The third sector:
Value driven, transparently managed

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The third sector, including voluntary, community, and not for profit organisations, social enterprises, and co-operatives, plays a fundamental role in addressing many of society's unmet needs. These organisations are typically value-driven, and function independently of government.

Third sector organisations have historically been well-respected and valued by the British public. Indeed, recent polling demonstrates that they are the third most trusted institution in the UK, slightly behind doctors and the police.[1] However, the Cup Trust scandal, the recent furore over heavy-handed fundraising approaches, as well as the collapse of a number of high-profile organisations have increased public and media scrutiny unearthing a range of possible issues both governance related and otherwise.

This short paper will explore these issues in detail before presenting a range of possible solutions drawn from the Good Governance Institute's (GGI) extensive experience in the health and education sectors, as well as from ideas put forward in interviews conducted to inform this report. It is our belief that the sector would benefit from more prudent financial management, an improved regulator, greater leadership development and succession planning, and further education around the role of the Trustee: in short, good governance. Lessons from other sectors can, and should, be learnt from and we present a few of these in the narrative below.

Uncertain funding

The majority of third sector organisations have to live with uncertain funding streams and the particular pressures and stresses that this brings. Voluntary organisations are increasingly relying on governmental funding, typically from specifically commissioned work under contract, over the pursuit of individual donors and more traditional funding streams.

Figures recently released by the National Council for Voluntary Organisations (NCVO) demonstrate that income to the third sector from government decreased by £1.9 billion, or 12.5%, between the years 2010-2013.[2] This has caused problems in the sector as charitable organisations are expected to take on an increasing amount of public sector work with fewer resources.

The consequent shift to payment by results (PbR) contracts – contracts that make any payment contingent on the independent verification of results – has altered the playing field and been met with concern by many in the sector. The NVCO reports that:

voluntary organisations typically have low reserves and this means that the cash flow required to implement and sustain services in a PbR model may be too great.[3]

Furthermore, a recent report by the Institute for Government argued that PbR contracts are "stifling innovation", with 80% of providers surveyed arguing that they are concerned by the financial risks inherent in the contracts.[4] It is too early to assess the evidence base for the effectiveness of this form of commissioning, but what is clear is that in developing and ensuring the effectiveness of PbR, the government will need to engage and work closely with the sector.

The sudden closure of Kids Company and BAAF clearly highlight the perils of charitable organisations not having enough cash in reserves. Most charities reportedly hold reserves of at least three months in hand. Kids Company's most recent accounts show that far from doing this it had £500,000 in reserve despite having annual staff costs of some £15 million.[5] Similarly, BAAF's 2014 annual report revealed that it had, in the year before its closure, a net income of £8.7 million and expenditure of £8.95 million, trebling its net liabilities in the process.[6] Effective financial management is of the utmost important in organisations that rely on public funding and confidence. As such, it is key that trustees are able to effectively scrutinise accounts and ensure that the organisation is operating within its means.

There are further lessons to be learnt from recent issues centring on alleged fundraising malpractice. NVCO's review Regulating Fundraising for the Future argues that:

> *As a response to the greater demands placed upon them, we have seen an increase in charities' fundraising activities. However this has meant that the balance between giving and asking has sometimes gone awry. Some of the techniques used, or the manner in which they have been used, present a clear risk of damaging charities in the public eye.*[7]

"Chugging' and other such practices are reputationally damaging to both individual charities and the sector as a whole. Whilst we understand the financial pressures many third sector organisations operate under, we would recommend that alternative fundraising avenues are explored.

The third iteration of Mervyn King's King Report on Corporate Governance for South Africa argues that "strategy, risk, performance and sustainability have become inseparable", and underlines the interconnectivity of non-financial performance and financial performance.[8] Although written for the corporate sector, there are lessons here for the third sector. King stresses the need for integrated reporting to become the norm. An integrated report is "a holistic and integrated representation of the company's performance in terms of both its finance and its sustainability."[9] GGI have petitioned for integrated reporting to be adopted by the NHS and would do the same for the third sector. Such reporting would provide clear information about an organisation's strategy, governance, performance and forecasts in both the short and long-term, and could help the sector better catch organisations at risk before they fail.

There is also a growing trend to implement better corporate governance, starting with the Financial Reporting Council's UK Corporate Governance Code, in the public sector. This document defines the standards of good practice in regards to board leadership and effectiveness, remuneration, accountability and relationships with stakeholders. We would argue that, as funders of third sector organisations, it is reasonable for the public sector to expect the organisations it commissions to comply with the Code.

The Charity Commission and other regulators

The Charity Commission is the regulator for charities in England and Wales. It is responsible for taking enforcement action when there is malpractice or misconduct, ensuring charities meet their legal requirements, and providing guidance to help charities run as effectively as possible. Recently, the Commission has faced mounting criticism from a number of parties including the Public Accounts Committee and the National Audit Committee.

In particular, the Public Accounts Committee has argued that the Charity Commission is not fit for purpose, citing "its feeble investigation into the Cup Trust" and arguing that it "too willingly accepts what charities tell it when it is investigating alleged abuses" and "too often fails to verify or challenge the claims made."[10]

Sir Stephen Bubb, Chief Executive of the Association of Chief Executives of Voluntary Organisations (ACEVO), following the collapse of Kids Company, levelled similar concerns, asking "Where was it [the Charity Commission] before now, did it not have any intelligence or knowledge of just how serious matters were with Kids Company and if not why not?"[11]

Part of the problem appears to be the Commission's own governance. Employee engagement figures, released by the Charity Commission in December 2014, reveal that just 32% of employees feel that the Commission is well run and that only 24% feel it has a clear vision for the future, perhaps indicating a loss of confidence in its leadership but also of the challenging climate in which the Commission operates.[12]

Certainly, the work of the Charity Commission has been severely hampered by funding cuts (a £29.3 million budget in 2010/11 has been reduced to £21.4 million this year), prompting William Shawcross, its Chief Executive, to point out that the Commission does "not have either the authority or the resources to scrutinise the activities or accounts of all 160,000 charities registered with us."[13]

Prime Minister David Cameron's promise to provide an additional £9 million funding over the next three years to "streamline lower-risk work and improve its capacity to identify abuse and mismanagement in charities" will certainly help, but is unlikely to be enough to make up the shortfall in funding or address all of the governance issues highlighted above.[14]

A possibility raised by the Commission itself is for charities to be charged for their own regulation, as is the case in a number of other sectors. The move would bolster the Commission's financial sustainability and has proven popular amongst the public, 69% of whom, according to research by Populus, would support the move.[15] A possible shift would be welcomed to a much lesser extent by charities themselves with recent polling highlighting that 68% would not be in favour of such a change.[16] Regardless, any proposal would have to be carefully considered and ensure buy-in from both Parliament and the sector.

Where those we spoke to felt that the Commission could really add value is in the fulfilment of its pastoral role: supporting charities, and providing guidance on governance and best practice. It was often pointed out to us in interviews that the Commission has a swathe of excellent published resources online, but that this is not effectively publicised. Strong demand also exists for a means of contacting the Commission for clarification and individual guidance. We believe that it is in maintaining this dialogue with charities that the Commission might best be able to capture some of the key governance issues before they occur or escalate further.

To support this push there is also a need for improved reporting in the sector. There is currently no public record, unless divulged voluntarily by a third sector organisation, of how public funding received by a charity is spent, whilst the Freedom of Information Act does not extend to charities, even when contracted by government. Geneveive Maitland Hudson, a former Kids Company employee and now a researcher at Osca, argues that charities are "immune from the drive towards transparency," and that there is an "absence of regulation and demand for it".[17] The experience of Kids Company is illustrative of this, highlighting the scope for organisations to report 'creatively' without scrutiny. Those we spoke to argued that there is no consistency of language in reporting and that more work needs to be done to specify how outcomes are defined.

Senior leadership, diversity, and succession planning

The third King Report on Corporate Governance for South Africa describes good governance as revolving around effective leadership. The report argues that "such leadership is characterised by the ethical values of responsibility, accountability, fairness and transparency," before pointing out that "every board should consider whether its size, diversity and demographics make it effective."[18]

In the third sector, despite women making up more than two-thirds of charity workers, boards remain dominated by older white men. Research by ACEVO reveals that, in 2015, 97% of charity chairs are white and 76% are aged between 55 and 74.[19] Among the top 100 charities in terms of income, just 14 have a female chair.[20] Similar analysis by Third Sector reveals that among the top 50 fundraising charities, 88% of chief executives are white, 70% are male. Where organisations do have a female chief executive, they are paid, on average, £10,000 less than their male counterparts.[21] The gender gap lessens when looking at senior management teams and trustees, though ethnic diversity remains an issue (94% of the top 50 charities' senior management teams, and 92% of their trustees, are white).[22]

Although these figures compare favourably with those of FTSE 100 companies (where there are just three female chief executives and one female chair), there is still much room for improvement. In the education sector, for example, women make up 17% of vice-chancellors,[23] whilst in the NHS 36% of provider chief executives, and 23% of provider chairs, are female.[24] It is well recognised and understood that diverse boards function better – they will have a greater range of collective skills and experiences, enhancing the level of challenge and the quality of decision-making.

Indeed, Principle 3 of Good Governance: A Code for the Voluntary and Community Sector argues that a board should have:

> a range of appropriate polices and procedures, knowledge, attitudes and behaviours to enable both individuals and the board to work effectively.[25]

A cultural shift is therefore needed in the sector to ensure that boards better represent their workforce and the public they serve. This should start with the recruitment of board members that match the organisation's needs in terms of skills, experience, and diversity.

A 2011 study by the Institute of Philanthropy found that some 49% of trustee appointments were made through personal recommendations from existing trustees, with just 20% citing public advertising as their primary means of recruitment.[26] Reliance on such practices can inhibit the pursuit of diversity and encourage the creation of trustee boards that more resemble an 'old-boys network'. Third sector organisations must broaden their recruitment pool by advertising widely, and ensure that diversity on the board and in senior management teams is an organisational priority.

To further encourage varying recruitment strategies and to prevent boards from becoming stale, it was suggested that introducing caps on the length of time a trustee can serve on a board might be an avenue worth exploring. Those we spoke to highlighted how it was not uncommon for trustees to serve on a board for more than five years. The NHS by comparison limits non-executive appointments to a maximum period of four years.

At the same time, greater developmental opportunities for females and those from ethnic minority backgrounds must be created to enable better access to senior management and board roles. How this might be funded is an increasingly problematic issue given the heavy impact of austerity measures on the third sector. However, an approach suggested by Women Count in its report Charity leaders 2012 that might yield positive results is for both the public and private sectors to engage in developmental, mentoring, and networking initiatives that incorporate women charity leaders.[27]

Those we spoke to suggested that there is an acute issue with succession planning in the sector. Mentorship programmes or cross-sector networking opportunities could potentially also help address this problem.

Trustee recruitment, development, and education

Trustees are a unique and valuable component of third sector governance. They fulfil a crucial role making up the governing body of a charitable organisation and bear ultimate responsibility for ensuring it is solvent, well-run, and achieving the deliverables for which it was established.

Despite the importance of the role, research suggests a wide variance in the quality of trustees, as well as a significant absence of development and learning opportunities available to them. Indeed, Grant Thornton's 'Charity Governance Review 2015', which examines the governance of the 100 highest-income charities in the UK, highlights that 78% of these organisations make no reference to having undertaken any sort of board evaluation at all in their annual reports.[28] Similarly, those interviewed in research for this paper emphasised how the lack of on-going training for trustees was negatively impacting their ability to understand and fulfil their role.

The dearth of development opportunities for trustees can typically be attributed to one of two factors:

i) The charitable organisation lacks the funds or resources to undertake regular development opportunities
ii) The charitable organisation is wary of putting additional time pressures on their trustees

As we explored earlier, funding streams for third sector organisations are becoming harder to come by. However, if they are to fulfil their duties to best effect it is vital that new trustees undertake a skills audit, receive adequate pre-training, are properly inducted before joining the board, and are given regular opportunities for personal development.

A 2009 New Philanthropy Capital report 'Board matters – a review of trusteeship in the UK' argues that:

> *the best way to have a sustainable impact on a board is through bespoke help from someone with excellent technical expertise in improving governance.*[29]

King too suggests that as part of good governance practice "the evaluation of the board, its committees and the individual directors should be performed each year."[30] We agree, and would point to recent governance failings in Kids Company as indicative of the dangers of an ineffective board, and as an example of a case in which trustees found it difficult to challenge the organisation's founder.

Lessons can be learnt from the NHS where Monitor, the NHS' financial regulator, expects NHS foundation trusts to undertake an external review of their governance every three years, arguing that "regular review can provide assurance that governance systems are fit for purpose."[31]

Additionally, we would advocate the requirement that new trustees complete some sort of accreditation process that properly documents their suitability to the role, and that works to ensure an adequate skills mix on a board. For instance, GGI has developed the NHS Director Competencies Maturity Matrix, a practical tool that enables directors to identify their developmental progress against a set of key competencies, such as the understanding of their role, their leadership calibre, and their technical knowledge. This could readily be adapted for use in the third sector.

Service quality and good governance: *the quality competency framework*

In 2011, the Chartered Quality Institute (CQI) conducted research demonstrating that effective quality management contributed some £90 billion (6%) to the UK's GDP.[32] Effective governance is a core component of delivering quality services.

As such, CQI have produced a competency framework (summarised below) that provides an overview of the competencies that quality professionals need in order to do their job properly. Particular focus is given to governance, leadership, assurance, and improvement. As can be seen, there is much crossover between the issues covered in this framework and those that we have identified as being of particular significance within the third sector.[33]

Governance: Ensures that all organisational requirements are reflected in operational frameworks, policies, processes and plans.

Governance

External focus	• Uses appropriate methods to establish stakeholder needs and views. • Ensures that the organisation's policies, processes and plans reflect these needs. • Evaluates problems and solutions from a stakeholder point of view.
Internal focus	• Ensures that policies and processes are effective in meeting stakeholder expectations, removing variation, minimising operational risk and maximising efficiency. • Ensures that the operational approach and management system are continually assessed and improved.

Leadership: Uses leadership behaviours to maximise influence and develop a culture of evaluation and improvement.

Leadership

The quality advocate	Articulates a clear vision for quality as a strategic imperative that supports the organisation's broader aims and objectives.
The stakeholder advocate	Acts as the conscience of the organisation, making any interventions necessary to address stakeholder relations.
The systems thinker	Looks across business functions to promote a holistic view of the organisation.
The fact-based thinker	Promotes a culture of decision-making based on factual evidence and performance measurement.
The quality planner	Advocates and instigates the principle of planning for quality.
The quality coach	Develops knowledge of quality principles and capability in quality tools throughout the organisation.
The quality motivator	Motivates and empowers others to take accountability for improving performance standards.
The quality collaborator	Works with all internal and external stakeholders to resolve issues associated with organisational performance.

Assurance: Embeds a culture of assurance to ensure that policies and plans are effectively implemented, and that all outputs are consistent with requirements.

Assurance	
Business (internal) assurance	• Ensures the flow-down of customer and stakeholder requirements across the organisation. • Ensures management intent is effectively implemented. • Ensures effective action is taken to resolve any failures and non-conformances related to stakeholder requirements.
Supply chain assurance	• Ensures appropriate methods are used to select suppliers and to ensure flow-down of stakeholder requirements to the organisation's supply chain. • Uses appropriate methods to assess supplier performance and to identify risk and failure. • Supports the development of appropriate mitigation strategies.

Improvement: Facilitates a culture of evaluation and improvement that drives development in strategy implementation, reputation-building and profitability.

Leadership	
Gathering insight	• Uses appropriate methods to understand stakeholder needs and to identify any changes to the organisation's context. • Uses tools such as benchmarking to evaluate performance and improvement priorities.
Evaluating measures/ results	• Helps develop appropriate measures of operational performance and product quality across the organisation. • Helps establish priorities for change.
Implementing change	• Evaluates the nature and magnitude of change required and how to achieve the required changes. • Identifies any cultural issues relating to the organisation's operational performance.

Conclusion

The challenges facing the third sector are diverse and significant, and are likely to become more so in the coming years. Issues relating to uncertain funding, the need to strengthen regulation, as well as a lack of diversity and development among senior management teams and boards, require urgent attention. Outlined below is a set of recommendations addressing these areas of concern.

It is clear that without strong governance and direction the sector will struggle. Lessons can be learnt from other sectors, and the Good Governance Institute is committed to developing a robust body of knowledge in this field. We would welcome feedback and comments.

Recommendations:

Third sector organisations should extend the good governance agenda that the public sector has been embracing. In particular we recommend that organisations:

1. Invest in trustee and leadership development to support the better oversight and management of the organisation.

2. Review trustee performance regularly and encourage change in membership.

3. Encourage greater diversity amongst senior management teams by looking at alternative recruitment methods, and providing improved development opportunities for all staff.

4. Recognise the financial challenges facing the sector, act within their means, and not be overly dependent on predicted future revenue streams.

5. Look at other sectors, including health, for examples of best practice in relation to governance.

6. Be as transparent as possible in their reporting.

Notes

1) NCVO, The charity sector and public services
2) NCVO, Civil Society Almanac
3) NCVO, Payment by results in the voluntary sector
4) Institute for Government, Beyond big contracts: commissioning public services for better outcomes
5) Kids Company, Annual Report 2013
6) The British Association for Adoption and Fostering, Annual Report 2014
7) NCVO, Regulating fundraising for the future
8) Mervyn King et al., King report on corporate governance for South Africa
9) Ibid.
10) Committee of Public Accounts, Forty-second report of session 2013-14
11) Sir Stephen Bubb, Where was the Charity Commission when Kids Company collapsed?
12) Charity Commission, Civil Service People Survey 2014
13) William Shawcross, Trustees bear responsibility for charities, not regulators
14) Third Sector, David Cameron announces £9m new funding for the Charity Commission over three years
15) Charity Commission, Trust and confidence in the Charity Commission
18) Mervyn King et al., King report on corporate governance for South Africa
19) ACEVO, Pay Survey 2013/14
20) Grant Thornton, Charity governance review 2014: Navigating a changing world
21) Third Sector, Diversity: the deficit at the top of the biggest charities
22) Ibid.
23) Cara Aitchison, Universities take baby steps towards diversity
24) Health Service Journal, Women still in the minority in NHS leadership roles
25) Good Governance: A Code for the Voluntary and Community Sector
26) Institue of Philanthropy, The state of charity boards
27) Women Count, Charity leaders 2012
28) Grant Thornton, Charity governance review 2014: Navigating a changing world
29) New Philanthropy Capital, Board matters – a review of trusteeship in the UK
30) Mervyn King et al., King report on corporate governance for South Africa
31) Monitor, Well led framework for governance reviews
33) The Chartered Quality Institute, The quality competency framework

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