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## Policy Paper

# Foundational Economy 2.0

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## About FSB Wales

FSB Wales is the authoritative voice of businesses in Wales, with around 10,000 members. 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.

Throughout 2020 FSB Wales is speaking to businesses the length and breadth of Wales through our campaign *Our Business is Wales*. The conversation will be used to inform practical policy suggestions to improve the business environment for SMEs in Wales.

## Introduction

Significant strides have been made in recent years to create a unique agenda to Wales around the Foundational Economy. The Foundational Economy relates to those everyday goods and services that we all rely on but that are often undervalued from an economic policy perspective.

Things such as the food we eat, the nurseries we send our children to and the pipes that carry water to our homes are all parts of the foundational economy. The economic crisis caused by the Coronavirus has put this in stark terms – whilst many businesses have been closed, those that we rely on for our day-to-day lives have stayed open. These sectors quite often have large proportions of SMEs that are visible in almost every community across Wales; they are the nurseries, dentists, care homes, butcher shops, food producers that we all value and that have kept our standard of life high, despite the challenges posed by the pandemic.

Despite this, firms in the foundational economy are often facing challenges; working with impossible margins, low productivity, difficulties in providing good working conditions and progression for their staff. FSB Wales has been a key driver in change on this agenda, with our work with CRESC at Manchester University *What Wales Could Be?* Providing a catalyst for a conversation on how to improve the Welsh economy and the wellbeing of Welsh citizens at the same time.

Furthermore, from our research on *Wales' Missing Middle* we've identified a lack of medium sized companies in Wales as a strong contributor to our economic challenges. The result of this campaign has been a recognition and adoption by the Welsh Government through its Economic Action Plan that foundational sectors are important to us all and need to be nurtured.

## Foundational Economy 1.0

As a result of the inclusion of the foundational economy in the Economic Action Plan Welsh Government under Welsh Labour has embarked on a three-pronged policy approach as follows:

- 1) *The Foundational Economy Challenge Fund* – This experimental fund invited proposals for pilots in foundational sectors with a value up to £100,000. 52 have been awarded across diverse issues such as social care, procurement and housing and a community of practice is being formed to share learning.

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- 2) *CLES+ Procurement with PSBs* – the Centre for Local Economic Strategies (CLES) has been brought in to provide support for four PSBs to help them act as ‘change makers’ and influence public procurement to help retain wealth locally.
- 3) *Building the Missing Middle* – A shift in emphasis towards developing the cohort of medium-sized firms in Wales. This has focused on the redesign of the Business Wales contract for 2021.

These three areas of focus have been a welcome first attempt to craft policy in an area of economic development that does not have an already established menu of options. Significant learning will come from this and as a result the agenda will undoubtedly move on positively as a result of this ground-breaking activity.

## Foundational Economy 2.0

The challenge for all political parties hoping to form the next Welsh Government will be how to scale this thinking and make it relevant to a larger number of firms in the foundational economy. For this, we begin to develop Foundational Economy 2.0. Taking the experiences of the challenge fund, the focus of the missing middle and the good practice on procurement we can develop several key themes. Foundational Economy 2.0 needs to be firm-centred. It needs to focus on how individual companies relate to the concept of the foundational economy and look at developing their capability to grow and be successful. It needs to be unashamedly pro-growth in its approach, looking to develop Welsh companies using our own foundational markets so that they can be successful at home and abroad.

## The Foundational Economy Lens

In order to achieve this, FSB Wales believes we need to develop a foundational economy ‘lens’ which guides policy making in foundational sectors. For FSB Wales, this lens would include:

- ***Diverse local economies*** – We usually focus on ‘what’ policy needs to achieve but we neglect questions around ‘who’ delivers policy and ‘how’ they deliver it. Through the FE lens, areas of public policy would move beyond only narrow outcomes and would work to ensure a diverse mix of organisations (SMEs, social enterprises, third sector etc) are able to deliver foundational services whilst supporting their own growth.
- ***Procurement that encourages diversity*** – Procurement practice is key to much of this. It drives behaviours throughout the supply chain and is a practical means by which to make change. The FE lens means working on presenting contracts and commissions in ways that make it accessible to SMEs within a competitive environment.
- ***Building the capacity of small firms*** – Presenting opportunities is only one side of the coin. The other side is building companies that can capitalise on the opportunity. Business support needs to look toward building companies, particularly towards the medium-size cohort, by helping them to increase capacity and move up value chains in foundational sectors.
- ***Rewiring public sector funding models*** – Many FE sectors such as childcare and social care are the products of public funding. If we want to develop businesses and their



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employees in these sectors then we have to accept that public sector funding models need to shift from appraisals of cost towards value.

- **Asking larger businesses to support SMEs** – Some sectors are dominated by large firms that have disproportionate influence. For instance, supermarkets are highly influential when it comes to the food we eat. For FE policy to work, we need to work with them to help more local producers to get through these systems and disrupt the current flow of products. Focusing on supply chains through the economic contract is one means of doing this.

This lens is not sector specific. It can be applied to any public policy challenge or sector and can help to shift the dial towards more diverse and locally anchored economies. It requires policy makers to think differently about how they do things; but they should be supported to do this.

**One practical step would be for the next Welsh Government (and local authorities) to develop in-house expertise on the foundational lens that can be used to help other departments to deliver this approach in dealing with their own policy problems.**

## Covid-19 and Business Resilience

The crisis caused by Covid-19 has tested the resilience of businesses across Wales, not least in the foundational sectors. Many have faced business challenges that previously were the subject only of the worst case planning scenarios such as a reduction of cashflow to zero, a fundamental shift in business models to online working and trade almost overnight and the need to adapt working practices to radically different social distancing environments. Undoubtedly government support has helped make firms resilient during this crisis, but at significant cost to the exchequer. Despite the support given, there will be firms that will have gone out of business in the face of these challenges.

With the very real prospect of a second peak of the virus, a deep recession or even in the longer-term other similar pressures to the current pandemic emerging, it is vital that we learn the lessons around business resilience now to prevent further vulnerabilities to similar crises. Business support needs to help businesses to undertake 'pandemic proofing' in the short term and to build resilience in the longer-term. This should include helping businesses to develop digital adaptability and connectivity which has been a key asset for many businesses in their resilience through the crisis. Similarly, helping businesses understand the vulnerabilities in their supply chains provides an opportunity, particularly as has been seen in relation to PPE in foundational sectors such as care.

**Business Support needs to help businesses strengthen their resilience to shocks such as the current Covid-19 pandemic.**

## Foundational Challenges

In order to narrow down the scope of action further, the next Welsh Government should consider a small number of foundational challenges to which it will apply the lens. These will act as opportunities for scaling up past thinking and will require cross-departmental working. In our view, three challenges would be a good starting point. These challenges would look to improve



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productivity in the sectors identified, help the firms involved to grow and become capable grounded firms.

**The next Welsh Government should adopt three 'foundational challenges' that it will address, seeking to build more diverse local economies whilst solving public policy challenges. They could be; decarbonisation of existing housing stock, food procurement and social care.**

Taking each in turn, we could see the following activity.

## Housing Decarbonisation

Climate change is a pressing concern for everyone in Wales as we seek as a nation to achieve the aims of the Paris Agreement. As FSB Wales set out in its report *The New Normal* SMEs have an important role to play in this agenda. One area that's an opportunity for significant change is the retrofitting of existing housing stock.

As the *Independent Review of Housing Decarbonisation* points out, if we are to meet Wales' targets for a 95% reduction in carbon emission on a 1990 baseline, then significant action must be taken, including retrofitting properties from the current EPC average of D to A and B, wherever possible.<sup>1</sup> The review suggests a 30 year residential decarbonisation programme is undertaken in order to achieve this.

This is an ideal policy area for foundational thinking. There's a policy challenge that requires long-term action to be addressed. Traditional approaches would look at the challenge, devise the outcome and set a programme in place to achieve that outcome. But adding a foundational lens brings further questions into the equation such as; how do we design this 30 year programme to deliver maximum social and economic opportunity?

Taking this approach into practice, the 30 year programme would need to focus on ensuring the opportunities are open to all and that procurement practices enable smaller businesses to provide work for the programme. Furthermore, business support would be used to encourage companies in Wales to increase their capacity, developing skills and products to help meet the challenges of domestic housing decarbonisation and grow and become more productive in the process.

By approaching it this way a number of objectives would be achieved. Firstly, the decarbonisation aims would be delivered. Second, SMEs in communities across Wales would be stimulated to grow and develop over a long time frame. Finally, in developing these SMEs more wealth would be created locally and better employment prospects could be delivered.

## Food Procurement

The food that we eat and how it comes to be on our plate is as good an example as any when it comes to the foundational economy. Put simply, we have to eat food and therefore it's spending

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<sup>1</sup>Independent Review on Decarbonising Welsh Homes. 2019. [Online]. Available at:

<https://gov.wales/sites/default/files/publications/2019-07/independent-review-on-decarbonising-welsh-homes-report.pdf>



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that goes on in every part of Wales on every day of the week. However, the routes by which the food reaches our plate is often not clear and for the majority of us purchasing groceries is much less about the local butcher, farmers market or brewery and far more about the weekend trip to the supermarket.

For this reason, there are a small number of large businesses that play a pivotal role in what food we eat and how it gets to us. For the public sector, the cost of food is around £74m per year according to a 2018 report by the Senedd Climate Change and Rural Affairs Committee.<sup>2</sup> However, the sector as a whole in Wales produces around £7bn in turnover a year according to the same report, showing the scale of the sector in Wales.

The existing food and drink strategy has done an admirable job in pursuing growth in the sector over past years. However, as the Committee's report notes; *"given the potential benefits of food policies, this focus is too narrow. There is currently a need for a strategic vision for the Welsh food sector which makes connections between different policy areas, such as health, wellbeing and sustainability, alongside economic growth."*

With a foundational lens, we can adapt the current approach to food away from raw growth figures and towards a more granular and diverse understanding of the sector. This would mean looking to encourage more SME food producers by helping provide a route to market and ultimately onto the plate for those companies.

The easiest place to start would be in the public sector. The demise of the National Procurement Service has given local authorities the ability to undertake procurement more locally again for food in schools and other settings. This provides a strong opportunity for the development of Welsh food companies, with the right business support.

However, the conversation should not stop at the public sector alone. Supermarkets are they key player for a large portion of food purchases in Wales. Welsh Government often provides grants for supermarkets and local authorities often provide consents through the planning system for new developments. With an economic contract geared up towards increase local supply, both of these situations provide opportunities to encourage supermarkets in Wales to increase their use of Welsh producers and suppliers and to improve their supply terms.

Similarly, many restaurants and bars are often supplied by food wholesalers. For instance, we're fortunate in Wales to have a major player in Castell Howell based in Carmarthenshire. A new approach to food would place a premium on working with wholesalers and other key market players to increase their supply from Wales. This would require close collaboration with wholesalers but also business support to ensure those firms able to grow are encouraged to do so to sell to the Welsh market (and further afield).

## Social Care

Health policy is a one of the largest areas of devolution. Frequently, the discussion on health relates to the NHS which is a significant portion of Welsh Government's spend in every year. However, social care is also extremely important. While the NHS has a model of state delivery,

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<sup>2</sup> National Assembly for Wales Climate Change, Environment and Rural Affairs Committee. 2018. *Rethinking Food in Wales* [Online]. Available at: <https://senedd.wales/laid%20documents/cr-ld11576/cr-ld11576-e.pdf>



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social care is very different. The sector is made up of diverse participants including local companies, larger regional chains, local authority run operations and national chains often backed by international capital. This makes social care policy far more economic in nature than the broader subject of health.

What's clear, is that an ageing population is providing a challenge in terms of how to fund social care in an equitable way. The consensus is that more money needs to be provided to the system. For instance, Prof Gerry Holtham's report *Paying for Social Care* suggests "that demand for spending is projected to rise by just over 85 per cent by 2035, at 2016-17 prices, comprising a 20 per cent increase in spending per head and an increase in numbers requiring care of over 55 per cent."<sup>3</sup> The report concludes that "Either care standards will fall, conditions for access to assisted care will be tightened considerably or a new revenue source must be found".

The challenge for social care is therefore clear. There are many ways of potentially resolving this issue – indeed Prof Holtham concluded a new contributory levy should be created in Wales – however almost all involve more funding. The question from a foundational perspective then, is if more funding is going to be delivered, who is going to deliver the funding and to what end?

If we apply the foundational lens highlighted above, it's clear that any increase in funding needs to go hand-in-hand with an economic strategy for the sector. From an FSB Wales perspective, such a strategy would look at the levels of funding needed to ensure viable businesses are able to grow, employ staff on decent salaries and encourage progression. Given the diversity of provision in the sector, this will require close working with SME care providers and encouragement to ensure that they're able to grow with expanding provision in a sustainable way over the long-term.

An economic strategy for social care would look at businesses from their perspective, understand their needs and pressure and look to work with them to develop provision in a way that helps build better public services along with better businesses.

## Conclusion

The experiments of the last few years around the foundational economy have helped shape our thinking as to what works. The next Welsh Government will need to take this a step further and scale up its thinking. We believe the three challenge areas identified above offer a strong starting point for this scaling up activity. If done properly, the next Welsh Government could be one that delivers better public services and economic growth whilst building wealth locally and improving the vitality and diversity of Wales' local economies.

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<sup>3</sup> Prof Gerald Holtham. 2018. *Paying for Social Care in Wales: An Independent Report Commissioned by Welsh Government*. [Online]. Available at: <https://gov.wales/sites/default/files/publications/2018-11/paying-for-social-care.pdf>