

An IWA report | September 2021

# The impact of regulation in the Foundational Economy

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## About the authors

Dr Jack Watkins is a policy lead for the IWA's project on the foundational economy in Wales. Prior to joining the IWA he worked in a variety of community development, research and public policy roles in Wales.

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IWA – Institute of Welsh Affairs, 56 James Street, Cardiff Bay, CF10 5EZ  
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## Foreword

Having lived through a challenging year and with hope that COVID-19 continues to be managed effectively, attention is turning to the costs borne as a result of lockdowns and restrictions. The Local Data Company has estimated that during summer 2021 around 50 high street shops were closing in the UK per day, a truly staggering figure considering that the impact of ending the Job Retention Scheme is yet to be felt. The hospitality and leisure industries have to adapt in ways that have made many businesses unviable, while sectors like social care have faced pressures that they could never have anticipated.

These changes are not all because of COVID-19, but they were certainly accelerated by it. We are now in a phase of wider transition in the Welsh economy in which it is not certain what the future will look like, in terms of the jobs we do and the goods and services we buy. If previous economic changes are to be a guide, then we know that businesses and policy-makers will need to be quick to respond and flexible enough to recognise when established ways of doing things are no longer appropriate.

It is in this context that we have turned our attention to regulation. Rarely a hot-button political issue, regulation nevertheless shapes the everyday operation of hundreds of thousands of businesses in Wales. Governments and public agencies design rules to protect us from harm and to provide clarity, yet this process is always mediated by the desire to facilitate business activity. Simplistic arguments, either for punitive enforcement or for laissez-faire, do not capture the reality of a system that is in a constant state of re-balancing one way or the other.

The Welsh Government's focus on the foundational economy – the everyday essentials of care, housing, food and utilities – provides an important incentive to consider how this balancing act can be brought up to date. In identifying substantive differences in how different firms contribute to or detract from many things that society values, the foundational economy requires us to consider how all aspects of policy making affect different types of businesses, within an enormous spectrum from multi-nationals to sole traders.

Working in collaboration with The Means, a consultancy with a long track record in analysing local development, we conclude that regulations and enforcement often have a disproportionate impact on smaller, newer businesses. Complex rulebooks, lengthy application periods and the gradual creep of regulations create burdens that fall disproportionately on smaller businesses but which large firms can either absorb, find ways of adapting to, or deploy the resources to challenge. The impact is a disincentive against growing a business or entering a new market.

We are not calling for a bonfire of red-tape. Many of the responses we heard were measured and recognised the value of regulation for providing consistency and creating a level playing field. However, business owners want to see a regulatory regime that is more relational, with regulators and inspectorates being open to hearing their concerns and reflexive in how changes are implemented. Ultimately many businesses feel that their aims – employing more local people, developing new products – are beneficial to society, and they want to face fewer barriers to achieving them.

The IWA aims to help shift Wales towards having a clean, green and fair economy that is sustainable and equitable. Welsh businesses are essential to achieving this, and it is important that they are incentivised to do the right things. We hope that our recommendations provide insight into how small changes can create a more relational environment where businesses and citizens work towards the same goals.



**Auriol Miller**

Director of the IWA

## Introduction

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

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

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

The project's first report<sup>1</sup> addressed business support programmes and how these can be made more accessible to a wider range of firms, recognising the potential for growth to come from unexpected places and also the wider social value inherent in grounded businesses in foundational sectors.

This second report summarises a period of research and analysis looking at regulation in the Welsh context, and specifically at how regulation impacts on 'grounded firms' – those businesses that are rooted and committed to their local area, with commitments to improve those places. We have focused on four sectors: three that are routinely categorised as part of the foundational economy of everyday essentials (social care, construction and food) and one that sits in the space between everyday essentials and consumer goods (manufacturing). Looking at these sectors has given us the ability to compare experiences in different markets, and crucially in different regulatory regimes.

Our research is focussed principally on the issue of the *relative impact* of regulation i.e. is the perception and experience of regulatory impact the same across sectors and size of enterprise. Here size of enterprise is being used as a proxy for firms that are operating within the Foundational Economy. Our findings (through literature reviews and one-to-one interviews with those operating within the foundational economy) illustrate the difficulties regulators face in achieving the right balance between the competing objectives.

## Context - the Foundational Economy

The term Foundation Economy (FE) was coined in 2013 by a group of researchers working at the Centre for Research on Socio-Cultural Change (CRESC) with the publication of the 2013 Manifesto for the Foundational Economy<sup>2</sup>. It focussed on:

- achieving better outcomes for those geographical areas whose economies are rooted in sectors that have been ignored by global market theory, and
- making ‘the economy’ work for more people.

It points out that whilst recent industrial policy has been focussed on advanced technology, it has very little to say about more mundane, essential services such as farming, food retailing and healthcare. It grouped a number of sectors into what it termed the Foundational Economy. These provide essential services and therefore tend to have more long-term local connections to areas, and it is assessed that this part of the economy provides 40% of jobs in the UK. As such it should receive more support and policy focus. The foundational economy includes the following sectors:

- Utilities
- Retail banking; food and petrol retailing; food processing
- Networks and services such as rail or bus for transport and distribution of people and goods
- Telecommunications networks
- Health, education and welfare/social care.

The value of the foundational economy is increasingly recognised by governments and by citizens, both in terms of its potential to lift the economic performance of regions and the ability to deliver wider community benefits.

The original Foundational Economy manifesto argues for:

- Greater focus on geographical areas and demographics that rely more on foundational economy jobs – in other words, economic policy that works for more people
- A high standard of, and good accessibility to, basic services – arguing that we consume many essential services, such as utilities infrastructure or healthcare, communally and should therefore invest in these communally and value social outcomes over market-led approaches
- Quality and quantity of local employment – improving conditions, driving job-creation and improving skill levels and progression routes in the foundational economy, results in improved conditions and job opportunities for a larger part of the workforce than focussing on success in R&D, for example.

To date, policy support for the foundational economy has been concentrated on three elements:

1. Adapting public sector procurement to incentivise greater social contribution from firms winning procurement contracts, as well as boosting opportunities for locally-owned firms
2. Programmes of investment to improve the resilience of key foundational systems, such as social care, housing and transport
3. Supporting businesses through information and advice services, the development of 'patient' loans and grant-making to encourage innovation.

As the topic has become much more prominent in academic and government thinking, an increasing, though limited, number of case studies are regularly referenced to inform and encourage future practice, particularly in public procurement where there is widespread support for a more local focus. Perhaps the urgency has never been greater than currently. Thinking has continued to develop and expand so that the approach to the foundational economy has become interlinked with a number of other schools of thought. Some examples of these are:

- Procurement policy that is oriented towards social value as described in the 'Preston Model'<sup>3</sup>, and in the Welsh Government's Procurement Policy Statement<sup>4</sup>
- A push for public ownership of key assets and local economies<sup>5</sup>
- The desire to build 'resilient' communities, as described during the debate on the foundational economy in the Welsh Senedd in March, 2017<sup>6</sup>
- The climate change crisis. Some make practical links, such as suggesting that efforts to address climate change are an opportunity to support local jobs and skills, for example through insulation programmes that utilise networks of local builders. Others, such as the Foundational Economy research collective, make deeper links, arguing that environmental sustainability is an essential service and, as such, is part of investing in the foundational economy.

Whilst the potential value of the foundational economy is widely recognised, research by the Wales Audit Office and others has indicated significant hurdles that impede progress towards delivering better outcomes – not least the dilemmas that arise when introducing a mix of motivations into public procurement processes, the design of which has previously been heavily weighted towards achieving value for money<sup>7</sup> in the sense of lowest cost. The introduction of other considerations, such as social value, requires measures to be put in place to support commissioners' decision making in those areas. And procurement personnel need the skills, knowledge, training and crucially institutional support to implement new approaches.

<sup>3</sup> See Preston City Council, n.d., 'What is the Preston Model?'

<sup>4</sup> Welsh Government, n.d. Written Statement: Publication of the Wales Procurement Policy Statement

<sup>5</sup> Democracy Collaborative, 2020, COVID-19 and 21st Century public ownership

<sup>6</sup> Vicki Howells MS speech in Plenary, 8/03/17

<sup>7</sup> Audit Wales, (2017) Public Procurement in Wales

In addition, there are obviously two sides to procurement: supply and demand. Whilst procurement policy has focused on boosting demand for local businesses, this requires the widespread supply of the kinds of goods and services that the public sector needs to procure. One of the more worrying features identified in a 2017 FSB report<sup>8</sup> was that the number of small and medium enterprises (SMEs) that had worked or considered working for the public sector is falling. It appears from their data that the operation of Framework Agreements in local authority procurement has contributed to this.

The procurement example illustrates that it is not enough simply to make opportunities available to small, local businesses. The procurement process needs to be demystified for them and they need encouragement and the confidence to engage, and policy-makers need to gain a better understanding of what disincentivises firms from tendering.

The experience of procurement highlights a theme that we return to throughout this paper. It might be more convenient for policy makers if they had a few big targets to tackle, such as overly diligent aspects of regulation that could be safely rolled back. But the reality may be that firms are put off by the aggregate and incremental impact of a number of small considerations.



## Regulatory Impact

‘Regulation’ refers to a statutory provision which imposes requirements, restrictions or standards in relation to business activity, with the expectation that compliance with these conditions can and will be enforced. As such it entails imposing limits and constraints on businesses’ freedom of action. The justifications for any such curbs are in the proposed benefits for employee and consumer protection, the creation of a level playing field for economic actors to compete on the same terms, and the concern to steward the world’s natural resources responsibly. A *well regulated economy* is generally considered to be a good thing, including by firms. The challenge is to determine what good regulation looks like in a dynamic, fast changing and complex environment. Policy development in this field needs to consider *inter alia*:

- *Relative impact* – is the perception and experience of regulatory impact the same across sectors and size of enterprise?
- *Proportionality* – are the benefits and / or protections that accrue from regulation sufficient justification for the burden of compliance?
- *Equivalence* – global trade, i.e. that between countries, is accounting for a growing proportion of economic activity. To what extent are efforts to improve regulation at the nation state level hampered by the demands of having to trade internationally?
- *Innovation* – the so-called *knowledge economy* accounts for a large proportion of growth in jobs and productivity. This represents particular challenges to regulators in achieving the understanding and expertise to rule at this cutting edge and in avoiding setting frameworks which frustrate innovation.
- *Who regulates the regulator* – regulators need the scope to respond to changing circumstances with agility. In many instances they are independent of government and their independence is their hallmark. How can sufficient consistency and predictability of process and implementation across different regulators be achieved? Uneven development between sectors inevitably means that regulators are confronting different kinds of issues at different times.

Developing regulation involves political, social, economic and moral choices. It would be remarkable if there was no divergence internationally. The incentive to grow global trade has been a driver in attempts to harmonize regulation between nations. This ambition inevitably places additional stresses on regulatory reform.

Our research is focussed principally on the first of these considerations, specifically on the issue of size of enterprise, which is used here as a proxy for firms that are operating within the Foundational Economy.

## The Better Regulation agenda across the UK

The UK's regulatory landscape includes a wide range of public agencies performing a range of different functions.

<p><b>UK Government</b></p>	<ul style="list-style-type: none"> <li>— Sets policy for UK-wide regulators and for England-based regulators.</li> <li>— Proposes legislation that empowers regulatory agencies.</li> <li>— Acts as a regulator and inspectorate in some cases.</li> </ul>
<p><b>Devolved governments</b></p>	<ul style="list-style-type: none"> <li>— Set policy for regulators based in their nations.</li> <li>— Propose legislation that empowers regulatory agencies within their nations.</li> <li>— Act as a regulator and inspectorate in some cases.</li> </ul>
<p><b>Regulatory agencies</b></p> <p>(UK-wide regulators include utilities regulators such as Ofgem, financial regulators such as the Financial Conduct Authority, transport regulators such as the Civil Aviation Authority, as well as the Health and Safety Executive and Food Standards Agency)</p> <p>(Welsh regulators focus on devolved competences, including education (Estyn and Qualifications Wales), health (Social Care Wales) and Natural Resources Wales)</p>	<ul style="list-style-type: none"> <li>— Set regulations, rules and conditions within the remit set by governments.</li> <li>— In many cases, regulatory agencies license businesses to enable them to provide certain goods or services.</li> <li>— Some regulatory agencies also act as inspectorates, monitoring practice to identify compliance.</li> <li>— Some agencies can also impose sanctions in cases of non-compliance.</li> </ul>
<p><b>Local authorities</b></p>	<ul style="list-style-type: none"> <li>— Local authorities set policy and exercise decisions in respect of planning, within the bounds of policy set by government.</li> <li>— Local authorities act as inspectorates, enforcing compliance with regulations set by regulatory agencies, for example in food hygiene.</li> <li>— Local authorities are also themselves subject to regulation and inspection in relation to their role as providers of education and social care.</li> </ul>

The complexity of the overlapping responsibilities of these different bodies has arisen gradually, but accelerated during the 1980s during a period in which many state-owned enterprises were sold or broken up, creating new markets in key utilities which required regulatory oversight.

Over the last decade, there has been greater interest in the ‘better regulation’ agenda at both UK and EU levels. This has been motivated by widespread perceptions among business owners as to the disproportionate impact of regulations, and the effect that this has of limiting their ability to grow in terms of output or employment<sup>9</sup>.

Within the literature on better regulation, the way that regulation operates in the **United Kingdom** is highly regarded. The OECD awarded it the highest individual country score<sup>10</sup> in an international index, and the UK is ranked ninth amongst the top 190 economies for the ease of doing business. In its 2020 report on Better Regulation, the Department of Business Enterprise and Industrial Strategy (BEIS) described the regulatory environment as amongst the best in the G7.

The UK Government’s Better Regulation Framework represents the central articulation of the wider aims of the better regulation agenda. The framework:

*‘...is intended to ensure that government regulation is proportionate and is only used where alternative non-regulatory approaches would not achieve the desired outcomes.’<sup>11</sup>*

It supports the view that the introduction of any new regulation would need to satisfy two key tests:

- providing clear evidence of benefits to society; and
- being as easy as possible for businesses to implement.

Building agreement around the appropriateness of these two tests has been straightforward. The difficulty arises in their interpretation and implementation, and increasingly in the dynamic environment in which they are to be applied. This context includes not only the challenges resulting from industrial innovation, but also the tension of simultaneously seeking to promote the principles of subsidiarity, and of growing trade between nations.

<sup>9</sup> [Department for Business, Energy and Industrial Strategy, \(2019\) Business Regulation Understanding business’ perceptions and behaviour](#)

<sup>10</sup> OECD (2018); “OECD Regulatory Policy Outlook 2018”

<sup>11</sup> [Better Regulation: government’s annual report, 2018-19; Department of Business Enterprise and Industrial Strategy: 2020](#)

The 2019 White Paper<sup>12</sup> *Regulation for the Fourth Industrial Revolution*, characterises this as follows:

*‘We need a more agile approach to regulation, that supports innovation while protecting citizens and the environment.’*

Similarly, the UK Government’s 2017 Industrial Strategy<sup>13</sup> includes a government commitment to support businesses with regulation that stimulates and facilitates innovation.

The UK’s better regulation agenda has also influenced policy in the devolved context in Scotland. Following the enactment of its Regulatory Reform Act (2014) the devolved government in Scotland, which had established a Regulatory Review Group as early as 2004, developed more tools such as *Business and Regulatory Impact Assessments* to support its Better regulation principles of being:

- Proportionate
- Consistent
- Accountable
- Transparent
- Targeted only where needed.

In Wales, there is evidence that firms find regulation to be a greater problem than in either England or Scotland, with 51% of respondents to the BEIS Small Business Survey in Wales describing regulation as their most significant challenge<sup>14</sup>. The 2016-2021 Welsh Labour Government highlighted the role that regulation plays as a driver of economic development, and made a commitment to enhance its effectiveness:

*We will improve the economic impact analysis undertaken on new regulation and we will consult with the business community on existing regulation. We are clear that sound regulation provides important protections to consumers, workers and people generally. The Welsh Government will work to preserve and improve such regulation. Good regulation supports competition, allows markets to function, protects our environment and safeguards rights in the workplace. We will work with business, trade unions and others to consider the impact of regulation now and in a future outside of the EU.<sup>15</sup>*

This commitment built on the two tests that are associated with the better regulation agenda and proposed using regulation as a means to further the Welsh Government’s societal goals - though it is not yet clear how the Welsh Government intends to implement this commitment. The extent to which the second of these tests - ease of understanding by business - is being pursued formed a key point of the discussion with the SMEs interviewed as part of this commission.

<sup>12</sup> [Regulation for the Fourth Industrial Revolution White Paper June 2019](#)

<sup>13</sup> [Department for Business, Energy and Industrial Strategy, \(2017\) Industrial strategy: Building a Britain fit for the future](#)

<sup>14</sup> [Department for Business, Energy and Industrial Strategy, \(2020\) Official Statistics Small Business Survey 2019: businesses with employees](#)

<sup>15</sup> [Welsh Government, \(2017\) Prosperity for All: Economic Action Plan](#)

## Regulation and SMEs

Both of the themes of **supporting innovation** and the **development of SMEs** lie at the heart of the **European Commission's** regulatory policy development. It is particularly concerned that regulation should not inhibit innovation as this would have a negative effect on the growing sectors in which the bloc already underperforms against American and Asian comparators.

*'Some very innovative solutions fail to see the light of day because of regulations which might be outdated or poorly adapted for fast evolving technologies. One way to address this is through regulatory sandboxes. This enables innovative solutions not already foreseen in regulations or guidelines to be live-tested with supervisors and regulators, provided that the appropriate conditions are in place, for example to ensure equal treatment. Regulatory sandboxes provide up-to-date information to regulators and supervisors on, and experience with, new tech, while enabling policy experimentation'<sup>16</sup>.*

The Commission's other major concern, and most relevant to this study, surrounds the impact of regulation on SMEs which are described in this communiqué as the backbone of Europe's economy. As in Japan, it is companies of this size that have often powered economic growth. The 25 million SMEs make up 99% of all businesses in the EU; employ around 100 million people, 2 out of 3 jobs; and account for more than half of Europe's GDP<sup>17</sup>.

The Commission's research indicates that 78% of SMEs cite complex administrative procedures as the biggest obstacle to operating in the Single Market. The Business Europe directorate has emphasised the disproportionate impacts that regulatory compliance place on SMEs compared to larger firms:

*'When a big company spends €1 per employee in connection with regulations, a small business has to spend €10 on average. Excessively complex or burdensome legislation do not reach their target, and result in scarce SME resources being spent just applying the rules rather than growing the business and creating jobs.'<sup>18</sup>*

In response the Commission has committed to:

- reduce the burden on SMEs and to give them a stronger voice along the Better Regulation cycle using 'Think Small First' principles;
- systematically screen existing EU legislation through the 'Fit for Future Platform' with the aim to reducing administrative burdens and simplifying legislation;
- make more systematic use of fitness checks to look at ways to digitalise, simplify and achieve the objectives at the lowest cost to the benefits of SMEs under the regulatory fitness and performance programme (REFIT);

<sup>16</sup> European Commission, (2020) *An SME Strategy for a sustainable and digital Europe*; European Commission: March 2020

<sup>17</sup> *ibid*

<sup>18</sup> Business Europe, n.d. *Policy Briefing - Reducing Regulatory Burdens on SMEs*

- tackle the danger of ‘gold plating’, and make ‘once only’ and ‘digital default’ central tenets of the regulatory culture; and
- deploy Sustainability Advisors to help SMEs with environmental and social challenges and improve access to skills.

It is notable that where the European Commission has worked to create alignment between its SME and Better Regulation agendas, in the UK these agendas tend to operate apart from one another. Attempts to manage regulatory impacts typically focus on how those impacts will affect all firms, rather than making distinctions between large and small firms. Nonetheless, there is growing evidence to support the view that SMEs face disproportionate impacts. Fears that the impact of regulation was more of an issue for SMEs were confirmed in research BEIS conducted in 2019<sup>19</sup>:

*‘The interviews highlighted that regulatory compliance burdens are disproportionately felt by smaller businesses, especially where the time and resources required to administer regulations does not change in line with the size of the business. Likewise, it is the smallest businesses that are most adversely affected by changes in regulation. That said, when exploring how specific regulatory burdens impact business, most interviewees understood that regulations existed for a reason and they were necessary.’*

This confirmed earlier findings which attempted to quantify the impact. It assessed that SMEs spent between 1 and 2 days per fortnight on regulatory issues<sup>20</sup>, and that they lacked managerial capacity and capability which exacerbates the impact of regulation on small enterprises. The lack of support on interpretation of regulations meant that SMEs either under or over comply, and this has led to a level of complexity that has resulted in negative outcomes such as reluctance to employ. A key conclusion was that many micro-businesses were struggling with regulation and that policy makers were not thinking *small first*.

The same picture emerges from research<sup>21</sup> conducted in Wales by FSB, the body that represents SMEs. It concludes that smaller businesses are disproportionately impacted by regulatory burden.

This study drilled down to determine what issues and aspects were most significant in their potential to alter behaviour, such as creating a disincentive to invest or employ. The survey undertaken of FSB members indicated that nearly nine in 10 (88%) identified some aspect of regulation that was a barrier. Of these:

- almost half (43%) highlighted the overall quantity.
- over a quarter (28%) cited poor design, while
- just under a quarter (23%) cited overly complex or inconsistent language.

<sup>19</sup> [Department for Business, Energy and Industrial Strategy, \(2019\) Business Regulation Understanding business' perceptions and behaviour](#)

<sup>20</sup> [Better Regulation Executive, \(2010\) Lightening the Load: The regulatory impact on the UK's smallest businesses](#)

<sup>21</sup> [FSB, \(2015\) Better Regulation for Wales](#)

SMEs also highlighted barriers associated with implementation. Of these:

- monitoring, recording, and reporting requirements were the primary barrier.
- the associated cost of advice to aid compliance was the primary concern.

The sample was asked what benefits regulation can provide and there were significant levels of support for the role that regulation can play in:-

- helping to build trust among customers (51%),
- creating a level playing field with competitors (36%), and
- enabling productivity and innovation (34%).

These results are open to interpretation, but it is interesting to register that just over half the sample saw the advantages that regulation brings to such a key metric as building trust with customers.

However the headline figure remains that two thirds (62%) of small businesses believed the burden of regulation outweighs the benefits. What is particularly noteworthy is that the regulatory areas that are of most concern to SMEs appear to be those that are of central importance for small businesses:

- workplace health and safety (71%),
- employment law (62%),
- data protection (59%),
- company law (52%)
- pensions (50%) and
- tax administration (46%).

These represent areas of regulation that small firms report as particularly relevant, impacting on the day-to-day running of their businesses.

Elsewhere the FSB has pointed to what it describes as the *missing middle* in the profile of Welsh firms<sup>22</sup>. In Wales micro businesses and large corporations dominate the landscape in what the FSB describes as a 'dumbbell profile': only 10,000 firms and 25% of employment are in the size range 10-250<sup>23</sup>. It attributes this to an industrial history which at the outset was orientated towards extractive operations and their heavy industry customers. These sectors demanded high levels of capital investment and large labour counts. More recently the economic development strategy prioritised inward investment projects that had the capacity to replace the lost jobs at scale.

22 [FSB, \(2017\) Wales' Missing Middle](#)

23 [What Wales Could Be: CRESC Report for FSB Wales](#)

## Experience from foundational sectors

Current evidence on the impact of regulation on SMEs has been informed by both quantitative techniques (and particularly the use of modelling in regulatory impact assessments) and through qualitative methods (including interviews and surveys with firms). Existing research has highlighted important distinctions between the perceptions of governments and regulators and of firms on the other, with the overall extent of regulatory burden being contested<sup>24</sup>.

To gain a better understanding of the impact of regulation on SMEs, interviews were conducted with a range of small companies and representative organisations across a number of sectors. The interviews were complemented by a review of policy literature and other ‘grey’ literature including reports by sectors specific bodies and evidence reported by regulatory agencies.

We have focused on four sectors: three that are routinely categorised as part of the foundational economy of everyday essentials (social care, construction and food) and one that sits in the space between everyday essentials and consumer goods (manufacturing). Looking at these sectors has given us the ability to compare experiences in different markets, and crucially in different regulatory regimes.



## Construction

The house building industry, so key to the UK economy, has been hit particularly badly by the severe financial crises over the past 40 years. It recovered strongly from the 2009 crash, and has continued to perform through the current pandemic with demand fanned by government incentives. Yet under the headlines there has been a significant change in the nature of the industry, as:

*‘...the small and medium-sized enterprises that were once responsible for delivering up to half of all new homes, have struggled to expand in an environment that increasingly necessitates scale’<sup>25</sup>*

This is borne out by the data. In the late 1980s, SME builders built 40% of all new homes, in 2016 this proportion had fallen to a mere 12%. In Wales, whereas previously each town had its local firms that were active in the housing market, this has shrunk to as few as 12 working across the whole of south Wales.

The representatives of the industry interviewed argued that this is due to the cumulative effect of three distinct considerations. Firstly, and most significantly, the **operation of the planning system**, including access to land. Increased environmental standards inevitably entail more complexity in delivery of schemes.

- Promoting bio-diversity requires the appointment of Ecology Consultants, which adds a fixed cost to each development.
- Arrangements for on-site retention and drainage of rainwater, requirements for the use of swales and other features, and the requirements for applications to local authority-based Sustainable Drainage Application Boards add complexity and timing issues, and have also seen building firms and developers need to establish commuted sums for maintenance in perpetuity.
- The requirement for larger gardens has reduced density by around 20%, while at the same time larger space standards need to be met within each housing unit.
- There are often additional remediation issues associated with brownfield sites where smaller builders are active which aren't a consideration on the greenfield sites that volume house builders favour.
- Added to all this are the challenges for a small company to deal with the unpredictability and lack of consistency between authorities, and with highways departments adding further requirements.

The second area of concern that respondents raised was around **finance** and how it shapes both planning and development. For the above reasons and more, negotiating planning is both risky and takes time. This places a burden on small enterprises as lenders are not prepared to lend on a scheme until planning permission is achieved. This creates advantages for larger firms with higher capital, but has come in parallel with a stall in the overall numbers of homes being built - two features of the current housing system that some stakeholders believe to be related, as constraints on the range of builders reduces the overall capacity of the sector to meet the full range of housing needs<sup>26</sup>.

<sup>25</sup> Home Builders Federation, (2021) *State of play: Challenges And Opportunities Facing SME Home Builders*

<sup>26</sup> See [responses to the Welsh Government's 2019 consultation 'Delivery of housing through the planning system'](#)

Access to finance for home-buyers also impacts on decisions made in the planning and construction stages. In particular, mortgage lenders' approaches to risk constrain the greater adoption of prefabrication and other techniques known collectively as Modern Methods of Construction (MMC). Greater uptake of MMC has been a priority for Welsh Government, but respondents noted that lenders' concerns over the life-spans of properties built using these building techniques mean difficulties in potential buyers accessing mortgages, resulting in limited take up by developers and builders.

Thirdly, respondents felt that the performance of **utility companies** causes further frustration and costly delays. As documented above, planning approval requires significant engagement with utilities. Some interviewees felt that utility companies' monopolistic position reduces the incentive to improve charges and service. This perception on the part of housebuilders raises questions as to whether current regulation of utilities is effectively mitigating the potential effects of monopolies, at least in a way that is visible to these firms.

A further challenge was highlighted to us that has arisen as a result of work in Wales aiming to support the foundational economy. The move towards more socially-oriented procurement is intended to provide a platform for grounded firms to engage with contracts for public works, yet one firm noted challenges that arise where commissioning authorities apply certain measures of social value for specific contracts.

### Construction Case Study

#### Wynne Construction

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This long established, family-owned business, based in Bodelwyddan, has been successful in being accepted on procurement frameworks in all parts of Wales. Growth has meant expanding its geographical area across the country and into the North West of England. It has embraced the social value approach and believes that this and its history of apprenticeships has played a big part in employee retention.

This is managed through its *Construction Futures Foundation* set up as a separate entity with its own Manager. Its Key Performance Indicators (KPIs) in social value and Corporate Social Responsibility (CSR) are clearly aligned with Welsh Government and are an exemplar of good practice as the industry begins to address the impact of TOMS -The National Social Value Measurement Framework<sup>27</sup>.

The TOMS framework is a toolkit used within the procurement profession to assess applications in relation to metrics of social value, and as such represents a form of regulatory expectation. However, despite Wynne Construction displaying a combination of ambitions for growth and commitment to social value, the firm faces challenges in satisfying the regulatory requirements associated with the TOMS framework, including:

- that when commissioners ask firms to use local suppliers, local is not always defined (i.e. by what radii)
- significant challenges for firms being expected to use local sourcing in location such as rural Powys
- complications whereby different approaches taken amongst the different commissioning authorities: for example, the percentage of sub-contractors who need to be from the local area varies between 20, 30 and 40%
- difficulties in predicting in advance the factors that form part of a firms' offer on TOMS, including the number of ex-offenders, amount of community engagement activity, the number of apprentice starts; and the risk that setting these unpredictable quantitative targets can be linked to financial penalties.

## Social care

Wales is the country with the oldest population in the UK, with the number of over-75s due to increase by 70% and over-85s expected to double by 2040. The cuts to local authority budgets together with the inescapable implications of these demographic pressures resulted in 17 councils having overspent by £35m to meet increasing social care bills in 2020, according to the Welsh Local Government Association.<sup>28</sup>

Concerns over financial shortfalls for social care are mirrored in respect of labour supply. With salaries below those for comparable roles in the NHS, attracting staff and retaining them within the sector are challenging. Despite this, the pandemic has highlighted the value of care workers<sup>29</sup>. Whilst there is ongoing debate about political solutions to the long-term funding issues that have plagued the sector, it is also apparent that innovation and flexibility are required, along with an examination of how the current regulatory regime operates.

One of the avenues worthy of investigation is how care workers' previous experience can be used within the accreditation framework as a way of indicating competence, providing an alternative to the current reliance on formal assessment for qualifications. This has been explored and implemented as part of the review of social care qualifications undertaken by Qualifications Wales and Social Care Wales, and an experience-based route to qualification has been created alongside a parallel study-based route. Early reflections from local authority recruiters, including as part of a programme funded by the Welsh Government's Foundational Economy Challenge Fund<sup>30</sup>, have indicated that the ability to recruit on the basis of values, experience and aptitude is valuable in terms of bringing new entrants into the sector.

One potential innovation within the care sector that may require different approaches to regulation is the growing role of micro-firms in providing care. Currently, so-called **Micro Carers** are limited to no more than 4 clients before becoming subject to a different level of regulations on training, and qualifications etc., and the requirement to register with the Care and Social Services Inspectorate for Wales. This effectively poses a barrier to the growth of these small enterprises.

There has been interesting work in the development of micro-enterprises as an option to support the social care needs of individuals in Flintshire.

<sup>28</sup> [The Guardian, 12/02/21 Wales care crisis: 'We've been trying to get him home for months'](#)

<sup>29</sup> Comments by Sue Evans, CEO, Social Care Wales; 20 March 2020

<sup>30</sup> [North Wales Collaboration, n.d., Foundational Economy Challenge Fund Project](#)

### *Social Care Case Study*

#### **North Wales Collaborative**

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The North Wales Social Care and Well-being Improvement Collaborative is a project in which includes the six local authorities in North Wales, Betsi Cadwaladr University Health Board and other partners. Its aim is to improve services, make the most of the resources available, reduce duplication and make services more consistent across North Wales.

Members of the Collaborative engaged with 49 micro-providers, third sector organisations, statutory services and others including those who have developed micro-care development opportunities across the UK, gathering information about these programmes and highlighting potential opportunities for micro-care to be promoted in the area.

The Collaboration has highlighted through this work the importance of support from agencies. Many wanting to establish a micro-care service have limited experience of this type of work and are not confident enough to start their own business. If the micro-care enterprise remains small (supporting fewer than four people) they can operate within the current legislation but may still need support from a quality and safeguarding perspective. The collaborative highlighted the potential role of secondary support services providing advice on human resources, legal issues, finance, tendering, quality and safeguarding.

With this advice and support they can be encouraged to provide domiciliary care in a way that promotes the principles of the Social Services and Well-Being (Wales) Act 2014, and in particular its duty on commissioners to prioritise provision by social enterprises and the not-for-profit sector.

## Food

The production, distribution, preparation and consumption of food presents a huge opportunity for grounded firms. In 2020, the WWF published research that called for a food system strategy<sup>31</sup> for Wales. The report recommends that a new co-created food vision for Wales should be developed, centred around re-localising the food system, restoring environmental, social and human capital to strengthen food security and capture more value locally.

The role of regulation in the food sector is important for defending the interest of consumers. Initiatives must pay full regard to this imperative. As consumer interest grows in the local provenance of food supply both from a quality and 'air miles' perspective, there is a growing impetus to explore to what extent a 'Think Small First' approach would alter the landscape – literally and metaphorically.

Standards are set by the UK-wide Food Standards Agency, while inspection and enforcement is led by local authorities. Interviews with artisan producers illustrated some of the issues associated with regulation.

### Food Case Study

#### The Nut Butter Company

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The Nut Butter Company produces artisan peanut butters from their small factory in south Wales, selling across the UK and having been featured on BBC 2's 'Top of the Shop' with Tom Kerridge.

The firm consciously uses only organic ingredients. However, they are not able to certify their own products as organic, highlighting that the accreditation process is costly in terms of time and money:

*'We would love to be able to label and market our nut butters as organic as the ingredients all are accredited with the soil association but legally we can't unless we get accredited ourselves which is cost prohibitive for small producers... [we] fully appreciate the need for strict regulations but it does push small producers out of the organic market place.'*

The firm has faced a similar situation in attempting to enter new markets, specifically the market for animal feed:

*'The process of complying with the animal feed regulations was too complicated for us to manage and so we stopped our peanut butter for dogs...sadly this meant the loss of 3 clients but it was too complex for 1 product.'*

When asked what could be done to improve matters, their response hinted at the complexity of regulatory reform:

*'In honesty I don't know, regulations need to exist and be implemented but at the same time small producers shouldn't be excluded from the market through bureaucratic costs.'*

### Food Case Study

#### Aur Y Ddraig

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Aur Y Ddraig Ltd is a honey farm based in the Llŵchwr Valley, which forms the border between Carmarthenshire and Swansea. As well as selling honey directly and to retailers, they also offer services related to beekeeping.

The firm reported a feeling that many of the labelling requirements that they have been advised of by regulators are not followed consistently by other firms, placing them at a disadvantage:

*'We feel we are at a disadvantage when other companies or sellers do not comply and appear to have no consequences. For example in our adherence to the label regulations we were advised not to use key words like 'raw' and 'pure' at our detriment as some honey companies use this wording.'*

### Food Case Study

#### Fudge Pots

Fudge Pots produce hand-made spiced Welsh fudge, updating traditional recipes. They sell directly and through retailers.

The firm were relatively positive about their experiences of regulation, but noted that the cost associated with food hygiene certification was disproportionate to its direct value in instances where staff have less front-line involvement in food production.

*'The H&S people were actually very helpful and haven't taken up a huge amount of time at all. The only thing I would query is whether it is necessary to send every single member of staff on a course costing nearly £100 – in a small confectionery business like mine, the only requirements would literally be to teach my single assistant how to wash their hands and carry out the cleaning rota, which is written out for them. Sending them on a course which covers things like meat preparation and freezing techniques wouldn't add anything to our hygiene practices, so I wonder if exceptions might be made to certain categories of micro-business.'*

This highlights an example of confusion in food regulation. Many employers are under the impression that Food Hygiene Certification for staff is a requirement, as reported on the gov.uk website:

*'Employers are responsible for staff hygiene training. It can be either a formal programme or informal training, such as on the job training or self study.'*

The legal requirement is to provide all staff with supervision and training, but there is no legal requirement for any particular level of certification, as the Food Standards Agency notes:

*'By law, food business operators must ensure that food handlers receive the appropriate supervision and training in food hygiene, which is in line with the area they work in and will enable them to handle food in the safest way. In the UK, food handlers don't have to hold a food hygiene certificate to prepare or sell food.'*

There is, therefore, considerable confusion within the industry that is not helped by ambiguous wording, and a significant industry has been built around the provision of food hygiene training and certification as a means of providing proof that firms are meeting regulatory requirements.

These firms highlight what they sometimes felt were inconsistencies in how specific requirements were communicated, noting that they were required to meet several different types of regulation at once and had to manage not only initial recognition but ongoing changes. Some respondents believed that larger firms were often more confident to push the limits of what was permitted. An example was given of how regulations themselves can be disproportionate: through the planning system, where large companies can intensively plant thousands of hectares under permitted development rights, but community growers need planning permission for a potting shed. This may be particularly relevant as social enterprises pursue urban growing projects. Regulators should therefore be mindful of the resources that different firms have and how this may affect their ability to comply with key regulations.

One factor that made this complex process easier for the Nut Butter Company was their involvement with business support programmes, working in collaboration with a business support agency and a project based at Cardiff Metropolitan University's Food Industry Centre.



### Food Case Study

#### Zero2five: Cardiff Metropolitan University

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Zero2five are based at Cardiff Metropolitan University and provide technical support to food businesses around food safety. They support local or regional firms to gain Safe and Local Supplier Approval (SALSA) status, an approval scheme which enables these businesses to gain recognition outside of their area and sell to wider markets, and to meet the BRC Global Standard for Food Safety. This is a programme which is part of the Global Food Safety Initiative that has standardised requirements and is accepted by some of the world's biggest retailers.

Zero2five noted the problems that small businesses face in engaging with complex, often overlapping regulatory requirements, noting that food production is a low margin industry where it is essential to limit unnecessary costs and where scale is a real advantage – a fact that is emphasised by the system of retail distribution. In addition to governmental regulation, many retailers impose their own requirements before offering products shelf-space. In addition to Food Safety Accreditation there are company level regulations which do not always align with or account for global regulation.

Zero2five also noted the entrenched nature of the systems for food regulation and that the task of unravelling it is significant. Hence, their own work has shifted focus to finding ways in which impacts can be mitigated for small operators, encouraging more collaborative working.

As they note, Zero2five works in collaboration with similar centres with similar aims in Horeb (which also rents out food production units) and in Anglesey in conjunction with Coleg Menai. Together these centres offer support as Food Innovation Wales, receiving financial support from the Welsh Government and working in collaboration with Business Wales.

The Nut Butter Company were positive about the support they received from Zero2five:

*'The food labelling might have been more onerous but luckily the business support group, Cywain, put us in touch with Zero2Five who took our lists of ingredients and worked out all the percentages and nutritional values, which was great.'*

This model of collaboration and developing 'shared back offices' could take the form of what the Wales Cooperative Centre refers to as 'secondary co-ops', or 'co-operative consortia'. The approach is also relevant to construction, particularly in the context of the requirement to involve Sustainability Advisers in project design. This kind of support chimes with the idea, often associated with the foundational economy, of cooperatives playing a greater role in the private sector. The notion of 'platform cooperatives' is often drawn on to promote sharing of key resources in a way that is analogous to the more profit-oriented platforms such as Uber or Amazon. Alongside established support mechanisms such as Social Business Wales, programmes like Zero2five point towards important collaborative structures that can aid firms.

One of the potential benefits of collaboration with a sector is the capacity to speak with a unified voice and use this influence not only in influencing regulation but also other firms. As Zero2five noted, many of the requirements that food producers are compelled to meet come not from governments or public agencies but from large sellers and distributors such as supermarkets. The Rhymney Brewery experience highlights how a strong sector can start to influence these larger firms.

### *Brewing Case Study* **Rhymney Brewery**

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The Rhymney Brewery has over 140 years of history in brewing beers and ales in Wales, and has in the past been Wales' largest brewery. They noted that Welsh beers and spirits have found it very difficult to strike commercial deals with large chain pub owners.

They noted that this is despite the significant growth of the sector. Enjoying Welsh Government financial support, the number of Welsh breweries has grown from 18 in 2004 to 118 in 2021. This has enabled stronger recognition for Welsh brewing more generally.

Rhymney Brewery highlighted the way that other sectors of food and drink have created pressure on large distributors to include their products. Following a campaign that exposed their absence, supermarkets began to stock Welsh milk and dairy products in their Welsh outlets. This is now generally viewed as a positive step, and has fed into much of the Welsh Government's own promotion of Welsh produce.

The role of large distributors and their power within markets raises big questions about what can be done to promote local or heritage brands and products. Clearly the practice of food producers is shaped not only by regulators but by distributors, who set their own requirements outside of government control. The responses here highlight the potential for specific sectors and firms to strengthen their ability to negotiate with these distributors through collaboration.

## Manufacturing

Making up 16.8pc of Gross Value Added, manufacturing is the largest contributing sector to productivity in the Welsh economy<sup>32</sup>, and is comparatively more important to Wales than to any other part of the UK<sup>33</sup>. It has held up well through the Covid-19 crisis but faces further challenges in the years ahead, particularly in responding to the needs of a low carbon economy.<sup>34</sup>

Many manufacturing firms in Wales are foreign-owned and controlled, and this has been associated both with bringing new technologies and processes into the sector, with exposure to global economic shocks and with a lack of commitment to Wales, with firms seeking the most cost effective locations for their manufacturing activities<sup>35</sup>, with these implications having been all too visible during previous downswings.

The Welsh Government is committed to supporting Welsh firms in the manufacturing sector to grow and expand, developing new products and entering new markets. We heard examples of how regulation can help to support this, in particular through the consistent application of key standards across nations.

### *Manufacturing Case Study*

#### **EBS (Llanelli)**

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Mike Evans runs EBS in Llanelli which develops AI and Robotics solutions for a UK and international customer base. Mike has sat on the board of Industry Wales for 28 years and is university governor.

Manufacturing for a global marketplace relies on comparability of standards and on clear labelling. The long-standing CE mark scheme indicates that a product has been assessed by the manufacturer and deemed to meet EU safety, health and environmental protection requirements, facilitating access to a wider range of markets. This was recognised as a strength of regulation, as in a highly competitive global marketplace regulations assist in maintaining a level playing field when some countries enjoy structural advantages both from labour costs, access to technology and government support.

However, EBS noted that changes in CE marking typically cause disruption to finely-tuned production processes, and that Brexit will bring about changes in how England, Scotland and Wales-based firms meet these standards. The replacement of the CE mark with a new UKCA mark is being staggered until January 2023 when it will become compulsory. Firms worry about these changes, as there is a perception that in the UK the tendency is to be copper-bottomed and risk averse in applying regulation. Most importantly, it was felt that there is insufficient consultation around implementation and a sense that the industry, its experienced practitioners and representative bodies aren't being heard.

<sup>32</sup> [StatsWales, n.d., Gross value added in Wales by industry](#)

<sup>33</sup> [ONS, n.d., Nominal and real Gross Value Added balanced by industry](#)

<sup>34</sup> [Welsh Government, \(2021\) Manufacturing future for Wales: A Framework](#)

<sup>35</sup> [Munday, M. & Roberts, A., \(2008\) Foreign Direct Investment in Wales: Past, present and future, in Wales Economic Review, 20](#)

The example above emphasises the challenge that firms face when regulations change. Even if changes are relatively superficial, time and resources have to be committed to understanding new rules and embedding them into production processes.

Aside from product standards, firms gave examples of the challenges they face as a result of employment regulation. Business organisations have argued that the approach to employment law in the UK is needlessly complex, with examples of European Union directives being ‘gold plated’ with additional requirements upon application in the UK<sup>36</sup>. The Confederation of British Industry, the Wales Trades Union Congress and the Welsh Labour Government recently collaborated with other partners on a campaign to strengthen knowledge of employment law and regulation, with then-Deputy Minister for Housing and Local Government, Hannah Blythyn, noting that:

*Employment law can be highly technical and complex. For this reason, many workers and businesses in Wales are often unaware of either their rights or responsibilities.*<sup>37</sup>

Two firms – EBS and Tofaen-based Pro-Steel Manufacturing – highlighted particular issues around employing apprentices. One respondent noted that apprenticeships contribute significantly to demands on their back-office functions, with general Human Resources taking up around 25% of senior management staff time. These firms felt that the quantum of rules and their application had gradually over time become disproportionate to their intended purposes, and instead provided a disincentive to employing apprentices.

Both of these firms contrasted the difficulties they faced in employing apprentices with the increased burden placed on them by the introduction of the UK-wide apprenticeships levy. The levy, which is taken from all firms with an annual payroll bill of over £3 million, provides funding for apprenticeships to all employers, essentially redistributing from large to small firms. However, these respondents noted that this new tax had not been matched by an improved offer of training and qualifications, with EBS having to develop bespoke training in collaboration with a local university. Their experience appears to be shared more widely, with the Institute of Directors reporting that only 14pc of their members find the Levy fit for purpose, and over a quarter of those who don’t employ apprentices highlighting regulatory burden<sup>38</sup>.

<sup>36</sup> Flores, P. (2011) CBI calls for new approach to employment law, in HR Review

<sup>37</sup> Welsh Government, (2020) Press release: Know your employment rights and responsibilities' urges new campaign

<sup>38</sup> Institute of Directors, (2018) New business survey shows need for Apprenticeship Levy reform

## Recommendations

The findings from these interviews suggest that while each sector has its own circumstances, there are a number of general features of regulation that are common across all sectors, and across SMEs in particular. There are a number of practical steps that the Welsh Government and other regulatory bodies in Wales can take in order to address the variable effects of regulation on SMEs. Some of our recommendations address specific fields of regulation, such as the planning system.

### 1. Formalising the ‘Better Regulation’ and the ‘Think Small First’ principles for Wales

As part of the UK and, until recently, the EU, Welsh public agencies have been influenced by programmes of regulatory reform at these levels. The creation of the Welsh Regulators Forum with input from the Better Regulation Delivery Office is an example of how regulators in Wales (both working on devolved and reserved competences) are collaborating in practice.

However, unlike at either UK or EU levels, there is no formal statement of the Welsh Government’s approach to regulation, either in law or in policy. As such, it is not clear the extent to which regulation relates to other responsibilities and priorities.

As we noted earlier in this report, it is not clear what action was taken following the commitment to reviewing regulation in the Welsh Government’s 2017 Economic Action Plan. Since that time, Brexit has meant that the Welsh Government has taken control over thousands of new regulations whilst moving away from the general umbrella of policy-making at the European Commission level.

We believe it is therefore timely to consider how the principles of better regulation and of thinking small first can be embedded in Wales. There are several things that could be done to achieve this:

- In addition to fulfilling the previous Government’s commitment to review the processes for regulatory impact assessments, the Welsh Government should support a further development of the evidence base on regulatory impacts through commissioned research and analysis focusing on Wales-based regulators and specific impacts on SMEs. Both of these topics are relatively under-researched, and more evidence could help to inform both policy and regulators’ practice.
- The Welsh Government should consider how to formalise the ‘Think Small First’ principle, potentially through a policy statement or through legislation. UK-wide regulators and agencies are currently prompted to report on specific impacts of

regulation on SMEs as a result of provisions in the Small Business, Enterprise and Employment Act 2015, and the Scottish Government has set out statutory duties on regulators through the Regulatory Reform Act 2014, however no comparable provisions exist in Wales. There is an opportunity to set policy that pays specific attention to the role that SMEs play in the Welsh economy, recognising the important role that they play in Wales' business demography<sup>39</sup>.

- The Welsh Government, local authorities and Welsh regulatory agencies should consider investing in short-term experimental projects that encourage collaboration between the public and private sectors. The experience of the 2016 - 2021 Welsh Government's Foundational Economy Challenge Fund illustrated the potential for this type of funding to create a safe space for learning and for challenging established practice. Collaboration across sectors in this way can also help inform the culture of different organisations, leading to a more proportionate and 'better' regulatory environment.

## 2. Using principles and outcomes where appropriate

The way that regulations and rules are communicated creates a disproportionate burden on SMEs, with many lacking an understanding of rules and lacking the resources to buy-in legal support to aid with their understanding. The complexity of requirements also encourages risk aversion and gaming, and creates situations in which firms can fall foul of regulations unintentionally.

Where possible, Welsh regulators should explore models of either principle-based or outcome-based regulation as ways of enhancing understanding of and engagement with regulations in everyday practice. The principle-based approach has been pursued by many of the UK-based regulators, particularly in utilities and financial services, and has been associated with a more collective sense of responsibility for delivery<sup>40</sup>.

There is no one-size-fits-all approach and some areas will benefit from the clarity that rules provide (particularly where there is a clear risk to public safety) but consideration should be given to the quantum of regulations and conditions being set and to whether or not certain rules could be expressed other than as requirements.

<sup>39</sup> Findings from the Welsh Longitudinal Business Survey suggest that SMEs make up 99% of firms in Wales. However, as we described in our report '[A Better Balance: Business Support for the Foundational Economy](#)', the role of these businesses in Wales differs slightly from other nations of the UK with large firms providing a higher proportion of total employment and with Wales experiencing relatively lower rates of start-up growth. These observations suggest that SMEs face particular issues in Wales, and these issues should be considered in defining a research agenda for regulation.

<sup>40</sup> [Black, J., Hopper, M. & Band, C. \(2007\) Making a success of principle based regulation, Law and Markets Review, May 2007](#)

### 3. Support and guidance

Both Welsh regulators and business support agencies should play a stronger role in providing information, advice and guidance for new entrants to help them to understand requirements. At present, there are circumstances in which firms may be receiving support from government for their role in economic development while facing unnecessary barriers from regulators elsewhere in government that limit their capacity to grow. Business may under- or over-comply, creating both risk and risk aversion.

The food sector provides an example of a solution to complex regulation. Rather than governments supporting firms by deregulating, agencies have instead worked to demystify regulation and in the process have encouraged firms to improve their practice so that they not only meet requirements but innovate and grow. We heard of the impact of Food Innovation Wales in its centres across Wales and how it works directly with firms to help them to understand the relationships between different regulations and markets, and to embed compliance into their everyday work.

The availability of this kind of hands-on support reflects the importance of the food industry both as a source of economic development (particularly in Wales), and as a foundational, everyday essential. This model – of public funded expert bodies providing targeted, sector-specific support – should be developed in relation to other foundational sectors, including social care and construction, both of which are large employers in the Welsh economy and are essential to securing important social objectives.

### 4. Resources for regulators and inspectorates

The capacity of inspectorates and compliance regimes has in many cases not kept pace with the growth in the quantum and complexity of regulations, leading to 'hard-and-fast' judgements on compliance. Larger firms with well-resourced policy, compliance and legal divisions are better able to manage this type of regulation.

The creation of new regulations should be accompanied by an assessment of the capacity to enforce them, and should result in relevant increases in budgets to enable this. This assessment of capacity should be incorporated in the processes for assessing regulatory impact. Fulfilling the previous Welsh Government's 2017 commitment to reviewing the impact assessment process would provide a good opportunity to embed this practice.

Better resourcing of local authorities in particular would enable a more relational approach to inspection. In public procurement, the relational approach has been associated with stronger relationships with local businesses, and subsequently their greater role in local supply chains, a key feature of the 'Preston model' and of Welsh Government policy on procurement. The same principles – of building relationships and of bringing considerations of social value and economic development into decisions about procurement – can be applied to regulation and inspection.

As with procurement, embedding a more relational approach in regulation is a long term project. Where greater resources are a key starting point, local authorities should start to consider ways of innovating in how they engage with the firms that they inspect to promote more long-term relationships, considering how these firms can be supported to improve their compliance in a way that creates new economic opportunities.

## 5. A better balance in the planning system

There is widespread frustration with the operation and outcomes of the planning system. Many citizens feel that the planning system is ‘rigged’ in favour of developers and places burdens on infrastructure<sup>41</sup>. However, as we have heard, and has been reported by the Fifth Senedd’s Economy Infrastructure and Skills Committee, many SME housebuilders feel that the design of the system works against them, with the outcome that the proportion of homes built by SMEs has collapsed in the last decade.

The EIS Committee recommended in 2020<sup>42</sup> that greater proportionality for SME housebuilders could be achieved by raising the threshold for what constitutes a major development (and therefore the types of developments that would require pre-planning consultation with residents and statutory agencies). In its response<sup>43</sup>, the Welsh Government stated that the requirement for pre-planning consultation will remain set at sites with 10 homes or more, noting the impact of such developments in rural areas and the importance of consultation for the place-making agenda and the Well-being of Future Generations Act 2015.

Nonetheless, this is likely to remain a topic of debate. Planning reforms in England that were proposed in 2020 suggested a move to a more rules-based planning system in which developers would have greater freedom to build if they met rules for land use and building codes, regardless of the views of residents. These proposals ignited a political debate that now cuts across left and right, with some arguing that objections by residents are serving to constrain new housing supply in a way that feeds a housing affordability crisis<sup>44</sup>.

The Welsh Government has emphasised the importance of community involvement and highlighted the impact of potential development in rural areas. Nonetheless, setting detailed aspects of planning policy at a national level risks a broad-brush approach that reduces the capability of local authorities to adapt and respond to local conditions. The Welsh Government should therefore consider how it could devolve more decisions about pre-planning requirements to local authorities, allowing for a more localised approach to achieving the right balance of permissiveness and control. Housing needs in Newport and Powys are unlikely to ever align completely, and yet setting thresholds at a national level may produce outcomes that are sub-optimal for both.

<sup>41</sup> [Welsh Government, \(2012\) Public attitudes towards the planning system in Wales, p.20](#)

<sup>42</sup> [Economy, Infrastructure and Skills Committee, Barriers facing small home building firms April 2020](#)

<sup>43</sup> [Written Response by the Welsh Government to the report of the Economy, Infrastructure and Skills Committee entitled Report on the Barriers facing small home building firms](#)

<sup>44</sup> See coverage by [the Centre for Cities](#) and evidence from [polling by YouGov](#)



## 6. A more nuanced approach to social value in procurement

We spoke to a number of firms who were involved in public procurement. Their reflections touched on the ongoing efforts to better incorporate social value into public procurement – a key feature of policy support for the foundational economy in Wales and elsewhere.

However, our findings also illustrate how challenging it is to combine social and economic value in this way, and how setting rules without sufficient engagement can work against social value. In particular, we heard about how existing metrics of social value, like those found in the TOMs framework, can be applied in ways that do not capture the specific requirements of local places.

Use of frameworks and established metrics should therefore be sensitive to local conditions. This means recognising that certain key markets – such as construction – draw on complex supply chains that stretch well beyond local authority borders. Commissioners must be careful to recognise that it is not possible to deliver all public works projects with local labour and local suppliers, particularly in rural areas.

One way to reflect the geography of key markets is to collaborate across authority borders. There are promising examples of collaboration such as the North Wales Construction Partnership, in which the six local authorities of north Wales agree on frameworks for construction projects that ensure consistency across areas, whilst allowing for different expectations for different sizes of project, essentially breaking down public procurement into pieces that are more accessible for firms of different sizes.

As well as collaborating, commissioners can better reflect local conditions by developing nuanced measures of social value that emphasise, for instance, the quality of local employment opportunities rather than their quantity. Developing these kinds of locally-relevant measures should be informed by broader engagement to identify what local people want and what local suppliers can provide. Resourcing this kind of engagement may seem more expensive than relying on pre-existing frameworks and templates for social value, but is likely to generate better outcomes in terms of local development, as local firms who lack experience in procurement and social value can develop a stronger sense of what is expected of them

## 7. Bringing micro-providers into the mainstream in social care

Micro-providers of social care (defined as providers with fewer than four clients) are a valuable part of the care workforce and meet the Welsh Government's vision for person-centred care provision, but there is evidence that they struggle with understanding regulatory requirements, local authority procurement and receiving referrals<sup>45</sup>.

The Welsh Government, Social Care Wales, local authorities and business support agencies should collaborate to provide information, advice and support to micro-carers, building on recommendations by the Association of Directors of Social Services Cymru as part of their work with the Welsh Government on the Delivering Transformation grant programme<sup>46</sup>. In particular, this work has identified gaps in how micro-providers understand and engage with procurement and in how statutory agencies understand and refer to micro-providers. Local authorities in particular should seek to engage with micro-carers to explore opportunities to include them on preferred-supplier lists, and to encourage social services departments to make referrals.

These same agencies should also consider an appropriate definition of micro-providers to inform regulation, as there is some variance across the UK (with researchers emphasising number of employees and regulators emphasising number of service users).

## 8. Planning for change

Welsh businesses in sectors like food and manufacturing are reliant on importing and exporting. This is in turn facilitated by having trusted standards that are shared across international borders, but the ability to do so may be altered by Brexit and potentially by subsequent trade deals.

To date, Brexit has seen the transfer of thousands of regulations to the Welsh Government and other Welsh regulators such as Natural Resources Wales. The time requirements of this process has meant that in many cases regulations have simply been transferred with little opportunity to engage with firms. However, this situation also presents an opportunity to build better relationships in the future by aligning regulatory change with the Welsh Government's ongoing Future Trends work, using this platform and the various business support agencies to conduct more proactive engagement with businesses on upcoming or proposed regulatory changes.

<sup>45</sup> Needham, C., Allen, K., Hall, K., McKay, S., Glasby, J., Carr, S., Littlechild, R., Tanner, D. and the Micro-Enterprise Co-Researchers. (2015). *Micro-enterprise: Small enough to care?*

<sup>46</sup> Association of Directors of Social Services Wales. (2019). *Delivering Transformation Grant Programme 2018-19: Mapping Cooperative Provision - Domiciliary care*

## Concluding remarks

Over recent years, debates over Brexit have included the claim that new international market opportunities would be realised once Britain was freed of European regulation. With the reality that thousands of provisions have moved from the European level to the UK and devolved levels of government, now is an opportune moment to consider whether regulation is imposing a disproportionate impact on firms and on economic development.

The system of regulation found in the UK has developed over decades and is highly sophisticated, with overlapping responsibilities shared by governments, public agencies and local authorities. While this complexity should not dissuade the search for easy wins, there is little chance of fulfilling the easy rhetoric of phrases such as ‘the bonfire of red tape’. Real progress in making regulation more effective for the public and for businesses is likely to be a painstaking process, which will benefit from being structured around some organising principles and lines of enquiry.

An appreciation of the distinct features of the foundational economy should be one of these principles. As we have shown, smaller, more grounded firms struggle to engage with the full complexity of the regulations that they are subject to, resulting in both over- and under-compliance, leading to them falling behind. In foundational sectors, this situation is ultimately reducing the range of actors able to contribute to key social goals, such as improved access to housing and care.

We have set out a range of recommendations that point towards a more relational approach. Key to delivering this new approach will be the political appetite for change, built on a recognition that regulations have been developed for good reasons, to safeguard the interests of consumers and employees. There is neither the political will or time to promote a radical deregulation agenda, and so policy makers need to engage constructively with the more granular task of improving the functioning of current systems of regulation.

Perhaps more important, and more difficult to achieve, is change at a cultural level. The evidence we gathered suggests that many of the challenges firms face in complying with regulation come from the way in which rules are interpreted, both by themselves and by regulatory bodies and inspectorates. The relational approach to procurement that has been a focus for policy makers in Wales in the last five years provides an example of how, with a clear vision, public bodies can re-interpret rules to better fit their local circumstances and current priorities.

We believe that with the right resourcing, the relational approach presents a way forward for a better regulation agenda for Wales, in which regulators and firms work as partners in trying to achieve their shared interests - of public safety and strong provision of everyday essentials through well-functioning markets.

