

# Understanding the Third Sector: the work of the Third Sector Research Centre 2008 - 2013 (Part 1)

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## Summary

- This briefing – the first of two – provides a summary of the research carried out by the [Third Sector Research Centre](#) (TSRC) over the five years of its existence and comments on the implications for local authorities.
- The TSRC was a five year initiative launched in 2008 to address the lack of research attention focused on the third sector in the UK. From 2008 to 2013, the Centre provided independent academic research on issues affecting the third sector to support improvements in policy and practice. It was jointly hosted by the universities of Birmingham and Southampton and funded by the Economic and Social Research Council, the Cabinet Office, and the Barrow Cadbury Trust. This funding came to an end in August 2013.
- In March 2014, the TSRC published a final report, [Understanding the Third Sector](#), summarising its contribution to the research evidence on the third sector. Many of the Centre's research programmes and key findings will be of interest to local authorities.
- This briefing focuses on third sector policy in the UK and the changing relationship between government and the third sector, including an increasing emphasis on the role of the third sector as public service providers. A second briefing (to follow) will focus on volunteering and 'below the radar' activity.
- This briefing will be of interest to Elected Members, commissioners and policy officers within local government as well as other officers with an interest in third sector issues.

## Background

The [Third Sector Research Centre](#) (TRSC) was established in 2008 to provide independent academic research on key issues affecting charities and voluntary organisations, community groups, social enterprises, cooperatives and mutuals. It was a five-year collaborative venture hosted by the universities of Birmingham and Southampton, with contributions from well-known names in the field of social policy.

The Centre was founded in response to the relative under-development of research activity on the third sector in the UK, and in particular the need for reliable and independent sources of quantitative and qualitative data. Its mission has been to enhance knowledge and understanding of the third sector and develop a strong evidence base to support improvements in policy and practice.

The Centre was funded through a five year joint investment from the Economic and Social Research Council, the Cabinet Office, and the Barrow Cadbury Trust. This investment came to an end in August 2013, although the Barrow Cadbury Trust has renewed its funding for a further five year period. The report [Understanding the Third Sector](#) was published in March 2014 and outlines the work of the TSRC from 2008 to 2013. Over this five year period, the Centre carried out a number of research programmes which will be of interest to local authorities and their public sector partners, including:

- Independent analysis of central government policy and practice in relation to the third sector
- Analysis of quantitative data to understand trends and patterns in the sector, including volunteering levels and geographical variations in third sector activity
- Review of research evidence on the role of the third sector organisations (TSOs) in delivering public services
- Research into the role and nature of small community groups operating 'below the radar', their strengths and the challenges they face.

The Centre was established at an opportune point in recent history, as the first five years of its existence has been marked by dramatic changes to the economic and political environment in which TSOs operate. Researchers have therefore been able to observe the third sector during a period of 'unsettlement', characterised by a significant reduction in financial support from central and local government, changing political and policy priorities, and new expectations of TSOs in terms of their role and how they should operate.

Significantly, the delivery of key central and local government policy agendas is predicated on a number of important assumptions, some of which are challenged by research findings from the TSRC. These and other relevant findings are set out in this briefing as well as a second briefing, which will follow shortly. This first briefing focuses on research into the changing relationship between government and the third sector, while the second forthcoming briefing will examine research findings in relation to volunteering and 'below the radar' activity.

All TSRC publications, including over 100 Working Papers, can be accessed via the [Third Sector Knowledge Portal](#) – a new online catalogue of research and information on the sector, developed in partnership with the British Library. The LGiU briefings focus exclusively on research considered pertinent to those working within local government.

## **A note on terminology**

When the TSRC was launched in 2008, the term ‘third sector’ was widely used to describe to what is generally referred to today as the ‘voluntary and community sector’ (VCS) or the ‘voluntary, community and social enterprise sector’ (VCSE). It is an umbrella term incorporating the diverse range of organisations which occupy the space between the formal state/public sector and the private sector. This includes local community and voluntary groups, registered charities both large and small, foundations and trusts, social enterprises, cooperatives and mutuals. TSOs share common characteristics: they exist to pursue social, environmental or cultural objectives, and they reinvest any profits or financial surpluses back into their organisation or the community to further their social, cultural or environmental goals. Whilst recognising that ‘third sector’ remains a contested term, it is used in this briefing for consistency purposes.

## Public Policy and the Third Sector

There are a number of competing theories as to the role of the third sector in society and its relationship to the formal public sector (the ‘state’). One approach considers voluntary action to be a substitute for state provision, implying a ‘zero sum relationship’ between government and the third sector in which public service spending ‘crowds out’ third sector activity. Another view is that voluntary action is additional and/or complementary to state action, suggesting a relationship of cooperation and interdependence where neither sector displaces the other but instead addresses the other’s limitations in meeting social need.

The third sector policy environment has been a key focus for the TSRC, and authors argue that the divergent policy agendas pursued by the successive Labour and Coalition governments have been driven by different views of the third sector, its role in society and its relationship with the state.

### 1997 - 2010: Partnership and mainstreaming

The TSRC suggests that the third sector achieved a higher profile during the 13 years of the Labour government than at almost any other point in history. The previous Labour government openly committed itself to promoting and supporting an active partnership with the sector, including ‘underwriting’ the sector through increased levels of direct financial support. According to the TSRC, this emphasis on collaboration stemmed from the perceived interdependence between government and the third sector. Together with the private sector, the third sector was recognised as an equal and complementary partner in the implementation of the ‘Third Way’ and a mixed economy of welfare. Income from government grew from £8.4 billion in 2000 to £12 billion in 2007, and all of this additional funding came in the form of public sector contracts.

By the mid-2000s, a range of new institutions had been created to act as sites for policy development and provide a new structure for the government’s relationship with the third sector. These were rationalised through the creation of the Office of the

Third Sector (OTS) in 2006, bringing policy coordination for the voluntary and community sector together with social enterprise, cooperatives and mutuals – organisations which traditionally had not been seen as belonging to a collective third sector.

The Labour government invested considerable sums in initiatives to support organisational development and build the capacity of TSOs to engage in public sector delivery. Two major investment programmes included Futurebuilders, a £125 million investment fund which provided grants or loans to help TSOs bid for public funding; and ChangeUp, a £150 million strategy to improve support and infrastructure for TSOs.

Third sector representatives were encouraged to engage in policy planning and implementation through the national Strategic Partners Programme, with funding provided to key national agencies to support their policy, advocacy and representative work with government on behalf of their members. In this context, the TSRC argues, it was beneficial for TSOs to portray themselves as a single cohesive sector, and national bodies forged a unified single sector perspective to pursue the government's new policy agenda of promoting and developing the third sector.

In a discussion paper published ahead of the general election in 2010, the TSRC noted that much of the positive engagement and partnership occurring under new Labour had been driven by high levels of financial support available through OTS. Whilst political support for partnership may have continued into the next administration, the author questioned the ability of the government to sustain this level of support in aftermath of the 2008 economic recession, whichever party took power.

## **2010 - present: Separation and transition**

According to the TSRC, a fundamental shift has been occurring under the Coalition government, based on a very different perception of the third sector. The current government's vision of a vibrant and independent third sector (relabelled 'civil society'), freed from political interference to develop effective local responses to local needs, is guiding significant changes in policy. Whilst there are important continuities with the previous administration, the emphasis has moved from interdependence between government and the third sector to the promotion of an independent third sector as a site of self-organised social action and an alternative to state provision.

Underpinning the discussions and debates on the Big Society is the view that the third sector has become too close to the public sector, too dependent on income from government sources, and stifled by bureaucratic processes and regulation. In an interview with [Third Sector magazine](#) in August 2010, newly appointed Minister for Civil Society Nick Hurd explained: "The heart of the big society agenda is about trying to reduce people's sense of dependence on the state, and that goes for the sector as well." He said that the sector's "creeping dependence" on the state was "not compatible with our long-term vision of the sector, which is of a robustly independent and resilient pillar of a stronger society where there's a better balance

between state, market and civil society.” Similar views were articulated in the Conservative Party’s 2008 policy review *Voluntary Action in the 21<sup>st</sup> Century*, which argued that the sector had been directed and controlled by the state, becoming “not partners but servants”.

The TSRC argues that Coalition policy on the third sector can therefore be seen as an attempt to recast the relationship between the state and the third sector. Some policy trends initiated under Labour have continued, such as the drive to involve TSOs in commissioned public service delivery, and the expansion of social investment funding to enable TSOs to adopt more sustainable business models. In contrast to the close alliance developed under Labour, however, the current government has sought to divest itself of responsibility for the third sector, dismantling existing institutional arrangements and support mechanisms and promoting independence from financial relationships with the state. Key examples of separation include:

- **Changes in central government architecture** – The Office of the Third Sector was renamed Office for Civil Society and its budget cut by 60 per cent, significantly reducing its capacity to play a coordinating role across government.
- **Changes in the relationship between central government and key national representative organisations** – Funding for the national Strategic Partners Programme was scaled back and gradually phased out over three years from 2011 to 2014, effectively ending the programme which facilitated closer policy relationships between the state and third sector.
- **Changes to investment in capacity building and local infrastructure support** – Both Futurebuilders and ChangeUp were abandoned and replaced by the lower cost Transforming Local Infrastructure programme, the explicit aim of which was to help the sector “make the transition to greater strength and independence” through “transformational activities” and “more sustainable business models.”

### Comment on implications

Central government’s conception of its relationship with the third sector has implications for local authorities and their relationships with the sector at a local level. For example, under the Labour government, partnership was actively encouraged between local authorities and TSOs through initiatives such as Local Compacts; Local Strategic Partnerships; National Indicators, specifically ‘NI 6: participation in regular volunteering’ and ‘NI 7: environment for a thriving third sector’; Comprehensive Area Assessments, which included a focus on how well local public bodies work with each other, the private and third sectors; and the Duty to Involve.

The majority of these initiatives have been abandoned by the Coalition government, and there is no mandated third sector representation on new partnerships such as Local Enterprise Partnerships and Health and Wellbeing Boards (with the exception

of Local HealthWatch). Furthermore, local authorities have not been given a formal role in the delivery policy initiatives such as [Community Organisers](#) and [Community First](#), which involve TSOs based within their administrative boundaries. Rather than promote local partnership working and collaboration around mutual objectives, these programmes can potentially lead to community action which is at odds with strategies and plans of local authorities.

A lasting legacy of the new Labour government is its portrayal of a diverse array of organisations operating between the public and private sectors as a single coherent 'third sector'. The idea of a third sector and its increased profile in public policy continues to provide a unifying framework for a wide range of organisations and interests, including charities, voluntary and community groups, social enterprises, co-operatives, and faith groups which previously had been more fragmented and less effective at a strategic level.

Although not necessarily labelled as such, the notion of a cohesive 'third sector' has also been institutionalised locally through the creation of Local Compacts, the majority of which use a similar definition of the sector to that developed by the new Labour government (bringing together small community groups, charities and other voluntary organisations with social enterprises, mutuals and cooperatives).

While the concept of the third sector can be useful for organisations in terms of articulating their distinctiveness and unique value in relation to private and public sector providers, this idea that it exists as a single unified entity can also be problematic as it implies a degree of homogeneity. Local infrastructure bodies or 'sector representatives' are often asked to provide a 'sector view' on policy issues – an impossible task when one considers the diversity of organisational interests. Most organisations are likely to see themselves as operating within 'subsectors' (for example, housing, advice, mental health, social care, training) and may have more in common with public and private organisations operating within the same field than another TSO operating within a different field. As an example, employees or volunteers in a Citizens Advice Bureau are likely to identify more closely with other organisations operating within the advice subsector (regardless of sector) and look to similar local agencies and national bodies, such as Citizens Advice, to promote and represent their interests rather than any over-arching third sector umbrella body. There is a risk that local public sector organisations establish only a single route to engaging with what they understand to be the third sector, meaning that the voices of many organisations potentially representing the interests of key customer groups and vulnerable populations are not heard.

As councils move to strengthen their Community Leadership role and gain a deeper understanding of their communities in order to manage demand, they may wish to consider how best to enable a diversity of voices from the sector.

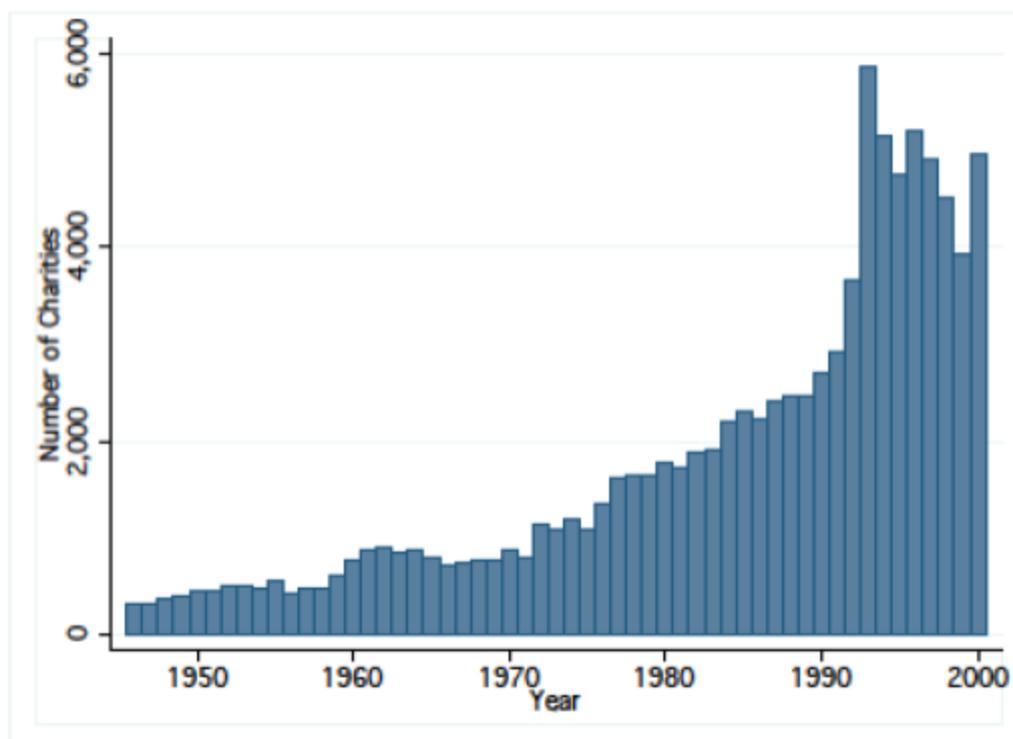
"Too often the assumption is a shared position – yet it is unusual for that to exist. We need coherent channels for enabling multiple voices to be heard. Like a choir." (Participant in a debate on the third sector and leadership, hosted by the TSRC in February 2013)

## Does the state 'crowd out' voluntary and community activity?

The TSRC suggests that Coalition policy has been guided by a 'zero-sum' view of the relationship between government and the third sector. The belief that TSOs will step in to replace reduced public welfare provision is based in large part on the belief that public welfare provision has 'crowded out' voluntary action. In order to understand the relationship between public service expenditure and third sector activity, the TSRC examined data on charity formation since the creation of the 'welfare state' following the Second World War.

According to a survey of public spending in the UK by the Institute for Fiscal Studies, the total amount of public spending has grown relatively steadily in real terms throughout the post-war period, with an average annual real increase of 3.4 per cent between 1948/49 and 2008/09. TSRC analysis of key data found no evidence that this increase has occurred alongside a decline in the scale of third sector activity; rather, a steady rise in the numbers of registered TSOs suggests a more or less continual process of growth over the latter half of the twentieth century. Over the last decade, the sector's workforce has increased by 40 per cent, rising from 566,000 employees in 2002 to 800,000 in 2012, and this expansion has occurred during a period characterised by particularly large increases in public spending (1997/98 – 2010/11). Furthermore, national survey evidence shows that levels of participation in formal volunteering (i.e. unpaid help taking place as a part of a group, organisation or club) have remained relatively stable since records began in the early 1980s.

**Figure 1: Growth in Charity Foundation from 1945-2000**



### Comment on implications

Long term analysis of charity registrations indicates that third sector activity has expanded not declined alongside the development of the post-war welfare state in the UK, challenging the notion that voluntary and community action is ‘crowded out’ by increasing levels of public service expenditure. Some commentators maintain that government plays an important role in enabling a thriving sector, and the rapid expansion of activity in the first decade of the new century has indeed been facilitated by significant financial support from government. Rather than promoting the growth of a vibrant and independent sector, it could be argued that reductions in public expenditure and efforts to ‘shrink’ the welfare state could lead to a decline in third sector activity.

### How dependent is the third sector on public funding?

In promoting the idea of the ‘Big Society’, ministers have at times implied that the third sector has become too dependent on public funding. The TSRC analysed data from the 2008 National Survey of Third Sector Organisations (NSTSO), a representative sample of 48,000 TSOs in England, to understand the importance of statutory funding to the sector.

TSRC analysis indicates that approximately 36 per cent of TSOs received public money in 2008, and only 14 per cent (23,000) organisations regarded statutory funding as their most important source of income. Of those organisations in receipt of public funding, only 30 per cent saw the public sector as their most important source of funding. Donations and fundraising were regarded as more important by 17 per cent of organisations that received public funding, and membership fees were regarded as the most important source by 10 per cent. Information from the NCVO Civil Society Almanac 2014, issued earlier this month, confirms that income from individuals remains the largest source of income for the sector.

The likelihood of receiving public money in 2008 varied according to the size, age, geographical location and purpose of the organisation.

- Size: larger organisations were more likely to be drawing on public funding
- Age: charities registered since 2000 were significantly more likely to be in receipt of public funds than charities registered in earlier years.
- Region: 33 per cent of organisations in London and the south-east received public money compared to 42 per cent of organisations in the north-west and 43 per cent of organisations in the north-east
- Level of deprivation: the higher the level of deprivation in an area, the greater the likelihood that the organisation was in receipt of public funding and regarded statutory funding as its most important source of income
- Main areas of work: organisations were much more likely to be receiving public funding if they criminal justice, equalities and civil rights, capacity building and other support for TSOs, or social cohesion and civic participation.

### **Comment on implications**

Data from the 2008 NSTSO challenges the idea of third sector 'dependency' on the public sector and suggests that concerns about third sector decline as a result of current austerity measures may be misplaced. Although UK government spending on the sector fell by 10 per cent from 2010/11 to 2011/12, all other major sources of income increased or remained relatively stable over this period. Income from individuals – the sector's largest source of income – rose from £16.9 billion to £17.4 billion, a rise of 3 per cent. As a result, the decline in total sector income was 1.8 per cent – much less than one would expect if the sector was overly reliant on public funding.

The findings do, however, indicate that a sudden withdrawal of public funds could have a disproportionate effect on some TSOs relative to others. These include those organisations based in disadvantaged communities and 'younger' organisations, which themselves are more likely to be located in disadvantaged areas that have benefited from recent regeneration initiatives.

Based on the funding patterns present in 2008, we might expect organisations serving the most deprived areas of the country – those with the highest needs – to have been disproportionately impacted by the £1.4 billion reduction in government funding for the sector from 2010/11 – 2011/12.

## **Third Sector, Social Enterprise and Public Service Delivery**

The way that public services are delivered in the UK has changed markedly in recent decades, with an increasing role for private and third sector organisations as contracted providers. A central claim by successive governments is that the third sector in particular can deliver services in distinctive ways, which will improve outcomes for service users and generate additional social value beyond the basic requirements of a contract. There is a general consensus among policy makers about the unique characteristics of TSOs which make them particularly suited to public service provision. Specifically, TSOs are perceived to be closer to communities, with a better understanding of local needs and the needs of specialist client groups; more trusted by service users; more flexible, responsive and innovative; and driven by values and a caring ethos. Furthermore, TSOs are able to draw on a wide combination of resources, including the contributions of volunteers, philanthropists and other charitable donations.

The marketisation of health and social care services in the early 1990s opened up new areas of work for charities and non-profit organisations, and their role in service delivery rapidly expanded under the New Labour government, which saw the sector as a key player in a mixed economy of public service provision. As strategic commissioning gained prominence within local government, funding relationships between local authorities and TSOs have been reconfigured away from grant-aid towards services provided under contracts, encouraging a shift in the sector towards greater emphasis on earned income through trading.

Pressure on TSOs to operate in a commercial manner has continued under the Coalition government's 'Open Public Services' agenda, which centres on the themes of greater private and third sector involvement in the delivery of public services; improving service quality and efficiency through choice and innovation; market mechanisms and 'payment by results' (PbR) contracting. Economic uncertainty and increasing competition for charitable donations and statutory grants also means many charities are seeking to generate additional revenue through trading activities in order to sustain their core charitable work.

The changing nature of the third sector's role in service delivery is reflected in the fact that many TSOs – including registered charities – now refer to themselves as 'social enterprises'. There is no legal definition of social enterprise, but the term is widely used to refer to organisations that trade in the open market to achieve social impact rather than generate profit for owners and stakeholders. Social enterprises fund their social mission by reinvesting their profits back into the business or the local community. A key difference between a social enterprise and a traditional charity's approach is the move from a reliance on grants and voluntary donations to an emphasis on trading activities – selling products and services to customers

(including public sector agencies). Both are focused on delivering a social mission but social enterprises do so in a business-like way.

## Review of Evidence

Public sector commissioning and the implications for the third sector has been the subject of much research in recent years. Studies have tended to focus on the willingness and capacity of TSOs to engage in public sector commissioning, their support needs, and their experiences in the new service delivery landscape. The TSRC carried out an evidence review in 2010 to understand what the existing research tells us about the impact of the new contracting environment on organisations and service users. Reviewers examined 48 separate studies published between 2004 and 2010 which considered the role of the third sector in delivering public services.

### Impact on third sector organisations

Expansion of contract funding for service delivery has been warmly welcomed by some in the sector, while others have raised concerns about the potential impact on organisations. Six concerns in particular are discussed in the literature:

- Erosion of independence – a fear that the sector’s role in community action, advocacy and campaigning will be sidelined as organisations face pressure to conform to statutory funders’ agendas
- Mission drift – the pursuit of specific funding streams may cause organisations to drift away from their founding mission
- Loss of responsiveness and innovation – a narrow contracting culture might encourage service providers to focus only on what is specified in the contract
- Employment conditions – concerns about downward pressure on pay, terms and conditions, and increasing employment insecurity as a result of short term contracts
- Inter-organisational relationships – increasing competition (for public service contracts) is not conducive to collaboration within the sector
- Polarisation within the third sector – risk of increasing disparity between organisation successful in winning contracts and those that are unsuccessful, or are unable or unwilling to engage in public service delivery; between larger and smaller organisations, with resources increasingly concentrated in fewer larger organisations; between national and local organisations, with non-local organisations accused of ‘parachuting in’.

The review found that research findings on the actual impact of new commissioning processes on TSOs are ambiguous and sometimes contradictory. Much research

attention is given to the concerns of third sector staff, but the extent to which these trends are actually materialising remains unclear and under-researched according to the reviewers. In other words, existing research examines the perceived risks and expressed anxieties rather than considering their actual incidence and the different circumstances in which they might transpire.

### **Impact on outcomes: does sector matter?**

To date, research has tended to focus on the experiences of third sector providers and their view of performance rather than evaluating the impact on service users. Little research attention has been given to the nature of the services commissioned from TSOs, whether new contracting arrangements are leading to service improvement, and critically what differences the services have made for service users.

Empirical evidence of the impact of public service provision by the third sector is scarce, and it is not clear whether TSOs are better equipped than public or private sector organisations to achieve outcomes because of a lack of comparable data. This is due to the dearth of cross-sector comparative research in different fields of service delivery. The very limited number of studies available (at the time of the review) do not support the claim that the third sector is inherently more innovative and they demonstrate little or no systematic differences in outcomes of public services across different sectors. This is not to suggest that third sector services are not distinct from those provided by other sectors, and there exists a multitude of examples of excellent practice and innovation within the sector. It simply means that further research is required to assess the relative strengths and performance of organisations from different sectors when delivering comparable services.

### **Comment on implications**

Despite constant government support for third sector involvement in public service delivery, there is surprisingly little objective evidence to justify this policy direction. The state's interest in and promotion of social enterprise in particular seems to be based more on expectations and assumptions of innovativeness than on reliable evidence. The high profile accorded to social enterprises since the early 2000s is even more surprising when one considers the importance attached to evidence-based policy-making under the preceding government. Critics have long argued that the continued and accelerated outsourcing of public services by consecutive governments has been driven by ideology rather than evidence.

'Evidence-informed' decision-making is arguably increasing in importance as public sector resources diminish and local authorities consider alternative models of service delivery. A much stronger evidence base for the potentially distinctive and added contribution that the third sector can make over and above public or private sector provision would be beneficial for local authority leaders and commissioners. While there is no doubt that TSOs can deliver social value, this could conceivably be provided just as easily by public and private sector organisations.

The newly established 'What Works' centres could potentially play a part in closing this evidence gap; however, it should also be recognised that demonstrating distinctiveness may be extremely difficult given the diversity of organisations that constitute the third sector. This could present an insurmountable challenge to creating a robust cross-sector assessment framework.

## **Social enterprises and employment**

There has been a growing interest in the role of TSOs in employment provision either as direct providers of jobs, or contracted providers of training and support to help vulnerable individuals find employment. However, very little is known about the quality of jobs they create or the impact of their services in comparison to those provided by the public or private sectors.

### **Support into employment**

The TSRC reviewed the limited number of studies in the field of homelessness that explore the impact on beneficiaries of social enterprises contracted to provide them with employment support. These studies reveal the challenges involved in balancing social and economic goals – i.e. generating a sufficient surplus whilst continuing to meet the needs of clients who often have complex (and costly) needs. Researchers found that outcome related payments and the need to generate a surplus drove some organisations to 'skim off' those clients easiest to place into employment or provide advice to (often referred to as 'creaming', whereby resources are focused on easier-to-help individuals at the expense of those who are further from employment). This has led to warnings that as TSOs become more market oriented, they may face pressure to abandon those clients with the most complex and acute needs on the basis that these groups are not profitable enough to work with.

Despite the paucity of comparative evidence, the third sector's role in welfare to work provision has continued and indeed intensified under the current government. The Work Programme, one of the largest and most high profile exercises in out-sourcing services, has provided the TSRC with an opportunity to compare the experiences of third sector providers with those of public and private sector providers operating in the welfare to work market. Concerns have been raised about the structure of the programme – specifically its use of arms-length management (which transfers the financial risk away from the Department for Work and Pensions to prime contractors), payment by results and a supply chain model – and the potential impact on third sector providers who risk being squeezed out of the market or marginalised within in.

A year-long study by the TSRC found little evidence that there is anything genuinely distinctive about the experiences of TSOs compared to providers from other sectors. Instead, what are often perceived as uniquely third sector issues are actually programme design issues affecting providers from all sectors. How organisations experience the programme is most strongly influenced by their position in the supply chain, which dictates whether or not they receive sufficient client flows or referrals to remain financially sustainable. Prime contractors – the vast majority of which are

private sector providers – can either deliver employment support themselves via their own ‘in house’ services and/or subcontract to tier one ‘end to end’ providers, who effectively take a client on the complete journey from unemployment to a two year sustained job outcome. At the time of the study, 41 per cent of tier one subcontracts were held by TSOs. End-to-end providers (primes and tier one) can then subcontract to tier two suppliers who offer specialist interventions to participants with particular needs or barriers to employment. Tier two operates with spot purchase agreements rather than outcome-based payments, meaning that end-to-end suppliers have to take on additional financial risk, paying upfront for support to a client who may or may not achieve a sustainable job outcome (and results payment) in the future.

The TSRC found that low volumes of Employment Support Allowance (ESA) claimants on the Work Programme have had a knock-on effect for referrals to tier two suppliers, who are most likely to provide services to ESA claimants. This is a challenge in particular for third sector providers because the sector holds the majority (51 per cent) of tier two subcontracts; however, tier two providers from the public sector and private sector have been similarly affected.

Researchers also uncovered evidence of widespread ‘gaming’ behaviour among end-to-end providers (primes and tier one providers) from all sectors, particularly the ‘parking’ of harder-to-help clients (i.e. individuals deemed unlikely to generate an outcome payment are put to one side or receive the bare minimum service), which has undoubtedly contributed to the lack of referrals to specialist providers. This is occurring despite the programme’s differential payments designed to discourage such behaviour. Even where a need had been identified, few end-to-end providers were referring clients to tier two specialists, preferring instead to keep provision in-house or signpost clients to ‘free’ services provided by local authorities and housing associations.

Prime and tier one providers interviewed over the course of the study argued that the current contracting and financing arrangements meant they did not have the resources to fund specialist services for clients who were unlikely to trigger a job outcome payment. The researchers conclude that the payment by results model, in combination with unpredictable/below-target client flows and the difficult economic conditions, has led to a situation in which advancing funding for specialist interventions is deemed too great a risk for most end-to-end providers, regardless of sector. Gaming behaviour is therefore seen to be a product of the programme structure, and the funding model in particular, rather than the motivations of providers.

### **TSOs as employers**

As well as delivering welfare to work services, many social enterprises are established to create employment for the most vulnerable people in the labour market. In 2012 the TSRC conducted a [large international survey](#) of social enterprises (655 organisations across eight countries) on behalf of the OECD to gain a greater understanding of the working conditions within these organisations, and the

challenges involved in providing high quality employment while keeping costs down in order to operate in competitive markets.

The TSRC found a striking degree of consistency when respondents were asked which aspects of job quality were most difficult to deliver. Job security, training and career progression, and adequate pay were most frequently identified the aspects most difficult to deliver. Those organisations which employed vulnerable people were more likely than others to find it difficult to provide adequate levels of pay.

Respondents were also consistent in their reasons why certain aspects were difficult to deliver. Difficulty in delivering job security was most frequently attributed to uncertainty about future funding, short-term government contracts, and changing government priorities over time. Many organisations did not generate sufficient revenue to pay employees a living wage because they worked in highly competitive sectors characterised by low pay, with some social enterprises reducing wages to compete with private sector companies for public service contracts. Career progression was said to be difficult to deliver due to the flat organisational structures of the social enterprise model and the lack of funding for training.

A key finding from this research was the sense that social enterprises employing vulnerable people felt it was the government's responsibility to meet the costs of the 'social dimension' of their work – i.e. the additional costs associated with employing vulnerable individuals who may otherwise not find work. By providing high quality jobs for vulnerable individuals, these organisations can make a significant contribution to society but they cannot be expected to do so without sufficient financial support.

### **Comment on implications**

Social value clauses in public procurement have a central role to play in promoting social inclusion, but it is important that the cost of creating this additional social value is taken into account by commissioners. Otherwise, there is a risk that social value clauses will favour TSOs but leave them to deliver services on insufficiently funded contracts, putting downward pressure on wages.

The findings demonstrate the need for public sector contracts to be at a level that enables TSOs to deliver both high quality services for users and key aspects of job quality for employees, such as adequate pay, career progression and security of employment. This applies not just to the third sector but to the private sector as well – for example, the Equality and Human Rights Commission has already called on councils to change their commissioning practices in relation to home care provision in order to tackle the poor pay and conditions of care workers. Addressing these issues will be particularly challenging for local government in the current fiscal climate; nonetheless, many local authorities are starting to consider whether a living wage is paid when procuring new contracts.

Many Local Enterprise Partnerships have stated that social enterprises will be key contributors in the implementation of their European Structural and Investment

Funds Strategies, particularly in delivering skills and employment programmes to vulnerable groups. Local authorities should seek to ensure that programme funding meets the full cost of providing high quality support and/or job opportunities for individuals with complex needs, and avoid unsustainable contracting models that leave organisations with little choice but to ‘game’ the system. It is also important to recognise that while the social enterprise model may be suitable for some projects, others – particularly the provision of support to individuals with the highest level of needs – are likely to require more diversified income streams.

## Public service ‘spin outs’

There is a growing interest in social enterprise ‘spin outs’ from the public sector, and the Coalition government has been actively promoting this option as a means of “bringing higher levels of staff engagement, efficiency and innovation into public service delivery.”

The TSRC had the unique opportunity to observe the experiences of community health workers in the West Midlands who were seeking to develop a social enterprise under the ‘Right to Request’ scheme introduced by the Department of Health in 2008. The Right to Request was open to all community health workers in England and ultimately resulted in 40 new social enterprises, involving approximately 20,000 NHS staff.

TSRC researchers identified a number of challenges for NHS staff in the West Midlands who were interested in ‘spinning out’ their service. Right to Requests which failed to progress did so for the following reasons:

- **Lack of staff support** – all of the Right to Request groups in the West Midlands reported staff anxiety and/or opposition to the potential of their services being transferred from the NHS to a social enterprise, and in some cases this led to the enterprise not being able to proceed. Clinicians in particular (as opposed to managers) were not comfortable proceeding unless the overwhelming majority of their colleagues were in favour of the proposal.
- **Lack of skills and confidence** – many frontline staff lacked the confidence and capacity (outside of their clinical responsibilities) to progress their vision to the next level as well as the business and management skills required to set up a social enterprise and survive within a competitive market. Senior managers leading larger service areas were more familiar with business planning processes and were more likely to have both the skills and confidence to take forward their proposals, develop a sound business case and convince stakeholders of the worth of their vision.
- **Lack of organisational support** – aspiring entrepreneurs whose managers held negative views of the social enterprise model found it difficult to move beyond an expression of interest. This was due to their belief that the proposal would not proceed without support from their senior manager or

because they perceived that their manager was actively blocking their proposal. Some staff were also concerned that there could be repercussions for them if they went ahead without their managers' support.

- **Lack of commissioning support** – the degree to which proposals fitted with existing commissioning strategies was another determining factor; some commissioners did not believe that a social enterprise was an appropriate model for the service in question, while others were unclear about the advantages of social enterprise more generally.

Based on the experience of Right to Request groups in the West Midlands, the TSRC makes three broad recommendations for public sector organisations interested in developing alternative and employee-led service delivery models:

- **Evidencing the potential** – research is needed to analyse the impact of social enterprises on the outcomes of the populations they serve, and how this compares with the public sector and private businesses.
- **Entrepreneurial readiness** – staff require more training and support if they are to have vision, confidence and skills to consider developing social enterprises, and this needs to be introduced systematically across their careers.
- **An enabling environment** – line-managers need to understand and promote the benefits of the social enterprise model to their staff and actively support individuals who express an interest in 'spinning out'. Commissioners also need to be willing to give enterprises time to develop (during an incubation period, for example) and then have a market development strategy that enables enterprises to compete to retain current services or gain new work.

The Right to Request programme was replaced by the 'Right to Provide' scheme in March 2011, which extends the right to 'spin out' to all English health and social care workers. The Coalition government has since extended support for employee-led initiatives to other parts of the public sector through its Mutual Pathfinder programme as well as the [Community Right to Challenge](#) introduced by the Localism Act 2011.

### Comment on implications

Local authorities exploring the 'spin out' option can learn from the experiences of community health workers under the Right to Request scheme. Existing studies on staff-led mutuals within local government indicate that the barriers encountered by local authority staff during the spin-out process are very similar to those identified by the TSRC in the health sector. Support from the senior management team in particular is fundamentally important; without this, it is unlikely that a proposal will succeed. The NHS experience indicates that securing senior level buy-in will require a robust business case with a strong cost-benefit analysis. However, it also highlights the influence exerted by middle management, and local authorities keen to

develop employee-led social enterprises might consider targeted communications to ensure that key messages permeate all levels of the organisation.

Unfortunately, there is limited evidence to date on the outcomes of public sector spin-outs and their performance relative to in-house provision. As mentioned previously, comparative research is required to build a strong evidence base in support of the social enterprise model so that the potential benefits can be clearly communicated to staff, service users and potential commissioners, as well as Elected Members.

TSRC researchers note that local authorities are perhaps more experienced in outsourcing in-house services and working with the third sector than many health bodies, but issues regarding staff confidence and competence to successfully spin out into a private business will be similar. A study of local authority spin-outs in London found that while staff were extremely capable of delivering services, writing bids and working to contract specifications, their skills in relation to business strategy and administration, and their capacity for entrepreneurial thinking were more limited. Organisations have addressed this skills gap in a number of different ways, including:

- Building entrepreneurship into existing training and development programmes so it becomes an option with which people are familiar
- Providing short information sessions for staff based in services well suited to the social enterprise model to help them understand the opportunities and better quantify the risks
- Delivering training courses in business administration to key staff interested in developing a social enterprise
- Business mentoring by private sector partners
- Recruiting people with the requisite skills onto the board of directors – for example people with a background in finance, fundraising and marketing, and those working in the commercial sector who have an interest in tackling social issues
- Seeking advice from local authorities and other public sector organisations across the country who can act as mentors

Recognising that many councils will be considering service spin-outs in response to budgetary pressures, a clear message emerging from the research is that spinning out to avoid the alternative (e.g. the service being withdrawn or put out to tender) may result in a business case that does not stack up, ultimately leading to a service which is unable to compete in a competitive marketplace. To mitigate this risk, local authorities might consider adopting a two-stage approach that includes an incubation period in which to test the business model and secure support from commissioners.

### **Related briefings:**

- Understanding the Third Sector (Part 2) – *forthcoming*

- [Challenges faced by the voluntary and community sector in supporting local services and developing resilient communities](#)

### External resources:

- [Third Sector Research Centre – List of Publications](#)
- [Third Sector Knowledge Portal](#)

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