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Unlocking Welsh Economic Potential

Lessons from Global SME Research

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Unlocking Welsh Economic Potential: Lessons from Global SME Research

A briefing note from Cadbury and Jones

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Introduction

Micro, small, and medium-sized enterprises (MSMEs) are the backbone of the Welsh economy, comprising over 99% of all businesses in the region¹. Despite their significant role, MSMEs in Wales often underperform relative to the UK average in productivity - a key factor in driving economic growth and regional prosperity.

Recent analysis by the McKinsey Global Institute highlights global trends in MSME productivity, offering insights into sectors where smaller firms can outperform their larger counterparts. In the UK, MSMEs achieve 84% of the productivity of large firms, significantly above the average of 60% in other advanced economies. However, this national figure masks regional disparities, with Welsh MSMEs trailing behind².

This briefing explores opportunities for Welsh MSMEs to close this productivity gap by leveraging existing strengths, such as lower operating costs, sector-specific clusters, and strong institutional support. It identifies priority sectors, strategic challenges, and actionable recommendations for policymakers, business leaders, and advisors.

Global Context & Welsh Opportunities

McKinsey's comparative analysis of MSME productivity across 16 advanced economies reveals the UK as an outlier, with small businesses achieving 84% of large enterprise productivity. This exceeds performance in countries such as the US (76%) and Japan (62%). Welsh MSMEs, however, have struggled to reach this benchmark, reflecting structural barriers such as limited access to finance, skills gaps, and underinvestment in technology requiring bespoke support and advice.

SMEs in the UK contribute over half of value-added services in sectors like construction, professional services, and ICT. This aligns closely with Wales' economic structure and presents clear opportunities for targeted growth. Wales also benefits from distinctive advantages:

- **Lower operating costs:** Competitive property and labour costs compared to South-East England.
- **Emerging sector clusters:** Expanding technology hubs in Cardiff and Newport.
- **Institutional support:** The Development Bank of Wales provides tailored financial solutions to bridge funding gaps.

These factors, combined with improving infrastructure such as the South Wales Metro, create a foundation for sustainable SME growth.

Sectoral Analysis: High-Impact Opportunities for Wales

1. ICT and Digital Services

Computer programming and ICT services represent 17% of potential productivity gains identified by McKinsey. Wales's growing technology hubs and recent investments in digital infrastructure position it well to capitalise on this high-growth sector. Initiatives like Cardiff's FinTech cluster demonstrate the potential for sector-specific strategies to drive innovation and attract inward investment .

2. Professional Services

With a productivity rate of 73% compared to large firms, professional services are a strength for UK MSMEs. Wales, with its competitive labour market and proximity to key English cities, can expand its share of this high-value sector. Enhanced collaboration between businesses and universities could further develop workforce skills and foster innovation.

3. Specialist Manufacturing

While overall UK manufacturing MSME productivity reaches only 64% of large enterprises, subsectors such as fabricated metal products and machinery manufacturing stand out, each contributing 2% of potential productivity gains. Wales' established industrial base and skilled workforce, particularly in regions like Ebbw Vale, provide a solid foundation for growth in these areas.

Strategic Considerations for Welsh MSMEs

Closing the productivity gap among Welsh MSMEs could deliver substantial economic benefits. McKinsey estimates that addressing the national SME productivity gap could add £73 billion to UK GDP. For Wales, with its higher proportion of SMEs, the regional impact could be transformative.

1. Skills Development

Addressing skills shortages is essential to improve productivity, particularly in:

- **Digital literacy:** Ensuring workers can leverage data and technology effectively.
- **Leadership and management:** Strengthening strategic planning and operational capabilities.

- **Sector-specific skills:** Developing expertise in ICT, professional services, and advanced manufacturing.

2. Financing Innovation

Wales benefits from the Development Bank of Wales, which provides patient capital and targeted funding. To maximise this advantage, efforts should focus on:

- Expanding equity finance options for start-ups.
- Increasing R&D tax incentives for MSMEs.
- Promoting awareness of available funding streams among business owners.

3. Technology Adoption

Technology is a critical enabler of productivity. Welsh MSMEs should prioritise:

- **Process automation:** Using tools to streamline operations and reduce costs.
- **Digital transformation:** Adopting cloud-based and AI-driven solutions to enhance decision-making.
- **Collaborative innovation:** Partnering with universities to access cutting-edge research.

Recommendations: Pathways to Growth

For SMEs:

- Invest in high-productivity sectors such as ICT and specialist manufacturing.
- Leverage Development Bank of Wales funding to drive innovation.
- Build partnerships with other businesses and research institutions to share knowledge.

For Professional Advisors:

- Support SMEs in strategic planning and financial management.
- Facilitate access to grants and investment capital, including support with the creation of robust business plans and financial forecasts..
- Promote best practices in operational efficiency and technology adoption.

For Policymakers:

- Enhance skills training programmes in ICT and advanced manufacturing.
- Strengthen infrastructure, particularly in digital connectivity and transport.

- Offer targeted incentives for innovation and R&D investment.
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Conclusion

Welsh MSMEs have a unique opportunity to drive regional economic growth by closing the productivity gap. With strong institutional support, competitive operating costs, and emerging sector clusters, the foundations for success are already in place. However, realising this potential will require coordinated efforts from businesses, advisors, and policymakers to address key challenges in skills, finance, and technology. By focusing on these areas, Wales can unlock the full economic potential of its SME sector and create a more prosperous future.

References

This briefing note draws extensively on the findings of the McKinsey Global Institute report, *A Microscope on Small Businesses: The Productivity Opportunity by Country* (2024). The report provides a comparative analysis of MSME productivity across 16 advanced economies.

¹ Welsh Government: [Size Analysis of Businesses: 2022](#)

² ONS: [Subregional productivity in the UK: June 2023](#)
