



For Love and Money

Governance and Social Enterprise

Executive Summary Report

FUNDED

The Governance Hub is a partnership of nine organisations that provide support to the voluntary and community sector: Association of Chief Executives of Voluntary Organisations (acevo), Black Training and Enterprise Group (BTEG), British Association of Settlements and Social Action Centres (bassac), Charity Trustee Networks (CTN), East Cornwall Council for Voluntary Services (ECCVS), National Association for Voluntary and Community Action (NACVA), National Council for Voluntary Organisations (NCVO), Social Enterprise Coalition (SEC) and Volunteering England. The accountable body for the Governance Hub is NCVO (charity number 225922).

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The Social Enterprise Coalition is the UK's national body for social enterprise. The Coalition supports its members by influencing national policy, showcasing the benefits of social enterprise and promoting best practice. For more details visit www.socialenterprise.org.uk

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Foreword

Social enterprises are an increasingly important part of our national economy and are growing rapidly. They include social firms, an increasing number of voluntary organisations who are setting up trading activities, co-operatives, credit unions, community businesses, development trusts and housing associations.

The social enterprise and social entrepreneurship movement is very important, and is driving a big change. It is influencing the private sector to take ethical values into account, the public sector to be more focused on users in its delivery of public services, and charities to develop trading activities.

Good governance in social enterprises is essential for the movement to continue to thrive and be sustainable. Good governance provides legitimacy, accountability and transparency for all stakeholders, and provides a framework for responsible decision making and safeguards for investors.

I am very pleased this report has been produced. It will be of great value to all those that are supporting social enterprises including the Social Enterprise Coalition and the new Leadership and Governance National Support Service.



Campbell Robb
Director General of the Office of the Third Sector

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I. Background and aims

Social enterprises that trade for a social or environmental purpose are a rapidly growing part of the third sector. They comprise a very diverse range of organisations, including co-operatives, community businesses, credit unions, development trusts, trading charities, housing associations and social firms. Social enterprises may take a variety of legal forms; for example they may be registered as companies limited by guarantee or shares, industrial and provident societies, as community interest companies or take unincorporated forms.

Their growth and significance is due in part to changes in government policy, which sees a greater role for social enterprises in, for example, restructuring public services, community development and welfare to work initiatives, as well as the emergence of new ethical markets such as fair-trade. The growth in the contracting out of public services, the move from grants to contracts and the development of new forms of 'venture' philanthropy has led to a general trend of increasing levels of earned income in many third sector organisations. This has raised concerns about how to manage new entrepreneurial initiatives and risks whilst sustaining core values. As in other sectors the quality of governance² and accountability are crucial in maintaining reputation and public trust.

However, the evidence base on the distinctive governance challenges of social enterprises and how they can be best supported is not well established. As a result the Governance Hub, in partnership with the Social Enterprise Coalition, commissioned this report by third sector researchers from the Open University to:

- Identify any characteristics of governance practices specific or distinctive to social enterprises.
- Identify and examine the governance support needs of social enterprises, the specific sources of governance support they currently access and the limitations and gaps in this provision.
- Explore how Governance Hub strategies, services and resources, and those of its successor, might be communicated, adapted, or extended to meet the needs of all types of social enterprises.



HCT is a social enterprise providing transport solutions in London and Yorkshire alongside community training services.

² Governance is often defined as the systems and processes concerned with ensuring the overall direction, supervision and accountability of an organisation.

2. Research approach

Given the lack of existing knowledge about the distinctive governance challenges of social enterprises, the research adopted a qualitative approach to research in order to explore in detail people's experiences of social enterprise governance. The research used a combination of interviews and focus groups with a range of governance advisers, board members and managers in the sector. In all, more than 45 people from across 40 organisations were interviewed or took part in focus groups during a four month period in the summer of 2007.

A critical consideration in designing the research was the great diversity of the sector. It was important to include people from a range of organisations that captured at least some of this diversity on important dimensions, such as size, legal structures, and origins that were likely to shape the governance challenges the organisations faced.

However, not all types of social enterprise could be covered in a relatively small study and it was

decided to exclude housing associations, because

there is already good support available for boards and managers in this field, and social enterprises established as sole-traders or partnerships, because their governance challenges were likely to be simpler (although as they develop the study findings would be highly relevant). As a result the research focused on co-operatives, credit unions, development trusts, football supporters' trusts, health social enterprises, social firms, leisure trusts, trading charities, and a regional group including a range of different types of social enterprise. The advisers interviewed often dealt with a range of organisations and were able to offer at least a partial overview.

Drawing on existing research, a framework was established to guide the conduct of interviews and focus groups. A semi-structured format was used so that interviewers had the freedom to follow interesting issues as they emerged or probe for more detail. The main areas of questioning included:

- Legal and governance structures.
- Typical governance problems and challenges in various areas including: board recruitment, board roles, relationships with management or staff, relationships with stakeholders and funders, balancing social and business goals, training and development, member relations, regulation and accountability.
- The availability of governance support, advice and training and gaps in provision.
- Awareness of Governance Hub services, website and materials; their relevance and extent of use; and the potential for adapting them to better meet the needs of all types of social enterprises.



3. Research findings: governance in social enterprise

The research suggests that, despite the apparent diversity of the different types of social enterprise, there are some similarities in the governance challenges they face. There seem to be two dimensions which are important in helping to understand some of these similarities and differences. The first dimension concerns the origins of the social enterprise and the second the governance structure.

The **origins** of social enterprises are significant because the social enterprise sector is in a state of emergence and social enterprises are developing from very different roots. These different roots affect the transitions they have to make and can influence both the way governance structures are constructed and developed, and the types of issues that emerge. The research identified four important **origins** of social enterprises: mutualism (e.g. credit unions, co-operatives), public sector spin-offs (e.g. leisure trusts), charitable and voluntary activity (e.g. trading charities), new enterprises established by social entrepreneurs, either linked to new social movements (e.g. fair-trade and recycling organisations), or from the business sector.

One important way in which **governance structures** vary is in terms of whether the organisation's board is self-selecting or whether the board is elected by a wider membership, to whom the board is accountable.

Despite the diversity of social enterprise, there are some general themes that have emerged to varying degrees across the research; as well as some specific themes that relate to different types, or the different origins and paths of development, of social enterprise. And while a lot of concern was expressed about governance standards in most of the sub-sectors researched, almost all could point to excellent examples of effective governance.



General themes

- Choosing and developing appropriate *legal and governance structures* for a social enterprise is important, but can be quite complex and difficult. A number of advisers highlighted the importance of good *legal advice* and suggested that from their experience poor decisions could come back to haunt the organisation. However, it may be particularly difficult for small organisations to access this advice, either because it is not available in their locality or because they cannot afford it.
- *Board recruitment*: many people reported problems with 'recruiting or electing' people with the *right skills* and experience onto boards, particularly people with financial,

business and strategic skills. The problem appeared most acute in disadvantaged communities and among smaller organisations. It is difficult to know how much this is due to a genuine shortage of people willing to volunteer their time and how much is contributed by poor recruitment processes.

- *Membership* sets particular governance challenges for how members influence the board. Sustaining active membership becomes more difficult with increasing size (though footballers' trusts offer one model for addressing this issue), but when membership is active, it can be a considerable strength.
- There may be problems maintaining an appropriate balance between *social and business goals*. Some social enterprises may become too focused on social goals at the expense of building a strong, sustainable business and hence jeopardise their survival. Conversely, some may become too focused on business goals at the expense of social goals, which may lead to *mission drift*, compromising the real purpose of the organisation. Boards play a key role in ensuring that any plans for the organisation are subject to critical scrutiny in relation to mission, and that resources are used for their intended purposes.
- *Founder syndrome*. Many new social enterprises may be set up by strongly committed *social entrepreneurs* intent on creating a new market niche such as fair-trade or finding innovative ways of meeting social needs. Governance issues may seem like a low priority as they strive to establish the business, yet as they grow crucial governance decisions can be made by default. There is also a danger that the board may be dominated by strong founders, who may have influenced the selection of board members in the first place. Boards need to be in a position to hold managers and staff to account for their actions. Good governance helps bring new perspectives and a more detached view to make sure that proposals are robust and well thought out.
- There are often problems managing the competing *demands of different stakeholders* – particularly around public service contracts, and with multi-stakeholder boards. Good governance ensures an appropriate balance between the interests of the organisation and its obligations to different stakeholders.
- There is sometimes insufficient clarity about *board/staff roles*, and developing staff support for effective board functioning is often not achieved.
- There can be a number of important constraints that make *board development* challenging, with resources for training often limited and board time at a premium. This highlights



The money that the Eden Project raises goes towards work on education, research, conservation and creating sustainable futures.

the importance of recruiting or electing members with appropriate values, skills and experience and also establishing expectations that board members are expected to devote time to board development activities.

- Perhaps paradoxically, *senior managers* have a key role to play in improving board effectiveness. Boards cannot function effectively unless management supply them with appropriate information and options, and encourage board scrutiny of, and challenge to, their proposals. Senior management are also often in a better position to help identify board development needs and encourage training or other forms of board development. Senior managers may also require training to help them carry out this board development role.
- In small organisations which employ only a small number of staff or no staff at all, the boundaries between governance, management and operational matters can be very blurred. Often current advice and support materials are not so appropriate for these organisations as they assume a professional management structure and fairly clear division of responsibilities between the board and staff.



Specific themes

Social enterprises with small business origins

- Business people moving into the social enterprise sector, do not always recognise the need for transparency and accountability. Their interest often stems from pressure from public contractors/funders expressing concerns about the adequacy of governance.

Member-led/mutual organisations

- In these social enterprises the *board is elected* from the membership. This can mean that boards are elected that do not have the '*appropriate*' mix of skill that is desirable to run the business.
- Another common problem is *maintaining membership involvement and commitment*, particularly as the organisation grows and becomes more professionally led.
- There is a danger in membership organisations that over time the active membership may become *dominated by a particular sectional interest or clique*, who do not represent the interests of the broader membership. Hence the priorities of the organisation may become distorted. For example, a consumer co-operative may become dominated by staff members (although they can only take a minority of seats on the board) and no longer reflect consumers' interests.

Social enterprises with charitable origins

There is good evidence of governance improvements in this segment of the third sector. But although there are important examples of charities engaging whole-heartedly with entrepreneurial ventures and government contracting, particularly amongst larger charities, for many small and medium-sized organisations considerable challenges remain:

- One such challenge is constructing appropriate *governance structures for trading charities*. Broadly speaking, where trading is not central to the charity's mission it is beneficial to establish a non-charitable trading subsidiary, and hence a multi-organisational structure. Legal advice is likely to be needed to design an appropriate structure, including governance arrangements.
- Some charities and voluntary organisations experience problems establishing a social enterprise when moving from a charitable culture to an *enterprise culture*. For example, board members may lack business skills, board members and staff may be risk averse or the organisation may lack a sustainable business model for their enterprise.
- There can be big risks associated with *public service contracting*, particularly for small to medium-size organisations. They may not have the expertise or influence necessary to negotiate successful contracts, for example, achieving full-cost recovery. There may also be a danger of over-dependence on a few sources of income, leaving them vulnerable to sudden changes in public policy. Good governance helps to ensure a strategic approach to managing the risks of such opportunities.



Divine Chocolate is a farmer-owned fair trade company that produces the Dubble and Divine chocolate bars.

Public sector spin-offs

Social enterprises that originate as spin-offs from public bodies have particular challenges for their boards and staff;

- The development of new public service markets can create considerable *uncertainty about appropriate governance arrangements and business structures*. For example, difficulties in transferring staff over pension liabilities and terms of employment may influence business structures and can result in difficult periods of transition. This uncertainty during the phase of market construction can be exacerbated by considerable variation in the practices of service commissioners; and by uncertainty about responses of regulatory bodies, such as the Charity Commission.
- Many social enterprises in this field have multi-stakeholder boards, and there can be a challenge moving away from '*delegate syndrome*', where stakeholders represent particular stakeholder interests rather than the interests of the organisation as a whole.

- With a multi-stakeholder board it can be a particular challenge *recruiting enough people* to the board who have the necessary *business skills, expertise and time* to help run what can be a multi-million pound enterprise. In the early days this can be important in helping establish the legitimacy and market presence of the new enterprise.
- Some social enterprises in this field include staff in their membership. Maintaining *staff membership and involvement* can be a challenge as, over time, staff leave, and new staff who were not involved in the initial transfer may fail to see the benefits. Staff recruitment, induction, training and consultation procedures can be crucial in helping maintain staff involvement.
- A key challenge is *developing boards and staff for market challenges and culture change* – moving away from bureaucratic processes and structures, and reconfiguring and balancing powerful interests like trade unions, staff and funders against those of service users.
- Developing appropriate mechanisms to *involve service users* is often a priority but notoriously difficult to achieve. Boards need to consider how this can best be achieved on a regular basis. In practice, it is likely that combining a variety of mechanisms, ranging from customer satisfaction surveys to board involvement, will be more satisfactory than relying on just one method.
- Many social enterprises are *highly dependent on the contracting relationships* with a dominant funder, such as the local authority or health trust. This can leave them vulnerable to changes in public policy and cost cutting pressures.

4. Support for governance in the social enterprise sector

State of advice/materials in the social enterprise sector

- *Advice on legal structures* – for many individuals and groups wanting to establish a new organisation one of the biggest challenges is deciding on the legal form and governance structure of the organisation. People may not be well-informed at this stage, with choices based on dominant legal forms rather than an informed consideration of a range of structures. Similar problems can also occur if social enterprises wish to change their legal structures or governing documents later in life.
- Larger established organisations are more likely to have enough knowledge of governance and the resources to select appropriate professional advisors; similarly, public sector spin-off organisations can draw on the expertise and resources of the public body from which they originated.
- Smaller and medium-sized social enterprises with less resources and less knowledge of infrastructure are frequently unsure where they can get good governance advice, or feel that it is not affordable.
- Occasionally, people may find well informed local advisers. In general, agencies like Councils of Voluntary Service were not felt to offer much more than basic information and Business Links were perceived as more oriented to other business models and were not felt to understand the needs of social enterprises.
- Some agencies specialise in social enterprise support, such as regional bodies like RISE (for the South West), and SEEM (for the East Midlands). They generally recognize the need for governance support and training and provide basic support on, for example, legal structures. However, such resources are limited.
- Umbrella bodies for particular types of social enterprise, such as the Development Trusts Association or ABCUL for credit unions, are often the first port of call for governance advice and training for social enterprises in their field, but again they have limited resources.
- *Peer-to-peer learning* is sometimes facilitated by umbrella bodies and also takes place through local networks and relationships, as well as through visits and publicity about 'model' organisations.
- There are several *Codes of Practice* and *Toolkits* designed for different types of social enterprise that are attempting to raise the quality of governance. However, it was often felt that social enterprises need advice and training on how to use these effectively in their organisations.
- Overall the picture of *support available* is one where standards are highly variable from locality to locality; and where low-cost, specialist governance advisers are thin on the ground, if not impossible to find.

Governance Hub materials

- The Hub materials were generally known and valued by governance advisers. The Hub was valued for its clear, principled, ethical approach and for being a one-stop shop for advice for trustees and board members of voluntary organisations.
- Chairs and chief executives were much less likely to have heard of the Hub, or the materials and the support it offers, though when presented with some of the material they were usually impressed.

However it was also felt that there were some weaknesses or gaps in the Governance Hub provision in relation to social enterprises:

- The general feeling was that the Hub was a *good web resource* – but there remained an important gap between the web-based resources and the direct support that many organisations needed. It was felt that many social enterprises would require support or facilitation by intermediaries to use the materials effectively.
- It was felt that the materials are better for larger, more formal organisations and that the *needs of smaller organisations* are less well catered for.
- Many social enterprises have their *preferred channels* of information and support, particularly via trusted umbrella bodies for the particular type of social enterprise. So unless these bodies provide links to the Governance Hub many social enterprises are likely to remain unaware of what is on offer.
- The Governance Hub materials were originally designed for use by voluntary and community organisations and charities, which has influenced the *language* in which they are written (for example, board members are often referred to as ‘trustees’). This language is off-putting to some social enterprises, so the materials may need to be revised accordingly.
- Similarly, some aspects of the Governance Hub advice are only appropriate to charities (for example, that board members in their capacity as trustees should not benefit personally from their role) and may not be relevant to other types of social enterprise, such as co-operatives. Similarly, other types of social enterprise may want to emphasise their *own distinctive characteristics* such as the seven co-operative principles.
- There needs to be better coverage of *membership issues*, for example maintaining an active and committed membership, managing member relations, and involving members in governance issues.
- It was felt that the Governance Hub materials under-emphasised the potential impact on governance of *entrepreneurial and trading activities* (which are crucial to social enterprises). So, for example, case studies do not generally address trading issues.

5. Recommendations

The following are recommendations to the Governance Hub, its successor and national bodies responsible for governance support in this sector to enable them to better support the good governance of social enterprises:

1. The Governance Hub and its successor are going to better meet the needs of social enterprises it will need to find a way of *differentiating and tailoring its resources* to reflect the needs of different types of social enterprise and the issues they face. This will involve both adapting the language used to reflect that used in the particular types of social enterprise and considering some issues in more depth.
2. The Hub and its successor should consider developing *better information and support* for social enterprises on the following topics:
 - *overseeing commercial activity and managing business risks*
 - *legal and governance structures for trading subsidiaries*
 - *the governance of multi-organisation partnerships*
 - *membership issues* e.g. maintaining an active and committed membership, developing members so they have the skills to serve on the board
 - *user involvement*, including how to involve users in governance issues and increase accountability to users
 - *the governance of smaller organisations.*
3. The Hub and its successor should explore developing *closer relationships with umbrella bodies and local agencies* that support different types of social enterprise to achieve enhanced support for social enterprises. This might include umbrella bodies adapting and contextualising Governance Hub resources to support governance in their area, ensuring there is better signposting of each other's resources, and developing possible pathways of support related to different types of social enterprise.
4. Many social enterprises are likely to need face-to-face advice and support if they are to use many of the Governance Hub resources effectively. An important priority will be to work to *strengthen links with governance advisers and consultants* working at local, regional and sectoral levels, and provide them with appropriate training and support.
5. The Hub and its successor needs to consider more *active strategies for improving governance*; for example, joining with infrastructure bodies and regulators to raise awareness of the importance of governance, promoting the opportunities for different groups to become involved in governance, particularly under-represented groups such as young people, and providing training and development opportunities.
6. The Hub and its successor should explore the possibility of aligning good practice codes of governance and other standard governance advisory materials amongst third sector umbrella bodies, by drawing out common principles and standards which would form the basis for different versions for different types of social enterprise (as suggested in 1 above).

Social enterprises – organisations that trade for a social or environmental purpose – are a rapidly growing part of the third sector. They comprise a diverse range of organisations, including co-operatives, community businesses, credit unions, development trusts, trading charities, housing associations and social firms.

As in other sectors the quality of governance and accountability in social enterprises are crucial in maintaining reputation and public trust. However, the distinctive governance challenges facing social enterprises and how they can be best supported is not well established.

For Love and Money – Governance and Social Enterprise is the result of research commissioned by the Governance Hub, in partnership with the Social Enterprise Coalition, and conducted by third sector specialists from the Open University. It aims to:

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