

Public procurement in the foundational economy: Submission to EIS Committee

Q. “To what extent could increasing local procurement by the public sector create stronger supply chains and build wealth in communities across Wales”

A. The large potential here can be realised but only if we clearly set the objective of building capable supplier firms and then purposively work both demand and supply side policy levers.

1 Confusions about localism: how and why public procurement in Wales has promised more than it has delivered

1.1 Adding up totals of Welsh Government (WG) or NHS procurement in millions creates an Impression of unrealised opportunity. But the total is in silos in different organisations, budgets and activities, so large values are difficult to access. The procurement function in local authorities, health boards and housing associations is under-resourced with few trained staff. The public sector typically defaults onto least cost and big contract and only in Welsh housing have Can do Tool kits been widely adopted.

1.2 Post code localism, and measures based on counting supplier invoices, then compound confusion by producing a false sense of achievement. As in Wales 2012-14 when ministers celebrated a 34-52 % rise in public procurement spend within Wales since 2003; and all political parties, big and small business and Wales TUC then asked for more ¹The recurrent problem is that local invoice totals do not separate out procurement from local branches of national chains (eg kitchens from Howdens or vans from the local dealer) which generates little value added and employment or capability

1.3 Localising supply is in any case a dubious objective when much Welsh economic activity is located along two short corridors (Wrexham/ Flint and M4), and capable Welsh firms in tradeable sectors should be capturing non-Welsh demand and exporting goods and services across Offa’s Dyke. Local preference by anchors institutions risks creating incapable client firms, where small scale employment depends on local preference within a small area.

¹ <http://hummedia.manchester.ac.uk/institutes/cresc/research/Final%20Cresc-FSB%20Report%20FOR%20RELEASE%20%281%29.pdf> pp 48-50

1.4 If Wales was a large, relatively closed national economy we might be able to stop purchasing leakage and get multiplier benefits from circulating demand internally. But stopping demand leakage from a small area (Keynesianism in one town like Swansea or a sub region like Swansea Bay) is a defensive game where first mover advantage could easily turn into a zero sum, competitive game with adjacent regions; without any guarantee that local demand preference will create or strengthen more capable firms on either side of the local or regional boundary.

2 Adding analysis: clarifying objectives, engaging specifics and understanding leverage

2.1 The primary aim should be to use volume public procurement strategically in a few key sectors to build a stock of more capable, secure and grounded Welsh supplier firms; specifically to grow the stock of grounded SMEs and to support the often precarious micro firms who account for one third of Welsh employment. From this point of view, Increased output and employment are not an objective but a consequence of sound purchasing policy.

2.2 From the Blaenau Gwent experiment of three housing associations, building capable suppliers requires a less transactional and more relational approach to procurement through conversation about purchasing requirements, spending plans and supplier needs leading to more mutual understanding, predictability of workflow and building of contractor capabilities.

2.3 The benefit would be a changed ecology of Welsh business i.e. make the relations between firms inside Wales more mutually supportive, creating business networks of partners who remain financially independent (move away from Anglo American transactional relations and more towards Japanese style Keiretsu supplier networks albeit without financial cross holdings).

2.4 This is difficult because it involves playing chess in three dimensions:

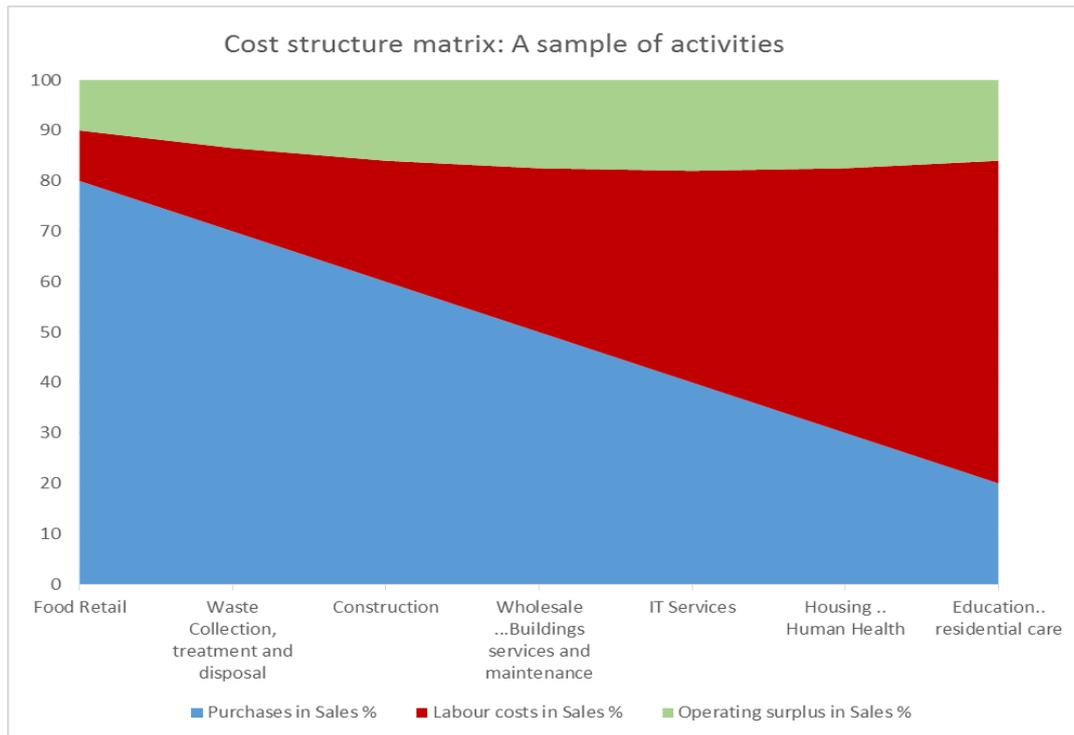
- a) **Spatial:** purchasing is geography and area based which is especially important given Welsh topography and the differences between South, Mid and North Wales.
- b) **Categories:** purchasing engages with services and product which have very different characteristics eg economies of scale and scope in manufacturing vs economies of density in services where spatial proximity is important.
- c) **Organisations:** purchasing is an activity dispersed across different public and private sector organisations with different agendas and autonomy of action.

2.5 Business analysis of (public and private) activity specifics indicate the sectors in the foundational economy at which we could find leverage of different kinds and where we would be wasting effort:

- a) Labour intensive public services (health education + care) link mainly through wages to where their workforce lives and works + their material purchases are long distance e.g. Welsh Hospital and Community Care 2017-18 splits 73% labour costs vs 23% purchases (of which 60% is clinical supplies, generally deemed as non-influenceable). Anchor purchasing by eds and meds therefore offers very limited leverage.
- b) Distribution (retail and wholesale) has a high purchase to sales (P/S) ratio; food distribution has a consistently high P/S ratio of around 80% so that 83% of Castell Hywel Foods £100 million turnover is purchases. This looks like an opportunity but is not easily levered because limited local purchasing reflects the weakness of Welsh branded food and the volume requirements of UK super market chains.

- c) Tourism matters because major tourist attractions bring in visitors + spend (e.g. Zip World at Blaenau Ffestiniog brings in 250,000 visitors a year). Here the neglected issue is how do the tourist feet fall and does money stick for local benefit.

2.6 The chart below shows that as we move from retail towards housing and residential care activities, the leverage arising from purchasing out of total income drops but the leverage via wages and salaries paid to employees increases. Activities on the left hand side of the chart offer a greater prospect of procurement leverage but this all depends upon (a) how it is possible to influence different organisational types to reconsider their procurement /value chain calculations and (b) size of sector because, of course, 75% of a very small sector is not worth much.



Notes:

Industry activities are located on the basis of their collective ratios: purchases in gross output, labour costs share of total gross output and operating surplus as a share of gross output. Gross output is total sales revenue earned by these activities. Purchases are after deducting value added (or value retained from gross income). Labour costs are total employee compensation.

Operating surplus is either cash (earnings before interest tax and depreciation) or in the case of public sector enterprises mostly depreciation.

Source: Supply and Use Tables, 1997 – 2016 National Income Blue Book, ONS.

2.7 Sectoral demand and cross sectoral opportunity is then important:

- a) On current spend the priority should be strategic focus and/or demand aggregation in two or three key foundational sectors. Care, construction and potentially food are substantial sectors with care and construction each employing around 6% of the workforce; and here we have enough controllable public and/or not for profit spend to sustain one or more SMEs on a sub-regional basis (e.g. in NE Wales ie Gwynedd and Mon) .
- b) Public sector outsourcing contracts also need to be reviewed in a few key sectors (e.g. food, grounds maintenance,) so we identify possibilities of unlocking demand (e.g. Sodexo)

provides a catering service for more than 4,000 workers at DVLA, where purchases account for 40% of £550 million of turnover because of extensive contractualised outsourcing).

- c) Capital spend also needs scoping, starting here by obtaining 3-5 year spending plans for all the utilities active in Wales (gas, electricity, water, telecoms etc.) + then engaging utilities about contract size etc.
- d) Identifying cross sectoral service opportunities is important because in e.g. health as in blue chip manufacturing, material supply chains lead out of Wales but indirect service requirements can be met locally (e.g. electrical and IT).

(3) A strategic approach: how to lever change that builds capability

3.1 The strategic approach here is to identify a series of actions which act as levers to procurement reform that builds supplier capability. Much (though not all) of this will be at the interface of public sector procurement and SMEs in a few foundational sectors. The levers are analytically distinct but practically must be pulled together so that, for example, reform of public sector demand pull is a necessary but not sufficient condition of reform.

3.2 Lever: Reform demand pull i.e. work from the purchasing organisation side to raise the standard of average purchasing practice. Purchasers will never reform practice unless and until it is supported as a strategic procurement function by leaders within their organisations. This is a task for the 20 Welsh PSBs² based on the 22 local authority areas, plus the housing associations and the utility bodies such as BT and Dwr Cymru. All these organisations should:

- a) resource the specialist procurement function at organisation level so that change has an internal champion – a strategic procurement officer. Embedded officers with a clear change agenda are likely to deliver more than consultants who support projects.
- b) ensure purchasing organisations have relevant information about their spend data e.g. as recently as 2015, an FSB Wales FOI request showed only 2 Welsh local authorities knew how much they spent with SMES³;
- c) ask purchasing organisations to publish 3-5 year pipelines for current and future capital programmes; e.g. housing association maintenance + utility company capital spending plans are important for the construction sector.
- remove obstacles to bidding by smaller firms and by SMEs without strong balance sheets; e.g. shared preferred supplier lists, divide contracts + on larger contracts recognise that financial penalty clauses narrow the field of bidders.

3.3 Lever 2: Identify and mentor SME and micro firms with ambition i.e. do not take supply side push for granted: Only a subset of supplier firms have ambition and that does not automatically translate into capability. Supply side improvement is culpably neglected in most of the purchasing reform literature:

- a) Find out what matters to supplier firms. Identify a subset of 6-10 interesting £10-20 million turnover SMES and interview 2 senior managers in each to see why they do not do more business with public sector and feed back to purchasing organisations.

² PSB's create a new base for action in 19 local authorities where they bring together LA, Health Board, Fire and Rescue + Natural Resources Wales. 8 are scheduled to be involved in CLES experiment

³<https://www.walesonline.co.uk/business/business-opinion/local-councils-should-act-now-9074525>

- b) Provide capability support with SME contracts. Add free checks of productive, market and financial capability followed by mentoring for SMEs likely to hold a stream of contracts as preferred suppliers.
- c) Pay micro firm principals (and e.g. their partners who do the books at home) to spend a day on practical running a small business training e.g. dealing with customers, charging overhead, digital book-keeping etc. Ask FE colleges across Wales to develop a national course which can be given at many different sites like the Pop Up Business School operation
- d) Anticipate the problem of succession in family owned firms like Castell Howell foods, with £100 million turnover and highly attractive as a bolt on acquisition. So it does not go the way of the Gwynedd laundry firm Afon Wen which went to the Johnson Group in 2016⁴.

3.4 Lever: Tap regional (North, South and Mid Wales) opportunities for aggregating public and not for profit demand to build capable SMEs (for profit and not for profit) with up to £20 million in target sectors. Put simply, Wales has a few firms like Pendine Park in the Care Sector (£20 million turnover) who have found a way through obstacles; how can we use purchasing to make it easier for the next generation of regional suppliers?

- a) Scope 2 or 3 key sectors like care, construction and maybe public sector Food for existing size of demand across region, typical contract size + criteria, stability of demand, amount locked up in outsourcing contracts etc. Report and set SME friendly targets to build a few regional champions with even handed support of for profit and not for profit firms
- b) Engage purchasers with suppliers in conversation about each side's current requirements, upcoming innovation and future demand for eg care, retro refit, catering supply

3.5 Lever: At area level tap the cross sectoral opportunities for meeting indirect service requirements locally + creating opportunities for micro firms: Services (electrical work, grounds maintenance, cafes) are generated and consumed at point of use making them difficult to ship long distances, therefore retained value added can be higher. This is the opportunity for micro/ small business who are more likely to support the process rather than contribute to the finished good (e.g. fitting & maintenance, professional services etc.)

- a) Get public + not for profit + private large employers together (in something like the Swansea large employers group) with brief to see how they can collectively make their services more micro friendly e.g. via shared preferred supplier lists and small labour mainly contracts
- b) Get (a) large employers (e.g. DVLA and Morriston Hospital each employing 3k plus) and (b) major tourist attractions (e.g. Zip World at Blaenau Ffestiniog bringing in 250,000 visitors) to see their role in sustaining micro firms (a) especially on the local high street by taking responsibility for where their employees live and work or (b) through tourist footfall.

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⁴ <https://www.bbc.co.uk/news/uk-wales-36169341>

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