

Federation of Small Businesses Wales

Consultation Response to the AI and the Welsh Economy Inquiry

About FSB Wales

Celebrating its 50th anniversary, FSB 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

Artificial Intelligence (AI) has seamlessly integrated itself into many aspects of our everyday lives. Early examples of generative AI, such as predictive text, are now commonplace, while more advanced applications like Spotify use AI to analyse our listening patterns to recommend music. In transportation, platforms like Uber leverage AI to match drivers with customers based on proximity, while adjusting prices dynamically based on demand. Whether you're a private citizen or an SME, AI is increasingly shaping how we navigate our daily routines.

There is no single, universally agreed definition of AI. The House of Commons Research briefing on AI and employment law, published in August 2023, defined AI as 'technologies that enable computers to simulate elements of human intelligence, such as perception, learning, and reasoning. To achieve this, AI systems rely upon large data sets from which they can decipher patterns and correlations, thereby enabling the system to 'learn' how to predict future events. They do this by creating rules – algorithms – in response to the data, turning it into actionable information.'

In our UK report 'Redefining Intelligence'¹ published in March 2024, FSB refer to AI as: generative AI (including chatbots); machine learning; predictive AI; robotics; computer vision; natural learning processing; deep learning. FSB figures used in this evidence are mostly drawn from this report.

To what extent are businesses in Wales making use of AI and planning to do so in the future?

There are 5.5million small businesses in the UK, with 20 per cent already using AI, their role in AI's trajectory is undeniable². Small firms are agile and can make quick changes to their operations, so with the right framework, they will be able to embrace AI at pace. Forgetting them when looking at the opportunities – and risks – AI will bring would be a grave error. Developing digital leadership should be a continuous endeavour that demands substantial investment in advanced data processing, analytics, and cybersecurity capabilities.

We know through our 2023 UK report on innovation, 'The Tech-Tonic'³, that the larger a business, the more likely they are to have innovated, particularly when looking at size of turnover and number of

¹ Federation of Small Businesses. *Redefining Intelligence: The Transformative Potential of AI for Small Businesses*. Accessed November 25, 2024. <https://www.fsb.org.uk/resource-report/redefining-intelligence.html>.

² *ibid*

³ Federation of Small Businesses. (n.d.). *The Tech Tonic: How Small Businesses are Adopting and Adapting to New Technologies*. Retrieved from <https://www.fsb.org.uk/resource-report/the-tech-tonic.htm>

employees. Small businesses that plan to grow (*increase their turnover/sales by over 20% per annum in the next 12 months*) are more likely to be planning to use AI in the next two years. Of the businesses we interviewed for the purpose of this report, that are planning high growth, only 32 per cent said either that AI is not appropriate for their business, or they are not planning on undertaking any measures in relation to AI. This is compared to 51 per cent of all small businesses who said that AI was involved in their growth plans. This evidence provides an interesting snapshot, indicating higher adoption of AI could lead to high small business growth.

To understand the take up of AI in SMEs, it is useful to see the data from our 'Redefining Intelligence' report in more granular detail. 20 per cent of small businesses say they use one or more of the below technologies within their business:

- Generative AI (12%)
- Machine learning (3%)
- Predictive AI (5%)
- Robotics (1%)
- Computer vision (2%)
- Natural language processing (5%)
- Deep learning (2%)
- Other technology related to AI (2%)

However, this varies by sector:

- 37 per cent of small businesses in professional, scientific, and technical activities -
- 34 per cent of small businesses in information and communication -
- 14 per cent of small businesses in manufacturing -
- 12 per cent of small businesses in accommodation and food services -
- 11 per cent of small businesses in wholesale and retail -
- 1 per cent of small businesses in construction benefits

For the small businesses who currently use AI:

- 37 per cent say that large businesses have more resources to better utilise AI.
- 35 per cent have concerns about abuse of IP rights.
- 31 per cent are concerned about the commercial impact of deepfake technology.

When broken down further, we see that 40 per cent of small businesses in manufacturing say that large businesses have more resources to better utilise AI. This suggests that support will be needed to ensure the dissemination of this process innovation and support for businesses to take advantage of technological changes. While small businesses are agile, innovative and resilient by nature, there are undeniable barriers that are holding them back from tech adoption and innovation. The challenges faced by small business owners looking to grow their business or work more efficiently range from the lack of capital to the lack of understanding of implementation. This varies depending on the firm's sector, size, years in business and region as well as the small business owner's age and gender⁴.

What are the potential economic opportunities and risks that AI may present for Wales, and how might these vary across different parts of Wales and across different sectors?

⁴ Federation of Small Businesses. The Tech Tonic: How Small Businesses are Adopting and Adapting to New Technologies. Accessed November 25, 2024. <https://www.fsb.org.uk/resource-report/the-tech-tonic.htm>.

Our UK survey around the 'Redefining Intelligence' provides useful data to look at this area. However, we do not have data by geographical location to look at take up in different parts of Wales. In terms of potential growth, it is to be noted that AI take up is linked to growth in firms. Of the small businesses that are planning to grow rapidly in the next 12 months (increase turnover/sales by more than 20%), 60 per cent have plans to make use of AI within their business. 55 per cent of small businesses state AI could provide their business with potential benefits. These include:

- Working more efficiently (40%)
- Being able to automate tasks (29%)
- Developing / improving products and services (24%)
- Improving customer experience (22%)
- Providing cost / budget savings (21%)
- Gaining insights into their customer base (18%)
- Eliminating administrative tasks (15%) - Initiating new business models (13%)
- 73 per cent of small businesses still have concerns as to how AI might potentially impact their business.
- 46 per cent of small business owners say they or their workforce lack the knowledge and/or skills to utilise AI successfully. -
- 31 per cent of small businesses are concerned about their ability to manage AI securely / manage security risks. -
- 29 per cent of small businesses say that large businesses have more resources to better utilise AI. -
- 24 per cent of small businesses are concerned over the impact of deepfakes on their business brand / reputation. -
- 20 per cent of small businesses are concerned about the abuse of their Intellectual Property (IP) rights.
- 12 per cent of small businesses are concerned that AI will reduce the long-term viability of their business.

Over a quarter (26%) of small businesses do not believe that AI is appropriate for their business. This varies by sector:

- 51 per cent of small businesses in construction
- 45 per cent of small businesses in accommodation and food services
- 34 per cent of small businesses in wholesale and retail
- 25 per cent of small businesses in manufacturing
- 10 per cent of small businesses in professional, scientific and technical activities
- 5 per cent of small businesses in information and communications

This suggests there is a need to show the different uses of AI and targeted interventions need to show how it may be relevant in different ways to different sectors.

In July 2023, Google estimated AI tools could generate over £400 billion for the UK economy by 2030⁵ and save the average worker over 100 hours a year and it is important that SMEs benefit from this growth. Our research⁶ shows that over two thirds (69%) of small businesses have introduced some

⁵ Google. The UK AI Opportunity Agenda: A Pathway to Economic Growth and Responsible Innovation. Google, 2023.

⁶ ibid

form of innovation over the past three years with there being a significant number of small firms carrying out several different types of innovation, with 25 per cent of small businesses who introduced new products almost a third (31%) have introduced new or significantly improved processes. Some small businesses are more likely than others to have made innovative changes to their business in the last three years either to maintain a competitive edge over bigger companies or to simply improve efficiency and administrative systems that reduce labour intensive tasks such as data analysis and monitoring which allows the business to focus more on interacting with their customers.

Specialised and advanced digital/AI skills will be increasingly important to certain sectors looking to scale and remain ahead of innovation curbs. However, we should view digital skills more broadly. 46 per cent of all small businesses say that they are concerned that they lack the knowledge and/or skills or that their workforce needs to utilise AI successfully. 20 per cent of small businesses are concerned that their workforce lacks sufficient skills to utilise AI.

Bigger companies have the scalability and recourse to invest in advanced technology methods and have already started heavily investing in AI to reduce cost and remain agile against major competition. One of the most important priorities for policymakers in Wales is to address the opportunities that come with Digital Strategy Wales and to work towards clear objectives that maximise the potential to improve access to business support, healthcare provisions and education. The emergence of AI cannot be reversed, and so public bodies have a social responsibility to demonstrate the value of its uses.

This will require Welsh Government to avoid working in isolation of the private sector and research institutions who are developing tools and systems to be adopted by individuals and businesses. We need to ensure we're creating the right environment for small firms and while many associate 'digital first' as replacing human functionality in a business, the focus is on improving front facing roles by reducing the impact of back-office admin or labour-intensive maintenance through digital infrastructure already in use by businesses and organisations of all sizes.

Taking inspiration from best practice - It should be noted that the ability to take advantage of AI will be shaped by how effective introduction of digital infrastructure has already happened, with other small countries currently in a better position due to historical investment. This persistent gap in Wales puts at risk the potential for growth in the Welsh economy alongside other small nations such as Estonia and Denmark who have directly worked on frameworks such as government led digital strategies that lay an elementary level of digital infrastructure for both private citizens and businesses. Denmark have been a leader in providing this digital infrastructure, using it to shape e-governance and public sector delivery since 2006, and this means the digital architecture in place already means they are able to add on new tech and functionalities in an integrated way. Wales needs to look to long term digital infrastructure with a greater strategic lens in a similar way.

Estonia's e-Residency program provides us an excellent example of how to remain innovative in the face of competitive challenges on the international stage, whereby non-Estonian entrepreneurs are permitted to register and manage EU-based businesses online without being physically present in Estonia. Launched in 2014, the e-Residency visa grants access to Estonian digital services, such as company registration, banking, and tax filing, helping streamline international business operations. While not a residence or travel permit; it's aimed at enabling global entrepreneurs to operate in the EU's single market remotely. The direct economic impact of the e-Residency programme for the state budget amounted to 31 million euros in the first half of 2024. In addition, e-resident entrepreneurs

reportedly contributed over 11 million euros to Estonia's economy annually by using local business services⁷.

In this case, where small EU countries are re-thinking their digital economies, Business Wales and the Development Bank of Wales should remain strongly capitalised to support SMEs in innovation and to help connect firms with potential partners in tested economies for which could share knowledge and experience to further help develop the Welsh tech space. Alongside countries such as Denmark, who have established a specific Digital Agency to oversee the implementation of the Danish Government's policies for developing the digital public sector as well as large parts of the Danish digital service infrastructure, serious consideration should be given to how a similar function could exist within a newly established Economic Development Agency for Wales. We know through our research that 49 per cent of small businesses in Wales would go to Business Wales for advice if they were looking to grow their business. Apart from FSB, this is the highest percentage out of all business support services in the UK. This finding is similar to results of previous surveys, which confirms that Business Wales is well known and regarded by small businesses as a one stop shop for business support. It is currently a competitive advantage for the Welsh business environment however if digital infrastructure, which includes AI, is to be truly unlocked, the business support infrastructure needs to be better geared towards many of the challenges firms continue to face which have otherwise been overcome in other countries.

Wales has already shown its ability to lead on some of this through its universities and colleges. Cardiff University's Centre for Cyber Security Research (CCSR) is a leading UK academic research unit for cyber security analytics, focussing on the fusion of data science and artificial intelligence methods with interdisciplinary insights into cyber risk, threat intelligence, attack detection and situational awareness. A primary focus for businesses in the coming years will be to either implement research based solutions into their firms or to expand AI implementation across their organisation that directly improves human-to-human interaction rather than to replace it. Emerging technologies are crucial for the evolution of the SME sector. Especially when working to remain at pace with major competitors in their industries.

Business Support - AI can have the greatest impact on the way in which data is collected, analysed and translated for the end user(s). In this respect, financial services and business support providers have the most to gain from deep integration. Enhancing Information Management System (IMS) will help bodies such as the Development Bank of Wales (DBW) streamline informed decisions which offer end-user reports, data extraction reports and dynamic reporting capabilities. These basic functions are important foundations in building DBW capabilities to evolve and remain dynamic for its customers and to start delivering on commercially significant investment opportunities. The fundamental goal should be in gearing the Welsh economy towards being continuously agile, and efficient by using existing digital infrastructure alongside other global economies.

To do this, investing in IMAS (Internal Model Investigation and Analysis System) and EDRA (Electronic Data Reporting Framework Analysis) models will allow business support providers, including DBW to continue making human judgment calls that seek to improve the end user's outcome and thus access to business support, but through less labour-intensive monitoring methods.

The European Investment Bank has already adopted similar models to hold to account executives and decision-making processes, with cost savings being one of the main drivers, allowing for

⁷ e-residency applications and company incorporation increased 7% in first half of 2024 Katrin Vaga, <https://www.e-resident.gov.ee/blog/posts/e-residency-applications-and-company-incorporationincreased-7-in-first-half-of-2024/>

customer facing roles to be more effective and even more accessible with time being spent on the end user rather than systems and maintenance processes.

Nordea, a Scandinavian based SME bank have demonstrated the value of investing heavily in proprietary AI tools through their own developed 'Wisdom Engine' system that improves decision making processes, actionable insight and improved strategic decision making. In a bid to drive forward with capital intensive investment projects, the bank has also invested heavily in other systems such as 'Open Banking' to improve end user experience through improved exchange of data.

Efficiency is key to driving productivity and thus economic growth. The Development Bank of Wales sits in a unique position where they can potentially pioneer alongside other international development and investment banks due to both the eco-system it sits in and the support it receives from Welsh government. Harnessing Digital Strategy Wales, to support institutional overhauls of digital infrastructure is an opportunity that cannot be missed. As seen with other countries around the world, digital infrastructure within public bodies is key to strengthening transparency and government-based business support. Welsh Government should look at prioritising its digital strategy, acknowledging the broad benefits it could bring to public bodies in helping them remain agile and efficient alongside the private sector.

How is AI likely to effect jobs and workers in Wales, and what actions might the Welsh and UK governments need to take in response?

FSB research suggests use of AI by small businesses could eliminate jobs with routine tasks. In total, 15 per cent of small businesses state AI could eliminate administrative jobs, and this figure rises to 20 per cent for those small businesses already using AI. We should note that this allows for productivity gains, and space for other jobs based on different tasks, rather than necessarily loss of jobs wholesale.

35 per cent of small businesses have plans to make further use of AI within their business in the next two years. Specifically, they plan to:

- Undertake a course to improve their skills / knowledge in AI tools / technology (16%) -
- Explore new AI technologies to initiate new business models (13%) -
- Use AI to improve customer experience (13%) -
- Review internal / customer facing processes to see what could be automated (12%) -
- Use AI to drive cost / budget savings (9%) -
- Use AI to gain insights into their customer base (8%) -
- Invest in workforce training to upskill their staff to use AI tools / technology (8%) -
- Hire a consultant to enable their business to make better use of AI (2%)

Significantly, plans for such skills development are much higher in firms who have already adopted AI. As such support for AI take up will also lead to demand for skills.

It is nevertheless important to note that SMEs thrive too on their personal relationships with staff and others – people skills will remain vital, and AI should be introduced in a way that is complementary and augments these strengths. In our 'Redefining Intelligence' report, many FSB small employers report that their staff are empowered to share ideas and influence key decisions. Previous FSB research from 2018 found a "high willingness amongst small business innovative employers (86%) to take up innovations suggested by employees, which is a key indicator of employee engagement". The growth in AI should not impede small business employee engagement.

In the case of employment decisions there needs to be a human between the outcomes generated from AI and the final decision made by the employer.

There are undoubtedly concerns across sectors and in the wider economy about potential threats to roles in the adoption of AI and these can be felt at a granular level in individual businesses among employees. As with the wider conversation about certain productivity measures, smaller businesses and networks need to be supported in the communication of the intention and opportunity to adopt new technologies and need to be supported in understanding opportunities to redeploy or upskill staff to support retention.

So too will there be concern among self-employed and other micro businesses in areas such as accountancy and book-keeping about the potential impact of AI on their specialism, their professional input and a market need for that. As AI impacts functions develop across the marketplace, it will be necessary for business support systems to help guide small and micro businesses and help them adapt to new products and services which help them retain their competitiveness.

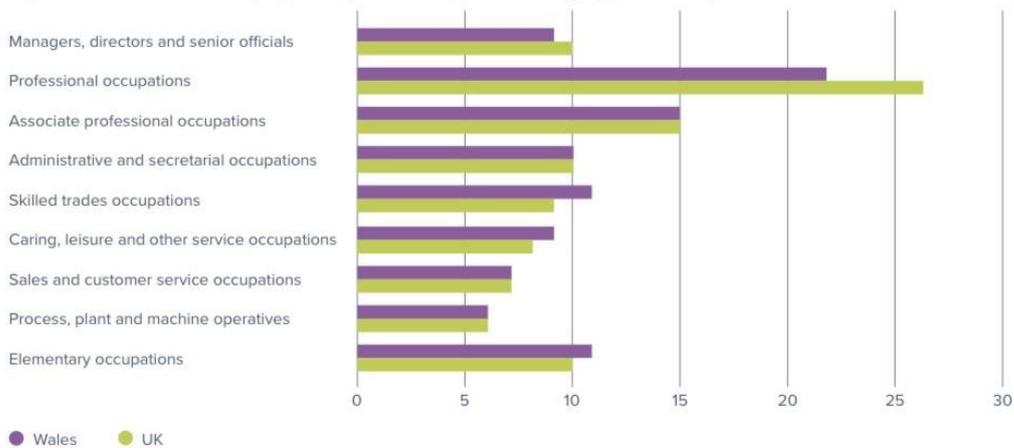
The skills of the population are an important component of labour productivity with improvements in skills estimated to have accounted for 20% of the UK's productivity growth before the financial crisis⁸. Compared to the UK average, Wales has a higher concentration of low-skilled adults (NVQ 2 and below), and a lower concentration of adults educated to degree level or above (NVQ 4+).

There have been improvements over the last decade, with a substantial reduction in the proportion with no educational qualifications. However, while there has been growth in higher-level qualifications, this has not kept pace with the UK average:

- The proportion of working-age residents with no qualifications has fallen from 12% in 2011 to 8% in 2020. This represented a fall of 34% in the total number of working aged residents without any qualifications against a decline of 37% across the UK as a whole.
- The proportion of adults educated to NVQ Level 4 and above has increased from 29% in 2011 to 39% in 2021. This represented an increase of 31% in the total number of working aged residents qualified to degree level and above, this was below the UK-wide figure of a 37% increase. Wales has fewer 'high skill' jobs compared to the UK average.

⁸ BIS (2015) 'UK skills and productivity in an international context'
(https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/486500/BIS-15-704-UK-skills-and-productivity-in-an-international_context.pdf)

Figure 4: Skills demand – employment by broad occupational category (SOC 2020)



Source: ONS/Annual Population Survey Oct 2021-Sep 2022

In 2022 46% of employment in Wales was in the top 3 occupational categories compared to a UK average of 51%. This was almost entirely driven by lower levels of employment in professional occupations (22% vs 26%). Figure 4 shows how the occupational structure of Wales has changed over the past decade. The pattern has largely followed that of the wider UK economy, with growth concentrated amongst the top three occupational categories. However, there are several important differences to note:

- Wales has seen much greater growth in the number of people employed in caring, leisure and service occupations
- Growth in professional occupations has been considerably lower than the UK average
- Wales has experienced a higher rate of growth in the number of people employed in associate professional and technical roles.

Despite these trends, there is a growing mismatch between the demand for professional roles and the available workforce. This gap exists even though Wales has shown remarkable growth in its FinTech sector. In 2023 Wales had one of the fastest growing FinTech sectors in the UK and in 2024, Cardiff had the highest GVA performance outside of London⁹. In a recent report from FinTech Wales, the industry currently employs 16,000 people and has seen investment grow by 300% since 2022. In the 12 months up to October 2023, Welsh fintech firms raised £53m in publicly announced funding rounds, demonstrating Cardiff's vibrant and rapidly growing tech sector, particularly Fintech, which is supported by university-led incubators and has fostered a world class start-up culture. In H1 2024 alone, there was £25m of venture capital invested in Cardiff for these start-ups, making up 19 deals in total. The tech sector accounted for 47% of these deals, consequently raising £8m of venture capital, and further enhancing the tech sectors presence within Cardiff¹⁰.

Exploring the potential of AI in Wales' emerging and established industries could improve productivity and commercial viability. This should include examining specific tasks where AI can add

⁹ PwC. Good Growth for Cities 2024. Accessed November 25, 2024. <https://www.pwc.co.uk/government-public-sector/good-growth/assets/pdf/good-growth-2024.pdf>.

¹⁰ Savills. *The Growth and Transformation of Cardiff*. September 2024. Accessed November 25, 2024. <https://pdf.savills.com/documents/The-Growth-and-Transformation-of-Cardiff-Sept-2024.pdf>.

value, particularly for SMEs who have the most to gain from cross sector collaboration. As seen in FSB Wales' recent report 'The Power of Creativity'¹¹ uncertainty around the significance of AI and its use generally among the SME community is reflected in the creative industries. Given the uncertainty around its significance and potential for exploitation, it's perhaps unsurprising that it was the question on 'what AI means for your business' that drew the most varied response, with a spectrum of 'techno-pessimists' through to 'techno-optimists' and most places in between. This reflects the recent findings of FSB's Redefining Intelligence report for the wider SME community, with 55% seeing opportunities for their business whilst 73% of SMEs expressed concerns.

It was notable that those most concerned were those in the music industry who feared the potential impact on the market for their skills. This section of the conversation broadly reflected the general uncertainty and confirms what FSB have found in our report on AI and SMEs which is that an AI strategy is needed which looks at how its practical use for firms and good practice can be disseminated. Many would benefit from practical training to reduce admin time and costs. Specifically for creatives, there are potential uses of AI for creative events, performances and products, and these could be facilitated through proactive development of networks of AI experts that other creatives can access.

In general, governments should follow FSB's recommendations from its Redefining Intelligence report, including issues around copyright and enforcement. This regulation is a vital part of providing a fair level playing field and that creative work is valued properly.

- UK and Welsh Government should include AI information and training across support programmes emphasising its practical and creative use at the firm level.
- Creative Wales should work with the clusters to proactively develop networks of AI experts that other creatives can access to explore new ways of using tech in creative products and events for creative SMEs in a way that levels the playing field.
- FSB's 'Redefining Intelligence' report's recommendations on AI should be adopted, including:
 - Legislation that ensures that all AI created output clearly outlines that the content has been AI generated and a review into the use of AI and copyright and establishing auditing of AI use.
 - AI skills and tech adoption should be encouraged among SMEs through an independent UK body that provides policy recommendations, an Automation Fund, and a section on the successful use of AI within businesses within management courses (such as Help to Grow).

What skills are likely to be needed because of increased use of AI in the workplace, and how well placed is Wales to deliver these?

Digital literacy remains a significant barrier in terms of being able to implement AI tools that everyone, of all professions and background can effectively use. Researchers at Northeastern University have extensively invested in this, exploring AI's global economic impact by studying how generative AI will reshape labour markets and require new regulatory frameworks to improve productivity¹². Analysing policy shifts to anticipate AI-driven changes across various sectors and economies, will ensure insight leads to a balance of innovation with societal benefits. So far, the

¹¹ Federation of Small Businesses. The Power of Creativity. Accessed November 25, 2024.

<https://www.fsb.org.uk/resources-page/the-power-of-creativity.html>.

¹² Northeastern University. *Northeastern Researcher Creates AI Tools That Help Gig Workers Solve Problems*. Accessed November 25, 2024. <https://phd.northeastern.edu/news/northeastern-researcher-creates-ai-tools-that-help-gig-workers-solve-problems/>.

University have been successful in creating artificial intelligence tools to help freelancers organise, collect their own job-related data, analyse their work problems and develop strategies that can be adopted into everyday challenges. The tools currently draw on large language models and social theories to create “intelligent assistants” that help freelance workers understand their collective problems.

There is a need for deeper analysis of the growth ceiling being reached by certain sectors in the Welsh economy, such as FinTech, its relationship with higher education (HE) and further education (FE) institutions, and how improved methods can ensure supply and demand is met.

Addressing economic needs is a vital foundation for providing firms and learners with the opportunities available in a growing economy. Putting them at the heart of the system, and ensuring we identify SME needs is vital for knowing the skills needed to succeed. Small businesses typically find navigating the skills and training system more difficult than larger firms. For those that don’t invest in external training, a lack of awareness of the availability of provision as well as the benefits of investing are key barriers to overcome.

FSB Wales has continuously advocated for better alignment between skills support and business support that could help overcome obstacles alongside the increased availability of more suitable training opportunities, that are bespoke and flexible. The aims set out MEDR’s strategy has the potential to develop a structured approach that provides a central knowledgeable contact point to work with matching skills with SMEs. However, the lack of a robust business plan and identifiable KPIs, across several areas, suggests that this level of coordination has yet to take place within MEDR, putting at a disadvantage Wales’s opportunity to capitalise on the FinTech sector and the jobs created around it.

To better understand the potential for AI technology to be a driver in the Welsh economy, Welsh Government need to address the R&D gap that persists in this field.

- Academic research needs to be tested in areas of society that most of us understand and encounter every day.
- Welsh Government should consider what available recourses are available to attract major tech firms to HQ in Wales, thus helping feed a broader and more extensive eco-system that supports academic research and industry piloting projects.

Final Recommendations:

- Alongside the UK Government, Welsh Government should ensure that funding and capacity for Business Wales is retained after 2025, and that the Development Bank of Wales remains strongly capitalised to support SMEs in innovation.
- Welsh Government should acknowledge the opportunity that comes with Digital Strategy Wales and work proactively with business organisations, academic institutions, public bodies and the private sector to develop and deliver at pace its objectives.
- Welsh Government should support initiatives that improve SME access to finance through bodies such as Development Bank of Wales, working proactively with other institutions that have already adopted best practice.