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EXPLORING WHAT WORKS

FRONTIER REPORT



02 CONNECT

The Missing Middle

Building Stronger Welsh SME Ecosystems

September 2026

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Shahbaz Husain | September 2026

THE PROPOSITION

Wales should make SME-to-SME ecosystem development an explicit economic objective. The priority is not to create more clusters of organisations. It is to create more useful economic relationships: firms trading, innovating, bidding, exporting and sharing capability together.

The Argument In Brief

Welsh economic policy often treats the firm as the unit of analysis. A business is started, financed, trained, advised and encouraged to innovate. That is necessary, but incomplete. Small firms operate with fewer internal capabilities than large ones. The question is not only how to make each firm stronger in isolation, but how to give independent firms reliable access to capabilities they do not need to own themselves.

The OECD describes networks as strategic assets for SMEs because they can ease access to knowledge, technology, data, skills, finance and markets, capture knowledge spillovers and create external economies of scale. Strategic partnerships, consortia and clusters can therefore allow small firms to achieve collectively what would be uneconomic individually. [1]

This report calls the missing layer between the individual SME and the wider economy the Missing Middle: the relationships, institutions and shared capabilities that let independent firms cooperate without requiring them to merge. The phrase is often used elsewhere to describe a shortage of medium-sized companies; Frontier uses it here in a different, relational sense.

Wales has an innovation problem — but networks are a mechanism, not an explanation

Only 28% of Welsh businesses covered by the 2025 UK Innovation Survey were innovation-active in 2022–24, against 34% across the UK. Wales recorded the lowest rate of the four UK nations. The survey covers businesses with ten or more employees, so it says little about the very smallest firms. [2]

That gap does not prove that weak networks caused weaker innovation. It does make the channels through which smaller firms acquire knowledge and capability from outside their own organisations worth closer attention. OECD evidence shows that SMEs are particularly dependent on external networks to access knowledge, technology, finance, skills and other strategic resources. Collaborative firms also tend to be more innovative than non-collaborative firms, although that association should not be treated as proof that collaboration alone caused the difference. [1]

Welsh trade data also point to how little we understand about the depth of domestic business relationships. The 2022 Trade Survey for Wales estimated that 47% of sales value went to customers in Wales, while only 24% of purchase value originated in Wales; 42% of purchases came from the rest of the UK. But the survey achieved only a 15% response rate, left 16% of purchase value geographically unallocated and remains classified as official statistics in development. [3]

THE IMPLICATION

Wales should not infer a simple "leakage rate" from provisional trade data. It should recognise a data gap: if strengthening SME ecosystems is an objective, Wales needs better information on who Welsh firms buy from, collaborate with and reach through those relationships.

Small firms can borrow scale through relationships

The disadvantage of smallness is not simply headcount. It is the fixed cost of capability. A ten-person firm cannot economically maintain every specialist function, piece of equipment, laboratory, export capability, procurement team or R&D resource that a much larger organisation can absorb. Requiring each SME to acquire these capabilities internally is therefore the wrong test.

Networks provide another route. Firms can share market intelligence, refer work, collaborate on product development, use common facilities, pool training, combine technical capability or form a consortium for a contract too large for any one member. In OECD terminology, this creates external economies of scale: some of the advantages of scale arise through the network rather than inside the firm. [1]

UK evidence from fashion micro-clusters makes the mechanism tangible. Research led by the Creative Industries Policy and Evidence Centre found that small firms within regional micro-clusters used proximity to share contacts, knowledge and production

advice, and gained access to specialist skills, universities, laboratories and equipment. The study also identified barriers — particularly informal networking, weak cross-cluster links and IP uncertainty — and was explicit that its exploratory methodology should not be treated as causal proof. [4]

What the SME lacks	Network route	Potential result
Specialist capability	Shared expertise, facilities or training	Access without carrying the full fixed cost
Scale for a contract	Consortium or joint bid	Larger opportunities without merger
Innovation capacity	SME–SME and university collaboration	Knowledge spillovers and faster experimentation
Market reach	Joint promotion / internationalisation	Access to customers beyond the existing market
Resilience	More suppliers, customers and partners	Less dependence on a single relationship

Italy shows that collaboration can be formal without consolidation

Italy created a particularly useful mechanism in 2009–10: the contratto di rete, or network contract. It allows independent firms to formalise a shared programme to improve innovation and competitiveness, exchange commercial or technical information and services, or undertake activities jointly, while remaining separate businesses. [5]

The model is no longer a small experiment. Italy's official business-register platform reported 54,788 participating enterprises and 10,824 network contracts at 3 August 2026. OECD work also describes network agreements as a route through which firms can share costs, exchange knowledge and undertake activities that individual businesses would struggle to perform alone. [5] [6]

More importantly, the evidence has moved beyond programme description. A peer-reviewed staggered difference-in-differences study by Pieroni, Lattanzi and Riccaboni finds persistent positive effects from network-agreement participation on revenues, value added and EBITDA, strengthening through roughly the third year of collaboration. Micro firms benefited particularly when working with larger partners. [7]

That does not mean Westminster should reproduce Italian legislation word for word. The UK already permits contractual collaborations, joint ventures, special-purpose vehicles and consortium bids. The useful question is whether Italy has reduced the friction of sustained collaboration more effectively by giving SMEs a recognised, standardised framework.

FRONTIER PROPOSAL

The UK should examine an Italian-inspired standard SME Network Agreement. Wales should not wait for legislation: it can pilot partner matching, model agreements, joint-bid support, shared-capability projects and network management under existing UK legal structures, then use the evidence to make the case for UK reform if a legal gap remains.

A firm that is too small for a contract may not be too small for the opportunity

Consortium bidding is already recognised in UK public procurement. Government guidance explicitly welcomes two or more suppliers coming together where they cannot individually meet a tender's requirements but can do so collectively. A consortium does not need a particular legal form to submit a bid, although the eventual contract may require an agreed delivery structure. [8]

The barrier is therefore often not legal permission. It is practical formation: finding complementary partners early enough, agreeing roles, allocating risk, pricing the combined offer, protecting IP and deciding who leads. These are precisely the coordination costs that small firms struggle to absorb.

The Procurement Act 2023 requires contracting authorities to have regard to the barriers SMEs may face in participating in public procurement and to consider whether those barriers can be removed or reduced. That creates an opening for economic-development support to help credible consortia form rather than leaving firms to discover the route by themselves. [9]

PRACTICAL TEST

Where a Welsh SME is capable of delivering part of a major opportunity but cannot meet the whole specification alone, the economic-development question should be: who else in Wales or the wider UK could complete the capability set, and who helps them form a credible bid?

Clusters should be judged by economic behaviour, not by the label

Clusters can matter because proximity and repeated interaction reduce the cost of exchanging specialised knowledge. But a cluster designation is not itself an outcome. The danger is counting organisations, events or memberships when the economic objective is firms changing behaviour.

The strongest recent evidence comes from Flanders. A peer-reviewed evaluation by Pierluigi Angelino, Dirk Czarnitzki and Astrid Volckaert used firm-level data and difference-in-differences methods and estimated an average productivity effect of around 4% for firms joining the Flemish Spearhead Cluster programme. The mechanism analysis points towards knowledge spillovers, with benefits weakening as distance between members increased. [10]

Wales already intends to identify and develop science and technology clusters through its Innovation Strategy delivery plan. That is sensible. But measurement should move beyond whether clusters have been "created" or designated. The relevant questions are whether participating firms collaborate, innovate, win work, enter markets and remain connected after public support falls away. [11]

Weak cluster measure	Better economic measure
Number of clusters designated	Firms participating in sustained commercial or innovation relationships
Events held / members enrolled	Joint projects, contracts, products and market entries
Grant expenditure	Private investment and capability created
Local supplier count	Supplier diversification, standards gained and external sales
Programme completion	Network durability after public support reduces

Galicia shows what a region can organise deliberately

Galicia is a useful comparator for Wales because it is an autonomous, peripheral region with significant rural territory, a strong language and cultural identity and a mixed industrial base. Its current cluster policy is explicit about collaboration between firms, technology organisations, research bodies and training institutions.

In 2025, the Xunta supported 19 cluster projects with nearly €2 million across sectors including automotive, aquaculture, health and the circular economy. These are programme facts, not proof that cluster policy caused Galicia's wider economic performance. [12]

The more distinctive lesson is market reach. Galicia Exporta Organismos Intermedios supports joint international promotion through business intermediaries to encourage cooperation, exploit synergies and help groups of firms internationalise together. Wales should investigate the same principle: networks should help smaller firms reach customers they would struggle to access independently. [13]

THE PRINCIPLE

A stronger Welsh SME ecosystem should be outward-facing. Local relationships are valuable when they increase capability and resilience; their ultimate test is whether they help firms compete successfully in larger UK and international markets.

A separate question: how should SME ecosystems interact with much larger organisations?

The argument so far concerns relationships between independent SMEs. A separate but related question is what happens when those firms interact with organisations many times their size.

Universities, health bodies, local authorities and other major public institutions can provide demand, knowledge, assets and convening power. Large private employers and inward investors can provide similar opportunities through supply chains, technology, standards and access to wider markets.

These relationships can strengthen an SME ecosystem. But they are different from SME-to-SME collaboration because the balance of economic power is different and dependence on one large organisation can itself become a source of vulnerability.

DEFINITION

An anchor institution is a large, relatively place-rooted organisation — such as a university, health body, local authority or other major public institution — whose employment, purchasing, assets and convening power can materially shape its local economy. A major private employer or inward investor can play a similar economic role but is not necessarily rooted in the same way.

Large organisations should strengthen SME capability — not become the ecosystem

Inward investment remains an important part of Welsh economic development. The additional question is whether it strengthens the surrounding business ecosystem.

OECD analysis of more than 24,000 firms in Germany, Italy and Romania finds positive SME productivity associations with FDI, with the strongest and most consistent results where foreign buyers purchase from domestic suppliers. The analysis is not proof that FDI caused those productivity gains, and the OECD stresses that outcomes depend on skills, innovation capacity, infrastructure and the strength of the local SME ecosystem. [14]

The policy implication is therefore not simply “increase local sourcing”. It is to use commercially viable supplier relationships to transfer capability that Welsh firms can subsequently deploy elsewhere.

Ford Bridgend demonstrates why the presence of a major employer should not automatically be equated with a deep domestic supply chain. In evidence after the closure announcement, Ford Europe said a significant proportion of material and components for the plant’s engines were produced outside the UK, without giving a precise Welsh sourcing split. [15]

Sony provides a more nuanced counter-example. Gooberman and Munday's 2026 study of Sony in Wales argues that longevity reflected multiple forms of embeddedness: external relationships with the regional economy and public sector, together with entrepreneurial local management able to reposition the Welsh operation within the multinational. Television manufacturing ceased in 2005, yet other operations survived and grew. [16]

THE LESSON

Embeddedness is not simply the number of local suppliers. It includes relationships, management capability and the ability of a local operation to acquire new roles as the multinational changes.

The test is whether capability becomes portable

A supplier can grow substantially while becoming more vulnerable if that growth depends on one dominant customer. The stronger outcome is a firm that uses the relationship to acquire management capability, technical knowledge, quality standards, certifications, intellectual property, equipment or market credibility — and then applies those assets to other customers.

The practical resilience test is: would the supplier remain viable if the major customer reduced procurement, relocated or left Wales?

Supplier development should therefore measure customer diversification and wider-market sales alongside contracts won from the large organisation. A relationship has created durable productive capacity when the supplier becomes more capable and more independent, rather than simply larger.

What should change

1. Make SME ecosystem development an explicit economic objective.

Welsh Government should measure the quality of relationships between firms, not only the performance of firms individually. A small Welsh SME economy will always depend on external capabilities; the policy task is to make those connections easier to form and more economically useful.

2. Launch a Welsh SME Network Pilot using existing legal structures.

Business Wales should test a practical offer combining partner matching, model collaboration agreements, consortium and joint-bid support, IP guidance, network management and shared-capability projects. The pilot should be evaluated before Wales argues for a new statutory vehicle.

3. Support clusters selectively and require evidence of additionality.

Cluster support should focus on real economic concentrations and value chains with credible firms, knowledge assets and markets. Evaluation should ask whether public intervention created relationships or outcomes that would not otherwise have occurred, and whether mature networks can sustain themselves with less public subsidy.

4. Build market reach into collaboration policy.

Welsh networks should be designed to help SMEs win larger UK contracts and enter international markets. Galicia's collective internationalisation approach deserves a Welsh pilot, particularly where groups of complementary firms can share market-development costs.

5. Make relationships with major organisations build independent suppliers.

Supplier-development programmes around inward investors, anchor institutions and major projects should measure the capabilities firms acquire and whether those capabilities lead to additional customers and wider markets. The objective is not permanent dependence on a large buyer, but stronger firms capable of surviving changes in that relationship.

6. Build a Welsh SME relationships dashboard.

Wales should improve data on intra-Wales purchasing, SME collaboration, joint innovation, consortium activity, relationships with major organisations and network-assisted market entry. Programme attendance is operational information; it is not evidence that an ecosystem is becoming denser or more productive.

Who can act?

Welsh Government can act directly	UK Government / Westminster action
Economic-development support, Business Wales network services, grants and finance within existing powers, cluster support, data and evaluation.	**Creation or regulation of a new business-association form; company law; competition law; much intellectual-property law.**
Public bodies in Wales can encourage SME participation and consortium formation within the applicable procurement framework.	**Any dedicated statutory "network contract" regime modelled on Italy would require UK competence or detailed legal analysis.**
Welsh Government can pilot model agreements and gather evidence of barriers under current law.	**Welsh Government should work with UK Government if a pilot identifies a legal or regulatory constraint that Welsh powers cannot remove.**

Wales operates under a reserved-powers settlement. Economic development support is broadly within Welsh executive competence, but Schedule 7A to the Government of Wales Act 2006 reserves matters including business associations, competition and intellectual property. That makes experimentation under existing legal structures the practical first move. [17] [18]

Connection creates capability; KEEP asks whether it survives

Stronger relationships can make SMEs more capable, but that does not guarantee that the capability becomes durable. Contracts end. Major customers leave. Businesses are sold. Founders retire. Management teams move.

The companion KEEP Report examines the next part of the economic system: whether the firms, people, knowledge, relationships and capital created through business success are retained or recycled into future productive activity.

References and archive links

All links below are included so that the underlying sources can be downloaded or saved. Where a source reports programme outputs rather than causal evaluation, the report says so.

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7. Pieroni, V., Lattanzi, N. and Riccaboni, M. (2024). The dynamic impact of inter-firm network agreements. Small Business Economics 63, 939–969. Source / download — Peer-reviewed staggered difference-in-differences evaluation.

8. UK Government. How to bid for government contracts as a consortium. Source / download — Official guidance confirming consortium bidding and legal-form options.

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11. Welsh Government (2023). Wales Innovates: Creating a Stronger, Fairer, Greener Wales — delivery plan. Source / download — Current Welsh innovation and cluster policy context.

12. Xunta de Galicia / Oficina Económica de Galicia (2025). Support for 19 Galician cluster projects. Source / download — Programme implementation evidence.

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16. Gooberman, L. and Munday, M. (2026). Assessing the embeddedness of a Japanese-owned factory in the UK: The case of Sony in Wales, 1973 to 2016. Business History. Source / download — Peer-reviewed case study of multiple embeddedness and local management.

17. Government of Wales Act 2006, Schedule 7A, as amended. Source / download — Primary constitutional source for reserved matters.

18. Welsh Government (2026). Cabinet handbook — Section 6: Legislation and the law, paragraphs 6.1-6.7. Source / download — Explanation of the devolution settlement, economic-development responsibilities and reserved matters.

Use of artificial intelligence

Artificial intelligence tools were used in the preparation of this publication as research and editorial aids. They assisted with:

- identifying, cross-checking and corroborating sources and factual claims;
- testing internal consistency, including terminology, evidence strength and, where relevant, constitutional competence;
- improving the structure, clarity and readability of the text; and
- identifying claims or areas requiring further verification.

The selection and interpretation of evidence, analysis, arguments, conclusions and recommendations are those of the author. Sources cited in the publication were checked against the underlying material before inclusion.