CRESC Working Paper Series

Working Paper No. 139

The missing Welsh Mittelstand: an argument for re-connecting finance with ownership

Rachel Bowen, Lucy Brill, Julie Froud, Peter Folkman, Sukhdev Johal and Karel Williams

CRESC, The University of Manchester and the Open University

March 2015

The missing Welsh Mittelstand:

an argument for re-connecting finance with ownership[1]

Rachel Bowen, Lucy Brill, Julie Froud, Peter Folkman, Sukhdev Johal and Karel Williams[2]

Wales has a double economic handicap. It suffers from an underperforming economy and from a failure of policy imagination about what could be done to address that deficit. There is no easy fix for embedded and enduring problems in a country which has no tradition of radical economic thought. A serious political response to embedded problems requires prior intellectual effort on two related fronts. First, we need a major reframing of Welsh economic problems and possibilities which takes us beyond the idea of closing the GVA gap with more fortunate English regions. We have taken up this challenge elsewhere with our ongoing argument about the foundational economy and its relevance to Wales[3] Second, we need a policy engagement with Welsh specifics which are largely invisible in reports which recommend generic policies –like infrastructural improvement – for Wales (as they do for every other laggard region). This short article for the Institute of Welsh Affairs (IWA) takes up the second task of engaging specifics and is organised in a relatively straight forward way into three sections. The first section starts from observations about firm size and demonstrates that Wales has a problem about a missing Mittelstand and absent Welsh brands because it has too few solid middle sized firms. The second section explains this absence by analysing the conditions of enterprise in Wales. UK wide problems about broken supply chains are in the Welsh case complicated by the topography that creates a corridor economy; and by a financial system that incentivises owner managers to sell early so that Welsh SME operations become adjunct branches of a larger combine. The third and final section on policy observes that many existing policies to encourage SMEs have the unintended consequence of incentivising early sale; and then proposes new forms of ownership and financial products which would strengthen owner manager incentives to hold and build.

A missing Mittelstand and absent brands

Much existing discussion of Small and Medium Sized Enterprises (SMEs) is preoccupied with the generic processes of economic renewal and firm growth and this framing has encouraged a focus on start-ups and the minority of fast growing firms, especially in sectors which embody high tech and high productivity. All this is of limited relevance to Wales for several reasons: most of the Welsh economy produces mundane goods and services; few firms in any economy sustain high growth rates for long; and small firm experts in the US and UK long ago concluded that exceptional success cannot be easily predicted or replicated[4]. It is often more interesting to discuss enduring peculiarities in the stock of SMEs firms in a national or regional economy. High rates of churn are inevitable when up to 15% of SMEs typically fail each year; but stock characteristics often change very slowly because (as argued in the next section), the conditions of enterprise change slowly. On firm stock, Wales has long standing and specific weaknesses in two respects: first, a very small number of medium sized SMEs; and, second, a very weak presence in branded, identifiably Welsh consumer goods. Let us consider both specifics in turn

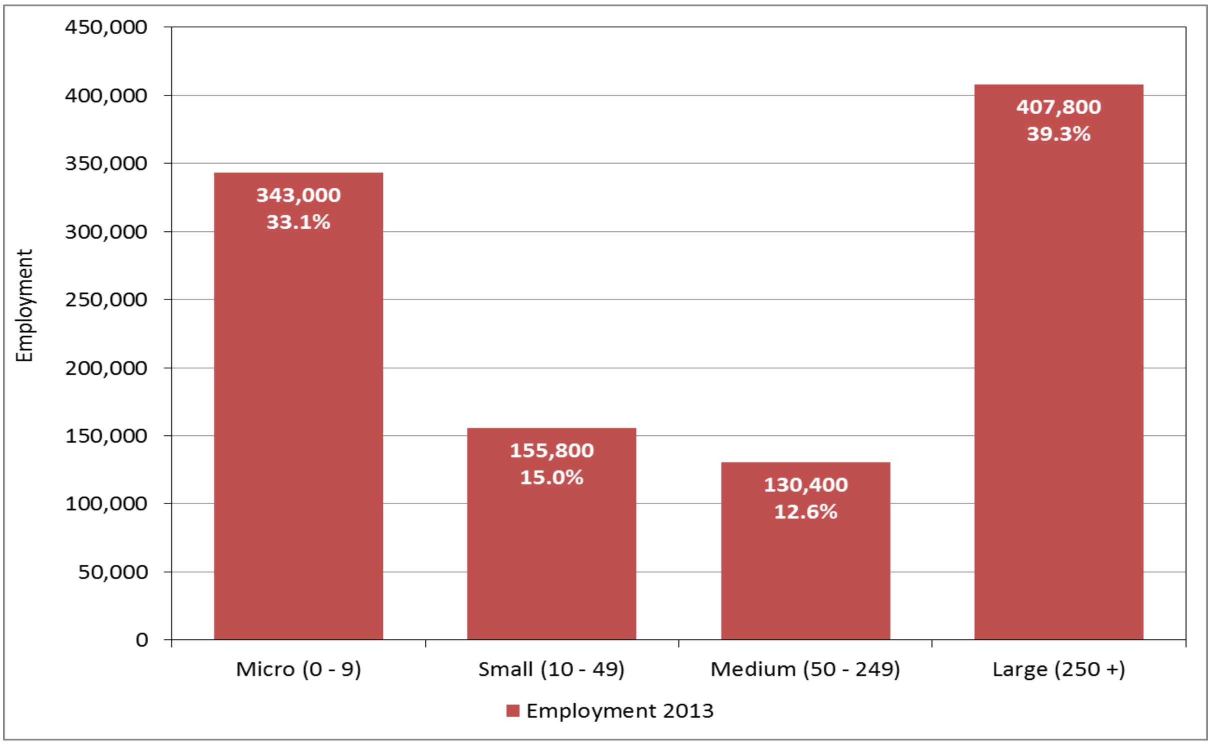
If we consider firm size in Wales, the most obvious structural economic peculiarity is the missing Mittelstand. Exhibits 1 and 2 show that Wales in 2013 has more than 200,000 firms but only 8,000 small firms employing 10-50 and 2,000 medium firms employing 50 -250; as exhibit 3 shows this distribution is long established, and the increase in Welsh firms numbers by 50,000 over the past decade is almost entirely accounted for by micro firms.[5]

Exhibit 1: Wales's private sector enterprises, employment and turnover in 2003[6]

	No. of Enterprises No.	Employment No.	Turnover £m	Share of total employment %	Share of total turnover %	Share of total enterprises %
Micro (0 - 9)	159,985	285,400	12,694	31.1	18.1	93.8
Small (10 - 49)	7,200	136,700	7,999	14.9	11.4	4.2
Medium (50 - 249)	1,735	114,800	9,195	12.5	13.1	1.0
Large (250 +)	1,615	381,600	40,192	41.5	57.4	1.0
TOTAL	169,535	918,500	70,800	100.0	100.0	100.0

As exhibit 2 shows, the distribution of employment by firm size is strongly bi-modal so that a histogram shows not a bell curve but twin peaks.

Exhibit 2: Wales private sector employment by enterprise size in 2013



One-third of Welsh employment is in micro firms employing less than 10; here we have two men in a van or a small workshop because the average Welsh micro firm employs just 1.7 and its turnover (including bought in materials) is less than £80,000 per year. At the other pole, 40% of Welsh employment is in enterprises employing 250; here we have branch factories, large call centres and such like. With three-quarters of employment concentrated in micro firms or large enterprises, small and mid-sized firms altogether account for just over 25% of Welsh employment. This Welsh peculiarity is part of a larger UK problem because England or Scotland also have missing Mittelstands, although average turnover is substantially higher in UK medium firms.

Exhibit 3: Wales's private sector enterprises, employment and turnover in 2003[7]

	No. of Enterprises No.	Employment No.	Turnover £m	Share of total employment %	Share of total turnover %	Share of total enterprises %
Micro (0 - 9)	207,500	343,000	16,351	33.1	14.1	94.6
Small (10 - 49)	8,300	155,800	11,879	15.0	10.3	3.8
Medium (50 - 249)	2,015	130,400	13,638	12.6	11.8	0.9
Large (250 +)	1,590	407,800	73,744	39.3	63.8	0.7
TOTAL	219,405	1,037,000	115,611	100.0	100.0	100.0

The low turnover in medium-sized Welsh firms relates to a peculiar weakness arising from the absence of identifiably branded Welsh consumer goods. Of course matters are confused by the way in which prestige English brands are wrapped in the Union Jack as in the case of Land Rover or Brompton bicycles. But Wales has nothing that, in terms of international recognition, corresponds to Scotch whisky or Irish Guinness. This point was made by Rhys David in a 2007 IWA memo to the Welsh Affairs Select Committee lamenting the "absence of indigenous Welsh companies projecting their own brand". He then posed a rhetorical question: "ask people in England, leave alone the rest of Europe, to name a product that instantly says Welsh and excellent and you are likely to get blank stares"[8]. Across Northern Europe, Ifor Williams horse boxes and trailers are the only branded products that clearly meet this test of visible Welsh excellence.

The general absence of Welsh brands with major market presence is quite striking. Welsh lamb means something but, as Rhys David argued, the Welsh "have failed to establish even a major dairy products industry". A subsequent survey of Welsh consumers established that point; only 47% of consumers were able to name a Welsh brand of milk and half that group named a supermarket own brand of Welsh milk[9]. If we consider more recently established branded products, like bottled water, the results are equally discouraging: when the "spontaneous awareness" of branded drinks by Welsh consumers was tested only two Welsh brands of bottled water (Brecon Carreg and Ty Nant) made the list with more than 5% brand aware. European and emerging market consumers will obviously have much more difficulty in identifying branded Welsh products. This then helps to create a vicious circle effect for new Welsh brands so that a recent survey found that only one in five emerging market consumers said a Welsh flag would attract them to a product, whereas 64% said the union jack would attract[10].

The conditions of enterprise (including ownership)

The statistics on firm size allow us to reframe Welsh economic problems in a more focused and structural way. If the Welsh can add an extra 50,000 micro firms[11] in the past decade, they do not lack enterprise and dynamism; but if the Welsh cannot build a Mittelstand and brands, they will always lack the solid market presence that sustains investment and technik. This crucial failure can be explained by considering the heterogeneous conditions of enterprise in Wales and the rest of the UK which create a productive and financial ecology that does not sustain a Mittelstand. The first set of conditions arises from the broken supply chains which are a consequence of recent British economic history; in the Welsh case, this is compounded by the specific and permanent handicap of topography and the mountains in the middle which make Wales a corridor economy. The second set of conditions arises from change of ownership and the way in which the financial system facilitates exit strategies for founding owners of Welsh SMEs: the founding owner realizes a capital gain by selling out to a larger combine which runs the Mittelstand firm as an adjunct branch. Let us consider both problems in turn.

Thatcher and New Labour presided over a process of careless deindustrialisation. The old British anchor combines, like GEC and ICI, were broken up by a combination of internal incompetence and external pressure for shareholder value. The result was whole sectors, from cars to building materials, dominated by foreign owned branch manufacturing. This was associated with broken British supply chains because branch plants were typically integrated into the European and global supply networks of foreign parents. A high propensity to import components is consequently embedded in the structure of British industry: a survey in 2012 for the Department of Business Innovation and Skills showed that only 36% by value of UK auto parts were UK sourced.[12] Domestic component suppliers are also concentrated in the lower tiers producing low tech, bulky items like exhausts for cars: Britain has no first tier supplier like Valeo or Bosch capable of supplying an electronic sub-system like engine stop start. The fragmentation of assembler demand and the absence of first tier coordination together ensure that there can only be a small British Mittelstand in automotive or many other sectors

In the Welsh case, the specifics of topography compound these problems in ways which are curiously not recognised in reports for Welsh government.[13]. The problem is the mountains in the middle which divide the Welsh economy into three corridors: the Cardiff Newport/M4 corridor, the Wrexham/Flint corridor and y fro gymraeg. The two industrial corridors are short and disconnected; the longer corridor from the Severn Bridge to Pont Abraham at the end of the M4 is just 80 miles long. In this case, the firm supply chain is often physically longer than the Welsh corridor which is defined by a fast road out of Wales. European manufacturing and distribution works through long distance trucking within and across national boundaries. Suppliers are often not located adjacent to assembly (as in Japan) though some European sectors, like textiles, are geographically clustered. The problem of Wales is that it has few clusters and large branch factories like Ford Bridgend or Airbus Broughton which do sustain a Mittelstand but mainly somewhere outside Wales through their large scale import of components. And when these large Welsh branch plants close, like Sony at Bridgend, they pay off their workers and leave behind no local Mittelstand of suppliers which is capable of finding different customers.

The organisational bias against a Welsh Mittelstand is reinforced by a financial system which incentivises early sale by the founding entrepreneur whose Mittelstand business then becomes an adjunct branch of larger combines which then play pass the parcel with relatively small non-core operations. This problem can be tracked by following up the good news stories about founders selling out to realise their reward for building a business. The most recent story was of Hayley Mills selling Go compare, the Newport based insurance price comparison site she founded in 2006. Nearly ten years later, it was reported that Ms Mills would sell her shares in the company for £95 million from which she would personally receive £43.7 million. Go compare went to Eastbourne based esure with Ms Mills insisting that the new owner would respect the company's Welsh roots:

> "I have always said that the staff at Gocompare.com come first and I will always do the right thing by them. As such, esure's commitment to keep our headquarters in Newport was an extremely important part of my decision to sell the business and I am confident that I'll be leaving it in very safe hands". [14]

The question then is whether, in the longer term, the next owner(s) do represent a safe pair of hands for the brand and the workforce. Here we have case evidence for the processed food sector which is important because this is a sector where Welsh brands should be more prominent; branded Welsh food draws on our agricultural heritage and is a defence against supermarket buyers who use their power to take margins from the makers of own brand supermarket lines[15]. Rachel's Dairy in organic yoghurt and Halo Foods in healthy snack bars both started up in mid-Wales in the late 70s or early 1980s and were built by owner managers into credible branded Mittelstand operations before they were sold to larger combines and then passed on, with increasing confusion about brand identity and /or production location, amidst struggles with supermarket buyers over volume and margins. Here are two dismal stories

- In 1999, the founding Rowlands family sold Rachel's Dairy to Horizon, a United States organic dairy company which initially expanded Aberystwyth operations. But in 2004 Horizon was bought by Texas based Dean Food, the USA's largest processor of liquid milk whose "Trumoo" line is the leading flavoured milk brand in the USA[16]. In 2009, facing an UK market in recession, Dean devised a new company logo "Rachel's" so that organic was less prominent on the pack[17] and then decided to focus on its core business by selling Rachel's.[18] The purchaser in 2010 was the French Lactalis combine whose major cheese brands include President and Galbani.[19] In 2012 Lactalis moved Rachel's into a joint venture with Nestle whose brief was to integrate Rachel's with other operations (which raised fears of redundancy)[20]. This corporate game of pass the parcel had produced four changes of ownership and control in less than 15 years.
- Halo Foods was bought back by its founder Peter Saunders after Nestle took over Rowntree in 1988 and then built to the point where it employed 500, mainly in mid-Wales[21]. In 2004, the company was sold to Glisten an AIM listed, acquisitive small health food combine from Blackburn which grew rapidly by reporting "record results"[22]. Glisten then hit a profits crisis in 2009-10[23] This was resolved by delisting the firm and selling out to the much larger Finnish conglomerate Raisio[24] best known for its Benecol, cholesterol lowering products; Raisio in 2013 then sold some non-dairy operations to Norwegian wholesaler Kavli Group[25] Raisio/Glisten then concentrated Halo production in Newport after obtaining a £356k grant from the Welsh government which was concerned lest production be moved to Eastern Europe[26]; the founder complained that the Tywyn factory had closed which "left many people without jobs, creating a devastating impact on a small community".

In many of these stories, it is difficult to avoid foreign (i.e. non-Welsh and non-British ownership). This is especially so in food. For example, the two Welsh bottled water brands with brand awareness are both foreign owned: Ty Nant is owned by an Italian drinks distributor and Brecon Carreg is owned by the Belgian Spadel group, a Benelux based competitor for the likes of Nestle. For this reason it is important to insist that the problem is not ownership per se but financialized calculation in a world where stock market valuations and private equity returns from "flipping" firms both depend on delivering rates of return and growth (which is most easily achieved by acquisition). These motives and calculations are increasingly present amongst Welsh entrepreneurs who can themselves initiate the moves which dilute a Welsh brand and demote the Mittelstand firm to adjunct branch.

The best example of this is Tinopolis, the Llanelli based tv production company built from early contracts to make programmes for the Welsh language channel S4C. The founder was Ron Jones who had previously been a partner in Arthur Andersen[27] which was (until its post Enron collapse) the most aggressive of the big accounting and consultancy firms. Tinopolis joined the AIM market by reverse takeover in early 2005[28] and, before year end, had acquired TV Corp which bought in the independent producers of BBC question time and a portfolio of sports programmes[29]. In this phase, Ron Jones was very clear that "there is a tendency in Wales to sell out early, but we don't envisage doing that"[30]. In 2008, Tinopolis management bought the company back with support from private equity firm Vitruvian partners in a £45 million deal which allowed shareholders to cash out at a premium price. By 2012 the company had made further acquisitions in the US and UK of A. Smith and Co[31], BASE productions[32] and Firecracker Films[33]; and the founder was then talking about "building a global company still rooted in Wales"[34]. By autumn 2014, Tinopolis management were marketing the company to media companies and private equity firms, seeking interest in the sale or part sale of Tinopolis with a guide price of £300 million[35]. The identity of the purchaser and commitment to local brand and operations are usually irrelevant when private equity seeks an exit that will realise gains.

Connecting SME finance with ownership

On SME finance, the Welsh political classes are currently preoccupied with the Task and Finish group's March 2015 proposals for a Development Bank for Wales which were argued using the language of "funding gap" and "market failure"[36]. This reflects a political consensus about institutions and lending practice: the political assumption is that Finance Wales is a failed institution and should be replaced by a new Development Bank for Wales; the economic framing is that existing finance provision is restrictive and the funding task of finance is to support SMEs by making cheaper finance more readily available. This same economic framing animates the Westminster and Whitehall debate and the policies of the BIS Department because centrist policy makers have a long standing preference for the generic indirect policy of adding finance rather than directly intervening to address the specifics of industrial organisation and supply chain problems in key sectors. Within this conventional Welsh and British framing, the problem of sales which create adjunct branches and hinder Mittelstand development becomes invisible; and there is no recognition that policies to improve the supply of finance may unintentionally establish perverse incentives for early SME sale to outside owners with limited commitment and larger concerns. Against this we would argue that the missing Mittelstand is an important problem in itself which *inter alia* requires innovative policies to sustain continuity of ownership that ballasts and stabilises the development of SMEs and Welsh brands. Let us turn to developing these arguments before proposing some new policies

The funding gap can be talked up by argument about the volume of bank lending to SMEs which has always been low in the UK and more recently has been declining in the aggregate, while often subject to onerous conditions about security and sometimes arbitrary demands for repayment. But, the high street banks can reply that current UK wide evidence shows they are already supplying cheap loans and overdrafts to a large proportion of the SMEs who apply for them. A 2013 survey by the University of Surrey concluded that 74% of SMEs who seek finance in any one year obtain it[37]; and, as long as monetary policy is ultra-loose, bank finance is typically cheap so that the current median interest rate for fixed rate lending is less than 4.5%[38]. A closer examination of the surveys shows low demand from debt averse SMEs; the Surrey University survey showed that only 20-25% of SMEs seek finance in any one year and the authoritative BDRC survey classifies 43% of SMEs as "permanent non borrowers" and reports 71% of SMEs interviewed in 2014 "agreed that their aim was to pay down any existing debt and then remain debt free"[39] If we then turn to key sectors of the Welsh economy, like food processing, we find that insecurity and power relations limit the SME appetite for debt (and also for investment from retained earnings): when we worked on the pig meat supply chain, we were repeatedly told that investment in process improvement was pointless for processors because all the gains would be captured by the supermarkets[40]. The implication is straight forward: freeing up the supply of finance will only produce benefits if it goes hand in hand with demand side measures to increase security for SMEs and micro businesses.

Meanwhile, existing policies to improve the supply of finance and incentivise entrepreneurs can add perverse incentives for early sale rather the retention of family and owner managed businesses over the long term. To understand these unintended consequences, it is necessary to understand existing SME support schemes which fall into three broad categories: first, support for lending to SME's; second, support for equity investment in SME's; and third, incentives to entrepreneurs and SME owners through the tax system. The detail below is technical and may be tedious but illustrates the complexity of existing provision and is necessary to the development of the argument about how worthy schemes can have unintended effects.

Lending to SME's carries a higher level of risk than lending to larger and more stable enterprises. For this reason, both cost of finance is higher, and availability is constrained. Several government schemes seek to mitigate the risk by providing guarantees to lenders[41].The National Loan Guarantee Scheme (NLGS) uses government guarantees on unsecured borrowing by banks, enabling them to borrow at a cheaper rate. Participating banks pass on the entire benefit that they receive from the saving of up to 1%. Community Development Finance is a £30m subsidy scheme operated through the Co-operative Bank and Unity Trust Bank to support small, micro and social enterprises in specific disadvantaged areas. The Enterprise Finance Guarantee (EFG) is a loan guarantee scheme aimed at firms with insufficient security or track record, under which the government guarantees 75% of the facility. Business Finance Partnership is a £1.2bn facility used to match an equal amount from the private sector invested through new funding sources aimed at SME's. The scheme's aim is to encourage the supply of capital through non-bank channels. The government will provide up to £100m to match lending through seven new players: Market Invoice, URICA, Beechcroft Capital, Funding Circle, Zopa, Boost & Co, and Credit Asset Management.

Other schemes are aimed at firms wishing to raise equity finance. They fall into two categories[42]. The first is tax incentives to investors (venture capitalists, business angels, family or friends) to compensate for the additional risk of investment in SME's. The second is public provision of low cost capital to specialist fund managers for investment in qualifying SME's.

- Tax based schemes include the Seed Enterprise Investment Scheme aimed at early stage companies wishing to raise up to £150,000 equity finance. Investors may offset 50% of the cost against income tax. Under the Enterprise Investment Scheme, for companies employing less than 200 people, investors receive income tax relief of 30% of the investment cost and tax free capital gains if the shares are held for 3 years. The Venture Capital Trusts Scheme mitigates the risk of investment in SME's by permitting the investor to channel the funds through an Investment Trust which provides the advantage of a diversified portfolio of companies. Investors may offset 30% of the investment cost against income tax, receive tax free dividends and capital gains. Eligible companies must employ less than 250 people and have net assets of less than £15 m.
- A second series of schemes provides public sector investment capital to fund managers. The Business Angel Co-Investment Fund is a £100m fund aims to support business angel investments in high growth potential early stage SME's. It does this by investing alongside syndicates of business angels (up to a limit of 49%). The Enterprise Capital Fund Programme scheme is aimed at small high potential companies where the size of investment is small and relatively costly to administer. This programme provides funds to private sector fund managers and comes in the form of capital into the fund capped at two thirds of the total fund size or

£25m. The UK Innovation Investment Fund is aimed at technology companies in "strategically important sectors" and is invested through private sector fund managers.

There are a separate structure of incentives through Capital Gains Tax and Inheritance Tax Reliefs which provide significant incentives to owner manager entrepreneurs and outside investors. Capital Gains Tax-Entrepreneurs Relief offers rebates on capital gains tax which is currently 28%. Owner managers are offered a concession so that up to £2.0m of lifetime gains are taxed at 10%. This concession only applies to qualifying shareholders so in the case of family owned Mittlelstand companies there may be different treatments between shareholders. Under Inheritance Tax-Business Property Relief, business assets are exempt from inheritance tax. On death the value of the asset for capital gains tax is ordinarily rebased at the market value on death. This means a tax saving of 40% of the value of the enterprise, making business assets a highly attractive asset class from a taxation point of view.

The policies above would usually be judged against their stated objectives which are to help SME's start and grow. They do this either by making finance available, which otherwise would not be; or enhancing returns to investors, by subsidising the cost of investment, thus enhancing the rate of return on the realization of the investment. But, from our point of view, their effect is to construct a structure of incentives for owner managers to sell early not hold the firm. The policies do not all work to establish one consistent set of incentives. Thus, Inheritance Tax Business Property Relief is a very significant incentive to retain qualifying assets; while the capital gains tax concession focuses entrepreneurs on life-time gains. But all the other policy measures provide incentives for early sale. Cash flow pressures from short-term borrowing place constraints on entrepreneur managers; other tax concessions focus investors on early realisation of their investment. While venture fund managers' incentives encourage early realization of investments: the funds they run are limited life closed end funds with personal remuneration, through carried interest, tied to cash to cash performance. These incentives for owners and outside investors are reinforced because many of these schemes have criteria limiting the size and nature of qualifying businesses. So that holding on to grow the company beyond say 250 employees is unattractive because larger companies are disqualified under many of the schemes, or the size of investment offered is not sufficiently large to be of interest.

If the structure of incentives is generally perverse and encourages early sales, we can only devise policies that provide different incentives after considering the motivations of Mittelstand owners and managers. After all, capitalism is a system where owners are free to do what they will with their own property and firm founder owners have earned that right through effort and property rights. The aim of policy should be not to impede sales of the business but construct incentives for holding, around the structure of legitimate owner manager motivations:

- ✓ Diversification of family assets. Successful entrepreneurs have a disproportionate share of their personal wealth tied up in their business and a sale is motivated by the desire to diversify personal wealth. Schemes to permit a partial disposal while retaining full control would be helpful.
- ✓ Freedom to take income. Generally owner managers sacrifice current income for future capital gain. Investor investment terms, which constrain owner managers from taking income, which may be used to build private savings outside the business, often act as an incentive for a sale earlier than the management would have chosen.
- ✓ Income for family shareholders. For family owned businesses, dividend income is often a strong motivation for shareholders to retain ownership. Meeting this requirement should be a feature of scheme design.

- ✓ Estate planning. Business asset relief is an incentive to those wishing to protect the family wealth from generation to generation.
- ✓ Funding for growth. Owners will wish to ensure that any steps to achieve their other objectives will not constrain funding options for future growth.

Any new policy intervention should seek to meet the objectives of continuing managers as described above while providing liquidity to investors in Mittelstand SMEs. It should also provide long term lending facilities to SME's which mitigate the cash flow constraints of current options. There are a variety of ways in which these objectives could be met. Here are two practical suggestions, about using ownership and new financial products, which we put forward as a way of starting debate about reframed SME policies. The activities of organised money are built on arbitraging the privileges of limited liability and tax relief on debt through the construction of corporate hierarchies which maximise private net gains for one class of investor; similarly new instruments are used as a basis for booking profit and maximising private gains. Why should the devil have the best tunes? Our idea is that this kind of imagination and innovation can be applied for constructive social purposes to change owner incentives and help build a Welsh Mittelstand.

On ownership, the simplest option is to use legislation regulating Employee Ownership Trusts which is already on the statute book. An Employee Ownership Trust may be established to hold a minimum of 51% of the equity of a private company. As an incentive to sell to such a trust the transfer of shares for cash is free of capital gains tax. The merit of the structure is that the corporate structure and management of the company owned by the trust remains in place. The trustees of the trust can be the existing management of the business. Although majority shareholding is owned on behalf of the employees, the employees do not run the business. This structure therefore provides liquidity to those wishing to sell, while leaving management and non-management shareholders with a continuing personal stake should they so choose. Finance Wales or the new Development Bank could be asked to consider assisting with the funding of the trust and if appropriate take a position as trustee to look after the broader public interest. If in due course it became appropriate to sell the business, then the trustees are open to do so in the normal way. The brief to the new Development Bank would be to promote Employee Ownership Trusts to private companies in Wales and to assist in this ownership structure as an alternative to outright sale.

Another possibility is a new product which would allow long term lending with returns tied to a share of exit proceeds. This product would address the investment needs of qualifying SME's. The concept of loan repayment and rolled up interest is already well developed in the bond market with the use of Payment in Kind (PIK) Notes, frequently used in private equity transactions. A long term loan product which pays a below market cash interest rate supplemented by final payment out of the proceeds of sale of the business may be highly attractive in that it deals with the cash flow constraints on owner managed businesses. Subject to meeting covenants the managers would be free to draw income to achieve diversification of their personal wealth. Finance Wales or the new Development Bank could hold these assets on its balance sheet subject to appropriate support from the Government of Wales.

Instead of a conclusion

We have presented evidence and developed an argument about firm size, conditions of enterprise in Wales and the need for new policies to change owner incentives and thereby help build a Mittelstand and Welsh brands. This all represents work in progress intended as a positive contribution to debate in the Welsh policy community. The medium term aim is, of course, to influence Welsh Government thinking on what policy and institutions like the new Development Bank might do. Our approach to economic policy is to engage Welsh specifics and then propose non-standard policies. Such policies would of course be experiments, undertaken without any assurance of success. But, the accumulating problems of Wales are now beyond orthodox thinking and generic policies. It is time for some experiment in Wales.

[1] This short article reports some research undertaken as part of a larger ESRC and Federation of Small Businesses (Wales) project on alternative economic policies for Wales. The main project report will be published in autumn 2015.

[2] Rachel Bowen is policy manager at Federation of Small Businesses (Wales). Lucy Brill is researcher on the FSB/ESRC Welsh policies project. Peter Folkman, Julie Froud and Karel Williams are all professors at Manchester Business School; Sukhdev Johal a professor at Queen Mary at University of London. The senior academics have worked as a team at the Centre for Research on Socio Cultural Change (cresc.ac.uk) and are currently developing the new Manchester Capitalism book series (manchestercapitalism.co.uk)

[3] See the foundational economy references at http://www.manchestercapitalism.co.uk/foundational-economy; and for Wales see the "Where is Wales" presentation for WISERD Cardiff http://www.slideshare.net/AdamLeaver/wiserd-wales-v2-kw-9-dec-

[4] D. J. Stofey (1994), *Understanding the Small Business Sector*, pp. 158-9

[5] This data is categorised as 'private sector'. However the ONS classification of the 'private sector' is broad as businesses are either as in the private or public sector. There is no intermediate classification so there is some blurring as hybrid businesses like charities are classified as public sector and universities and GPs are classified as private sector. The data will inevitably include activities overwhelmingly dependent public sector funding through either reclassification or the activity has been outsourced. Broadly the Public Sector is excluded from this dataset.

[6] Source: StatWales.

[7] Source: StatWales.

[8] David, R. 2007. *"What Visibility for Wales? Connecting with the Consumer."* Memorandum from Institute of Welsh Affairs submitted to the Welsh Affairs Select Committee Inquiry *Globalisation and its Impact on Wales*, (GLOB 12). http://www.publications.parliament.uk/pa/cm200607/cmselect/cmwelaf/ucglobal/m8.htm

[9] Enterprise Planning and Research (2012) *Welsh Dairy Products: Consumer Study Report*

[10] BBC News (3 October 2014) " Britain best brand for Welsh exports", http://www.bbc.co.uk/news/uk-wales-29461272

[11] Source: StatWales. In 2003 there were 158,985 micro enterprises and by 2013 this had risen to 207,500 enterprises.

[12] Business Innovation and Skills Department (2012) *Growing the UK Automotive Supply Chain*

[13] (2014) Centre for Supply Chain Operations and Productive Excellence, *Manufacturing Supply Chain Demand Study*.

[14] http://www.theguardian.com/business/2014/dec/08/go-compare-founder-bank-44m-selling-remaining-stake-esure

[15] A. Bowman et al. (2014) The End of the Experiment, MUP, Manchester; and Bringing Home the Bacon. CRESC public interest report at www.cresc.ac.uk

[16] http://www.deanfoods.com/media/93440/annual_report_-_pdf_for_web_posting.pdf

[17] www.telegraph.co.uk/foodanddrink/foodanddrinknews/5188377/Rachels-drops-organic-from-name-as-sector-suffers-in-downturn.html

[18] http://www.foodprocessing-technology.com/news/news91987.html

[19] http://www.foodprocessing-technology.com/projects/rachel/ , accessed Jan 2014

[20] http://www.bbc.co.uk/news/uk-wales-mid-wales-18088696

[21] www.petersaunderstrust.co.uk/saundersprofile.php

[22] http://www.thegrocer.co.uk/home/topics/glisten-reports-record-results/117974.article; http://www.lancashiretelegraph.co.uk/news/3654787.Blackburn_firm_s_bumper_profits/

[23] 23rd March 2010, http://www.walesonline.co.uk/business/business-news/halo-back-track-glistens-profit-1930826

[24] www.glistenltd.com/Glisten_Ltd/About_Us/Default.aspx?id=9

[25] SeeNews Nordic, May 10th 2013, downloaded 23.2.2025 from www.highbeam.com/doc/1G1-329295178.html

[26] http://www.insidermedia.com/insider/wales/92672-halo-foods-invest-newport
http://www.insidermedia.com/insider/wales/97102-halo-unveils-welsh-government-support/index.html

[27] *http://www.walesonline.co.uk/business/business-news/dragons-den-8-welsh-entrepreneurs-8516338*

[28] http://www.theguardian.com/media/2005/dec/20/independentproductioncompanies.broadcasting

[29] http://www.theguardian.com/media/2005/dec/20/independentproductioncompanies.broadcasting
[30] http://www.walesonline.co.uk/business/business-news/tinopolis-beats-fast-path-city-2408854
[31] http://www.theguardian.com/media/2011/jun/28/tinopolis-us-question-time
[32] http://www.walesonline.co.uk/business/business-news/tinopolis-buys-television-firm-base-1814934

[33] http://www.walesonline.co.uk/business/business-news/tinopolis-acquires-firecracker-films-2013027
[34] http://www.walesonline.co.uk/business/business-news/tinopolis-buys-television-firm-base-1814934
[35] http://www.theguardian.com/media/2014/oct/08/question-time-tinopolis-sale
[36]Task and Finish Group (2015) A Feasibility Study into the Creation of a Development Bank for Wales http://gov.wales/docs/det/publications/150311-development-bank-wales-en.pdf
[37] University of Surrey et al. (2013) SME Success in Challenging Times: Bank Finance – lost in translation, p. 1
[38] BDRC Continental (2015), SME Finance Monitor Q4 2014, pp172-99 on cost of finance
[39] BDRC Continental (2015), SME Finance Monitor Q4 2014, pp. 11-12
[40] A Bowman et al (2013) Bringing Home the Bacon, cresc.ac.uk
[41] Business Innovation and Skills Department (2013) SME Access to Finance Schemes: Measures to Support SME growth, p 4 et seq
[42] Business Innovation and Skills Department (2013) SME Access to Finance Schemes: Measures to Support SME growth, p 11 et seq