

# social enterprise for public service:

how does the third sector  
deliver?

Edited by Paul Hunter



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## how does the third sector deliver?

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This timely publication follows recent work that the Smith Institute has undertaken on charities, philanthropy and social enterprises. Social enterprises are growing in significance, employing 650,000 people and contributing £8.4 billion per year to the UK economy. Much of the sector's income now comes from the state to deliver public services. For many, social enterprises have the ability to offer a different approach and ethos, between the profit-driven private sector and the one-size-fits-all public sector. However, the sector is still small and faces capacity and capability constraints. With both main political parties committed to growing the third sector, this collection of essays highlights the challenges and opportunities that lie ahead.

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## Foreword

Kevin Brennan MP, Minister for the Third Sector

In June 2008 the prime minister launched the government's vision for public services in *Excellence & Fairness: Achieving World-class Public Services*, which identifies three characteristics of world-class public services:

- **empowered citizens** involved in shaping services, both directly by involvement in their design, and indirectly by exercising choice;
- **new professionalism** in the public service workforce, by investing in their skills and allowing higher levels of autonomy where they have shown ambition and capacity to excel; and
- **strategic leadership** from central government to ensure that direct intervention is concentrated on underperforming organisations, while creating conditions for the majority of services to thrive more autonomously.

At the launch, the prime minister said: "I want 'world-class' to mean what it says: every element of our public services to be the best in the world." He and I both have no doubt that the third sector has a vital role to play in helping us to realise that vision. It makes sense for government to turn to organisations in the third sector which share our commitment to social justice, to help us achieve our public service goals. I believe that at their best social enterprises can transform communities and help transform public services.

As many of the examples and case studies in this monograph show, social enterprises – as sustainable businesses with a mission for community benefit rather than just private profit – can bring dynamism and innovation to the design and delivery of public services. They can also help government achieve more with its investment through their double (and sometimes triple) bottom line. They can engage local communities by helping to find local solutions to local problems, bring innovative solutions and stimulate new markets. They can also help to empower citizens and bring new energy to public services.

Government has recognised the need for more evidence on the contribution of the third sector. This is why we have invested £5 million in the new Third Sector Research Centre, launched in October 2008. We are also undertaking a major new project, with the Scottish Executive, to develop guidance, training and infrastructure that will enable third-sector organisations to measure and articulate their social or environmental impact.

The Department of Health is also investing £100 million in social enterprises delivering services in health and social care. It has pioneered the "right to request" for public service

professionals to spin out and become social enterprises themselves. This will help to drive innovation, professionalism and flexibility throughout the services delivered. In *Excellence & Fairness* the government expressed an interest in the far wider development of spin-out models, and we are examining how this may be taken forward across a range of public service areas.

For these reasons I welcome this monograph, which seeks to examine the evidence for expanding the role of the third sector, and social enterprise specifically, in supporting the delivery of public services. Much of what is said in these pages will fuel discussion and thinking on how social enterprise can best help to realise our vision. Social enterprise is an idea whose time has come.

## Chapter 1

# Setting the scene and vision for the sector

Jonathan Bland, Chief Executive Officer of the Social Enterprise Coalition

## Setting the scene and vision for the sector

Communities can be transformed by public services that are responsive, innovative and deliver multiple outcomes. Social enterprises – businesses driven by a social and/or environmental mission – have the potential to lead the way in showing how to provide better services for greater public benefit. What is needed for them to set the standard is proper recognition of what they achieve.

Public services form the backbone of our society. Without the assurance of reliable energy, water, transport and waste collection, our communities would collapse; without successful healthcare, employment and housing services, the most vulnerable would be abandoned. Therefore the delivery of public services is one of the most important matters facing us not only today, as we confront one of the most extreme economic situations for 25 years, but far into the future. In difficult economic times, the effect that the quality of these services has on the general population cannot be underestimated. Loss of homes and increased rates of unemployment will have effects in terms of health, crime and social care needs. And as we look to an environmentally sustainable future, we must continue to strive for better ways of tackling waste and energy needs.

Right now, private companies provide a significant proportion of our public services. Private companies operating in competitive markets pursue, on the whole, purely economic ends – their primary motivation is not to provide freedom, justice, collective security, clean air or other social goods. In a well-functioning market, the private sector usually has an incentive to respond to customers' needs, but this is not always so in public services. The private sector will focus on fulfilling the needs of a contract agreed with the public sector – which, in order to be measurable, are often output-based – rather than focusing on the outcomes for the user.

Social enterprise can fill the gap by providing the motivation, ingenuity and customer focus that successful private companies are good at – while avoiding the simplistic “one size fits all” approaches that often characterise public services provided by the government, whether directly or “vended out” to private companies, under rigid or misguided rules that are designed to suit the convenience and political influence of the government bureaucracy.

A social enterprise's main purpose is to fulfil its social and/or environmental goals. This is achieved by reinvesting most of the profits in the business or the community. Because profits are pursued (and largely reinvested) to meet social aims, the quality standards of social enterprises tend to be placed above financial considerations. They will often have a

wider remit than service delivery and provide multiple outcomes across a wider range of objectives than a traditional, narrower approach to service delivery.

### **HCT Group**

But that does not mean that they cannot be hugely successful. For instance, HCT Group, an award-winning social enterprise, delivers transport services all over London and in Yorkshire. It has a turnover of £18.5 million per annum. The company applies its knowledge and expertise to provide a range of specialist transport and related learning services that are targeted at people who find it hard to use public transport. Profits from its mainstream transport services (it is a London red-bus service provider, for example) support its goal of making public transport available to all. Dai Powell, the chief executive of HCT Group, says: "Prioritising our social aims means we remain integrated with the communities which we serve and, I believe, leads us to provide a better service."

Additionally, unlike private enterprises, whose ownership is often determined by shareholder investment, social enterprises can be owned and controlled by the community or by the enterprise's employees.

However, social outcomes are not easily measured yet, and this has led to barriers in procurement and understanding. How do you measure the impact from the transport company that uses its profits from mainstream bus services to provide transport for those who are not able to access those services? How do you measure the effect had by the recycling company with a training programme for disabled adults? How do you measure the effect on a community when its drug users, homeless and most disenfranchised begin to take an interest in their health and well-being?

Social accounting is something that is in the early stages and its development needs to be further supported. However, there is no time to wait.

There is nevertheless already evidence available that demonstrates how social enterprises, because of their social and environmental mission and their focus on the consumer, can provide a better alternative to public service delivery, and ultimately lead to a more stable and prosperous society.

### **Making inroads in developing markets**

The sector in which social enterprise is already poised to have a large impact on public service delivery in the near future is healthcare. The case for increasing the role of social enterprise in the delivery of health and social care comes directly from the Department of Health, after studying existing social enterprises in health and with guidance from the

Social Enterprise Coalition. The opportunities that lie ahead are momentous and demonstrate that it is possible to influence a public service delivery system that might have been perceived as resistant to change. Moreover, what has already happened with health can serve as an example for other public service sectors.

In July 2008 the final report of NHS Next Stage Review, alongside the Primary and Community Care Strategy, together set out a new foundation for health to "empower staff and give patients choice". The NHS Next Stage Review includes a number of recommendations that present opportunities for existing and new social enterprises. Perhaps the most significant is the recommendation to create new social enterprises to deliver community services, and the commitment that primary care trust staff are given the "right to request" to set up social enterprises.

Social enterprises set up by primary care trust staff would abide by the ethos and values of the NHS, but operate outside them. An important characteristic of social enterprises is how they connect with communities and service users.

### Open Door

Open Door, a care centre located in Grimsby, was developed by staff at North East Lincolnshire PCT (now Care Trust Plus) and is an example of multiple outcomes achieved when the consumer is put first in designing and delivering service delivery. Health-needs assessment work at the primary care trust had identified approximately 1,000 people who did not, would not or could not access traditional primary care services. This included homeless people, problematic drug users, offenders, commercial sex workers, refugees and others who are excluded from GP lists.

With the support of funding from the Neighbourhood Renewal Fund, North East Lincolnshire PCT decided to work creatively with local people to design easier access to better health and social care services. At the heart of this concept was the call to engage in "co-production" with people who usually experience poor engagement with traditional service providers. Their aim was to create better access to healthcare for Grimsby's vulnerable groups without disenfranchising the mainstream.

Thus was created Open Door, an activity and social centre with health services available to all as well as providing a Citizens Advice Bureau, cookery classes, alternative therapies, showers and flexible activity space. Each of these facilities provides people with a reason to be there, a place of safety and the means to socialise.

Open Door's unique role in the local community has enabled strong relationships to

develop with many local stakeholders. The accident and emergency department at the local hospital automatically refers anyone not with a GP to Open Door, and the police work with Open Door staff to support prolific and priority offenders. In addition, a decrease in the neighbourhood's crime rate coincided with the opening of Open Door. Though there is no concrete evidence to credit Open Door for this, the police do believe it played an important role in making that happen.

### **Central Surrey Health**

Central Surrey Health is a pioneering social enterprise co-owned and run by the nursing and therapy teams it employs. They have been able to invest in telemedicine for people with a certain type of pulmonary disease, helping patients to remain living at home and able to monitor their own condition. The initiative has resulted in a 40% reduction in hospital admissions among these patients and a 26% reduction in bed days. In addition, patients have been observed to take a greater interest in their day-to-day care.

These case studies demonstrate why the Department of Health wants to open the market to more social enterprises. Social enterprises tackle a variety of complex issues through innovative solutions that result in outcomes that are tangible if not always easy to quantify.

There is certainly risk involved, and that is also an important aspect of social enterprise – taking risks, charting new territory and thinking outside “one size fits all” approaches for communities and service users.

### **Going forward: competing in new markets**

Our vision is not to have social enterprises deliver each and every public service but to make them a viable and visible alternative for communities that would benefit from them. What social enterprise is achieving in health can be achieved elsewhere.

Social enterprises show how business can operate competitively while still addressing social and environmental issues. This has become increasingly significant as public service provision has been opened to market forces in recent years. Social enterprises have taken on an increasingly important role as service providers and in demonstrating how a market that is primarily for public benefit can operate competitively.

The challenges we face demand a new business approach: a combination of business dedicated to resolving these challenges and the support of consumers to ensure that it happens. We cannot rely on price alone to motivate this change in behaviour at the speed required to make an impact. This is where social enterprises, through their unique

governance structures and social and environmental motivations, can alter the way businesses respond to these challenges. Social enterprises can be owned by their staff, the community or consumers, and as such they are able to connect and bring about individual responsibility in way that private business simply cannot.

### The Phone Co-op

Vivian Woodell, chief executive of the Phone Co-op, the UK's only telecommunications co-operative and an award-winning social enterprise, says:

*Increasingly, all businesses are finding that putting the customer first, respecting staff and protecting the environment are key factors in commercial success, not just bolt-on extras. These are the values that social enterprises have always held to be central to what they do and it is great to see that more and more people are demanding that those values should not be secondary to business, but absolutely fundamental.*

With current economic challenges gathering strength, it is time now also to consider how these principles can be extended to other public benefit goods.

### Glas Cymru

Glas Cymru is already demonstrating how this approach can be applied to large-scale utilities. Glas Cymru is a non-profit company that owns Welsh Water (Dwr Cymru). The company has no shareholders, and any financial surpluses are retained or reinvested for the benefit of Welsh Water's customers. Welsh Water's users are paid an annual dividend which, since 2001, has seen £98 million returned to customers. It is governed by 72 members, who are appointed under the recommendation of an independent membership selection board. Since coming seventh in Ofwat's customer satisfaction rankings in 2001, Welsh Water has consistently been ranked in the top four, topping the table in 2004/05.

Furthermore, it is repeatedly innovating the better to serve its customers and the environment, including trialling a new tariff, Waterdirect, which gives an additional £25 discount for any customers who choose to have their water bill paid directly from certain qualifying state benefits. This discount, for some of Welsh Water's less well-off customers, when added to the customer dividend, could reduce their water bill by more than 10%.

This is in addition to the existing WaterSure tariff, which helps low-income families and individuals whose water is supplied by meter by limiting their water charges, and the Customer Assistance Fund run in partnership with the Citizens Advice Bureau, which offers customers in arrears help to pay charges on a regular basis.

Welsh Water is also taking an industry lead in addressing the problem of disruption to the natural drainage systems, which is increasing the likelihood of sewerage flooding. It has commissioned large-scale studies in Wales as part of its surface water management strategy, which will provide a long-term vision of how Welsh Water will deal with surface water flows for the next 25 years. Its first goal is to encourage its partners in local and central government to legislate to protect green spaces, and to encourage the inclusion of sustainable drainage systems in new building developments.

By removing the motivation of shareholder profit, it has been better able to address the needs of its customers and the environment and bring about a joint approach to addressing some of the challenges we face.

### **Baywind Energy**

The same could be said for energy. Baywind Energy is the UK's first community-owned wind farm, helping to tackle climate change while creating income for the local community. The community in Cumbria owns a stake in the company. As well as getting access to a renewable source of electricity, they also receive a dividend on the company's profits. They went on to establish energy4all to support other community renewable energy projects across the country. It is important to note that Baywind was established at a time when groups across the country were protesting against the development of private wind farms in their communities. One could suggest that knowing that the wind farms would benefit the community in multiple, measurable ways lessened the negative visual impact people have ascribed to them.

Public benefit markets such as energy and water are already subject to a range of regulatory measures aimed to ensure that companies meet their environmental and social obligations. It therefore must be asked whether social enterprises, with their explicit social and environmental motivations, ability to change consumer behaviour, and lack of shareholder motivation, are a more efficient form of meeting these obligations than a highly complex regulatory framework.

The support for social enterprise in health and social care demonstrates an understanding that pure market forces cannot and will not provide the same levels and quality of service and that a market needs to be created so that it can support social enterprises that meet both sets of objectives. This has not previously been the case for most public-benefit markets.

As new market opportunities emerge, the government should now consider how these could be shaped to take advantage of the benefits that social enterprises offer. An example

of such a market opportunity would be the £3 billion of capital spending announced in the pre-budget report, some of which is to be invested in developing a green stimulus to support growth and job creation in low-carbon industries. The government has an opportunity to look at the market architecture in how it is establishing these markets and ensure that they will function in a way that considers both social and environmental considerations and takes consumer focus into account.

What is certain, however, is that long-term solutions to many of these problems – based entirely on government grants, subsidy or charitable donations – will not address the challenges of the future.

### **Conclusion**

Social enterprises, through their social mission and their focus on the user, can truly transform the most essential of public services and deliver multiple outcomes that are going to be more essential in today's economic climate than we yet fully understand.

Social enterprises' knowledge of, sensitivity to and expertise about the communities in which they work makes them ideally placed to shape service delivery. Social enterprises are able to build trusting relationships with service users, developing services specifically designed to meet their needs. This benefits not only the service users but also the wider community as a whole. We cannot forget that engaging the consumer is key to creating responsible, ethical and affordable services that do what they were meant to do: provide some of the most crucial aspects of a successful society.

We need more social reporting about the impact made every day by social enterprises delivering public services. But by waiting to have an evidence base, the status quo will never change. Social enterprise is not about working the system; it is about acting responsibly outside it and using the power of business to achieve social capital. We believe that developing markets and advancing the opportunity for social enterprises to have an equal playing field in delivering public services will result in a measurable and positive impact upon individuals, communities and society as a whole.



## The role of housing associations

Housing associations are major deliverers of public services. They are innovative, not-for-profit, social businesses. However, the position of housing associations illustrates some of the dilemmas for the third sector, including what its purposes and roles are in public service provision, and how they should relate to government policy, particularly in a changing economic climate.

The key questions seem to be:

- What is "public service" and who delivers this: government or third-sector organisations?
- How does this define successful delivery?
- Are housing associations third-sector organisations at all?
- Has their relationship with government meant they are in effect agents of government – a kind of quango – perhaps losing that independence of thought that characterises third-sector organisations?
- In a changing economic climate, can they continue to deliver?

It is a premise of this paper that housing associations are third-sector organisations and that their success over time has in large been part due to those third-sector characteristics of social entrepreneurship and independence of thought. However, how housing associations deliver reflects the times they work in; like any other organisation, they absorb the philosophical and organisational orthodoxies of the day.

### Defining "public service" and the "third sector"

"Public service" for third-sector organisations cannot simply be defined as the stated objectives of the government of the day. Many third-sector organisations owe their existence to collective action to recognise, deliver and meet a need for service that the government of the time did not recognise.

A continuing and fundamental role of the third sector is to deliver what services should be delivered, explore how these could be delivered and develop methods and practices for doing so. In other words, their role is to deliver against government targets when there is a convergence of belief in their relevance and worth but also to provide an intellectual and practical lead for policy makers.

As for a definition of the "third sector", I am not sure what a third-sector organisation strictly is, although I would agree that such entities exist. They are organisations that are not public or private, and where there is very significant activity that has a significant

economic and social value.

However, what third-sector organisations tend to have in common is a concern with a particular set of social issues often linked to particular parts of the population. They range from working at a national level to a concern with very specific local manifestations of wider issues. Much of these organisations' strength is their local focus, with an ability to respond to local circumstances to such an extent that many do not think of themselves as contributing to social policy at all but simply as making their community a better place.

The third sector also includes, however, large, financially weighty organisations that occupy a very significant position in the social policy/delivery arena: household names such as Barnardo's and Help the Aged.

### **The roots of housing associations**

Housing associations, compared with many other organisations in the third sector, are so large that they are often not considered to be third-sector organisations at all but in fact agents of government policy, more like a hospital trust, a school or a university body.

One of the problems with housing associations is that they have such a mixed history. Not surprisingly, given that they deal with such a basic need as that for a home, their history dates back a long way, right back to almshouses in the middle ages. Those interested in these things believe that housing associations' real history begins in the 19th century with the development of the idea of planned communities for workers and decent homes for the "deserving poor", model dwellings to combat squalor, disease and potential social unrest in Britain's heaving, ballooning towns and cities.

There is a tendency to think of these developments, from Port Sunlight to Octavia Hill and the Peabody Trust, as radical departures from the attitude and provision of the time. Actually, the opposite is true.

The social housing provision of the time reflected the concerns of politicians and the public of the time – and, perhaps most importantly, the way of doing business at that time. Victorian England was a place where 95% of the population rented homes, and large-scale housing developments for rent were financed, designed, built and let by mill owners, private companies and individuals everywhere. The real difference between these providers and the reformers – the so-called 5% philanthropists – were the lower returns investors could expect and the rules with which tenants had to comply. These were philanthropists, yes, but also patrons and moral guardians of the poor.

With the advance of liberal and socialist thought through the first three-quarters of the 20th century, the idea of the provision of good-quality housing for the poor became a key element of government thinking, at least at a municipal level. Concerns with public health and overcrowding, along with a need to satisfy an enfranchised working class, meant that local authorities began to take on the responsibility for provision of good-quality, affordable homes for local people, to a scale that housing trusts and societies could not achieve. While these bodies were still active in terms of providing housing for the "working classes" and "returning servicemen", their "housing" concern was widely defined to involve "creating well-being" and "communities", including provision of community centres and opportunities for training and work.

The triumph of Keynes and Marx through the Great Depression and the demolition of the Second World War, along with the belief in planned delivery of all kinds that emerged – not least in housing and urban design – led to 30 years of the most incredible investment in public housing.

What we think of as housing associations were born into a world where around 40% of total homes were in the public sector (rising to 65% in some towns and cities). This was a world in which access to social housing was controlled and allocated locally, and where local connection and connections were all-important. A significant but generally poor-quality private rented sector still existed, although in rapid decline, and in order to buy a home you needed to prove your reliability, prospects and ability to save.

It does not take much to work out that in the rapidly changing social and economic life of Britain in the 1960s there would be frictional costs in terms of housing need. The "new" associations developed largely through the association with Shelter, campaigning and building to meet this need; working together mostly at a local level, a "movement" was born.

These "third-sector" organisations were small, focused, entrepreneurial and active, utilising all funds available but outside government control and direction.

### **Five key steps towards change**

Over the years, five key events or factors changed housing associations' relationship with government. The first of these was the creation of the new, enhanced form of the Housing Corporation through the 1974 Housing Act, and the state funding and regulation of housing associations that followed. This was both welcome and necessary. The corporation was generally a dynamically benign organisation run by people who believed in the possibilities of housing associations. However, this change created a very different form of conversation with government for housing associations, which were increasingly

responsible to government and working within a context increasingly defined by policy makers.

The second driver of change was the slow, inexorable move away from a belief in state provision of housing. This took housing associations from a secondary role in the provision of affordable housing to a primary one. The process began with the cuts in local authorities' capital programmes and the cementation of housing associations as the only provider of new social housing in the 1988 Housing Act – and, most vividly, with the transfer of homes from local authorities to housing associations both through stock transfer and large-scale regeneration.

The third element illustrates the paradox of the relationship with government. The move to "mixed funding" that came with the 1988 act, whereby housing associations began to borrow against the value of their assets and future rental streams to provide new rented housing, was accompanied by a demand by government for a change in housing associations' role. There was a need for a move from local parochialism and provision for a matrix of local need, to professionalism and target-driven outcomes to house "those in the greatest need". Housing associations took on the role of providing housing for local authority nominations, but, more importantly, the nature of the sector had changed from a "movement" to a competitive marketplace.

The fourth major element of change involved government controlling a key element of associations' income – the rent! In 2000 the government introduced the concept of rent convergence, which in effect set rents for local authorities and housing associations. This ended any link between rent and service and acted to determine the ability and scale of housing associations' development programmes.

The fifth and final factor was the impact of what could be termed super-regulation and a drive toward homogenisation. Both the use of the Audit Commission to inspect and compare housing associations with public-sector bodies in terms of performance, and then the move to a regulatory regime with the establishment of the Tenant Services Authority, which places housing associations clearly alongside public-sector bodies, have changed once again the relationship with government.

### **The role of associations today**

Arguably, housing associations have moved away from a position in which they genuinely operate as independent, third-sector organisations; their form, nature and extent of growth are directed by government and they are unable to choose whom they house. They may be the "only game in town" as far as housing is concerned, but they dance to the government's tune.

However, if you speak to the chief executives and boards of housing associations, they would not regard their organisations in this way. They would not consider themselves delivery arms of government; if anything, they see housing associations increasingly taking on the complexion of private-sector organisations, with most of the funding for new social housing coming through loan finance. As the sector – and even individual organisations within it – borrows billions of pounds, banks are becoming significant stakeholders in housing associations.

The real turnaround in policy terms was the changed view on how associations should be treated financially: from “poor”, not-for-profit organisations in need of grants, to asset-rich organisations borrowing against the balance sheet and future rental streams. Housing associations are once more changing to reflect the faux free-market capitalist environment of the time; commercial and financial acumen on boards is becoming increasingly important.

The changing relationships with government in the recent past has worked to create a level of competition in the housing association sector which is surprising to those joining from true commercial sectors, particularly when the prize is loss-making social housing. Government practices have worked to encourage larger organisations. For instance, smaller and medium-sized housing associations are unable to become Housing Corporation development partners. The lexicon of housing has changed during this period from one with a co-operative tenor to one much more commercial, in which “mergers and acquisitions” is a common phrase.

It is difficult to define the tasks required of housing associations, but they could be seen as:

- to deliver more new homes at a reducing cost to the public purse;
- to spearhead the new environmental agenda in housing;
- to finance the improvement of large swathes of historic public housing;
- to provide excellent services to tenants and residents at reducing cost;
- to take on the wider stewardship of neighbourhoods with high concentrations of public housing, changing these fundamentally, physically and socially;
- to provide alternative housing products for those not eligible for social housing and unable to purchase in the marketplace;
- to hit social housing construction targets and facilitate the provision of housing by private housing developers;
- to respond positively to new government funding initiatives such as housing PFI; and
- to develop and fund comprehensive economic and community development services, particularly tackling worklessness among tenants.

## Success in delivery

What housing associations have actually done over the last decade or so has been impressive. Housing associations have met the challenges set by government, learning and changing both financially and organisationally. They have become experts in many areas and they have flexed their financial muscle to the limit that their board members think prudent or possible.

According to the 2007 Hills review of the sector,<sup>1</sup> housing associations produced 180,000 new homes between 1996 and 2005 and took transfer of 750,000 previously council-owned units, improving or replacing them. But all this happened during a period the like of which will not return. Can housing associations meet the challenge going forward? It depends on the scale of the challenge.

A number of factors will hamper the ability of housing associations to repeat such a level of achievement. No longer countercyclical, many of the larger and more active associations are increasingly victim to the same economic pressures as the rest of the business world. Access to new funds to invest in housing is limited, and the cash that is available is expensive. Equally important is that the sources of income that can be used to service this debt have dried up: sales income is negligible, and land values are impaired. Cross-subsidy through housing sales in regeneration has disappeared, limiting housing associations' ability to make and meet promises to local authorities and to tenants.

Housing associations do have advantages over other developers in that they can develop properties for different tenures. The variety between associations means that there is still underutilised capacity among the smaller and medium-sized organisations that have been less active in recent years but are close to and concerned about local need and local solutions. Housing associations have maintained a tradition of entrepreneurship and problem solving that is fundamental as the economic context changes. As we enter what looks like being a very difficult economic period, with banks quasi-nationalised, business and government will have to reach a corporatist accommodation to maintain activity and production. Meanwhile, the national aspiration for home ownership will become increasingly difficult to achieve and even irrelevant for many.

If housing associations are to continue to deliver, government agencies, local authorities and associations themselves have to recognise their convergence of interest. Wasteful competition needs to be eliminated, and a recognition of and renaissance in mutual

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<sup>1</sup> Hills, *J Ends & Means: The Future Roles of Social Housing in England* (Department for Communities & Local Government/Economic & Social Research Council, February 2007)

interest among housing associations encouraged. If ever there was a time for not-for-profit agencies, government and its specialist agencies to be having a "single conversation", that time is now. The two new housing agencies can facilitate this, and their arrival may well be just in time, but how effective they can be will depend to what extent they address the problems of the future as opposed to those of the past.



## Partnerships for growth

The last decade has seen a determined push by Whitehall to create a more mixed economy of public service delivery. The policy objective, initiated by the Blair governments, has been to transform the country's £79 billion public service market by widening choice, lowering cost and radically improving service delivery. The third sector has been an important part in this reform process, and is often portrayed by politicians (from all parties) as the key driver of change and an important element in mixed provision of services.

However, the reality of growing the third sector has not always matched the rhetoric. It is still very much the private sector that competes head to head with public agencies and challenges the status quo. Nevertheless, the third sector has grown and become more prominent and more assertive. Indeed, despite the current economic downturn there could be great opportunities for social enterprise in particular to expand into new markets. Accessing that opportunity may, however, rely upon partnerships and alliances with private providers to achieve a critical mass in capacity and capability in order to address larger and more complex service requirements.

### State of the market

The last decade of unprecedented strong public spending growth (especially in health and education) and increased "contestability" has helped open up the public services sector, with private providers (some operating internationally) accounting for a much larger share of the market. Recent forecasts by the Department for Business, Enterprise & Regulatory Reform suggest that growth will continue at around 3% a year until 2011 – which is around 2% a year lower than in the past but still significant. The value of the public service sector could well rise to over 6% of GDP, making it one of the largest public service markets in the world.

Social enterprise has benefited from the growth of the public service market, both in helping to pioneer new services and through driving innovation in service delivery. Increased commissioning and direct support, provided by initiatives like Futurebuilders, the National Third Sector Commissioning programme and the Department of Health's Social Enterprise Investment Fund, have all worked to increase the sector's profile.

However, compared with private and state providers, social enterprise is still a relatively small (and often niche) player. Most social enterprises are small in scale, local and active in underserved or under-commissioned markets. In addition, there is still a lack of awareness and understanding of the business model and uncertainty as to what the term "social enterprise" means.

Despite this lack of awareness, there has been a noticeable increase in activity among social enterprises in key markets such as social housing, health and social care. Many of these organisations are hoping to expand and are gaining considerable support from both government and consumers. A recent YouGov poll (taken in November 2008), for example, showed that people want more social enterprises to play a much bigger role. When asked what we need more of to ensure a sustainable economy for the future, 42% of respondents chose social enterprises, ahead of government institutions, charities funded by donations and traditional business.

A similar poll of public service users in November 2007 showed that 64% would choose a "business that reinvests its profits for the benefit of the community" to run their local healthcare, rubbish and transport services as efficiently as possible, provided that the cost remained unchanged. Only 5% said they would choose a "traditional charity", whereas 11% would prefer a government institution and 9% a "business that generates profit for owners and shareholders". The implication therefore is that there is widespread public support for greater participation of social enterprise in the market, which suggests considerable scope for expansion.

Both central and local government have strengthened their relationships with social enterprise, and are actively looking for new ways to improve and expand their involvement in service provision. For example, in the health sector, the Darzi review introduced a new "staff right to request" to set up social enterprises to deliver services. Leaving aside the arguments about the degree to which social enterprises can deliver services in a distinctive way and are better suited (and better able) to deliver services in certain markets than a pure commercial enterprise or public agency, there is arguably a case to support the sector in the interests of creating a more dynamic mixed economy. In this regard, social enterprises that want to expand and want to move into new and emerging markets (like some of their private competitors) could be an attractive investment and partner.

### **Keeping up with the competition**

However, the social enterprise sector faces constraints on its growth and has yet to compete across the board with private service providers. The challenge seems partly related to the sector itself and its lack of capacity and funding (and perhaps culture or confidence), and partly related to the way that commissioning and procurement systems favour larger private and public providers.

In the future it is likely that the public service market will become more competitive. To meet this challenge many social enterprises will have to significantly improve the way

they invest for growth, how they manage their operations, and their governance structures. Voluntarism and a commitment to reinvesting profits for social good are, arguably, not enough to claim a relatively larger slice of the cake. Social enterprises (like their competitors) need to demonstrate that they can deliver services efficiently and effectively, that they are fit for purpose, and that they offer first-rate service to customers comparable to what private firms and public organisations (which often have a similar ethos and philosophy) can deliver.

Craig Dearden-Phillips, chief executive of disability service users' advocacy business Speaking Up and co-founder of several social businesses, captured the challenge well in his September 2008 article in *The Guardian*, when he stated that:

*... regardless of which sector you come from, being professional, well-managed and economically dependent on good delivery are preconditions of success. Mission-related benefits only kick in, and are only of any genuine value to anyone (including the user) when execution is right.<sup>1</sup>*

Many social enterprises agree with this view, but face a test to get the skills mix, management, business planning and governance right. There are many examples that demonstrate the ability of social enterprises to innovate and improve their professionalism and business acumen. The question is whether they can make the leap forward quickly enough and on a big enough scale to make the impact on the public services market that politicians and others would like.

### **Accelerating the development of the social enterprise sector**

There is of course no universal solution for accelerating the development of the social enterprise sector. Different social enterprises have different ambitions and needs – one may need to improve its trading operations, while another, such as a housing association, may benefit from a merger. Nevertheless, many of the larger social enterprises are capable of "gearing up" and delivering substantial growth and expansion of services beyond their current size and remit. The challenge in achieving significant expansion is often around securing timely access to the capability and capacity necessary to build a wider and deeper service offering.

The fact is that most social enterprises are similar to any other business. The differences are often in terms of governance (where social enterprises have members and trustees, rather than shareholders), in management and operations (where there is often a more

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<sup>1</sup> Craig Dearden-Phillips "Our Mission Isn't Everything" in *The Guardian*, 10 September 2008

participatory culture, a strong sense of "social mission" and volunteering), and in access to finance (where social enterprises often struggle with conventional funding). These differences, rightly or wrongly, can often be the make-or-break factor, especially in today's more competitive public service markets.

### **Social-private partnerships**

The range of business support and advice on offer to social enterprises is making a difference. Social entrepreneurs are being encouraged through the school curriculum and with start-up funds to stimulate good ideas. But lack of funding to continue to build capability and expand is an ever more serious constraint, and many social enterprises, like many commercial businesses, are finding it difficult to grow in the current trading conditions. We therefore have a situation where government and much of the population wish to see social enterprise play a greater role in service provision but the economy and the relative immaturity of the sector are acting as a restraint on growth.

Given the financial and economic climate, one way of achieving a breakthrough expansion in the sector could be to actively promote and broker much closer collaboration between social enterprise and the private sector. A marriage of the two models through joint ventures and new social-private partnerships (SPPs) would enable social enterprise to scale up operations and access additional strategic, human and financial capital, and hence to secure delivery contracts. The SPP hybrid business model would seek to harness the best of the pure commercial sector to underpin a substantial expansion of social enterprise activity, aimed at generating a major increase in the achievement of the nation's social and environmental goals.

This partnership approach (which mirrors the growing partnership working between government organisations and private firms) can offer social enterprises the capability, credibility and capacity necessary to win, manage and operate more government contracts but with a clear focus on the delivery of positive or improved social and environmental outcomes. Partnership approaches can offer the potential to access resources (people, systems and finance) and opportunities, for example in new locations and as part of larger commissions.

On the other side, it also offers private firms a competitive edge, with access to specialist knowledge and expertise, innovation, an ability to connect with clients and users who are hard to reach and serve, and evidence of a commitment to the community. This type of partnership working can create a competitive advantage, strengthen corporate social responsibility and enhance management performance, as well as generating a bigger social dividend for us all, responding to the public desire highlighted above to see profits

being reinvested in communities. In simple terms, an SPP may enable a social enterprise to increase its market share and by maximising surpluses it is then able to reinvest for greater social benefit.

This growth model predicated on partnerships with the private sector may not apply to all social enterprises; it is perhaps most appropriate for established enterprises seeking to make the next step in the evolution of their business.

PricewaterhouseCoopers is finding that there is a growing demand from the private sector to engage with, and to procure from or provide services to, social enterprise. There is also a desire among social enterprise leaders to work more closely with business. Filling that "knowledge and partnership gap" will take on more significance as commissioning evolves and private firms look to diversify into new joint ventures and consortiums. Improving business support for individual social enterprises is important, but there is also a need to provide advice and perhaps incentives to drive the creation of SPPs.

Andrea Westall's November 2007 study, *How Can Innovation in Social Enterprise Be Understood, Encouraged & Enabled?*, notes the trend towards partnership working, but comments that:

*... there needs to be a much greater sharing of good practice and failures, as well as the development of useful processes and toolkits, before successful groupings and networks can become more than one-off examples.<sup>2</sup>*

### **The credit crunch**

The government's strategy for growing the third sector is praiseworthy, not least because it recognises the need to invest long-term in developing the sector's infrastructure and is actively promoting the social enterprise business model in a way that was unheard of a decade or two ago.

However, the credit crunch and pressure on public spending will make it hard to implement the government's Social Enterprise Action Plan in full. Many of the smaller (grant-dependent) social enterprises are going to find life difficult in the short term. Partnerships with the private sector may help many social enterprises to change and adapt to the new economic circumstances by drawing on previously unavailable knowledge, resources and new business opportunities.

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<sup>2</sup> Westall, A *How Can Innovation in Social Enterprise Be Understood, Encouraged & Enabled?* (Office of the Third Sector, November 2007)

Scaling up social enterprises so they can compete effectively for a greater share of the public service market will demand strong government support and perhaps tax and other incentives to promote joint ventures and SPPs.

In addition, there is clearly a need to increase the range and type of finance available to social enterprises and SPPs, perhaps including the creation of a new social investment bank and other new conduits between the transitional finance community and the social investment sector. A combination of access to new finance and additional capacity and capability would provide social enterprises with a solid platform on which to build an expanded and sustainable presence as key deliverers of goods and services and greatly increased social and other benefits.

### **Conclusion**

It is important not to exaggerate or confuse the role of the third sector. Much of the third sector will remain dependent on giving. Only 2% of total public spending is on third-sector delivery, and a high proportion of social enterprises are micro-businesses. However, the sector receives widespread support and is popular with government and service users. Moreover, if the goal is to create a mixed economy of providers then there will need to be more social enterprise involvement, especially in areas where private providers or public providers are dominant.

The economic downturn will act as a brake on the rate of growth and constrict access to conventional funding, but it may also open up new opportunities as the government seeks to fast-track spending in key areas such as health, education, housing and transport while also delivering on social outcomes, such as limiting worklessness and inequality. Advancement in outcome-based commissioning (whereby social or local added value, like volunteers or mentoring, are factored into the procurement process) and the introduction of full cost recovery should be real plusses.

A faster scaling up in the social enterprise sector will also require more collaboration and partnerships with the private sector. Partnerships and SPPs are not the only route to growth and will not be suited to every social enterprise. Some, for example, will feel their independence compromised. Others may see it as too risky and fear being junior partners, pushed out once work is won and the contract secured.

However, as the model and markets evolve there is a growing consensus that the social enterprise and private sectors have many common aims and objectives and hence shared interests. Using profit to deliver social benefits is a concept that the private sector has already embraced through its considerable investment in corporate social responsibility

programmes. Maximising profit should enable social enterprise to deliver a higher level of "mission benefits". Surely, therefore, the time is ripe to recognise the coming together of the two, related sectors, and to adopt a more assertive approach to partnerships between social enterprises and private firms in the provision of public services.

Working more together, sharing experience and resources, may indeed become a necessary means of achieving the traditional aims of both sectors while better harnessing public spending for the wider public good.

## Chapter 4

# Measuring the value of social and community impact

Professor Fergus Lyon of the Centre for Enterprise & Economic Development Research at Middlesex University

## Measuring the value of social and community impact

The roles of social enterprises are shifting, with a period of unprecedented change for the sector. While social enterprises were originally seen primarily as a way of meeting social needs for local communities that had been let down by both the market and the state, they are now seen as playing a greater role in a competitive market both within the private sector and within the markets for public services. It is the latter set of activities that is of particular interest here as social enterprises and other parts of the third sector increasingly become a delivery agent for the state, working in competition with other parts of the private, public and third sectors.

However, little is known about the impact of the third sector with regard to delivery of public services, and there is an urgent need to measure the social and community benefit. This needs to go beyond the boosterist analyses of successful case studies and include more critical appraisals of impacts (positive and negative), comparisons of social enterprises with other forms of public service delivery, and the dissemination of this information. This requires investment in research and auditing and a degree of bravery within the third sector. Without this, there is a risk of losing the chance to learn from successes or failures, repeating mistakes and damaging the reputation of the sector in the long term.

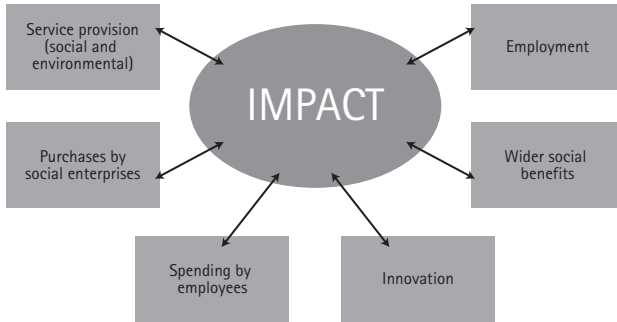
This essay will examine the different approaches to measurement, distinguishing between the need for individual organisations to measure their impact and the need for larger-scale studies that examine the impact of social enterprises more generally, providing the evidence base for policy makers. Looking forward, the opportunities and challenges are also presented. The ideas presented relate to those organisations with significant trading activity, which includes many charities, co-operatives and other parts of the third sector. Indeed, as third-sector organisations become more involved in contracts from the public sector, the distinction between social enterprises and other parts of the third sector becomes more difficult to make. This essay returns to some of these issues later. Given the lack of clarity in current definitions, future research on social enterprise is predicated on having an agreed definition of social enterprise.

### What to measure

Whether measuring the impact of a single organisation or the wider contribution of social enterprises generally, there is debate over the types of indicators of impact that can be used. Figure 1 identifies the range of indicators that have been used in different studies and for different purposes. These can be divided between the direct social and environmental impacts in terms of services provided and jobs created and the indirect benefits that are related to the spending and activities of the social enterprises. However, in many

cases the provision of services cannot be distinguished from their wider social objectives, such as the employment of people from disadvantaged groups in the delivery of services.

**Figure 1: Framework for assessing impacts of social enterprises on economies and communities**



The economic multiplier effect on particular localities can be measured by examining the extent of local purchasing by the organisation and its employers. Third-sector organisations may be able to increase their impact through actively using their procurement and employment spend to achieve local impacts. In addition, there are also wider social benefits in terms of providing jobs to disadvantaged groups, building community cohesion, strengthening links within and between communities, and the added value of voluntary activity.

There may be further impacts through advocacy and campaigning that influence public- and private-sector activity. Empowerment of those involved in social enterprises is presented as an under-studied aspect of social enterprise activity, but one that distinguishes the sector from more traditional views of charities because of its emphasis on self-help and entrepreneurial behaviour.<sup>1</sup> In this way social enterprises and other third-sector organisations can be seen to have a social multiplier effect as they encourage those involved to become involved in other activities with social and community benefits.

Social enterprises are seen as a source of innovation in the delivery of public services and as creators of new service opportunities. Indeed, it is this claim regarding the development of new approaches to meeting needs that has been central to the growing interest in social enterprises. There are numerous case studies of pioneering organisations that may

<sup>1</sup> Westall, A and Chalkley, D *Social Enterprise Futures* (Smith Institute, 2007)

find new ways of meeting needs and develop new services that had not been identified in the past.

This degree of creativity allows social enterprises to have an impact on immediate beneficiaries as well as through raising standards and developing models that are taken up elsewhere. However, this hypothesis has not been fully tested, with little research evaluating the impact of social enterprises compared with charities that are not trading and with bodies in the public sector and private sector. The public-sector procurement process has a central role in both encouraging this innovation and scaling up the impact of social enterprises through including innovative approaches in the specification for procurement of other services.

Measurement of impact should also consider the effect of social enterprise activity on the impact of other providers. Three key aspects need to be considered – raising standards, additionality and displacement:

- Social enterprises can *raise the standards* of service provision and encourage procurers to make other providers follow suit.
- *Additionality* refers to the extent to which social enterprises are providing services that would not be there otherwise. There is a risk that social enterprises will deliver services that are already being provided by other public-, private- or third-sector organisations. In the short term this may be considered part of a competitive marketplace with "winners" and "losers", but in the long run there is a risk of wasting public resources.
- *Displacement* refers to the effect on other organisations (including other third-sector organisations) that might be displaced by the growth of a social enterprise. This may be considered positive in terms of the "productive churn" bringing in new ideas, although it may have negative effects on the employees and beneficiaries of services delivered by other providers.

### **Measuring performance at an organisational scale**

Measuring the performance and impact of individual social enterprises has been presented as a key challenge for the sector, with much attention given to the development of tools such as social audits and social-return-on-investment (SROI) models. This is considered of growing importance as social enterprises recognise the need to demonstrate their impact and benchmark their activities.

The type of information required varies, but the challenge is finding ways to present wider social benefits in a way that is easily understandable. There are also challenges in having a range of different stakeholders all requiring slightly different information. For example, a community transport social enterprise may want to have information for potential investors, current investors, commissioners of subsidised public services in local authorities, employees, volunteers and the users who pay for the service.

There are a range of different approaches to measuring impacts and a recognised need to have greater consistency. The social-return-on-investment methodologies present particular opportunities through putting financial values on the wider social benefits in a common format, allowing comparisons to be made between organisations.<sup>2</sup> This may open opportunities for social enterprises in terms of accessing finance (through providing evidence to philanthropic investors) and delivering public service contracts (through providing evidence for commissioners of social benefits).

While this presents a powerful tool for analysing impacts, there are concerns over its ability to accurately quantify softer impacts such as empowerment or community cohesion. Some indicators of impact may not be so easily quantifiable, and there is a risk that organisations will prioritise activities related to the quantifiable indicators at the expense of their social values and mission.

### **Measuring at a macro scale**

While individual organisations want to measure their impact, there is also a need for more macro studies that examine the social and community impacts of social enterprises and provide an evidence base for policy makers. There is still a lack of evidence concerning the number of social enterprises and the size of the sector, with even less information on the contribution of specific parts of the social enterprise sector.

This evidence base is of vital importance for justifying the extent of public-sector investment at present, measuring its changing scale and scope to demonstrate the impact of public-sector support. Social enterprise is not a panacea, and without detailed evidence on how it performs in comparison with private- and public-sector organisations there is a danger of it being overhyped now and discarded as a fad in the future.

Existing mapping exercises have suffered from confusion over the interpretation of the definition of social enterprises. The definition currently used by the UK government is taken from the 2002 document *Social Enterprise: A Strategy for Success*.<sup>3</sup>

<sup>2</sup> Lawlor, E et al *Measuring Value: A Guide to Social Return on Investment* (New Economic Foundation, 2008)

<sup>3</sup> Social Enterprise Unit *Social Enterprise: A Strategy for Success* (Department for Trade & Industry, 2002)

*A social enterprise is a business with primarily social objectives, whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profits for shareholders.*

Documents defining social enterprise avoid using clear criteria but rather use a set of organisational forms and activities as a way of defining the concept.<sup>4</sup> There are also different perspectives on social enterprise coming from the rest of Europe and North America,<sup>5</sup> with the UK social enterprise movement drawing on a range of different traditions such as not-for-profit, third-sector, co-operatives, and so on, resulting in diversity but also confusion when trying to define and measure.

While a loose definition is inclusive and has enabled the concept of social enterprise to be embraced by a range of organisational types, the interpretation of the definition varies particularly with regard to how people define social aims and trading income. This variation between studies makes comparisons and the development of larger combined datasets problematic.

Particular challenges include the extent to which public service contracts are considered trading income and the extent to which they can be distinguished from grants. As public services delivered by the third sector have moved from grants to contracts, the wide range of charities involved in public service delivery have shifted from a grants-based system to a trading relationship with the state. Although these organisations may not define themselves as social enterprises, the National Council for Voluntary Organisations refers to this as social enterprise activity.<sup>6</sup> Questions still remain over whether this is a change in language or a more radical shift in the operational behaviour of many third-sector organisations, with a greater emphasis on enterprise and delivering services that are based on contracts awarded through a competitive tendering process.

There are also debates about the extent to which the activities of some types of organisations can be classified as having social objectives. For example, there are grey areas regarding whether to include or exclude organisations such as sport clubs, faith-based organisations and those in the cultural industries. The decision on what is included or excluded is based on how each mapping study interprets the loose definition and is based on personal preferences and political expediency.<sup>7</sup> This demonstrates the political nature

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4 Social Enterprise Unit *Social Enterprise Action Plan* (Department for Trade & Industry, 2006)

5 Westall and Chalkley, op cit

6 National Council for Voluntary Organisations *The UK Civil Society Almanac 2008* (2008)

7 Lyon, F and Sepulveda, I *Mapping Social Enterprises: Past Approaches, Challenges & Future Directions*, paper prepared for the Social Enterprise Research Conference 2008 at London South Bank University (2008)

of measuring social and community contributions, with political decisions having to be made with respect to what types of organisations are included and what indicators are used. While this may be hard to avoid, greater transparency of what is and what is not being measured is required.

### **Future directions and challenges**

As the social enterprise movement enters a new stage of development and continues to have considerable political support, the need for measuring impacts at both the micro and macro scale become ever more important. There is investment in the development of social-return-on-investment models, studies in particular sectors of the impact of social enterprises compared with private and public provision (for example in the health sector<sup>8</sup>) and also data collected for the development and evaluation of regional social enterprise support programmes.

In addition, there are a wide range of smaller studies by social enterprises themselves, social enterprise infrastructure bodies and academics, combined with a range of dissemination channels such as the *Social Enterprise Journal* and the Social Enterprise Research Conference. Social enterprise is also a central theme of the Third Sector Research Centre, which will be providing a rigorous evidence base to complement the other forms of research. This will bring together a range of datasets, both current and those being developed, to enable temporal comparisons to be made of the changing impact and scope of social enterprise. More qualitative studies will also be used to assess other factors that are not included in existing databases. The development of common forms of social accounting and social-return-on-investment models will also present opportunities for future research.

The changing political and economic context will present challenges for the measurement of social and community impacts. The way that social enterprises interact with the public sector may change, with the personalisation agenda allowing users of services to have vouchers and choose from whom to "buy" public services. This is already happening in social care and pre-school education, for example.

The economic climate and the period of recession may have a considerable impact on social enterprises, not only in terms of reducing their income from the public but also in their growing reliance on public-sector contracts that will insulate them from the

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<sup>8</sup> Allen, P et al *Social Enterprises in the NHS in England: The Emerging Role of New Providers Et their Potential Impact on Quality Et Innovation*, paper presented at Voluntary Sector Studies Network/National Council for Voluntary Organisations conference Researching the Voluntary Sector at the University of Warwick on 9-11 September 2008 (2008)

difficulties other enterprises may be facing. The decline in other parts of the economy may result in greater competition for public service contracts and pressure to reduce prices, which is likely to have an impact on the sustainability of third-sector organisations. Measuring the impact of social enterprises through the economic cycle may answer some of these questions.

As social enterprises become more involved in the delivery of public services, there is a need to assess both the positive and potential negative effects of this relationship. There is a need for more evidence on how social enterprises and other third-sector organisations innovate, the extent of this innovation and how procurement relationships encourage or stifle this. There is evidence that social enterprise may be innovating when delivering on a small scale, but there are questions concerning whether they can scale up these activities with larger public-sector contracts.<sup>9</sup>

Involvement in the procurement process may also inhibit innovation as risk-averse commissioners force social enterprises to mirror conventional private- or public-sector providers, lose their individual perspectives and develop organisational forms that fit the public-sector procurement system.<sup>10,11</sup> The impact on social enterprises from their involvement in public procurement raises further questions in terms of their independence, the ability to play an advocacy role, and the dangers of "biting the hand that feeds you".

Through all these changes, the need to measure the social and community impact will continue. However, the growing role of the public sector in procuring from social enterprises may result in social enterprises becoming overly dependent on the public sector, and putting themselves at risk from changing government priorities. There are further risks from having expectations running too high and the lack of evidence of the impact of different kinds of social enterprise and their activity in different sectors. Future activity on measuring impact needs to be supported to ensure that individual organisations can demonstrate their impact to a wide range of stakeholders, and that policy makers can have the evidence base they require.

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9 Amin, A, Cameron, A and Hudson, R *Placing the Social Economy* (Routledge, 2002)

10 Peattie, K and Morely, A *Social Enterprises: Diversity & Dynamics, Contexts & Contributions* (Social Enterprise Coalition/Economic & Social Research Council, 2008)

11 Nicholls, A and Cho, A "Social Entrepreneurship: The Structuration of a Field" in Nichols, A (ed) *Social Entrepreneurship: New Models of Sustainable Social Change* (Oxford University Press, 2006)

## Chapter 5

# European perspectives on social enterprise

Roger Spear, Chair of the Co-operatives Research Unit in the Communication and Systems Department at the Open University

## European perspectives on social enterprise

Social enterprises are organisations that have enterprise characteristics (trading in the market or contracting, employing people), but also have social goals and social process (participation, user involvement, community benefit).

It has always been possible to square the circle and make money out of doing good, but the present wave of social enterprise can be traced to developments in Italy in the early 1980s and 1990s. In 1990 a new journal was launched called *Impresa Sociali* (social enterprise), which was particularly concerned with the Italian social co-operatives, which now number more than 7,300, both for welfare services and for work integration. Impressive developments have also been seen in Finland, where a few thousand labour co-operatives have been developed to help the unemployed, and in Sweden, where a few thousand nursery co-ops (for childcare) have been formed. Many of these initiatives combine associative/non-profit and co-operative dimensions within the same structure.

Some common themes underlie these new social enterprises: the growth of the enterprise culture, market dynamics in public service provision, welfare reform, fair trade, and changes to philanthropy – from *transactional* (number and variety of grants) to *investment* and *venture models* using engaged, interventionist, strategic approaches.<sup>1</sup>

But as the EMES research network ([www.emes.net](http://www.emes.net)) argues, there are two major tendencies – the development of new social enterprise and the reshaping of established third-sector organisations in reconfigured market-like contexts.<sup>2</sup>

The other interesting feature of this development is that, although there are a multitude of new initiatives that conceptually fit under the label "social enterprise" (meaning entrepreneurial organisations trading for a social purpose), relatively few European countries have bought the social enterprise "brand" in the wholehearted way that the UK government and various UK third-sector players have.

This chapter draws on international experience and literature to explore the issues underlying effective social enterprise delivery of public services.

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1 Nicholls, A (ed) *Social Entrepreneurship: New Models of Sustainable Social Change* (Oxford University Press, 2006)  
2 See: Borzaga, C and Defourny, J *The Emergence of Social Enterprise in Europe* (Routledge, 2001); Nyssens, M *Social Enterprise at the Crossroads of Market, Public & Civil Society* (Routledge, 2006); work of the EMES research network ([www.emes.net](http://www.emes.net))

## Defining social enterprise and the third sector

The "third sector" is a term used differently in different contexts and countries. Sometimes it is defined as comprising just the non-profit or voluntary sector, but here we use the Office of the Third Sector definition – voluntary and community groups, social enterprises, charities, co-operatives and mutuals – which is virtually synonymous with the term "social economy" as understood in Europe in its institutional forms: co-ops, mutuals, associations or voluntary organisations, and foundations (CMAF). One approach to social enterprise is to consider it as the trading part of the third sector or social economy in Europe.

## Defining social enterprise

Within Europe, the EMES definition<sup>3</sup> has been very influential. It argues that social enterprises are third-sector organisations:

- with enterprise characteristics (trading in the market or contracting, employing people, and generating income);
- combined with social goals and processes (participation, user involvement and community benefit).

## The UK approach

The EMES criteria help specify an ideal type, but other approaches have adopted more straightforward ways of operationalising a definition of social enterprise. The UK Office of the Third Sector defines social enterprises as:

*... businesses with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or community, rather than being driven by the need to maximise profit for shareholders and owners.*

The National Survey of Third Sector Organisations, conducted in autumn 2008<sup>4</sup> by a

<sup>3</sup> The EMES criteria comprise economic and social dimensions of enterprises.

Four factors have been applied to define the economic and entrepreneurial nature of the initiatives:

- a continuous activity producing goods and/or selling services;
- a high degree of autonomy (versus dependency);
- a significant level of economic risk; and
- a minimum amount of paid work.

Five factors have been selected for the social dimensions of the initiatives:

- an initiative launched by a group of citizens;
- a decision-making power not based on capital ownership;
- a participatory nature, which involves the persons affected by the activity;
- limited profit distribution; and
- an explicit aim to benefit the community.

<sup>4</sup> See: [http://www.cabinetoffice.gov.uk/third\\_sector/Research\\_and\\_statistics/third\\_sector\\_research/measuring/research\\_paper.aspx](http://www.cabinetoffice.gov.uk/third_sector/Research_and_statistics/third_sector_research/measuring/research_paper.aspx)

consortium (led by BMG Research, and including Guidestar UK, the National Council for Voluntary Organisations and Inlogov) adopts a sample frame of community interest companies, companies limited by guarantee, and industrial and provident societies (but not including social enterprise using companies limited by share structures).

It uses the following criteria for identifying social enterprise:

- third-sector organisations (defined by the sample frame);
- earned income from contracts or from trading accounting for 50% or more of total income;
- a surplus or profit being used to further the social or environmental goals, by reinvesting it in the social enterprise, in another third-sector organisation or in the community; and
- possible use of a self-identification test, by asking respondents if they would call their organisation a social enterprise according to the following description: "Social enterprises are businesses with primarily social objectives whose surpluses are largely reinvested for that purpose in the business or community, rather than being driven by the need to maximise profit for shareholders and owners."

One further definitional issue requires discussion: the multi-organisational character of some social enterprise. Both in the UK and elsewhere, it is possible to find interlinked legal structures, the most common of which is a charity with a wholly owned subsidiary. For example, a very well-known Belgian social enterprise, Terre, combines a number of inter-linked structures for recycling, work integration, and third-world development. Kim Alter<sup>5</sup> develops a typology relevant to such organisations and their entrepreneurial activity. She differentiates between socially entrepreneurial activity that is – in relation to the overall organisation – mission-centred, mission-related, or mission-unrelated economic activity.

At another level, group structures are common in some countries, particularly in Italy where the "consorzi" (federations) are a typical way for SMEs to develop mutual support activities. Many social co-ops are organised into local consorzi that supply management services to the 10 or so member co-ops.

### **Trends in the development of social enterprise**

There are many trends and challenges for social enterprise, and the changing European policy context is one very important influence. Thus the EU agendas around social cohesion and social exclusion have helped shape the new wave of social economy initiatives in the area of work integration and community regeneration, particularly work

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<sup>5</sup> Alter, SK "Social Enterprise Models and Their Mission and Money Relationships" in Nicholls, A (ed) *Social Entrepreneurship: New Models of Sustainable Social Change* (Oxford University Press, 2006)

integration social enterprise like many of the social co-operatives in Italy. Recent work by the EMES network<sup>6</sup> has shown a broadening of the fields of activity.

The well-developed field of work integration social enterprise (WISE<sup>7</sup>) has become increasingly recognised as an area where social enterprises are effective. And social enterprises are also gaining recognition in proximity (community) services, and health/social services; this has broadened further in recent Italian legislation for social enterprise to "social utility", which includes environmental or ecological activities, culture, heritage, social tourism, research and education.

### Legislation for social enterprise

There has been quite a high level of innovation in institutional forms, with increasing numbers of new legal structures for social enterprise; many bring together co-operative entrepreneurial aspects and non-profit social aspects, thus better fitting them for welfare services and labour market services. Table 1 summarises the legislation for social enterprise across a variety of European countries, listing the type of structure, date of legislation, type of enterprise – whether providing social services (A) or work integration (B) – and, where known, the numbers of such enterprises formed.

**Table 1: Legislation for social enterprise**

Country	Type of structure	Date formed	Type of enterprise*	Number
Italy	Social co-operative	1991	A+B	7,000+
Portugal	Social solidarity co-operative	1996/98	B	500+
Spain	Social initiative co-operative	1999	A+B	
Spain	Work integration enterprise	2007		
Greece	Limited liability social co-operative	1999	B (mental health)	
France	Collective interest co-operative society	2002	A	94
Latvia	Social enterprises law	2004	All types	
Lithuania	Social enterprise	2004		
Poland	Social co-operative	2006	B	
Belgium	Social finality enterprise	1996	All types	400
Finland	Social enterprise	2004	B	69
UK	Community interest company	2005	All types	2,000+
Italy	Social enterprise	2005/06	All types	

\* A = providing social services; B = work integration

6 Defourny, J and Nyssens, M *Social Enterprise in Europe: Recent Trends Et Developments*, EMES working paper number 08/01 (2008) ([www.emes.net](http://www.emes.net))

7 There are four main modes of integration in European WISE: temporary or permanent jobs linked to temporary or permanent subsidies.

Social enterprise legislation is also planned or in place outside Europe, for example in Japan and South America, as well as in South Korea, where 154 type B social enterprises came into existence after a law was passed in July 2007.

This blossoming of new legislation indicates an increased recognition of social enterprise as a brand. The legislation often embodies hybrid legal forms, blurring boundaries between traditional social economy structures (co-ops and non-profit organisations), for example, with regard to non-profit distribution, market operation, and multi-stakeholder boards.

However, given the very different numbers of social enterprises created under each legal form (where data is available), it is clear that there is varying effectiveness of different legislations. There are only two clearly popular structures: those in Italy and the UK, as well as possibly that in Portugal. Many new social enterprises are formed instead under existing social economy legislation, preferring to use the most flexible legal form for the social economy – according to national preferences: for example, in Belgium the non-profit body (*association sans but lucrative* or ASBL), and in Sweden the co-operative.

Several structures are overly restrictive or do not provide sufficient advantage compared with existing social economy legislation – this appears to be the case in Greece, France, Finland and Sweden (where the "firm with limited profit distribution" structure established in 2006 has attracted little interest). For example, the Greek legislation is specifically for the social and work integration of people suffering mental health problems, and requires stakeholders from patients/users, staff, and representatives from private organisations. Similar multi-stakeholder specifications are required in the French legislation. Although not mandatory in the other legal forms, there is a general tendency towards multi-stakeholder structures: in the EMES comparative study of 160 work integration social enterprises in 11 European countries, 58% were found to have such boards.

Some structures are quite prescriptive about the proportion of disadvantaged who should be members of work integration social enterprise: 80% in Poland, 40% in Lithuania, 35% in Greece, 30% in Finland, and 30% in Italian social co-ops (under type B). In some countries there is an emphasis on social reporting, such as the UK's required annual report on community interest activities, the social balance sheet for Italian social enterprise, and similar requirements for Portuguese social solidarity co-ops with more than 100 workers.

Some social enterprise structures are non-profit (non-distribution of surplus), such as in Portugal, Spain, Poland, Latvia and Italy, while most others have restrictions on the distribution of surplus. Several have asset locks, and several encourage volunteer involvement (which may include family members).

Some legal structures are strongly linked to policy, which may only be available to specific legal structures – as is the case for several WISE legal structures/programmes such as the Greek case. Often legislation helps establish a brand and identity for social enterprise, but it is not essential for institutional innovation. For example, many Italian social co-ops were formed throughout the 1980s before the legislation for social co-ops in 1991. And, as noted earlier, social enterprise activity is also increasing within existing non-profits as the market reshapes welfare service relationships.

### **Institutions and support structures**

The EMES network has argued<sup>8</sup> that institutional development is an important parallel track for effective social enterprise – thus in the case of WISE, over a period of time pioneering initiatives were linked with specific public programmes, which co-evolved to establish an institutional niche with new legal forms and structured public policy frameworks. Institutionalisation may also involve some kind of support structure, such as the *consorzi* (local/national federations) that have been a key feature of social co-ops in Italy, providing managerial services for their members to secure economies of scale.

### **Contracting for public and welfare services**

In many countries, traditional partnership arrangements between the state and the social economy for welfare and public service provision are reconfiguring through more market-like arrangements favouring social enterprise. Similarly, there have been general trends from grants to contract funding. There is also a trend towards more mixed economies where public, private and social enterprise players compete. Contracting may be either in quasi-markets via the state or in consumer/user markets via voucher systems. This raises the issues: What is the added value of social enterprise? And how can it be best supported?

### **The added value of social enterprise**

As noted above, social enterprises may operate more flexibly than the public sector, and they have a trust advantage over for-profits.<sup>9</sup> They also claim to provide various externalities that add social value to market contracts. These added values are due to their typical operating characteristics, such as: participative structures giving user and staff involvement (as well as supporting active citizenship), multi-stakeholder structures providing more social cohesion, and proximity of services (locally based close to users and workers).

There is considerable European debate among social economy providers and policy makers about these issues, since health and welfare services are increasingly being

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<sup>8</sup> Nyssens, op cit (2006)

<sup>9</sup> Spear, R "The Co-operative Advantage" in *Annals of Public & Co-operative Economics* (Blackwells, 2000)

commissioned through market mechanisms. There is concern that the rules on competition, state aid and the internal market, on the one hand, are in tension with concepts of public service, general interest and social cohesion on the other; and that certain values in welfare/health services need to be preserved: values of equality, solidarity, respect for human dignity, and the principles of accessibility, universal service, continuity, proximity to service users (user involvement). It is argued that it should be possible to promote positive synergies between the economic and social aspects, within the EU framework of rules on competition, state aid and the internal market – and that the contribution of the social economy should be better acknowledged in public procurement processes and state aid procedures.<sup>10</sup>

This situation is exacerbated by policy trends influenced by Gershon<sup>11</sup> and Freud,<sup>12</sup> which give support to a growing tendency for contracts to be packaged into larger units to achieve economies of scale. Consequently, there is the issue of how smaller providers (like social enterprises) can manage the transaction costs of large contract processes or procedures, and access to public procurement markets.

But public service markets are very different – while most are *quasi-markets* where the state purchases on behalf of citizen-users, there is a growing trend towards *consumer markets* (via vouchers and personal accounts). International experience reveals different approaches to how social enterprise (and the social economy) can be positioned in these different markets:

### Quasi-markets

**Relationship marketing:** Procurement (by the state) of services varies considerably. Earlier adversarial, conflict-based “hard” or tightly specified contracting models have sometimes given way to “soft” relational contracting models that allow for more flexibility because a more trusting relationship has been developed. However, this may be easy only for smaller contracts, since larger contracts are subject to the full EU procurement regime, which is quite complex, and EU Treaty free-market rules apply to most contracts (fair, open, transparent and non-discriminatory competition). In addition, there may be a tendency for public authorities not to pay the full cost<sup>13</sup> of services provided by non-profits, and to assume that voluntary work and donations can compensate.

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10 See: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2007-0070+0+DOC+XML+V0//EN&language=EN>

11 Gershon, P *Releasing Resources to the Front Line: Independent Review of Public Sector Efficiency* (HMSO, 2004)

12 Freud, D *Reducing Dependency, Increasing Opportunity: Options for the Future of Welfare to Work*, independent report to the Department for Work & Pensions (HMSO, 2006)

13 “12% of charities delivering public services reported that they obtain full cost recovery in all cases; while 43% indicated that they do not obtain full cost recovery for any of the services they deliver” – UK Charity Commission report (2006)

Also, special relationships are always subject to challenge, thus the solution may be to specify more clearly the social outcomes delivered by social enterprise. For example, the Italian social co-ops in the early 1990s had a preferential procurement arrangement with municipalities. This was contested as a breach of European Commission competition law. However, they subsequently developed an approach consistent with EC procurement law whereby municipalities specify tenders for contracts from organisations to meet specific social requirements to employ a minimum number of disadvantaged people – and social co-operatives have continued to demonstrate their effectiveness in this respect.

*Protected niches via social clauses and registration schemes:* It is possible under the EU framework<sup>14</sup> to include social requirements ("social clauses") in contracts and in the whole procurement life cycle (provided the social value/outcome is properly specified); the proviso being that the *contracting authorities be predisposed* to do so – the main barriers are their motivation and any additional cost. In this way public-sector organisations can address social issues in their supply chains. None the less, there is pressure on costs, and although "best value" (which can include socially valued outcomes) is often the official criterion, it is easy to see that contracts might be awarded by lowest price. Registration schemes are also used where a public policy is linked to a specific legal form – for example, the Walloon region in Belgium only supports work integration organisations that are registered as a "société à finalité sociale" (social enterprise structure).

*Fiscal measures:* In many countries, members of the CMAF family of social enterprise (co-operatives, mutual organisations, associations and foundations) enjoy some degree of tax advantage (especially non-profits or charities), and in a few cases this position has been consolidated in recent years. For example, Portugal, Italy and Spain have been able to maintain their special tax regimes. But the trend is for these advantages to be eroded. And there have been legal complaints from private competitors against co-operatives' legal and fiscal frameworks in Italy, Spain and France. These private competitors demand that certain of these legal/fiscal provisions be considered as state aid and against European competition law.

### Consumer markets

Consumer purchasing of public services through voucher systems (for schools, healthcare, food stamps and the like) are generating considerable interest; they function through users purchasing services directly rather than through the quasi-market of state procurement. A recent Belgian voucher system has created a mixed economy market for work

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14 Commission of the European Communities *Interpretative Communication of the Commission on the Community Law Applicable to Public Procurement & the Possibilities for Integrating Social Considerations into Public Procurement* (2001)

integration and proximity services (with competitors from the public and private sectors as well as the social economy); it proved effective in eliminating the black economy (the informal economy) and creating 80,000 new jobs in four years (with subsidies both to service users and providers). But only 10% of the vouchers were spent in the social economy, and there were issues of "creaming" by private-sector providers. This may be compared with a voucher system for similar services in Quebec, which requires that all suppliers are social economy providers.

Operating in consumer markets requires a different approach from that of quasi-markets. Fairtrade provides a useful model, where brands, marketing campaigns, and marques become more important. And the development of *consorzi* social franchises offers the possibility of economies of scale. For example, the social franchise Age d'Or Services (a *coopérative à finalité sociale*) has 463 franchisees in Belgium, and has become one of the main networks for the delivery of proximity services and transport for older people and those with low mobility.

### Multi-quasi-markets

Since social enterprise organisations often provide multiple social outcomes, they provide transversal benefits to other departmental budget areas and so have to negotiate multiple contracts.

### Establishing the value of the social economy

There is considerable interest in developing methods for measuring the values, outputs and outcomes of social enterprise, such as social accounting, social audit, and social return on investment. This is partly because of the need to be more specific about added social value for public contracts, both quasi and consumer. But it is also because of the need to be more explicit in policy and evaluation studies about the added value of the social economy.<sup>15</sup>

### Isomorphism

Isomorphic pressures come from education (MBA courses for mainstream business), fluid managerial labour markets, and mimetic activity – copying what is seen to work in mainstream business. Thus, over time a strong value-based social enterprise will lose its values, or keep its values and fail. This can be seen in the degeneration of traditional social economy organisations such as building societies (mutuals), which subsequently allow

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<sup>15</sup> See: Bouchard, M-J *Evaluation of the Social Economy: An International Comparison* (Peter Lang, forthcoming); and Mook, L, Quarter, J and Richmond, BJ *What Counts: Social Accounting for Nonprofits & Co-operatives* (second edition) (Sigel Publishing, 2007)

demutualisation – conversion into conventional shareholding companies. There is enough evidence to suggest that this process is not inevitable – witness the UK Co-operative Bank's ethical services, and the Mondragon co-operatives in northern Spain. But the processes that support social values need to be continually sustained, by maintaining links with social movements, sustaining and using social capital.<sup>16</sup>

### **Conclusion**

Different historical institutional patterns of state, family, and religious development have contributed to a varied picture of social economy development in Europe, which in turn has laid the foundations for social enterprise in each country. Despite this variety, the general trend is for a growing social enterprise sector, with some countries, such as Italy, providing inspirational models. The UK is distinctive both in the extent of its development of public service markets and in the level of policy support for the social enterprise "brand".

New European trends in legislation indicate growing interest in social enterprise for work integration, welfare services and wider social utility, but this represents only the tip of the iceberg as non-profits are being reshaped into conducting more social enterprise-like activity in new market dynamics for welfare and public services. Across Europe there are different approaches to facilitate the effectiveness of social enterprise, with important differences between quasi and consumer markets. There are many challenges but considerable potential success in meeting such challenges.

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## Chapter 6

# Social entrepreneurs and public service delivery

Alastair Wilson, Chief Executive of the School for Social Entrepreneurs

## Social entrepreneurs and public service delivery

Our experience over the last decade of work at the School for Social Entrepreneurs<sup>1</sup> is that social entrepreneurs see things differently: the community is their market; an unmet need their business opportunity; a new organisation their means of making change. Their primary mission is a social one, and they have a clear vision of how to improve things for the better in their community, locality, region or nation. Having considered what activities they will carry out, how they will fund this work, and what governance they think appropriate, social entrepreneurs then choose the legal structure most fit to helping them achieve their goals. A combination of idealism and pragmatism, of passion and purpose, and of resourcefulness and persistence sees them create positive social change in manifold different ways.

Social entrepreneurs are self-appointed, sometimes viewed as outsiders or "mavericks", and challenge the status quo, no matter what scale they are operating at. And while they have existed for centuries, they are growing in number as wider societal and political trends have created conditions for the movement to grow: more people seeking meaning and purpose from their work; the wish for work-life balance and the associated wish for autonomy and flexibility in the workplace; the push for business to operate more ethically and sustainably; the rise of the environmental movement; disillusionment with the political system's ability to create change; and the merging of the traditional "right" (individualism, entrepreneurship, economic wealth) with the traditional "left" (collectivity, welfare, social justice) in the political sphere. Social entrepreneurs have played a role in our past, and thrive in our present, but the future looks brighter than ever.

Why is all of this relevant? Because such an overview helps to raise some of the key questions in any discussion of social entrepreneurs and public service delivery:

- Firstly, social entrepreneurs are motivated by a social mission, which is to address an unmet need that they have identified as not being met by any public service: can entrepreneurship be commissioned, or innovation procured?
- Secondly, social entrepreneurs tend to be unorthodox, stubborn, risk-taking and challenging the currently held view: how can they work with commissioners?
- Thirdly, social entrepreneurs are self-appointed and have little capacity in the early

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<sup>1</sup> The School for Social Entrepreneurs has run learning and support programmes for social entrepreneurs since 1998 across the UK, working with over 400 individuals operating across all sectors and fields.

years: how can they gain legitimacy and build effective relationships with the public sector?

- Fourthly, social entrepreneurs use a variety of legal structures, including charities, social enterprises (community interest companies, co-ops, social firms and the like) and operating within the public sector: is measurement more important than structure?
- Finally, social entrepreneurs innovate in many different sectors with different services, often creating multiple and varied outcomes, and have varying scales of operation: does public service delivery encourage them to both scale and conform?

This chapter will set out to try to answer these key questions and, in doing so, give a fuller understanding of the relationship between social entrepreneurs and the public service delivery agenda.

### **Can social entrepreneurship be commissioned?**

This is partly a rhetorical question, of course, but it raises an important point: namely, that many start-up and fledgling social entrepreneur-led initiatives do not fit any existing commissioning agenda. Indeed, they are often responding to niches in their "market", addressing needs that they feel are not being met by other means in their community (whether a geographic community or a "community of interest"). The kind of solutions developed by social entrepreneurs will usually be complementary to "normal" public services, providing greater user involvement, greater innovation, and the ability to take more risks.<sup>2</sup> As these organisations grow and prosper, procurement opportunities become more relevant, but the impulse to innovate and challenge the status quo remains.

Two points arise from this insight. The first is that the earlier, innovative stuff is more risky and requires funding that is less heavily administered and constrained: grants and local innovation funding pots will continue to have an important role to play in fostering the work of social entrepreneurs. Such funds also give leeway to the commissioner or civil servant, who can feel empowered to take risks as this is the very function of the ring-fenced money, and to recognise diverse organisations with intimate local knowledge and particular strengths. And this needs to happen locally, as well as through large national investment pots such as the Department of Health's Social Enterprise Investment Fund.

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<sup>2</sup> Examples include Patient Opinion, established by SSE Fellow Paul Hodgkin: [www.patientopinion.org.uk](http://www.patientopinion.org.uk); Bud Umbrella, established by SSE Fellow Amanda Roberts: [www.bud-umbrella.org.uk](http://www.bud-umbrella.org.uk); BikeWorks, established by SSE Fellow Dave Miller: [www.bikeworks.org.uk](http://www.bikeworks.org.uk) and many more.

The second point is that those in charge of commissioning and procuring services should be aware of this journey of development, learn about the organisations on the ground, and seek ways to encourage them to tender for relevant services. This could be done either through the disseminating of information (tender documents, upcoming deadlines, how-to-bid guides and the like), by advice about what is needed that the organisation does not yet have, or at the commissioning stage itself, when the frameworks are being drawn up. A greater understanding of how to bring such social entrepreneur-led organisations into the mainstream should result not only in higher-quality outcomes from services that are more fit to purpose and more appropriate, but also in aiding the financial sustainability of organisations that will have relied on donations, grants or traded income in the early stages.

### **How can social entrepreneurs work with commissioners?**

To achieve the kind of understanding outlined above, under which social entrepreneurs and public service commissioners can effectively work together, is no easy task. And the responsibility for shifting mindset and culture exists not only on one side of the relationship. For just as commissioners need to connect to grass-roots work, to build knowledge of new, innovative activities, so social entrepreneurs need to build *their* understanding of commissioning and its associated constraints.

Training and support for social entrepreneurs in understanding the broader context for commissioners, and in understanding how to approach them and build relationships with them, can make a significant difference. Of course, like all relationships, there is no accounting for personal chemistry, but encouraging the entrepreneurs to put themselves in the commissioner's shoes can substantially amend the way they approach such dealings. A similar attempt on the part of the commissioner to learn and understand what the social entrepreneur is going through on their journey will bring similar results. This should enable both parties to move away from simplistic "bureaucrat" and "troublemaker" stereotypes.

Partly, then, this is about clear communication on both sides: the limitations and constraints of the commissioner and what is viable; and an honest view from the social entrepreneur about what their organisation or initiative can deliver. It is also about fostering a sense of shared mission: it is overlooked surprisingly often by parties on both sides that they share a social mission and overall objectives. Alongside demystifying the process on both sides and creating clarity of communication in order to achieve this, there may be potential for more direct ways of transferring knowledge and experience through placements and exchanges. Such secondments and placements in the past have tended to be made available at the level of national government, but this could have even more effect at a local level, where most of these transactions occur.

## How can social entrepreneurs gain legitimacy and credibility?

The challenge for social entrepreneurs is that they are self-appointed and have to earn their legitimacy and their credibility in the eyes of funders, investors, policy makers and commissioners. And they have to earn this legitimacy, and build this credibility, during a period in which they have little capacity to do anything except direct delivery. Measurement and evaluation of social impact is obviously crucial in giving commissioners the necessary trust and assurance they need (of which, more below), but there are other ways of gaining credibility that merit consideration.

One is through the involvement of stakeholders, be it mobilising members of a particular community, involving them in shaping the design of a service, or providing them with representation in the organisation's governance. The myth of the heroic individual social entrepreneur is just that: a myth. To achieve any success, social entrepreneurs need to build teams and networks, and to mobilise supporters and resources. Our evidence is that supporting such individuals through a recognised development and learning programme can help to achieve these outcomes, while also providing a further means of legitimacy and credibility to potential funders and policy makers.<sup>3</sup>

The next point is about the making of policy. Where start-up and early-stage social entrepreneurs really tend to lose out is in their lack of capacity to advocate and lobby for changes in policies and, ultimately, commissioning documents. This is partly about the relationship building discussed above, but also about an understanding of how policy gets made, of when the key *internal* deadlines for writing tenders and conducting consultations are, and of how small, focused policy contributions can have an impact.

As with other areas, this requires action on both sides: an ability of the public sector to hear and incorporate the smaller voices and give them credence, and increased training and support work for the social entrepreneurs to develop their advocacy skills and learn about policy.<sup>4</sup> In particular, this should focus on creating lobbying strength through partnerships and utilising existing channels through umbrella bodies and other agencies. When the issue of scale is discussed in this context it is usually about the contracts being too large for smaller third-sector organisations to take advantage of, but the ability to

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3 An independent evaluation of SSE activity in 1997-2007 by the New Economics Foundation found: "The SSE opens doors and increases the capacity of organisations to effect change, giving students better positioning to funders, local authorities and other key decision-makers. Sixty-six per cent of respondents rated their organisation's credibility as 7 or above (on a 1-10 scale). In all but a handful of cases they attributed this directly or indirectly to their experience at the SSE. It was clear also that they believed that their association with the SSE ... increased their credibility with other organisations."

4 SSE, in partnership with UnLtd, conducted four advocacy and lobbying workshops with over 80 social entrepreneurs between September 2007 and April 2008; the feedback was overwhelmingly positive.

influence policy and the commissioning process before tendering is similarly an issue of capacity and scale.

### **Is measurement more important than legal structure?**

Social entrepreneurs choose whichever structure is most fit for helping them achieve their goal, and there is an increasing variety to choose from. But it is important to state that a legal structure does not guarantee positive outcomes: a co-operative can be poorly run, and a community interest company can have little positive social impact, just as a charity or private company can. Commissioning by legal structure is more easily “boxable” from a government point of view, but carries the risk of organisations from both the private and public sectors choosing to use a legal structure largely to gain access to the money associated with the contract. Further, this can result in losing the reasons for the commissioning of this sector in the first place: social mission, innovation, connection to the community or users, fit-to-purpose solutions and so on.

In a market where the boundaries between sectors are becoming increasingly blurred, it therefore becomes ever more important to emphasise measurement of impact, assurance of quality, and transparency of operations. There is a need for standardisation (of measurement tools, be they social return on investment, social auditing or others), but also a need for a levelling of the field. After all, where third-sector organisations do compete for public service contracts, they do so on the basis of price, service and quality, as well as on the social and environmental benefits they offer. Private businesses should, therefore, have to compete in terms of their social and environmental benefits, as well as on price, service and quality. Financial accounts are expected of both, and social accounts should be as well.

Until this is the norm, and local authorities and other public-sector agencies are rewarded for taking this area seriously (or penalised for the opposite), mission-driven organisations will always be disadvantaged. Social benefit clauses and the like are steps along this route, and there is room for more such innovations to be trialled. But central government can give the lead, particularly given that efficiency directives are often seen to conflict with directives to commission the third sector (though efficiency goes hand in hand with effectiveness). This leadership will be even more crucial given the current financial climate.

Finally, the social entrepreneurs also need to improve their measurement and evaluation skills. Support and training on evaluation knowledge and tools is important,<sup>5</sup> and support agencies should place an emphasis on the importance of evaluation. After all, if social

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<sup>5</sup> Such as the storyboard and impact mapping exercises on the [ProveAndImprove.org](http://ProveAndImprove.org) website

entrepreneurs cannot prove they are making change as they wish, why should potential supporters and investors (both within and outwith the public sector) choose to provide funding or award contracts? And the earlier that such processes are built into activities, the easier it becomes to measure and evaluate as the work continues and expands.

### **Does public service delivery encourage social entrepreneurs to both scale and conform?**

The innovative, complementary, niche nature of social entrepreneur-led organisations in public services should be recognised and celebrated: while there are a small number of such organisations at scale, capable of competing successfully for large public service contracts, many others are too small to do so. Rather than pressure them to scale up beyond their ambitions or capacity, government should seek to find ways to best utilise that complementary, diverse, tailored activity that they provide.

Work is under way on identifying the best ways to support the creation of functioning partnerships and consortiums<sup>6</sup> that can allow smaller organisations to work together to access seemingly out-of-reach contracts, which is welcome. It is also worth noting, however, that much can also be achieved by commissioning bodies through encouraging the use of smaller organisations in subcontracting or supply chain relationships. Indeed, these may be less time-intensive and resource-draining than consortium-based approaches.

The conforming issue is related, but different. Social entrepreneurs challenge the status quo through their actions and, in doing so, often prove that there was an unmet need to be addressed. In essence, this means the status quo, the public services being delivered in that particular area, needs to be updated and amended. At the very least, there should be a dialogue about what is needed and about what can usefully be additionally commissioned.

The alternative is that, through a need for funding and financial sustainability, the social entrepreneur-led organisation turns to delivering more in line with the status quo contracts rather than in line with what made them unique and innovative in the first place. This is a balance on both sides of pragmatism, opportunism, conversation and compromise, but it is crucial not just for the oft-discussed independence of the third sector, but also for the refinement and relevance of commissioned services.

### **Conclusion**

The shared missions of social entrepreneurs and the public sector mean that a relationship

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<sup>6</sup> For instance, Social Enterprise Coalition work through BASIS, Futurebuilders Partnership stream and RE:alliance

between the two is not only inevitable, but also necessary. At times this relationship is one of complementarity; at others, depending on many of the areas discussed, it is one of commissioning and procurement. And there are huge benefits to be reaped from such partnerships: user involvement, innovation, increased reach, fit-to-purpose solutions, increased active citizenship, and a whole range of other positive outcomes.

But government and social enterprise advocates should be wary of becoming convinced that contract clauses, legal structures, centralised funding pots and big partnerships are the only route to change and success in this field. Personal, trusted relationships, combined with influencing policy, alongside evidence of impact and quality, are the nuts and bolts of functioning public service delivery on the ground – and will remain so.

And that means there is much to do on both sides to encourage dialogue, foster understanding, provide relevant and appropriate support, and create frameworks and funding for local innovation and risk taking. For the main barriers continue to reside primarily in people, not on paper: in contrasting culture and mindsets, in gaps in skills and knowledge, in risk aversity rather than risk and reward. It is here that the toughest future challenges lie in achieving the public services we all want to see.

## Chapter 7

# Commissioning from the voluntary and community sector

Michael O'Higgins, Chairman of the Audit Commission and  
Chair of Centrepont

## Commissioning from the voluntary and community sector

Few people would disagree with the proposition that the voluntary and community sector – the third sector – has a role to play in delivering public services. The present government is certainly committed. “I want the voluntary and community sector to become more involved in an even wider range of community action and service provision,” said the prime minister in a speech to the 2007 conference of the National Council for Voluntary Organisations. In this area, if in no other, the main opposition party agrees. A recent Conservative green paper<sup>1</sup> highlights the importance of the voluntary sector and outlines an agenda to expand voluntary organisations’ role and influence.

Supporters of the third sector often advance two reasons for its participation in delivering public services. First, a thriving third sector is characteristic of a healthy society, and contributes to the development of social capital and community cohesion. Sixty-one out of 150 local area agreements include a commitment to national indicator NI6 as a local priority: creating the environment for a thriving third sector.<sup>2</sup> Local compacts cover 99% of council areas,<sup>3</sup> a clear indication of the level of commitment to that objective among public services around the country.

Second, supporters argue that involving the third sector improves public service delivery. Third-sector delivery organisations claim to be closer, or more sympathetic, to users and therefore capable of providing better service. Others claim to be more innovative than the private or public sectors or better able to deliver value for money in other ways. Whether this is true of individual organisations or not, it is likely that a wider field of potential providers of public services will deliver a more diverse range of innovative models of service delivery and, where that diversity leads to some form of competition, higher quality and lower costs.

When the Audit Commission investigated relations between local public bodies and the third sector in 2007,<sup>4</sup> we found there was little hard evidence for any of these contentions. The House of Commons Public Administration Select Committee echoed our findings in July 2008.<sup>5</sup> Few local public bodies evaluate the value for money they get from commissioning from the third sector.

1 Conservative Party *Voluntary Action in the 21st Century* (2008)

2 Under the new performance framework for monitoring and regulating local government, local area agreements agree as priorities up to 35 of the 198 national indicators that cover all the national priority outcomes which local authorities will be responsible for delivering.

3 Compact Voice website, November 2008

4 Audit Commission *Hearts & Minds: Commissioning from the Voluntary Sector* (2008)

5 Public Administration Select Committee *Public Services & the Third Sector: Rhetoric & Reality* (2008)

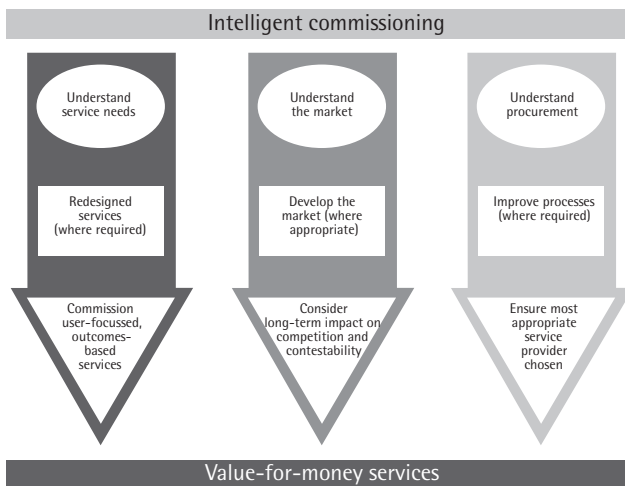
The sums of money involved are now very large. Local councils spend more than £3 billion a year with third-sector organisations. The public sector is the single biggest source of income for the third sector, accounting for two-fifths of total income.<sup>6</sup> Two-thirds of the largest charities derive over four-fifths of their income in this way.

We found that, in the absence of clear evidence that the third sector delivered better value, the best way to give it the greatest chance to do so was to adopt a set of simple principles, which we have assembled under the banner of "intelligent commissioning".<sup>7</sup>

### Intelligent commissioning

Intelligent commissioning should ensure that those who can do so best and most cost-effectively deliver public services. The principles are not restricted to commissioning from the third sector; they apply universally, regardless of the sector from which services are commissioned.

Figure 1: The elements of intelligent commissioning



Intelligent commissioning does not imply any preferential treatment for the third sector. Rather, it implies neutrality between different types of service provider; we also identified this as a precondition for effective use of market mechanisms in our *Healthy Competition* report.<sup>8</sup> Intelligent commissioning recognises that either the conscious choice of the

6 National Council for Voluntary Organisations *UK Voluntary Sector Almanac 2007*

7 Charity Commission *Stand & Deliver: The Future for Charities Providing Public Services* (2006)

8 Audit Commission *Healthy Competition: How Councils Can Use Competition & Contestability to Improve Services* (2007)

commissioner (for example, in order to develop third-sector capacity in an area), or the market, can determine who delivers services.

Intelligent commissioning requires a sound understanding of users' needs; an understanding of, and ability to manage, local markets; and good procurement practice.

### Understanding users' needs

Councils must understand their communities to understand what services they need to deliver and to whom. Personalisation of services in response to public demand implies an ability to identify the diverse needs of different people, and how best to meet these needs. Councils then need to identify what services they can deliver within available budgets. The hard choices that follow, about who should be entitled to services, and which users and which services to prioritise, are the political judgments that councils have to make every day.

To inform those judgments, service commissioners need good information on the composition, needs and aspirations of their target populations, and a clear and defensible basis for making decisions. The Audit Commission has produced the *Knowing your Communities* toolkit<sup>9</sup> to help local public bodies in this task. The Audit Commission's evaluation of resource use within comprehensive area assessments will include consideration of commissioning and procurement and of outcomes for local people.

Through their advocacy role, speaking for service users, third-sector organisations can help local public bodies to identify services users' needs and what matters most to them in the way these bodies deliver services.

Generally, we found that commissioners were willing to ask third-sector organisations to help them understand users' needs. However, council staff tended to meet these organisations through local partnership boards, rather than by directly contacting individual service providers. There was little evidence of a strong engagement or tangible benefits coming from this high-level approach alone.

Some commissioners in councils were nervous of engaging too closely with potential delivery organisations before conducting a formal procurement exercise. But we found some examples of good practice where people had overcome these challenges. One council's procurement team has run open days where they invite in potential providers from the third sector to discuss service needs. Another council consulted local third-sector organisations before remodelling service contracts. Westminster City Council has

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9 Audit Commission *Knowing Your Communities Toolkit* (2003) (<http://www.audit-commission.gov.uk/aboutus/diversity/knowingyourcommunities.asp>)

used grant aid money to build third-sector capacity to compete for contracts.

Commissioners should ask themselves:

- How can we identify users' needs effectively?
- Which features of service delivery do users say are most important to them?
- How are we involving service users in the design and delivery of their services?
- How can private-sector and third-sector providers participate in service design, to meet the user needs we have identified?

### Understanding markets

Just as commissioners need to understand the demand for services, they also need to be familiar with the landscape of potential suppliers. They need to know where there is a market, and where there is none. They need to understand how diverse and competitive the local market is, how much power they have in it, and how their own actions may influence its future development.

We found that commissioners and third-sector organisations had only a limited appreciation of the extent of local competition. Many assumed that a few large-scale suppliers would dominate the big block contracts, and that small, third-sector organisations would dominate the provision of niche services that do not attract any private-sector interest. However, there was as much competition between third-sector organisations, often between large and small, as from the private sector – particularly for contracts in adult social care or children's services. There was some competition between larger third-sector organisations and the private sector for adult social care services.

Local public bodies should assess the impact of their commissioning practice on the size and diversity of their local supplier base, and the consequent prospects of securing improved value for money in the future.

We found that the desire to minimise administration costs had led some councils to bundle services into very high-value contracts (for example, in community transport), or contracts extending for more than 10 years (for example, in domiciliary care); smaller voluntary organisations lacked sufficient capacity to bid for this work. This approach risks reducing the variety of options and also affects the prospects for effective competition in future.

Commissioners should ask themselves:

- Which suppliers, and how many of them, can supply the services we want?

- How do we identify potential local and national suppliers and involve them in designing services and commissioning processes?
- How competitive are the markets for these services?
- If there is no local market, what steps are we taking to create one?
- What effect is our current commissioning practice having on our local supplier market? And how could we improve it?

The responsibility for understanding the provider landscape does not lie only with the commissioning organisation. Third-sector organisations should market their expertise, skills and experience on behalf of client groups; they should not assume that local commissioners are aware of them and of their particular specialisms. They need to differentiate themselves from one another. Organisations that can show clearly how they will deliver value against commissioners' objectives will be in a much better position to bid successfully for contracts.

### Good procurement practice

The third element of intelligent commissioning is effective procurement. This means making careful judgments about the best way to procure services, based on sound information about service needs and the current state of the market, as well as conducting formal procurement exercises properly.

Councils need to align the funding mechanisms that they choose to use with the objectives of the funding. In *Hearts Et Minds*<sup>10</sup> we cited Julia Unwin's distinction between "giving, shopping and investing"<sup>11</sup> as modes of engagement with the third sector. This provides a good framework for councils to think about their reasons for engaging with the third sector and what that means for the form of funding.

Our research found no such clarity. We found confusion over the definitions of grants, service-level agreements and contracts, and a long-running debate about the relative merits of using grants or contracts to fund services delivered by third-sector organisations.

There are frequent claims that councils are replacing grants with service contracts, to the detriment of smaller third-sector organisations. We found little evidence of councils cutting grants to procure more services under contract. Rather, councils' increased spending with third-sector organisations is mainly through contracts or contract-like mechanisms. This is not necessarily a bad thing.

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<sup>10</sup> Audit Commission, op cit (2008)

<sup>11</sup> Unwin, J *Grant-making Tango: Issues for Funders* (2004)

Contracts can give service commissioners greater control over the services they buy, can be a better way of holding providers to account and can help them to secure value for money. And they do not necessarily disadvantage third-sector organisations. Contracts can give suppliers greater clarity about requirements and security of funding. Reporting performance against a contract specification can provide third-sector organisations with better opportunities to demonstrate their value than was possible under grant funding arrangements. We found third-sector organisations as well as councils that saw the advantages of working through contractual relationships.

We also found that many councils have reviewed their grants policies and are redistributing their grants in order to align them more closely to their strategic priorities. Moreover, many grants now have service-level agreements attached to them, and some third-sector organisations see these as contracts. There are fewer completely unrestricted grants. In some cases, councils are now procuring some services that were previously grant funded through competitive tender, and then using the grant funds to finance new third-sector organisations and to develop new services.

Councils should assess the impact of their commissioning practice on the third sector. Some procurement practices make it difficult for small providers to compete for contracts. Third-sector organisations told us about very large contracts; complex, bureaucratic tendering processes; poorly managed processes for issuing tender information; delays in announcing the results of a tender; and onerous performance-monitoring requirements.

Sometimes there are advantages in offering just a few large contracts (for example, in reducing procurement costs), but councils need to balance those against the risks of excluding niche providers and reducing the number of competitors for a contract. And we found some good examples of procurement practice too: some councils were breaking up over-large contracts (such as in older people's services), or providing opportunities for local third-sector organisations to subcontract or form bidding consortiums (such as for Supporting People contracts).

Commissioners should ask themselves:

- How are we going to fund what we want to buy: by a grant or a formal contract?
- How do we run a fair procurement process that gets us the provider that can do it best and at the best possible price?
- How do we determine the price we should pay for the service?
- How can we manage the service provider to secure accountability without being overly burdensome?

### **The benefits of third-sector commissioning**

Intelligent commissioning offers councils the best prospect of securing good value for the money they give to third-sector organisations. That value can come in many forms. For many commissioners, it is the value that the council achieves when it secures more for its community than it funds. For example, councils see the added value when volunteers deliver the service instead of paid staff, or when third-sector organisations are able to lever in match funding for a service that the council partially funds.

Third-sector organisations often think of added value as the less tangible but equally important economic and social benefits they claim to bring to public service delivery. Frequently quoted examples include accessibility to users, flexibility, specific knowledge, expertise and experience of particular user groups, innovation, trust and a strong user focus.

Some research shows that commissioning from local third-sector organisations can bring additional economic and social benefits to the locality. A study in Newcastle upon Tyne showed that, for every £1 that the city council gave in grant aid, voluntary organisations were able to bring in another £14, while bringing additional economic and social benefits to the locality. A study in Newcastle showed that third-sector organisations with a wider geographical remit were able to bring in £18 for every £1 of grant aid. In Nottingham, an estimate of the economic value of volunteers' time found the voluntary sector contributed an extra 1.7% to the local gross domestic product.

Councils should collect and analyse financial and performance information so that they can evaluate whether they are getting good value for money. That evaluation will need to look at long-term measures of outcomes and effectiveness, as well as inputs, outputs and unit costs. Commissioners should consider wider community or market development objectives as well as the costs and benefits of specific services.

For their part, third-sector organisations can work with councils, and improvement agencies, to develop a consensus on how to measure value for money. If third-sector organisations improve their understanding of their own costs, they should be able to submit realistic, high-quality, fully costed bids for service contracts that meet commissioners' requirements. And if they evaluate their own value for money robustly, they can use that evaluation to make the case for public service delivery through the third sector.

The principles of intelligent commissioning are not unique to commissioning from the third sector. Rather, adopting good practice in commissioning can benefit all local public bodies in commissioning services from all sectors. That includes enabling third-sector organisations to deliver public services where they are best placed to do so.



## Banking on the third sector

This essay primarily explores issues concerning the access to finance through banks by social enterprises. It explores a number of macro and micro issues that have been claimed to be "barriers" standing in the way of finance to social enterprise, then controversially suggests, firstly, that many of these barriers are in fact internal and primarily cultural.

Secondly, this paper submits that the schemes created by governments and by proponents of social enterprise using government money are in fact meddling in the market and, crucially, should be subject to critical examination, posing the question that they have had relatively "paradigmatic effect" and that the organisations that received finance would have had finance for such schemes elsewhere.

Thirdly, it suggests that support for social enterprise would be better geared towards looking at philanthropy and the new wealthy as an equity source, combined with a "business planning" approach to bank borrowing.

### Introduction

The paucity of a literature on banking practices in the third sector is testimony to how oblivious researchers and policy makers have been to exploring banking facilities, and particularly commercial loan finance. The wealth of publications on banking per se has been written almost entirely with the private sector in mind. Meanwhile other subjects pertinent to the third sector (such as management, marketing and accounting) have been given high priority, as evidenced by the plethora of research and publications over the last two decades.

Popular perceptions that almost all third-sector funding comes from the public through giving no longer holds true. Government funding, as monitored by the National Council for Voluntary Organisations' almanac research since 1995, has been increasing at a far greater rate than public donations and now accounts for some 39% of funding, compared with 43% from traditional giving. The NCVO almanac now estimates that the gearing of the third sector is some 3% – a remarkably low figure.

This paper looks at and discusses barriers to third-sector organisations seeking loan finance. But first will be given a short introduction to banking and its relationship to the third sector.

### A short history – and what is banking?

It is perhaps ironic that Western banking finds its origins in a third-sector organisation.

In the early 13th century the reputation of the Knights Templar for probity meant that they were trusted both to hold the money of others and to transfer it to different locations. The Templar lent money to individuals and institutions, and were the "bankers" of Christendom.

The origins of formalised banking in England, however, are rooted in the late 17th century. Traditionally, goldsmiths, because of their vaults and safes, looked after other people's money and issued receipts. These receipts became increasingly traded, in part to resolve the physical problem of moving heavy gold and coinage. The movement from goldsmiths' notes to banknotes can be traced back to the establishment of the Bank of England in 1694 with the power to issue notes, which became a near monopoly in 1708 and a total monopoly in 1844. Banks have no statutory definition. However, a definition given recognition by Lord Denning when Master of the Rolls in 1966 is that by Hart, who in his 1931 tome on banking law said:

*A Banker or Bank is a person or company carrying on the business of receiving money and collecting drafts for customers subject to the obligations of honouring cheques drawn upon them from time to time by customers.*<sup>1</sup>

There are several types of banks, but for the purpose of this paper the term is confined to only the "high-street" (or commercial) banks, and also those that are engaged in the activity of banking but are not necessarily part of the "London clearing banks", jointly referred to as deposit banks (including Scottish and Northern Irish banks).

Banks now engage in various other (non-traditional) activities – indeed in almost any business activity – however, the traditional services of banks are to take deposits and lend money traditionally secured by the deposit taken:

*The chief services of a deposit bank are, naturally, the receipt, transfer and encashment of deposits and the making of loans to customers; and its chief economic function is to provide a means whereby money (deposits) may be employed productively – whether in industry or in professional or private activity – rather than left idle.*<sup>2</sup>

The expression "loans" here alludes not only to a specific amount for a fixed term but also to overdraft facilities up to specific limits.

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1 Hart, HL *The Law of Banking & Stock Exchange Transactions* (Stevens & Sons, 1931)

2 Pringle, R *Banking in Britain* (Charles Knight & Co, 1973), p36

Banks' lending used to be constrained by the deposits they had taken and the regulations imposed by the Bank of England, particularly on balances they had to retain. These were relaxed in 1981 with the "acceptance" of foreign banks. Subsequent changes in banking regulation in 1997, including removing the supervisory power of the Bank of England and the lowering of gearing ratios, have in part been blamed for causing the credit and banking crisis of 2008 as banks sought to maximise their profits through activities outside their traditional orbit. As banks return to their traditional activities, it may well be, as we suggest later, that the third sector will become increasingly attractive as customers for both deposits and lending.

### **The third sector's relationships with banks**

The majority of a bank's lending is to the corporate sector. Banks, which exist to make profits, lend generously to sectors that are best positioned to offer security against the loans advanced. Inherent in corporate culture is the accumulation of assets (thus, security) through retention of a proportion of the profits generated in any given period of time and reinvested, including tangible assets. An issue for third-sector organisations is the conflict between applying their entire resources to fulfilling their mission versus accumulating assets that can be offered as security to lenders.

Banking for third-sector organisations in general is no more than a convenience for transacting their operations, not a business vehicle for fulfilling their missions. Projects are often stillborn for the lack of funds to provide impetus to kick start them, and social entrepreneurs rarely think of asking a bank to fund a new proposition, preferring instead to look for sources of finance from the public or corporate sector, in some form of philanthropy, and more recently from government sources.

Pioneering research funded by Unity Trust Bank in 2003, which is discussed later in this paper, found a communication problem whereby third-sector organisations believed that banks would not fund them as they were perceived as non-profit-making – and so how would a bank get its money back? A correct perception is promoted by finance journalists such as Patrick McCurry, who commented in the *Guardian* in 2000:

*But there are still significant obstacles to the development of loan finance, with banks often ignorant about how voluntary organisations work and with many charities lacking the proper financial systems to reassure lenders.<sup>3</sup>*

The deposit banks exist to cater for the needs of commerce and industry, embodied in the

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<sup>3</sup> "How Charities Can End Cash Worries" in *The Guardian*, 13 December 2000

corporate sector. Charges for their services, particularly interest rates, make no distinction about who the customer is. Free banking, for example, is often given to corporate customers in the first year and can be extended year on year according to the level of transactions and balances held. Unity Trust Bank for third-sector organisations goes a step further to support new smaller organisations and provides free banking until turnover reaches £250,000, after which it is negotiable. The emergence of Unity and other "social economy" banks such as Charity Bank and Triodos has provided a key alternative to the main high-street deposit banks, yet their market share, while significant, remains small in comparison.

### **Is there a barrier to debt finance for third-sector organisations?**

In 2003 Unity Trust Bank supported a research project undertaken by DG Raye under my supervision to look at this question.

A conceptual framework based on Brinckerhoff's business development process for social entrepreneurs<sup>4</sup> was used:

- Review your mission.
- Establish the risk willingness of your organisation.
- Establish the mission outcome of the business.
- Generate ideas.
- Undertake feasibility studies (preliminary and final).
- Formulate a business plan (including the financials).
- Prepare an implementation plan, with accountability.

An integral element of the business plan is the cash-flow statement, which takes cognisance of the inflow and outflow of cash. The importance of this statement is to flag monetary surpluses and shortfalls, which should initiate appropriate action as part of the financial planning process. Thereby the key requirements of a loan from a bank on timing – short- or long-term – and how it will be repaid would both be met.

Given the absence of research on the barriers to debt finance for third-sector organisations, an ethnographic approach utilising expert interviews and case studies to examine the issues associated with the deemed barriers to loan finance articulated by McCurry and others was used. Nine third-sector organisations from Devon to Tyneside were researched, all of which had successfully overcome these deemed barriers to debt finance using aspects of the conceptual model articulated.

<sup>4</sup> Brinckerhoff, P *Social Entrepreneurship* (John Wiley & Sons, 2000)

Barriers to loan finance were identified as follows:

- board members' worries about personal liability;
- withdrawal of the loan if the bank manager changed;
- takeover of the existing bank by another bank that might not be so sympathetic;
- withdrawal of a corporate partner in joint-venture schemes;
- overrun on initial costs on capital projects, undermining the financial facility;
- external developments beyond the control of the organisation – for example, tax changes;
- lack of a proven record in running this type of venture, including technical knowhow;
- withdrawal of government contract/finance;
- adversity to loan finance by board members;
- over-optimistic business plans;
- imposition of clauses in funding contracts resulting in bureaucratic delays;
- conflicts by government and trust funders on social aspects versus commercial outcomes, particularly where an organisation is grant-dependent;
- high-street banks' failure to understand a social enterprise and a bureaucratic process of decision making;
- high-street banks' reluctance to take managed risks;
- perception by bankers that social entrepreneurs are amateurs;
- banks' unfavourable rates and unsympathetic attitude;
- European Commission and UK government delay in providing funds;
- time-consuming issues of providing reports to the bank;
- cultural issues of borrowing and paying banks for social projects; and
- lack of available business expertise in third-sector organisations – and the cost of obtaining such advice outside the organisation.

These 20 barriers can be summarised and distilled into either internal or external barriers.

#### Internal barriers to loan finance

These are as follows:

- apprehension of borrowing from the potential risk of personal liability;
- an organisation's procrastination to decide on borrowing, borne out of caution, can delay or at worst scrap planned projects;
- resistance to borrowing, as it is not an integral part of third-sector culture, especially where there is no guaranteed income stream;
- lack of knowledge and expertise, in many instances, to frame proposals for borrowing (with deference to realistic timeframes) that are acceptable by the banks and the associated expertise to monitor and manage such borrowing;

- lack of financial planning;
- lack of knowledge of the available sources of borrowing (such as social economy banks);
- a cultural ethos that borrowing is an admission of failure to raise funds;
- governing documents that prohibit borrowing;
- for registered charities, concern that donors might object to borrowing; and
- inertia in organisations to moving their business from one bank to another.

### External barriers to loan finance

These are as follows:

- reluctance by banks to extend overdraft or bridging facilities without traditional security of asset collateral;
- commercial banks' own cultural misunderstanding of third-sector organisations;
- banking products geared to the commercial sector;
- the cost of obtaining professional advice, which is a deterrent;
- that changes in the law can change plans;
- slow payment for services by government; and
- lack of a proven record and being seen as amateurs.

### Observations and recommendations

While these are real barriers, the research found that there was no "market failure" but rather cultural misunderstanding and a failure to apply normal business processes. Many of the barriers – for example, government's slowness in paying funds over – are not barriers created by the banks. But in addition to this qualitative research, we now have statistics on some parts of the third sector and borrowing which suggest that perceptions that organisations do not borrow or cannot borrow are wrong.

According to the GuideStar database of charities in England and Wales, there are 7,000 charitable organisations that have bank loan finance (within the total number of charities of 169,000). Collectively, these charities have £5.2 billion of loans – 4,700 of them short-term and 4,000 long-term. If the most conservative and restrictive component of the third sector can be enjoying this finance, it raises the question of why the government feels the need to create new institutions to provide finance to social entrepreneurs. The market, it seems, is working; and the problem as identified by the Unity research is that, while there are some external barriers to surmount, the real problems are primarily self-imposed.

These self-imposed problems are related especially to culture, and particularly the inability of many to provide business plans. Clarity on legal liability is required, and forms

of association for social enterprises clearly need to be simplified and understood by banks and board members. Could some form of a charity envelope status be developed without the necessary cumbersome package of trustees and charity governance? This would be particularly useful as it could encourage finance from new philanthropists who, taking a social investment approach, could be the equity capital of the sector. At present tax relief to such individuals is only obtained through gift aiding to registered charities. A new approach to this issue was the request of papers by the Smith Institute.

Our recommendation is that thinking needs to focus more on legal structures, tax incentives and business education for social entrepreneurs rather than the current initiatives of recent years and those being proposed for new social economy financial institutions supported by government. For example, if the £300 million-plus set aside for these schemes had instead been allocated to providing gift aid tax relief to support the introduction of "remainder trusts" focused on social entrepreneurs, then some £1 billion of actual equity capital would have been created for social enterprises, which would have provided security for at least a similar sum of bank finance.

This paper challenges the perception of market failure and questions why the government, through initiatives such as Futurebuilders, has felt the need to get involved. It may be a paradox at a time of a credit squeeze to argue that there is not a borrowing problem for third-sector organisations, but we can find no evidence. Good propositions supported by appropriate business plans would not be turned away by Unity or the other social economy banks. Furthermore, as banks return to their "boring" core business, the high street may offer a welcome to a social entrepreneur who can pay them back – particularly if supported by a guaranteed government income contract.

## Chapter 9

# Investing in third-sector capacity

Stephen Bubb, Chair of Futurebuilders England and Chief Executive of the Association of Chief Executives of Voluntary Organisations, and Ralph Michell, Head of Policy at the Association of Chief Executives of Voluntary Organisations

## Investing in third-sector capacity

For the past decade, a great deal of effort and public money have been poured into building the capacity of the third sector. The driving logic has been the belief that the third sector has the potential to deliver more and better public service outcomes for the public, but that it often lacks the capacity to maximise that potential.

That lack of capacity might be a lack of capacity to leverage investment – for instance, by engaging effectively with public service commissioners, by accessing financial support, or by taking an entrepreneurial approach to income generation. Or it might be a lack of capacity to get the maximum organisational efficiency from that investment – for instance, through greater economies of scale, partnership working or professionalism.

Hence support to help third-sector providers tender for services through initiatives such as Capacitybuilders. Hence the attempts to provide greater access to loan finance through initiatives like Futurebuilders and the Adventure Capital Fund. Hence support for organisations looking at consortium building, or mergers, or leadership and professional development.

That was the logic then, back in “the nice decade”. Today, as we slide into recession, is it time to revisit that logic? Does the third sector really have more and better outcomes to offer and, if it does, can we really afford that added extra? Can we afford all the capacity building that would allow us to get to those better outcomes in the first place? And if we can, are the capacity-building tools we used in the nice decade the right ones for the nasty years ahead?

### Why bother?

First of all, does the sector have more to offer, and can we afford it if it does? The answer here must be an unequivocal “yes” – now more than ever before. As the social consequences of recession become clearer (more people falling victim to unemployment, crime, domestic violence, homelessness – the list goes on), we will increasingly need high-quality public services of the sort that the third sector is so good at delivering. And as recession kicks in and resources become scarcer, we will need to maximise efficiencies and secure real value for money. Taken together, those two needs make for a clear agenda. The recession does not call for cuts – it calls for innovation, newer ways of doing things. In essence it calls for wiser investment. And the third sector is that wiser investment.

So partnership with the third sector will be more important in the years ahead, not less. The case for capacity building in the sector remains.

Nevertheless, with the recession comes the opportunity for a radical rethink. To what extent does our current approach to capacity building really work? Given the limited resources at our disposal, do we have the lean, mean capacity-building machine that we need, or do we have a rather motley collection of disparate initiatives, the result of a sedimentary build-up of good intentions, diffuse pots of money and different people's superficial and divergent analyses?

It is clear that our attempts at capacity building have not been a failure. We can all point to excellent examples – both the Association of Chief Executives of Voluntary Organisations and Futurebuilders have been involved in many of them – where capacity building has transformed the delivery capability of a third-sector organisation, allowing it to provide excellent services not just for very few, but for very many.

But equally it is clear that the capacity building provided over the past decade has not resulted in the step change that many hoped we would see. The transformations have been limited to a small number of individual organisations, rather than applying to the sector as a whole. There remain countless third-sector organisations straining at the bit, providing outstanding quality, desperate to do the same for people receiving inferior services, but held back by a seemingly insuperable lack of capacity. We have achieved piecemeal change, but we have not achieved systemic change.

Our argument here is that this is because our approach to capacity building has been insufficiently systematic.

### **Changing the context to capacity building**

The problem we are trying to address is a vicious circle. Lacking in capacity, third-sector organisations often lack the money, expertise or time to identify and then buy the support that could address their capacity issues, which in turn hinders their attempts at getting hold of more money, expertise or time in the future.

Nose constantly to the grindstone, the third-sector chief executive might not be aware of what opportunities exist to build his or her organisation's capacity. Relatively inexperienced in particular fields of expertise, he or she might not be aware of where capacity is most seriously lacking in the organisation and therefore not know which gaps really need plugging. And often chronically underfunded, he or she might just not have the money to plug those gaps in any case.

With those capacity gaps persisting, the organisation is then at a serious disadvantage when attempting to sell its services to public service commissioners. Not only is it

disadvantaged in terms of winning the bid at all, faced with better-resourced competitors, but even if it does win the contract, the power imbalance between the agency with the purse strings and the organisation with the ability to deliver means that the terms of trade are more likely to see the third-sector organisation fail to recover its costs than make a surplus that it could use to build its capacity for the future. And so the vicious circle goes on.

The point of capacity building is to break that circle, and the justification for it is that without intervention the market would not break the circle itself. Indeed, as should be clear from the above, the market often tends to reinforce the circle that prevents third-sector providers from investing in their own capacity. Before going on to discuss capacity building in more detail, therefore, we should be clear that capacity building has to be accompanied by root-and-branch reform of the markets in which third-sector organisations operate. And, more often than not, the fundamental problem in those markets is the customer – that is to say, the state.

The customer does not know what he wants. Where he does know what he wants, it is usually not what is best for him. And then when he tries to get it, he is very bad at engaging with the people making and selling it. When it comes to public services, the customer is not always right. Very often he is wrong. So capacity building of the third sector needs to be accompanied by reform of the public sector – for instance, radical expansion of the “individual budgets” approach so that the customer is the service user rather than the procurement officer; levelling of the playing field with regard to pensions or the public sector’s assessment of its own in-house costs; and training of commissioners to embed the long-awaited but little-experienced “world-class” or “intelligent” commissioning.

### **Leveraging more into capacity building**

If the first step to more systematic capacity building would be reform of public service markets, the second would be leveraging more resources into the system, so that the injections of capital (in the broadest sense of the term) that capacity building involves are bigger and more numerous.

Capacity building the third sector is still seen, across government and beyond, as “something the Office of the Third Sector does”. Some might never have heard of the Office of the Third Sector (OTS), part of the Cabinet Office set up in 2006 with a brief including building the capacity of the third sector. Those who have heard of it will know that its budget hovers at around £500 million per year. Either way, it should be clear to all that the OTS alone is not in a position to inject capacity into the third sector in such a way

as to achieve the sea change we are looking for.

Capacity building, then, needs to be something that everyone does, rather than something that the OTS does. Something that all government spending departments do, something that the private sector does, something that the third sector does itself. We are seeing steps in that direction – the Ministry of Justice and the Department for Work & Pensions, for instance, have started to invest in building the capacity of third-sector organisations to enable them better to participate in procurement competitions, although the sums involved remain relatively small. Some private-sector prime contractors, which deliver public service contracts in part through networks of third-sector subcontractors, have started to invest in the capacity of their delivery partners in recognition of the benefits that they will ultimately bring to contract delivery.

Other private companies are starting to see capacity building as a corporate social responsibility activity with higher impact than the traditional model of corporate giving. And parts of the third sector itself are moving away from the old, shortsighted culture of putting every possible penny on the front line in the shortest possible time, and are instead starting to invest in their long-term capacity to achieve change (for instance, by spending more on staff skills or professional development).

These are steps in the right direction, but we could go much further. Government departments that commission services from the third sector need to take a more strategic approach to shaping the supplier market, and that will include building the capacity of the third sector. The culture shift that will have to underlie this more strategic approach is starting to happen, but there are ways to accelerate it. One of the tools that central government has used to encourage local authorities to invest in the capacity of the third sector is a national indicator target for a "thriving third sector". We see no reason why a similar lever (be it a shared public service agreement or several departmental objectives) should not be used at the national level to encourage commissioning departments to see the third sector as an opportunity whose development it is worth fostering and investing in.

At a more local level, the public sector could invest in the sector through the transfer of assets. The government is currently encouraging local authorities to review their buildings and land for opportunities to transfer these assets to community organisations, and local councils have the power to dispose of land and buildings at preferential rates if a wider community benefit can be realised through the transfer. A deepening and acceleration of this initiative could play a significant part in building the third sector's capacity by tackling one of the fundamental barriers to its growth – chronic under-capitalisation.

Government can also play a role in encouraging its private-sector service providers to invest in the capacity of their third-sector delivery partners. Partly that is a question of influencing provider behaviour by shaping market expectations. The work around the Department for Work & Pensions' commissioning strategy has created a clear sense in the market that successful prime contractors on welfare-to-work services will need to work with third-sector organisations in such a way as to allow or encourage them to invest in their capacity. That kind of approach could be duplicated in other commissioning areas. And, across the board, commissioning departments could go further – for instance, private-sector providers could be encouraged to invest in their delivery partners' capacity by a government commitment to match-fund an investment that would, after all, be beneficial to all parties concerned.

Finally, to maximise investment in the capacity of the third sector, we need to accelerate the culture shift already under way in the sector itself. We need more third-sector organisations to recognise that a failure to invest in the capacity of the organisation (in terms of the skills and professional development of the staff and chief executive, for instance) is a failure that the organisation's current and potential beneficiaries will ultimately pay for. And we need to recognise that the sector is the wrong shape to make maximum use of the limited resources it is able to draw on: having a multitude of small organisations duplicating one another's work is not a good use of what capacity does exist in the sector. So we need to encourage more partnership working, more sharing of back-office facilities, and more mergers.

### **Smarter capacity building**

The challenge, however, is not simply to leverage more investment into third-sector capacity building by making it a more mainstream activity across all sectors. In addition, we should be looking at how we can inject that investment into the sector more intelligently so as to counteract some of the inefficiencies associated with the top-down, command-control approach that capacity-building is inherently likely to suffer.

The two main obstacles to a more demand-led approach to capacity building are, as we touched on in describing the vicious circle we are trying to combat, that third-sector organisations may not have the money to access capacity-building resources, and that they may not yet know that they want to. They may not be aware of quite how much they are missing out on by not investing more in, for instance, the professional development of the chief executive, or in research and development.

There is scope to address those obstacles to more demand-led capacity building. Beyond increasing the overall level invested in capacity building, as described above, we might

start by trying to shift purchasing power from the state towards individual third-sector organisations.

Why, for instance, should we not experiment with an "individual budget" approach to capacity building, so that the Association of Chief Executives of Voluntary Organisations' leadership and professional development services, for instance, are not block-commissioned by the state but bought by individual organisations using their own individual packages of state funding? That approach might ensure that the money is spent in the most appropriate way for each organisation. It might also lead to more diversity and flexibility of supply, qualities that it is all too easy to lose with the current command-and-control model.

For instance, Capacitybuilders (the quango that commissions a significant proportion of government-funded capacity-building services), once committed to its latest three-year plan of spending priorities, has little room for manoeuvre allowing it to fund new ideas that might meet demand more effectively. And an individual-budget approach to capacity building might also encourage a more critical attitude within third-sector organisations to their own capacity – rather than "That service is out there; we might as well have it," the thought process might become: "Where are our weaknesses, and how do we best address them using limited resources?"

Paradoxically, however, where one of the barriers to capacity building is that third-sector organisations are not always aware of where their capacity gaps are, we need to find cleverer ways of building capacity from the top down. We have already mentioned the opportunity that exists for private-sector prime contractors to invest in the capacity of their third-sector partners or subcontractors. The advantage of that approach is not simply that it has the potential to get more resources into the system – it could also mean that those resources are put where they are most needed, with large businesses being potentially more aware of their partners' capacity gaps than are the organisations themselves.

A massive expansion of the financial services made available to the third sector could marry elements of a more demand-led approach and more "intelligently directed" support. More of the right kind of financial products could enable third-sector organisations to invest significantly more in their own capacity where they know they need it – for instance, the small interest-free loans in Futurebuilders' Tender Fund that help organisations tender for public service contracts, or the much larger Futurebuilders loans that allow providers to invest in their services.

But, equally, demand-led loan finance can be invested intelligently to stimulate the filling

of gaps that third-sector organisations themselves might not be aware of. For instance, Futurebuilders combines professional support with every full investment. An investment officer, often working with a business consultant, will provide specific advice on areas such as organisational and governance structures, business and financial planning, property and legal issues, full cost recovery, or marketing and PR.

And we can direct loan finance in such a way as to encourage behaviours in the sector conducive to maximum use of existing capacity. For instance, in part aiming to tackle the inefficient spread of resources across myriad small organisations, Futurebuilders' Consortia Fund provides loan finance for consortiums, alongside professional advice on areas such as tailoring the structure of the consortium to specific contracts, creating and finalising governing and legal documents for the consortium, and identifying additional partners.

We need many more of these kinds of products, much more investment behind them, a more strategic approach to developing the social investment market, and a clearer agenda for using that market to shape the sector so that its use of resources is as efficient as possible. The creation of a social investment bank to do just that, as proposed by the Commission on Unclaimed Assets, will be crucial. The commission called for the government to provide £250 million in start-up funding for the bank, with an annual income stream of £20 million for a minimum of four years; the money would be released from dormant accounts by the recently passed Unclaimed Assets Act. We now need the government to drive those proposals through.

Again, however, part of the answer here is to encourage cultural change within the sector in an effort to stimulate demand for capacity-building services. For the sector's capacity to be transformed, we will need third-sector organisations to be confident about creating surpluses and investing in the organisation; we will need them to be much more self-critical and aware of their capacity gaps; and we will need them to be much more aware of the resources available to them to fill those gaps.

At root, part of our problem is a culture that is not conducive to capacity building. Currently, however, it is much easier to access funding for work that chips away at the symptoms of that culture than it is to find money to tackle the culture problem itself. Government and other funders are more comfortable paying for a training course on tendering for contracts than they are on funding "policy wonks" to shift the boundaries of debate within the sector and move the consensus forward. And yet we know from the Association of Chief Executives of Voluntary Organisations' own experience that the latter can be extremely effective. Are we concentrating too many resources at the wrong end of the problem?

**Conclusion**

The case for investing in the capacity of the third sector to enable it to deliver better public services remains as strong as ever. But there is scope for our approach to capacity building to be more systematic, based on three basic pillars: better leverage of resources from across all sectors of the economy, smarter use of resources – more demand-led where possible, and where necessary with support to stimulate demand where required – and a radical reform of the public service markets in which capacity building takes place, without which these interventions will fall on barren ground.



## Chapter 10

# Releasing grass-roots organisations

Juliette Ash, Alliance Director at the Centre for Social Justice

## Releasing grass-roots organisations

Prior to the economic crisis, Britain experienced prosperity such as it had never known before. None the less, despite rising incomes, and huge levels of government spending, our most chronic social problems remain firmly entrenched. Rates of family breakdown, educational failure, welfare dependency, addiction and serious personal debt have increased alongside this success, and are stubbornly high. Despite a plethora of initiatives and government targets, we are still ranked lowest in a Unicef report of child well-being in rich countries,<sup>1</sup> and have among the highest levels of family breakdown and child poverty in Europe and some of the lowest levels of educational achievement. Well-intentioned and often generous quantities of public spending have in many cases made far less impact than anticipated and the resulting annual cost of social breakdown to the nation has been estimated at over £102 billion.<sup>2</sup>

It has long been recognised across the political spectrum, however, that the third sector (made up of small, grass-roots community groups, social enterprises and large national charities) provides part of the solution to these ailments. The third sector is successfully addressing these issues and turning lives around across the nation every day. Someone, somewhere, is addressing every social challenge that we face.

Even so, the characteristics, distinctiveness and benefits of third-sector organisations and their capacity to deliver public services have recently been brought into question through the Public Administration Select Committee's report on public services, *Rhetoric & Reality*.<sup>3</sup> This includes the entirely understandable question raised by Will Werry of the Commissioning Joint Committee:

*If the sector is so good, why are they not winning now?*

This is a timely question that provokes the response: should the debate be restricted to how the third sector delivers government-commissioned public services, or should it also consider the bottom-up approach of encouraging civil society to do what it does best, namely generate localised collectives that act around shared purposes and values to support those in need around them?

Anecdotal evidence and thousands of hours of hearings on the part of the Centre for

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1 Unicef *Child Poverty in Perspective: An Overview of Child Well-being in Rich Countries* (2007), p2 (<http://www.unicef.org/media/files/ChildPovertyReport.pdf>)

2 Social Justice Policy Group *Breakthrough Britain* (Centre for Social Justice, 2007), p12

3 Public Administration Select Committee *Public Services & the Third Sector: Rhetoric or Reality* (2008)

Social Justice indicate that grass-roots organisations of the voluntary sector in particular still face significant challenges and barriers in delivering such services and bringing about the life change that is so clearly still needed.

The remainder of this chapter will focus on addressing Will Werry's question and propose that part of the solution is to release the delivery capacity of grass-roots third-sector organisations. Specifically, it will show how they are uniquely placed to deliver life change and a second chance to, in particular, the hardest to reach and most vulnerable in society. It will confirm that they do indeed have the appetite and capacity to make this provision, and that they thrive where there is appropriate support and funding. It will also outline a series of proposals that would help bring about this change.

### **Grass-roots organisations deliver a unique portfolio of benefits**

In the "economy" of the third sector, smaller grass-roots organisations tend to grow organically, addressing local need. They are often born from one person or a series of people who have themselves experienced a related issue or recognised a local need. As a result they build more trust, access more of those that are hardest to reach and have more capacity to get to the root cause of a given issue than a comparable organisation. These are important benefits, because without them further breakdown in the lives of those involved is unlikely to be prevented.

They also naturally adopt a whole-person approach because their starting point is the need of the presenting individual, rather than a target or departmental category. Grass-roots organisations tend to go the extra mile because they are dealing with a neighbour or friend or someone living in their community, rather than just another client.

A further benefit is innovation. Innovation is essential to the economy of the third sector if we are to find even more effective solutions to some of our most challenging social issues.

Another benefit is value for money. The New Philanthropy Capital report *Funding for Success*<sup>4</sup> explains how the full social value of a grass-roots organisation cannot be recognised unless organisational outputs are distinguished from outcomes. Commissioners can mistakenly assume that the lowest-cost option represents the best value for money. The report gives the following example:

*Councils often award contracts for "meals-on-wheels" to the provider offering the*

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4 Brookes, M, Langerman, C and Lumley, T *Funding for Success* (New Philanthropy Capital, 2005)

*lowest-cost tender. This approach results in services designed to minimise cost rather than maximise results. Today, many meals on wheels services are based on the weekly delivery of frozen meals (the most efficient option; high outputs). Weekly deliveries replace the daily visits, personal contact and opportunities to build up trust offered by charities like the Women's Royal Voluntary service, (the most effective option; good outcomes). The latter represents the most effective outcome because personal contact combats isolation and builds a platform from which to understand and help tackle other problems that housebound people may face.<sup>5</sup>*

As a result, grass-roots organisations often deliver far more social benefit than even they recognise.

Passion for their work means an appetite to deliver; and organisational adaptability and flexibility are high. These are organisations that have an innate appetite for delivery because they are born out of local need, and generally against some degree of adversity, which creates a sense of ownership and dedication to persist on behalf of the clients against the odds. They also become accustomed to adapting to changing funding streams, as well as changing times and needs. Historically, many of our most effective charities have developed in this way. For example, Dr Barnado's response to the children living in appalling conditions in the East End of London in 1867 developed into Barnado's, the children's charity, and William Booth's efforts to address alcoholism, worklessness and crime gave birth to the Salvation Army.

### **Unnecessary barriers to delivery**

While it is possible at a macro level to identify issues and local needs in the UK by mapping the grass-roots organisations that spring up to address them, there are significant exceptions to this rule. For example, the most deprived areas in England, as measured by multiple indices of deprivation from *The English Indices of Deprivation 2007*,<sup>6</sup> do not tend to have exceptional grass-roots organisations delivering life change. In such cases, an external catalyst is required to help empower local people to be the source of the change that is required.

The North Benwell youth project in Newcastle is an excellent example, where a group of neighbourhood people, including a vicar, a doctor and a youth worker, formed a group to support young people in the area. One by one, the young people started to change their behaviours, aspire to more and in turn become peer educators for their parents and

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<sup>5</sup> Op cit, p4

<sup>6</sup> *English Indices of Deprivation 2007* (Department for Communities & Local Government, 2007)

community. After only a few years, they became sufficiently motivated to run large-scale community events to "give something back", and, as they have recently formed a youth ward committee, their potential to continue to transform the area in which they live is high.

This success story has, however, had to overcome unnecessary barriers, including being obliged to avoid tied statutory funding that would otherwise compromise the integrity of the project, being obliged to use a room of a house in a terraced row as a meeting place rather than having access to any bespoke community facility (none are available), and reliance on community funding from a local bank at risk of closure.

There are other unnecessary barriers to delivery. If we are to release the whole of the third sector to deliver life change, then some of the principal means of doing so are as follows:

- encourage innovation through reducing prescriptive and tied funding;
- provide stable funding and resources through promoting charitable giving and volunteering;
- introduce a funding reinvestment policy;
- reduce overly bureaucratic processes (funding and regulation); and
- ensure that third-sector organisations are fully understood by commissioners.

#### 1. Encourage innovation through reducing prescriptive and tied funding.

- ***Strengthen the independence and vibrancy of the third sector:*** Ensuring that government funding does not compromise the independence of third-sector organisations should be a priority for public bodies. This independence is often central to their success.
- ***Encourage community growth trust status:*** Smaller third-sector organisations with significant growth potential could apply for the new legal status of community growth trust. This would entitle visionary social entrepreneurs, faith-based organisations and community groups to deliver a progressively increasing range of public services to their communities as reward for proven competence.
- ***Create a level playing field for faith-based organisations:*** There is growing evidence that effective faith-based organisations are being discriminated against by statutory funders, with the vulnerable people they serve losing out as a result. To address this, legislation should be introduced to allow religious and non-religious charities to compete for public funding on equal terms, after a review of laws that faith-based

organisations consider are being used unfairly against them. A faith standard should also be used to help such organisations ensure the highest standards in serving clients from all backgrounds.

## 2. Provide stable funding and resources through promoting charitable giving and volunteering

- ***Increase levels of charitable giving and volunteering:*** Maximising rates of giving to the most effective charities is vital – currently around 35% of the sector's income comes from the public, without many of the strings attached to statutory funding. Volunteers, meanwhile, are the third sector's greatest asset. They can provide one-to-one care to vulnerable people in ways that are impossible for overstretched paid caseworkers.
- ***Make Gift Aid easier to claim:*** To make it easier for third-sector organisations to reclaim Gift Aid, a certain percentage, perhaps 80%, of all individual donations should be assumed to come from taxpayers. This percentage of all individual donations would qualify for Gift Aid without the paperwork currently needed to "opt in". This simplified system would generate a sizeable increase in fundraising revenue for many charities.
- ***Launch a "trustmarking" website:*** An independent website could be created to accredit the work of smaller, poverty-fighting third-sector organisations and promote giving to them. Run as a social enterprise, the site would help funds flow to charities that get good results. Initially, donations to trustmarked third-sector organisations through the site would attract enhanced Gift Aid at double the normal rate. A fixed fund of £50 million would generate an extra £150 million for participant third-sector organisations.
- ***Introduce charitable remainder trusts:*** Charitable remainder trusts (CRTs) could be introduced as tax-efficient vehicles for planned giving. These enable a person to donate assets while receiving tax benefits and an income stream from them. Many assets such as second homes could be transferred to charities during their owners' lifetimes.
- ***Boost corporate social bonds:*** To raise levels of corporate giving, a drive could be launched to increase the number and value of corporate social bonds. These raise funds from companies that forgo capital growth and interest income on their investment, but are guaranteed it all back after five years. Accumulated capital growth and interest is invested in local projects.

- **Promote volunteering in poverty-fighting areas:** Continued government funding for agencies such as CSV, Volunteering England and V that promote volunteering and provide volunteering opportunities should be made conditional on them doing more to increase rates of volunteering among poverty-fighting charities and socially excluded groups.
- **Set up a Community Foundation Challenge Fund:** A new, £50 million Challenge Fund would significantly boost grant giving to poverty-fighting third-sector organisations by the national network of 55 community foundations. The foundations' track record indicates they could generate an additional £100 million in private-sector giving, making a total £150 million fund. Invested in an endowment, this would enable £7.5 million of grants to be distributed to poverty-fighting groups annually in perpetuity.

### 3. Reduce overly bureaucratic processes (funding and regulation)

- **Strengthen the Compact:** To ensure charities get a fair deal in funding and other areas, the Compact's principles – including multi-year funding, prompt payment and full-cost recovery – must be enshrined in legislation. Whitehall's "Compact Champions" should operate at grade two not grade three, and local area agreements must include evidence of progress towards full Compact implementation by members of the local strategic partnership.
- **Make funding less bureaucratic and prescriptive:** Government funding, especially contracts, must be far less prescriptive, stating expected outcomes but respecting third-sector organisations' capability to determine how best to achieve these, rather than micro-managing the sector. Increased use of schemes that improve outcomes data, such as from the National Outcomes Programme or from a trustmarking website, will help here. More standardised contracts should help reduce excessive reporting burdens.
- **Assess and reduce the burden of irrecoverable VAT:** Charities are unable to reclaim up to £500 million incurred annually on activities in pursuit of their charitable objectives. Finding the money to tackle this injustice would be very difficult. Further research is needed to establish whether reform would significantly benefit third-sector organisations of different types and sizes, and how any changes might be phased in.

#### 4. Introduce a funding reinvestment policy

- *Promote spending efficiency and deliver further results:* In order to generate a healthy sector, successful organisations that manage to underspend in a given year should be able to reinvest their funding. Commissioners should neither aspire, nor be able, to claw back funding. Instead the organisations should be allowed to reinvest the monies to further their work.

#### 5. Ensure third-sector organisations are fully understood by commissioners

- *Ensure that commissioners fully understand the benefits delivered by the third sector:* If the public and voluntary sectors are going to work well together, they need to fully understand one another, and therefore, as Peter Kyle from the Association of Chief Executives of Voluntary Organisations suggests, the commissioning process should be developed to ensure that this takes place across the UK:

*At the moment, the full potential of the third sector is not recognised in the commissioning process. Not all commissioners understand the third sector ... Once the commissioning process recognises there are social outcomes as well as economic ones which the government wants to achieve, then I think there will be much greater potential to have a real step-change in the way that the third sector engages in delivering public services of all sizes.<sup>7</sup>*

### **Conclusion**

Grass-roots organisations within the third sector are capable of delivering life change to the most vulnerable. They have both the appetite and the capacity, but require public and private sectors to support them to generate new organisations in the most deprived areas and overcome some of the key barriers to progress. By adopting these proposals, rates of volunteering and charitable giving will be boosted. Current funding regimes will be delivered fairly and barriers that slow development and create frustration from bureaucracy will be reduced. Innovation will be safeguarded as funding is more equitably distributed to a broader range of groups and the sector will continue to thrive as its independence and vibrancy is preserved and encouraged.

Releasing grass-roots third-sector organisations is essential to create a stronger, more diverse and dynamic third sector, capable of maximising second chances across the UK today.

<sup>7</sup> Public Administration Select Committee, op cit, p64



## The users' experience

There is an increasing emphasis on putting users at the heart of public service delivery. At a national level, user involvement is firmly on the agenda of all political parties, and policy makers talk about the value of engagement in public service transformation. A duty to inform, consult and involve is enshrined in the Local Government & Public Involvement in Health Act, and the community empowerment white paper provides greater impetus for engagement at local and community levels.

Although this sometimes feels like rhetoric, there are signs of a shift in culture and practice as public services gradually become more responsive to the people they serve. Progress remains patchy, and the challenge is to find ways of helping services across the board, not just those at the leading edge, to implement engagement strategies. A variety of resources, including good-practice case studies, toolkits and sources of advice and expertise, are already available to help get new initiatives off the ground.

Greater involvement of the third sector in public service delivery is seen by all parties as another way to make progress on reform. This seems to be based in part on the premise that these organisations are closer to their service users and so will be able to deliver more user-focused services.

But there is little evidence one way or the other to show whether this is the case, which is why the National Consumer Council, one of the predecessor bodies of Consumer Focus, undertook a piece of ground-breaking research to find out what is really happening. This issue of designing user-responsive services based on effective engagement remains a key area of interest for Consumer Focus.

The original research looked in detail at user experiences in three areas of public service delivery – employment, domiciliary care for older people, and social housing – covering organisations from the public, private and third sectors. The project started by asking consumers to tell us what made up a good-quality service, which resulted in a set of 19 factors. We went on to survey a sample of over a thousand (1,231) service users about how far their providers delivered those criteria.

## The 19 factors of good-quality service

### Core service and staff skills

- Giving a service where everything works as it should do
- Sorting out problems properly when they occur
- Doing what they say they'll do when they say they'll do it
- Knowing you'll get the same standard of service no matter who you deal with
- Staff who are well trained and know what they are doing
- Staff who are helpful and friendly
- Staff who treat you with dignity and respect
- Being able to get hold of staff when you need to

### Communicating and responding

- Telling you everything you need to know when you need to know it
- Giving you information you can understand
- Listening to your views about how things can work better
- Acting on any comments that you give
- Providing a flexible service
- Giving a choice about what you can have or when you can have it

### X factors – going beyond the minimum

- An organisation that makes you feel part of the community
- Staff who are prepared to go out of their way to help you
- Staff who care about you as a person
- Offering extras that you wouldn't have expected
- An organisation you feel you can trust

## Little things are important

A good standard of service is important, but people care deeply about being treated with dignity and respect. Being listened to and having their concerns acted on are also high on the list of consumer priorities. But people were keen to stress the little things that made a big difference. Things like keeping promises by turning up when you said you would, or remembering people's names, made consumers feel more valued. Putting pots of flowers outside the door not only made consumers feel better about themselves – and the service – but improved the look and feel of the neighbourhood as well.

*They put buckets outside the front door with flowers in. It was that small little gesture which meant a lot.*

People want to be listened to – but most service providers are much better at providing information than responding to users. Consumers appreciate clarity – they want to know where they stand, what to expect, and how to hold providers accountable if things go wrong.

*I just want them to run a professional service. They should have a statement saying what we can expect and stick to that.*

Not listening, or appearing to take no notice, has a negative effect on consumers.

*They asked me where I wanted the radiators – “Where would you like them?” – Then they just did the complete opposite.*

These “little things” may seem obvious, but it is surprising how often they are missing even though they add so much to the quality of people’s experiences. It may be that providers across all three sectors underestimate their importance, or neglect them because they don’t normally feature as formal service requirements.

### **Reality and reputation**

Based on reputation, third-sector providers should do well on delivering factors such as dignity and respect, sorting out problems properly and acting on comments. But our research shows that they do not always excel.

For example, in social housing third-sector providers are no more likely than public-sector landlords to treat tenants with dignity and respect. In more personalised services, such as domiciliary care, more than three-quarters of service users said they were good. But the private sector came out even better. Third-sector providers did, however, stand out in employment services, where nine out of 10 service users said they were treated with dignity and respect.

In terms of sorting out problems properly, third-sector providers were not always rated highly, especially in social housing services. The third sector was no better than the public sector at acting on comments either, but came out much better on employment services and – to a lesser degree – domiciliary care. Consumers of services delivered by private-sector bodies were most likely to say their care provider acted on comments.

Overall, users of third-sector employment services were most likely to say their provider delivered the “good service” factors. Consumers told us that employment services in the public sector were robotic and dominated by targets rather than thinking holistically

about what people need in order for them to find work. People want services that see and treat them as individuals with complex needs, staff who care what happens and make an effort to help them.

*They're interested. They phone you and say: "How did that job go – did you go for that interview?"*

Crucially, consumers wanted to feel they could trust public service providers and wanted more sense of a community – a factor on which third-sector organisations were no "better" than private or public providers.

### **The third sector as a panacea**

Looking at the areas where the third sector claims to excel, such as flexibility and responsiveness, the research shows a subtle picture. The sector is not always as highly rated by users as might be expected, but there are areas where it stands out.

In fact, people's experiences of public services delivered by all three sectors are very mixed. There are examples of good practice and competent staff across the three sectors, but at the same time many are not providing the kind of service that consumers prioritise.

The third sector does best where it is providing services that focus on particular groups and getting an insight into their needs, for example in employment services. But the third sector does not have a monopoly in providing a human touch. In fact private providers of domiciliary care for older people do better in this respect. And there are other instances where the third sector does not stand out at all from public-sector providers, for example in social housing.

### **Intelligent commissioning**

Much has been made of the third sector's reputation for innovation and responsiveness, but the way services are commissioned does not always allow them the autonomy or scope to be creative. Changing the way commissioning is done could open up an opportunity to make sure providers – whatever their sector or background – are dynamic and creative enough to cope with diversity and respond to users' priorities.

Current practice tends to start from the provider perspective – regulatory, technical and financial requirements come first – instead of working with the people who use and provide services and finding out how to make them work better. This means that caution comes before creativity and the approach is better at prescribing inputs rather than outcomes. One of the lessons we have learned from regulation is that public servants can

be risk-averse, using contracts in a defensive way to concentrate on terms that protect the provider rather than help the consumer.

Developing a workforce of skilled and well-informed commissioners and contract managers who know the territory well enough to be able to put together successful mixes of provision and merge different cultures and areas of expertise in different providers is most likely to transform services.

Of course, commissioning is only one piece of the jigsaw, and this change needs to encompass inspection and regulation too, building in similar user-led values. Things are beginning to change in this respect, for example in the emphasis on user voice in the duties of the Care Quality Commission and the Tenant Services Authority.

### **Sharpening up**

The solution is not down to the third sector alone, but there are areas where it can take a lead. The sector overall represents an extensive and eclectic mix of variable interests and expertise. While many have championed the opportunities for further involvement in service delivery, others identify a potential threat to their mission and independence.

Organisations need to be clear about whether they want to be involved in public service delivery and how they can play a role in transforming services. Those that want to get involved need to look critically at the way they work to make sure they have the appropriate skills and structures. And then they must make sure they deliver on their promises and live up to their strengths.

The sector is already moving away from a reliance on its reputation. Now third-sector organisations need to move on to develop clearer evidence on what the sector has to offer, collectively and individually. Potential providers need more data about performance and service effectiveness, showing how they have achieved positive outcomes for consumers.

This evidence gathering should highlight and enhance existing strengths and identify gaps that need to be filled. Good customer insight draws on the relatively untapped resources of knowledge and expertise among front-line staff and service users, as well as independent assessments. There is a balance to be struck between a personal touch and consistency, procedure and flexibility, so staff need to be well trained and to feel confident that they have the authority to deal with day-to-day demands and can handle risk and flexibility to resolve issues that arise.

The sector is also well placed to take a lead in developing and demonstrating how short feedback loops help to collate user comments and complaints into management information to reinforce and encourage innovation.

### **Next steps**

The third sector – like any other – is not innately brilliant but has some examples of best practice that could be made more of, and shared more widely. At present there is little hard data against which we can test the existing anecdotal evidence to support the claims for the sector. The detail is vivid but impossible to quantify, leaving policy makers uncertain about the sector's relative merits and third-sector organisations themselves unclear about the basis for bidding to deliver public services.

The Office for the Third Sector is committed to building an evidence bank to reduce reliance on anecdote, which will help to clarify how the sector fits into the government's overall strategy and encourage more open and frank discussions about where and how to transform services.

To transform services effectively, change will need to be comprehensive, involving providers from the public, private and third sectors across the mixed economy. It requires a fundamental rethink – not just about commissioning, but across the whole process of service delivery and design, from inspection and regulation through to performance measurement and reporting. It would be unrealistic and inappropriate to expect organisations in the third sector to drive this change, but they could and should play a significant role in designing user-centred services.

The answer is not just about scaling up, which does not necessarily deliver local strengths. Our research seems to show that the bigger the organisation, the harder it has to work to get close to users – for example, in social housing, where there can be a disconnection between users and providers.

The third sector already has a crucial role in local partnership arrangements, one that is set to expand as local area agreements and comprehensive area assessments develop. At the same time, local authorities are taking on a stronger commissioning role to work through partners and providers, with a more strategic focus on the needs of consumers, drawing on the best from all sectors. What matters is that all providers of public services deliver effective, evidence-based and cost-effective services that respond to user need. And that consumers know what the lines of accountability are, regardless of who actually delivers their services day to day.

## References

National Consumer Council *Delivering Public Services*, NCC research report (2007)

National Consumer Council *Putting People into Public Services: Intelligent Commissioning* (2008)

National Consumer Council and *Unison Shared Solutions* (2007)

### Excerpt from the public service delivery data

Percentages that gave the response "very good" or "excellent" to the question "How do you rate the performance of your service provider?" on the following questions:

#### *Staff who treat you with dignity and respect*

	Social housing	Domiciliary care	Employment services
Third sector	46%	77%	90%
Public sector	47%	77%	37%
Private sector	N/A	91%	77%

#### *Sorting out your problems properly*

	Social housing	Domiciliary care	Employment services
Third sector	45%	50%	80%
Public sector	37%	55%	33%
Private sector	N/A	58%	64%

#### *Acting on your comments*

	Social housing	Domiciliary care	Employment services
Third sector	32%	41%	76%
Public sector	28%	53%	26%
Private sector	N/A	60%	63%

#### *Makes you feel part of the community*

	Social housing	Domiciliary care	Employment services
Third sector	38%	51%	82%
Public sector	20%	54%	24%
Private sector	N/A	71%	65%

