

Senedd Cymru

Pwyllgor yr Economi, Masnach a Materion Gwledig

Ymchwiliad: Yr Economi Sylfaenol

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Welsh Parliament

Economy, Trade, and Rural Affairs Committee

Inquiry: The Foundational Economy

Ref: FE09

Evidence from: Federation of Small Businesses (FSB) Wales



Foundational Economy Inquiry

Economy Trade and Rural Affairs Committee

Federation of Small Businesses (FSB) Wales

September 2024

About FSB

FSB Wales is the authoritative voice of businesses in Wales. It campaigns for a better social, political, and economic environment in which to work and do business. With a strong grassroots structure, a Wales Policy Unit, and dedicated Welsh staff to deal with Welsh institutions, media and politicians, FSB Wales makes its members' voices heard at the heart of the decision-making process.

Introduction

FSB Wales have been a key part in developing a foundational economy policy approach for Wales, working with academics a decade ago to provide the analytic framework for such an approach¹, and providing a model that underpins our approach to SME growth through the 'missing middle'.² In shaping our approach towards this Senedd term our 'What We Value'³ report took on many aspects of this approach and also illustrated the wide community and social value of SME growth.

It is useful to provide an understanding of FSB's analytic approach and where we see our view fitting in to the wider concept. This will in turn shape our responses to the questions asked by the committee.

The Foundational Alliance have provided a useful definition to outline the different ways the concept is used, 'both of which are correct and complementary':

- 1. A narrow, descriptive definition of the FE as the non-tradeable sectors providing basic services like health and care, utilities etc. These sectors have been neglected by those preoccupied with policies for high-tech and tradables but altogether they account for 40% of employment in Wales.*
- 2. A broad, analytic definition of the FE as the conditions of well-being: (a) the three pillars of household liveability (residual income after paying for essentials + access to basic services + social infrastructure) on the*

¹ See for example: 'What Wales Could Be' (FSB/CRESC 2015)

² 'Wales's Missing Middle' (FSB: 2017), <https://www.fsb.org.uk/resources-page/wales--missing-middle.html>

³ 'What We Value' (FSB: 2021), <https://www.fsb.org.uk/resource-report/what-we-value.html>

*demand side; and (b) the stock of capable resourceful firms on the supply side; with (c) consumption and production mitigating nature and climate emergency.*⁴

For the purposes of this paper, FSB will focus on where our concerns and expertise lies. For our purposes, FSB's concerns are most seen in

- (1) in terms of public procurement that allows for building capacity and capabilities (and so skills and supplier development) at a local level, and within
- (2b) developing 'the stock of capable and resourceful firms' on the supply side.

These two are to an extent interrelated, but one is specific and the other links to what should be wider economic strategy that focuses on building and growing SMEs in work (either through building capacity and capabilities, staff, turnover or expanding their potential markets).

It is through this focus that this paper responds to the committee's questions.

Questions

- **To what extent has the Welsh Government embedded support for the foundational economy into its overall approach to economic development? What further steps should it take to do this?**
- **Given the cross-portfolio nature of the foundational economy, how should the Welsh Government create a co-ordinated approach to mainstreaming support for foundational economy sectors across government?**

The Federation of Small Businesses Wales has long advocated a foundational economy approach focused on the 'missing middle' approach. This view has linked together a series of intervention focused on support for businesses with an aim toward SME growth, using all levers at the public sector (in particular, public procurement policies), and in terms of raising barriers for businesses looking to grow from self-employed to micro businesses, micro to small, and small to medium sized businesses. It is in this context that we scrutinise and assess how support is embedded.

The aim is to operationalise at a model of SME growth that is embedded in our communities, and provides access and development of skills, capabilities and capacity, and provides means toward dissemination of innovation to provide for

⁴ Foundational Alliance Evidence Paper, Sep 2024

community resilience and diversification of local economies. This provides a model of growth distinct to, but not necessarily separate from the agglomeration model that has dominated and focused on funding and infrastructure following areas that are already growth. As such it targets areas of potential growth that is across rural and urban areas and looks too to small towns as well as areas that are identified as high growth (e.g. M4 belt, North east Wales's manufacturing hubs).

It is widely acknowledged that the foundational economy can be an amorphous concept and as it is linked to local needs is applied differently in different areas. As the list of sectors covered in the FE data evaluation shows, it potentially covers a wide array of sectoral interests.⁵

One area of concern is that in implementing 'foundational economy' as a discrete policy area in practice leads to implementing a policy that separates away from a wider economic growth strategy and leads to a bifurcated approach that work parallel to each other rather than mutually reinforcing.

In this, there is a danger of having on the one hand a policy that focuses on specific actions around local economy – often with a focus on local social enterprises – and on the other elsewhere the larger growth strategy based around large investment and manufacturing. The danger is that an SME focused agenda is lost and falls between two stools, with SMEs focus being brought as a lower priority in foundational strategy on one hand, and a mainstream growth strategy (geared narrowly at productivity and GVA and large firms) on the other hand.

In FSB's view, an SME growth agenda would allow us to bridge the two approaches, providing for a growth agenda that is focused on building those resourceful firms across the piece and would marry up the two strands noted, with SMEs central to both for a 'missing middle approach' geared at building strong embedded firms, building capacity and capabilities to provide for skilled economies across Wales, but also in building competitive firms and spin offs for competing in wider UK and international markets.

When it comes to embedding foundational economy principles there have been notable successes. The challenge fund alongside communities of practice has been useful in embedding and sharing practice at local level. The targets around procurement in terms of local spend means that there is a focus for activity (although we would encourage a focus of how it grows the businesses as a result too so as to capture economic value- see below).

What is difficult to assess is:

⁵ See the wide variety of SIC codes covered for evaluation purposes here: [business-statistics-for-the-foundational-economy-in-wales-2019-to-2023-0.ods \(live.com\)](https://business-statistics-for-the-foundational-economy-in-wales-2019-to-2023-0.ods.live.com)

- a) Where this is activity that is because of foundational economy agenda or what would happen in any case (e.g. local spend)
- b) How the pockets of local success are a result of, aligned to, and feed into a wider economic strategy, such as building capacity and capabilities to make for fertile soil for future growth.

There are difficulties here, in that the funding and support context for SMEs is complex and multi-layered. Many will have gained SPF or levelling up project funding, but the complexity and lack of alignment across government on such funding geared at regional economic development makes it difficult to link success and intervention at which level. This is exacerbated by the amorphous way in which foundational approaches work, and how they are often place based and so necessarily inconsistent. As such, a focus on some of the outcomes, such as building 'resourceful firms' is a useful focus to pull together the impact across different economic interventions, and for focusing activity.

FSB Wales have called on UK and Welsh Government to work together on a Growth mission for Wales. Part of the rationale for such a multi governmental intervention is precisely to reform and align the activity across governments in a shared strategy.

With a new First Minister and new Prime Minister, and the same party in government at UK and Welsh Government, FSB Wales views this moment as an opportunity to focus on economic growth in Wales. Looking to a mission based approach we would expect work to provide better inter-governmental ways of working and institutional alignment to ensure all levers at all government levels are used to address SME economic development for the long term in Wales, and addressing Wales's historical position as an economic laggard in the UK. This will be how FSB scrutinise the success of both governments in Wales over the next few years.

The foundational element is a key lever Welsh Government and local government would have, and it should fit within any such growth mission, with a focus that bridges across different economic levels of intervention through a focus on developing SME firms.

However, it does seem that a long-term economic strategy does not link together the disparate interventions from within Welsh Government, and that this is something that could be addressed in a growth mission. A clear example of how long-term and short-term aims do not link for concrete decision is in 2023 the release of Welsh Government's 'economic mission' had little impact or crossover to the practical choices made in the draft budget released within a month later. For us to be able to assess FE approach and its working across and impact it does need to sit clearly within a strategy that looks to clearer milestones and measures for the short term and medium term so as to reach some of the ambitious long term goals (often in 2040 or 2050) – without such

clarity of approach and benefits of building prosperity, short term budgetary pressures are bound to take immediate precedence.

A positive sign in the new Government is that key Foundational Economy SME sectors such as hospitality, retail and tourism are now placed under the economy portfolio, whereas previously they had been separated. This suggests that these areas will be placed into a wider economic strategy rather than placed under a different portfolio.

- **Which of the Welsh Government's foundational economy policy initiatives have been most successful, and why? Which have worked less well, and why?**
- **What examples of best practice exist in different foundational economy sectors and places within or beyond Wales? How could the Welsh Government better support partners to deliver best practice, and to scale it up where appropriate?**

As noted above, there are excellent examples of practice at local level, and this often is linked with local leadership understanding the wider outcome and having the autonomy to push them through. As such, it is important that when looking at scaling up, or when sharing practice, it is important that context is clear, the problem that is being addressed locally is understood, and that the intervention is therefore understood accordingly. In other words, it is not only about the specific activity, but also about what the activity's impact would have in context.

An example may be Planed's recent work looking to develop new local markets and access for local food networks. As such, the intervention has not been about access to farmers' markets – which are only limited opportunities in terms of how often they happen. Nor are they about accessing supermarkets - where the leverage and value to cost ratio may be difficult for SME farmers and producers. They have developed accessing local food through local vending machines and thus open new route to a new market, creating and shaping that market.⁶

Whether or not this intervention works, the aim is to allow a new regular outlet for local produce, easily accessible for the public and available at their convenience. This intervention is on that looks to shape markets and create new access for SMEs, who together would struggle to coordinate access to their products at such a hub level. As such it provides for new market opportunities that links to opening local market to SMEs, while addressing wider aims of net zero goals, local food networks and so on.

The activity itself (vending machines for local produce) is certainly replicable, but it is important to understand the underlying rationale. Such innovation is

⁶ <https://planed.org.uk/projects/pembrokeshire-fresh-community-vending/>

something that should be encouraged, but also the value and the impact need to be captured in terms of the rationale for the intervention, as well as the unanticipated benefits and problems. The vending machines themselves may be a useful intervention in other places, but may have different impacts, and may be addressing different priorities, and being placed in a different market. As such understanding the underlying rationale is important for sharing good practice and for good strategic local leadership.

Good practice can travel well, but what underpins the practice needs to travel alongside it.

It's also important to note how foundational economy 'hubs' provide touch points for SMEs that allow them to build knowledge and networks and can do so to facilitate a firm's growth by diversifying their own services, which in turn helps them compete in a wider market. A case study we encountered was a firm gaining contract with local community energy enterprise to install heat pumps, but requiring upskilling of staff, and more skilled staff to fulfil that contract. This was achieved, and the firm doubled in terms of staff and was then providing this service across the region and not just for the community enterprise. Such case studies and capturing of such firm level growth and learning is important to understand impact, but also in order to ensure a focus on such growth activity, and also to understand the need for strong strategic local leadership, and local-national relations in terms of economic strategy that builds trust in that local leadership.

Experimentation has been useful in terms of pilots and initiatives such as the challenge funds. Looking to scale up needs a wider understanding of economic value and impacts on local skill, building capacity and capabilities in local firms, and this in turn serves to understand the economic growth strategy at the national level.

In terms of scaling up, and good practice, experimentation and learning is important as is understanding that not everything will work. The same project applied in different areas may not work, and as such building local leadership, local networks and hubs, and trusting local leadership is important to success as foundational economy approach does not work in terms of moving a successful model wholesale from one place to another. However, in order to understand the economic impacts that are desirable, need to be captured and which determine supporting SME growth and better jobs locally, with firms able to diversify and open to new markets, a central strategy is needed so as to understand the impacts and rationale of specific interventions, and not carry over specific activity expecting the same results.

- **What progress has been made in using procurement to strengthen the foundational economy since [our predecessor Committee](#)**

looked at this issue in 2019? What further actions are required to deliver greater progress, and what innovative examples of best practice could be built on?

There were interesting examples forced by the COVID-19 pandemic that we captured in our 'What We Value' report, and it would be useful to understand how these emergency innovative responses have had, or how they can be harnessed and provide learning to 'normal' times within the context of tightened public sector budgets.

As was widely reported as the Covid restrictions came into force, there was a shortage in PPE and other materials for the NHS. The dependence on supply chains which were from China and based on cost was a large part of this. Hywel Dda health board faced these challenges by focusing on procuring from local suppliers. They utilised the South Wales Additive Rapid Manufacturing ('SWARM') originally set up by as a loose network of businesses with Swansea University, who then came together to:

- coordinate local PPE production
- ensuring the standards were up to NHS stringent standards,
- provided coaching and upskilling of manufacturers, and proactive help to reach standard

SWARM issued a call to action, including across social media, to ask for help in producing materials for their Local Health Board.

As a result, much equipment of stringent and complex standard was sourced locally, as well as simpler things such as furniture.

Opening demand in Hywel Dda during the pandemic led to local businesses filling substantial gaps – due to the crisis, many of these SMEs repurposed their manufacturing skills to do so. Support through the peer-to-peer networks helped bring products to strict standards, but also provided upskilling that could then be used in future.

This illustrates that opening procurement demand means that it often can be filled – in this case it was often as SMEs felt the need to help their community with lives at stake. The question is how to do this in normal times, and how we can repurpose our systems to help recovery and build wealth and skills in our communities and in SMEs.

Hywel Dda were surprised to see that they found that costs locally were less high than anticipated, and any additional costs could be made up for by the fact they were quicker in turnaround. Local suppliers achieved the prices – or very near the prices – when aimed at. This is unexpected and shows these suppliers can compete at close to price with global chain in many areas.

Moreover, the experience points to the need to balance cost, with security of supply chains, as well as wider community benefits. It also allows for diversification of SME products and services, and builds new capabilities, with training provision to arrive at necessary levels.

While this is not an area where we have studied extensively subsequently, it would be useful to know to what extent this experience has shaped procurement subsequently. We would expect that due to constant cost pressures, and the time involved in accessing and developing a disparate supply chain that it is very difficult for NHS teams to justify balancing community benefits against cheaper products more easily accessible. However, there may be mechanisms that could be developed to provide and formalise a similar 'middleman' role to support this activity, as SWARM did during this period.

Understanding the different pressures on the buyer for a large organisation with multiple pressure points would be an important part of building toward that ecosystem – how can a decision-maker justify this approach when there are constant organisational budget and time pressures, and what mechanisms can make that decision easier?

It should be noted that NHS Wales have been very engaged in Foundational Economy and Social Value based procurement, and their involvement has driven new conversations and challenged assumptions on procurement. While the challenges above remain, the new statutory landscape around Social Partnership and Public Procurement (Wales) Act 2023, and specifically in the Health context the Health Services Procurement (Wales) Act 2024, can help embed this behaviour to add value across the procurement cycle.

Nevertheless, the key question of procurement teams often being under-resourced is and is likely to remain an issue in the current financial climate. Adequate resources for procurement teams – whether in health system, local authorities or wider planning - to be able and empowered to address wider value in procurement will remain something that needs to be addressed so that such legislation will work.

One area where new focus has been placed is in terms of increasing local spend and looking to 'Preston model'. This is positive, but we should look to understand how that model applies in different sectors – the impact of what counts as local spend in terms of supply chains is very different when looking at for example food networks where produce will be itself local, versus potentially very long supply chains in (say) manufacturing, where the supplier may be local, but the skills in primary production may yet be far away.

Moreover, the impact of support in those may be very different in terms of what gains are made in upskilling, in opening and shaping new markets and in building 'resourceful firms. As such the headline measure and indicator is welcome and suggests progress, and does drive movement toward community

wealth, but again more granular detail on the impact on that wealth across different sectors and different context, as well as whether the activity is geared at building skilful new firms able to then compete in different new markets.

- **How effective have the Welsh Government's actions to deliver fair work in foundational economy sectors been? What further steps should it take within its devolved powers to progress this agenda, and how can it work with the UK Government to drive improvements in non-devolved areas?**

In terms of fair work within SMEs, the role of building their capacity to be able to provide for progression and better pay links with building opportunities for them to grow. As such, contracts should be geared toward firms building that capacity (with expectations) rather than locking smaller businesses out. Many foundational areas, to provide success, need to fit the fair work agenda to SME pressures and needs, and a something for something approach would show the growth and benefits and not only point to costs. The important thing is that the building of firms sits alongside building fair work agenda within those firms.

In terms of foundational economy sectors, the differences in sectors and 'cross-portfolio' nature may make it difficult to extricate what are areas that the foundational economy approach is impacting and what aspects are sector specific. For example, areas in construction may have some issues in terms of pushing costs down the supply chain (but these may not be so acute in foundational projects from public sector), whereas some energy projects may not have the same issue. FSB Wales does not have evidence to this granular level within the foundational economy.

In terms of UK Government, we would not the importance of a Welsh mission for growth, which would sit beneath the UK mission, to align areas for common endeavour and ensuring that both levels (and local government) use the prudential approach for each governance level to 'do what you do well':

- Local: place making and local market knowledge
- Devolved and Regional (the latter includes the 4 growth regions, CJs etc); translate UK aims to regional economic policy and coordinating actors at that level.
- UK: Strategy for Growth (Fiscal Firepower and support; Funding pots).

The UK Government – or at least the Labour manifesto – has outlined areas of priority that include areas of importance to foundational economy. The utilities and sustainable as priority areas are clearly such areas, as is the focus on skills.

In these areas a common approach using levers at the UK level through to local to ensure maximum impact is important, and to do this the mission should drive the ways of working and expectations and responsibilities of different governments and different institutions to support those interventions.