in key industries). The internal market is small; one of the main difficulties facing businesses in the more peripheral parts of Wales is the small size of the local market, and the small population catchment area. Welsh businesses need to have access to large external markets.
2. With some 72% of Welsh exports going to the EU, Welsh business has been extremely hard-hit by the unfavourable fall in the Euro against Sterling. Whilst we have yet to see a severe decline in volumes, the current squeeze on margins is unsustainable. We expect some movement in our favour, with a rate of e 1.47 (DM2.90) forecast during 2003.
3. **Investment intentions** by Welsh manufacturers have declined, particularly in relation to new product and process development and plant and machinery. Investment in training is holding up well, demonstrating that despite some heavy job cuts, employers are committed to upskilling the remaining workforce. This confirms the importance of skills to competitiveness.
4. Whilst Welsh manufacturing employment has declined there have been some positive increases, particularly within consumer financial services/customer services companies based in Wales. **Consumer confidence** is holding up. Whilst it does so, the prospects for these firms remain good. **Priority areas for Assembly action**
5. It must be recognised that the UK Government is still responsible for setting the framework in a number of key areas, most notably on tax and regulation. Nevertheless, the National Assembly holds significant powers which determine whether or not the conditions for business in Wales are favourable. To date the Assembly has gone ahead with a number of useful initiatives on SME finance, community development and so on. But these initiatives can in no way drive the kind of economic growth Wales needs.
6. It is true that it is businesses themselves that must ultimately be competitive, and that

will depend on a range of other factors including finance, management and so on. But the environment in which they work will be crucial. With ever-greater flexibility in terms of location, particularly for higher value added firms, Wales must seek to provide the very best environment for business. The recent 2001 UK Index of Regional Competitiveness highlights the relative competitive position of Wales – 11th out of the 12 UK regions – and its competitiveness appears to be declining.

7. If it is to support the right conditions for growth, then the National Assembly must concentrate its efforts on the fundamentals:

- Transport
- Planning
- The labour market
- R&D.

Transport

1. It is sometimes argued that improved roads can ‘suck out’ economic activity from an otherwise peripheral area. This misses the point. To ‘protect’ economic activity in a peripheral area by reinforcing that relative isolation is to perpetuate the situation where companies will only be able to serve their local market, which is rarely large enough to enable businesses to reach a critical size. Opening up an area through improved transport links will certainly increase competition – but this will be good for consumers and will provide the opportunity to local businesses to compete in a larger market which will be vital for their growth.
2. Lack of demand within the Welsh economy should therefore be addressed by bringing Wales closer to potential markets. It is obvious that any business seeking to increase its trade outside a local region, whether that is to other parts of the UK or overseas, is reliant on a quality transport infrastructure. This will require excellent road links, reliable and efficient railfreight capacity, and of course, an international airport which is easy to access and has a good range of destinations.
3. Furthermore, the Assembly has identified the need to encourage higher value-added business activity in Wales and the WDA has been encouraged to focus on quality inward investment. Experience shows that the travel requirements of higher value-added business are extensive. London is the main financial centre and Europe and other world destinations form the marketplace. Bringing Wales closer to these destinations will be vital.

Get the planning system right

1. Planning policy needs to be much stronger on policies to stimulate investment to meet the most important requirement for Wales at present, which is to boost economic performance.

2. Whilst there is market demand to develop in certain locations, there is by no means a 'boom' in comparison to other parts of the UK. There needs to be a recognition that a significant part of the Welsh property and land base is now structurally obsolete, particularly within the industrial heartlands of the Valleys. Much of this property/land base has been provided as a result of long term planning to service the manufacturing sector – where there is much reduced demand due to Welsh and UK trends.
3. In order to compete for growth sectors there needs to be a flexible and positive response to each sector's requirements. Although it is generally desirable to use previously developed land in preference to greenfield sites, this may not always be possible or suitable. Old industrial sites and locations are unlikely to be suitable for 'new economy' growth businesses, whose needs are frequently better served at a greenfield location, close to a major transport corridor, with available quality housing and preferably an international airport.
4. Furthermore investing in Wales needs to be made easy. The time and cost involved in obtaining planning permission is a significant barrier to investment. **In a competitive world, investing in Wales needs to be quicker easier than investing elsewhere.** In fact Wales can give itself competitive advantage over other regions by getting the planning system right – and at no cost to the Assembly purse. CBI Wales has produced proposals that can make this a reality.

Focus on the labour market

1. Skills are at the heart of competitiveness. Skills needs have grown significantly over the last 20 years, in favour of more highly skilled, flexible workers. This trend will continue as increasingly numbers of unskilled jobs disappear with automation.
2. In order to meet this challenge the National Assembly must concentrate on getting the foundations for lifelong learning right. First get it right in schools by ensuring that young children in primary schools master the basics of literacy and numeracy as an absolute priority as these are the keys to all later learning. Then build on this to ensure that all pupils have ability in maths and science, together with strong key skills such as ICT, teamworking and self-improvement.
3. Stronger links between business and schools, colleges and higher education institutions will be needed if we are to increase the employability of our population. Problems with the availability of vocational/technical level skills are longstanding and continue to persist.
4. It must be recognised that it is not structures but the people in the system who are important. Teachers must be given support and encouragement to develop through a properly developed CPD scheme, teacher placements and so on. Getting good business people involved will also be crucial to ensuring useful outcomes. The recent CBI experience in Torfean has been disappointing.
5. If Wales is to develop higher value-added business then it must be able to both attract and develop an appropriate skills base. If we are to attract those people needed to drive R&D intensive activity then the provision of high quality leisure and housing facilities will

be crucial.

Creating capacity for R&D

1. If we cannot improve the capacity for R&D activity in Wales then we will provide neither support to our mature industries or to those new higher-value industries we wish to attract.
2. At present Wales trails its competitors in most sectors on both R&D spend and innovation. We are well behind other EU countries such as Sweden and Finland on almost every indicator used. The problems appear to be deep-rooted and will require significant real incentives and encouragement to turn around. In many cases the focus will need to be placed on getting business to start R&D activity in the first place. In others growing activity from a base that is below international benchmarks and, in a few cases, giving real support to world-class R&D players so that they continue to prosper. It must be fully recognised that R&D is as relevant to traditional industries, and at the lower end of science and technology, as at the "cutting edge".
3. Experience shows that artificial cluster creation will not provide the right route for increasing R&D activity. It is notoriously difficult to do successfully, matched only by the degree of difficulty in choosing the sectors to develop in the first place. We doubt whether a 'bricks and mortar' approach to the expansion of the Technium concept will achieve results. Clusters are first and foremost about people.
4. The development of centres of excellence within the Welsh education institutions could play a crucial role in driving forward R&D activity. The possibilities must be pursued with vigour.

What the Assembly must not do

1. Politicians with an eye on the electorate want to be seen to be proactive and claim quick and direct results from their actions. Such actions are frequently wasteful of resources and damaging to business in outcome. What the National Assembly does not do, however, will be as important as what it does do in terms of creating the right conditions for economic growth.

Adopt interventionist approach

2. Markets move very quickly. Bureaucracies move at a much slower pace. It is therefore highly unlikely that an interventionist approach to the economy on the part of the Assembly will result in successful growth. Such approaches elsewhere in the world prove this point.

Initiative fatigue

3. Research amongst SMEs suggests that too many initiatives can be a barrier to seeking help. The Assembly's own Economic Development Committee report highlighted the problems and European programmes could exacerbate the situation. New initiatives must only be brought forward where there is a very clearly defined need. Most importantly they must not be allowed to run on and on. Time limits must be imposed on new initiatives after which usefulness should be independently assessed.

Approach to taxation

4. The differing transitional arrangements for business rates in Wales compared to England already places Wales at a competitive disadvantage. The National Assembly would send a powerful and extremely negative message to the business community and investors if it were to seek primary powers to levy a supplementary rate on business. This must not be pursued.

Costs

5. Any additional cost burden on businesses in Wales, at a time when they are taking internal action to reduce costs to a minimum, must be resisted. That means thinking carefully about statutory obligations e.g. Welsh language, environmental requirements and so on.

Exploding myths

ICT and transport infrastructure

6. ICT will not remove the need for physical travel, either for people or products. A printer in Merthyr Tydfil can successfully compete nationally and internationally for business, with content being sent down wires using the latest ICT infrastructure. But the same company still needs to physically move lorry loads of magazines by road. Web designers can work from remote locations, but the sales process – winning customers – will usually require the kind of face to face meetings that it always has. Would you entrust your business to someone you had never met? ICT enables organic farmers in Mid Wales to sell their high quality products across the country and internationally via the internet – but the product still has to be shipped. A tool and hardware supplier in the Llyn Peninsula can ship its products on a next-day delivery basis thanks to the A55, but peripherality still puts it at a disadvantage when customers visit, or salespeople travel. ICT may change patterns of travel but not necessarily the overall level of travel.

New vs old economy

7. Traditionally, manufacturing has involved the process of making a product or the production of goods from raw materials. It is not uncommon to hear of manufacturing in decline, of falling employment and of manufacturing contributing an increasingly smaller proportion of output. This is a likely scenario in any developed post-industrial economy – though does not necessarily mean that manufacturing is in decline per se.
8. In reality, the shape, and hence the definition, of manufacturing is already changing. Where once we manufactured physical products for one time sale, the shift is increasingly towards building a long term, strategic relationship with customers to service their total package of needs based around a manufactured product.
9. Today, the manufacturing and service sectors are critically interdependent. A significant proportion of service-related jobs and associated wealth creation are dependent on manufacturing. Relationships exist between different industries at every stage of the production process.
10. Manufacturing will continue to play an important role in any economy. It is vital to traded goods and services – vital to a nation wanting to pay its way in the world. No economy can survive on service provision alone – a strong base of competitive manufacturing businesses remains a necessity through all periods of the economic cycle. Manufacturing is also important as a key element of regional policy and regional economic development.

Big business = deep pockets

11. On occasion policy proposals from government whether UK or National Assembly can appear to suggest that "big" businesses are immune to cost pressures, measures are proposed to "protect" SMEs whilst costs are passed on to large or multinational businesses. There is as much credibility in the proposal that the larger a business, the more internationally exposed it is, and the greater the importance of competitiveness. Bigger businesses will find it relatively easier to establish operations at multiple sites, and are better able to compete the relative cost basis of competing locations. Costs and margins are as least as important to larger companies as to SMEs.

Welsh companies are not mobile

12. They are. They will rarely relocate in the visible manner in which a multinational company might but they choose to expand elsewhere or to out source their operations. There are numerous examples of high tech businesses that have gradually established sales operations close to Heathrow often followed by relocation of management and RMD investment.
13. Welsh owned companies will have deeper commitments to Wales as a location but they are equally driven by the need to compete in an international area and will be influenced

by the quality of the business environment.