The governance challenges of social enterprises: evidence from a UK empirical study

Journal Item

The Governance Challenges of Social Enterprises: Evidence from a UK Empirical Study[1]

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Abstract

The social enterprise sector in the UK is going through a period of rapid growth, and is being seen by government as another important vehicle for delivering public services. As a result the issue of public trust in social enterprise is of growing importance. While there is a growing literature on the governance of voluntary and non-profit organisations, with some exceptions (e.g. co-operatives) there has been little research on the governance challenges and support needs of social enterprises. The research reported here aimed to help fill that gap. Based on interviews and focus groups with governance advisers, board members and chief executives it explores the typical governance challenges faced by social enterprises. Based on the research the paper develops a new, empirically-grounded typology of social enterprises based on their origins and development path, and presents findings about some of the governance challenges that are common across the sector and some of are more distinctive to the different types of social enterprise.

1 Introduction

Social enterprises are commonly defined as enterprises that trade for a social or environmental purpose. As well as meeting their social and/or environmental goals, they have to be business-like and meet financial and commercial goals. As a result they are sometimes referred to as having a double or even triple bottom line. The number of social enterprises in the UK has grown rapidly over the last 10 years, and includes 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: they may be registered as companies limited by guarantee, industrial and provident societies, and community interest companies or simply take a number of unincorporated forms. However, there is considerable debate about precisely how they are defined and Government estimates of the number of social enterprises vary considerably from 15,000 in 2004 to 55,000 in 2005 depending on the definition used; and, in particular, whether the estimate includes sole traders and partnerships.

In the UK, social enterprise is not just a conceptual category, but it is a “policy vehicle” which has become an important plank of government policy. In 2002 the New Labour government launched its Social Enterprise Strategy and established a Social Enterprise Unit (SEU) in the Department of Trade and Industry (DTI) to co-ordinate its implementation in England and Wales. In 2006 the SEU moved to the Office of the Third Sector and the government established a Social Enterprise Action Plan to encourage and support the development of social enterprises across the economy. Social enterprises are seen as having potentially important roles in the restructuring of public services as well as being a source of innovation in fields as diverse as recreational and cultural services, and recycling. For example social enterprises have been promoted as a new way of delivering some health and social care services and the Department of Health has established a Social Enterprise Unit to stimulate their formation and growth, and funded a programme of support for 26 social enterprises that can act as ‘pathfinders’ so their experiences and learning can be shared across the sector (Walsham et al, 2007).

Paralleling development in other sectors, the growth in the size and significance of the social enterprise sector and its growing importance as a plank of government policy has begun to raise new concerns about the quality of governance and accountability of social enterprises, and how governance arrangements can best be supported. However, the evidence base on what are the governance challenges of social enterprises, how distinctive they are and how social enterprises can be best supported to meet these challenges is very thin. While there is a growing body of research on the governance of voluntary and community organisations in the UK (e.g. Cornforth, 2003), research on the governance of other forms of social enterprises has been relatively neglected. Similarly, while there has been a good deal of effort devoted to improving the governance of voluntary organisations, most significantly by the Governance Hub and its successor[3], less is known about the distinctive governance support needs of social enterprises. To address this need, the research project on which this paper is based was commissioned in 2007 by the Governance Hub, in partnership with the Social Enterprise Coalition, to help fill these gaps in current knowledge. One of the main aims of this research was to identify any characteristics of governance practices specific or distinctive to social enterprises, and their governance support needs.

The paper is structured as follows. Section two examines in more detail the social enterprise sector in the UK. It considers the problem of defining of social enterprise, the blurred boundaries between the social enterprise sector and other sectors, and identifies some of the main types of social enterprise. Section three draws on some existing research on corporate governance in the private and voluntary sectors to examine some of the broader trends that have influenced corporate governance, the different schools of thought aimed at understanding what boards do and the common challenges that boards face. Section four presents the research aims and methodology, outlining the main sources of data used. Section five summarises the main empirical findings from the research, examining the governance challenges of different types of social enterprises in various sub-sectors. Section six discusses the main conclusions from the study.

2 The social enterprise 'sector'

There is no one well established definition of social enterprise and definitions vary somewhat between different countries and contexts[4]. The UK government's Social Enterprise Unit (SEU), now part of the Office of the Third Sector, developed the following definition:

> "A social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or the community, rather than being driven by the need to maximise profit for shareholders and owners" (DTI, 2002).

[3] The Governance Hub was established in 2004 as one of a series of hubs established under a government funded programme 'Capacity Builders' in the UK to strengthen the infrastructure of the voluntary sector. In 2008 it was replaced by the National Support Service for Governance and Leadership.

[4] A good overview of how social enterprises are viewed in some different countries can be found at the EMES Network website (www.emes.net), or by looking up social enterprise in Wikipedia (http://en.wikipedia.org)

The Social Enterprise Coalition, the main umbrella body for social enterprises in the UK, elaborates further identifying three key criteria. As well as an *enterprise orientation* and *social aims*, it highlights a third criterion of *social ownership*, which is defined as follows:

> "They are autonomous organisations whose governance and ownership structures are normally based on participation by stakeholder groups (e.g. employees, users, clients, local community groups and social investors) or by trustees or directors who control the enterprise on behalf of a wider group of stakeholders. They are accountable to their stakeholders and the wider community for their social, environmental and economic impact. Profits can be distributed as profit sharing to stakeholders or used for the benefit of the community." (www.socialenterprise.org.uk)

However, operationalising any definition and identifying social enterprises is not straightforward. The government's SEU commissioned two surveys in the years 2004 and 2005, using somewhat different criteria and surveying different populations of organisations; this produced widely differing estimates of the number of social enterprises.

The 2004 survey used a criterion of minimum of 25% income from trading activities, and democratic legal structures as indicators of social ownership and aims. The survey estimated that there were 15,000 social enterprises employing 475,000 people with a combined annual turnover of £18 billion (IFF Research Ltd, 2005). While the 2005 survey used the criteria of a minimum of 75% of income from trading, and not more than 50% of profits could be paid back to owners or shareholders; it included all legal forms (including companies limited by shares, unincorporated associations, partnerships and sole traders) thereby surveying a wider population of organisations (SBS, 2006). And the survey relied in part on participants self-identifying themselves as social enterprises. This later survey estimated that there were at least 55,000 social enterprises in the UK with a combined turnover of £27 billion per year, which constitutes about 5% of all businesses with employees. The majority of these businesses are sole proprietors, partnerships or limited companies with just one executive director (SBS, 2006: table 2.18). It was decided to exclude these very small businesses from this study because the governance issues that face them would be much less complex and challenging than other types of social enterprise. Nonetheless, it is anticipated that the findings of this study would be very relevant to such micro-businesses as they grow and develop.

As noted above social enterprises may adopt a variety of different legal forms, including incorporated forms such as companies and industrial and provident societies, and unincorporated forms such as associations and partnerships. In addition some social enterprises may choose to register as charities if they serve charitable purposes, or as community interest companies. Whatever its legal form, an organisation will also have a governing document (which may be called different things depending on the legal form) which sets out in broad terms how it is to be governed and run.[5] Hence it is not possible

[5] It is not possible in this short paper to go into detail about different legal forms and their implications for governance, but Co-operatives UK (2005, and with Governance Hub 2007) have produced two excellent guides.

to identify social enterprises simply by the legal form they may adopt. There are also a wide range of regulatory frameworks which influence governance issues, depending on the sector in which the social enterprise operates, (for example housing and credit unions are both highly regulated sectors).

As well as definitional problems recognizing and agreeing what is a social enterprise is difficult for other reasons. The term is a relatively recent one, and has not gained currency in some circles. There are also overlaps with other ways of categorizing organisations. As a result some organisations that fit the definition of social enterprise, such as trading charities and co-operatives, may not identify themselves as social enterprises. Equally there may be some organisations who don't meet all the criteria for being a social enterprise, but who identify themselves with the term.

One way of thinking about social enterprises is as the more business-like part of the third sector, where the third sector is seen as those organisations that are not part of the public and private sectors. The most commonly recognised structure of the UK social enterprise sector is a range of self-labelled forms of social enterprise, which often have their own representative bodies and federal structures. The main types include: co-operatives & credit unions, trading charities, community enterprises, development trusts, fair-trade organisations, green social enterprise, social firms, work integration social enterprise, leisure trusts, health & social care enterprises, and socially or environmentally oriented small businesses. The criterion for how much income has to be raised from trading for an organisation to be classified as a social enterprise is open to debate (see the two surveys above), although a common rule of thumb is 50%.

Co-operatives are probably one of the oldest forms of social enterprise. They are trading organisations that are established to benefit their members, who are often perceived to be disadvantaged in some way, rather than shareholders. There are a number of different types of co-operative depending on the needs they are trying to meet, for example consumer, worker, or housing co-operatives or credit unions. All these membership organisation are owned and democratically controlled by their membership on the basis of one member one vote, which has important implications for their governance.

Development trusts are extremely varied and are largely concerned with regenerating communities through development of community assets and enterprises. Another related group of social enterprises are trading charities. These are charities that have chosen to develop trading activities, such as charity shops, to fund their main activities alongside more traditional forms of fundraising such as grants and donations. In recent years an increasingly important source of funds, particularly in the areas of health and social care, has been government contracts to fund the provision of specific public services

A growing number of social enterprise are concerned with integrating the disadvantaged groups, such as people with a disability, back into the labour market through productive work; social firms have tended to focus on the most disadvantaged including those with learning disabilities.

Some social enterprises have been spun out the public sector to run a particular service. One example is Leisure Trusts, which have been formed to run what were previously the local authority leisure services, such as sports centres and swimming pools. Other examples are some of the social enterprises in the fields of health and social care formed to provide news ways of delivering these public services.

Other social enterprises are set up from scratch by entrepreneurs to address particular social issues, such as the ‘Big Issue’ to support the homeless or Jamie Oliver’s restaurants ‘Fifteen’ to offer opportunities to disadvantaged young people. Some of these new start social enterprises have links with particular ecological or social movements, such as those involved in fair-trade or green enterprises.

This typology of commonly recognised and self-labelled forms of social enterprise is a useful starting point but the forms are ambiguous and often overlapping. In addition, the boundaries between the social enterprise sector and other sectors are very blurred, and social enterprises may have multiple identities. A social enterprise may for example be a charity or a co-operative; it may have close links with the business or public sectors. Social enterprises may also identify and group themselves in terms of the issues they deal with or the services deliver, such as ‘social firms’ that were created to provide employment opportunities for people who are disadvantaged in the labour market, or development trusts which aim to regenerate local communities.

3 Governance reforms, problems and challenges

This section briefly examines why reforms to ‘corporate’ governance arrangements have risen up the policy agenda in all sectors and how changes in the private sector have often influenced changes in other sectors. Given the paucity of research on the distinctive governance challenges of social enterprises it then draws on existing research on the governance of voluntary and community organisations to draw out some of the main governance challenges they face. One of the main concerns of the empirical research was to examine the extent to which these governance challenges were similar or different in social enterprises.

Governance reforms

In recent years there has been considerable interest among policy makers in reforming ‘corporate’ governance arrangements across the private, public and third sectors. Much of the initial impetus for these changes came from the private sector, and many of the reforms that were initiated there have had an influence in the other sectors.

An important stimulus for change in the private sector were a number of major corporate scandals that occurred in larger public companies, such as Guinness, BCCI, Polly Peck and more recently Enron and WorldCom, which kept concerns over corporate governance in the public eye. These scandals occurred against a background of growing globalization and the deregulation of markets around the world, together with concerns over the growing power and perceived lack of accountability of modern corporations. As a result much of the focus of reform has concentrated on strengthening those aspects of corporate governance that could help prevent abuses of power by corporate executives, such increasing the power of independent non-executive board members and strengthening audit arrangements.

The main thrust of corporate governance reforms in the UK has been on improving self-regulation. Perhaps the most significant influence on reform process was the report of the

Cadbury Committee on the financial aspects of corporate governance of public companies (Cadbury, 1992). The committee was established to address concerns over the low levels of confidence in company financial reporting and auditing (Pettigrew and McNulty, 1995: 846). In addressing these issues it went beyond issues of financial audit and developed a Code of Best Practice in Corporate Governance, which was subsequently adopted by the London Stock Exchange.

Since then there have been a series of further reports into strengthening other aspects of corporate governance, which have resulted in a Combined Code of Practice (FRC, 2006). The Code is voluntary, but public companies are expected to comply with the Code or explain their position in their annual reports. In the UK companies have boards composed of both executives (i.e. the senior managers in the company) and non-executive or independent directors from outside the company.[6] The main purpose of these reforms has been to strengthen the position of non-executive directors on boards, so they are better able to hold the executive to account. The main structural recommendations were to separate the roles of chair and chief executive and establish internal audit and remuneration committees under the control of non-executives. Other recommendations include fair, open and rigorous appointment procedures, induction and development for directors, and performance appraisals for boards and board members.

Parallel developments have taken place across the third sector. However, the diversity of the third sector and the differing regulatory requirements has meant that different sub-sectors have often developed their own codes, for example there are codes for consumer co-operatives (Co-operatives UK, 2005a), for housing associations (NHF, 2004), voluntary and community organisations (Governance Hub, 2005) and the mutual insurance sector has an annotated combined code.

As well as the development of codes there have also been an increasing number of initiatives within all sectors to increase awareness of the responsibilities of board members and provide them with appropriate advice, support and training. In the voluntary and community sector one of the most significant recent developments was the establishment of the Governance Hub in 2004, one of several hubs set up with government money to build the capacity of the third sector. The hub played an important role in developing and disseminating the code of practice for voluntary and community organisations, developing a wide range of governance advice and training, and developing national occupational standards for trustees and board members.

Common governance challenges

Research suggests voluntary and non-profit organisations face a number of common governance challenges which are discussed below.

‘Recruiting’ board members with the right skills and experience

Getting board members with appropriate skills and experiences is important for board effectiveness. There is evidence to suggest it is becoming more difficult to recruit suitable board members in the third sector where most board members are volunteers. For

[6] This contrasts with many parts of the third sector where the norm is to have boards composed entirely of non-executive board members, although his norm is changing in some sub-sectors, for example some housing associations have changed their rules to allow executive board members.

example a survey of charities in 2000 showed that a much higher proportion of charities in England and Wales felt that finding board members was becoming more, rather than less, difficult and this was especially true of small to medium size charities (Cornforth, 2001:9). A further survey of charities in 2007 showed that 42% of those surveyed felt it was more difficult to recruit trustees (Baker Tilly, 2007). There may be a number of reasons for this. Perhaps as a result of these difficulties more voluntary organisations are beginning to use formal recruitment methods to find and select board members, such as external advertising. The 2000 survey suggested overall about 4% of charities used external advertising, although this figure rose to 20% for the largest charities. The 2007 survey suggested that 31% of those surveyed used external advertising and the figures rose to 40% for larger charities, although the different methodologies used by the surveys means the figures are not strictly comparable.

The lack of a dominant external stakeholder

In private sector shareholders are the dominant stakeholder in companies, that is to say, within various legal and regulatory constraints, companies are meant to be run in the interests of their shareholders. In the third sector the situation is often more complex, and a variety of stakeholders may have a legitimate stake in the organisation, for example, members, beneficiaries or users, and funders. In addition in many third sector organisations these stakeholder groups are explicitly represented on board, for example services users in a charity for those with a particular disability. An important role of the board of most voluntary and non-profit organisations is to balance different stakeholder interests, for example the interests of funders versus the interests of users or beneficiaries, or the interests of existing users versus the interests of future users. Multi-stakeholder boards have the potential advantage of bringing different perspectives to decisions and making sure the different interests are balanced against each other, however, concerns have been expressed that they may make in more difficult to achieve a clear purpose and reach agreements (see for example Hutton et al, 1997).

Managing membership

Many TSOs (such as voluntary associations, co-operatives and credit unions) are established as membership organisations, democratically controlled by their members on the basis of one-member one-vote. However, a common problem is that over time membership may decline or become inactive and over time may be come run by an elite of board members and, or full-time staff. Michels (1949) formulated this tendency of democratic associations to become dominated by elites as his ‘iron law of oligarchy’. While many studies have confirmed the widespread nature of oligarchic tendencies the inevitability of these processes has been challenged, and various factors have been identified that can help to safeguard member involvement and democracy (Knoke, 1990: 12-16 and 143-161). This has a number of implications for their governance (Spear, 2004). The difficulty of maintaining an active membership, especially as membership grows means that boards can lose their legitimacy and accountability as member influence declines. It may also be difficult to find members with the right skills and experience to stand for election to the board, possibly weakening the board’s capacity to govern and hold management to account (Cornforth and Edwards, 1998:24-8).

The power of boards to control management

There is a paradox at the heart of governance arrangements in all organisations that employ professional managers. While it is the board that is formally responsible for the overall control of the organisation it is management that have access to the main levers of power to carry out this responsibility; management have the time, infra-structure, information, skills and access to resources (Demb and Neubauer, 1992). The danger then is that managers may run organisations to further their own interests rather than the interests of their shareholders, members or other stakeholders. The view that managers have a tendency to dominate has early origins in the work of Berle and Means (1932) on business corporations, which asserted the dominance of management and argued there was a "legal fiction of shareholder control". As noted earlier, many of the private sector corporate reforms have been aimed at strengthening the hands of non-executive directors, elected by shareholders.

However, there remain important question marks about the ability of many boards to carry out this task, and in particular the competency of board members (e.g. Westphal and Zajac, 1995; Stone, 1991; Fletcher 1992). A common complaint of boards in all sectors is that they effectively become a 'rubber stamp' for management's proposals (see for example Steele and Parston (2003) research on boards in the public sector). Yet the conclusion that all boards become rubber stamps is too sweeping, the empirical evidence suggests a much more varied picture (e.g. Murray et al, 1992; McNulty and Pettigrew, 1999). Pettigrew and McNulty (1995) suggest that board members may draw on various power sources to develop a credible power base – relevant expertise, their reputation, their position on board committees, and their networks developed within and outside the boardroom, but that patterns of power and influence at board level will also depend on their 'will' and 'skill' to make effective use of these power (for example, using sound analysis, persuasion, persistence, tact, and charm).

Managing the interdependencies between boards and management

A frequent complaint about boards in voluntary and non-profit organisations is that they often stray into management's territory and meddle in their affairs (Middleton, 1987; Harris, 1999). Perhaps, as a result, much of the practice-based literature on governance stresses the importance of being clear about the difference between governance and management, and defining the different roles of boards. While it is important to have some clarity over these issues this prescription is in danger of over-simplifying the problem. The roles of boards and management are inter-dependent and the boundaries between the two are often necessarily somewhat blurred, particularly in smaller organisations (Rochester, 2003). For example it is often said that boards should stick to strategic matters and not interfere in operational issues. However, drawing the boundary between operational and strategic matters is itself difficult (Harris, 1993; Edwards and Cornforth, 2003). Strategy may emerge from practice and knowledge of operational matters may be important in making strategic decisions. Equally the boards of larger organisations are often dependent on management to draw up strategic proposals, and the appropriate level of board involvement may vary between different organisations at different times depending on the circumstances. What does seem to be important is that board members and management acknowledge this potential problem and recognise the need to review and renegotiate their respective roles and relationships from time to time (Cornforth and Edwards, 1998).

Balancing of social and financial goals

All voluntary and non-profit organisations have to balance social and financial goals. As a result boards may be faced with quite difficult trade-offs between different types of goals. However, for social enterprises that have to survive in the marketplace these problems may be particularly acute. As Pearce (2006) notes planning in social enterprises needs to integrate both social and business goals. The danger otherwise is that one set of goals may dominate to the detriment of others. Historically, the research on co-operatives has suggested that external market pressures may mean that social goals get squeezed out and the co-operative degenerates to become similar to other businesses. While the inevitability of 'degeneration thesis', as it became known, has been challenged by various researchers (see Cornforth, 1995), the dangers of financial considerations squeezing out social and other goals is a real one. Conversely too great an emphasis on social goals may mean important financial aspects of the enterprise are neglected threatening its survival.

4 Research approach and methodology

Given the lack of existing research about the distinctive governance challenges of social enterprises the research team adopted a qualitative approach in order to explore in some detail people's experiences of governance. The research used a combination of interviews and focus groups with a range of governance advisers, board members and managers in the sector to explore their perceptions of the governance challenges facing social enterprises.

The very great diversity of the social enterprise sector meant one of the first challenges the research team faced was to 'map' this diversity and decide what sorts of social enterprises to include in the research. It was felt important to include people from a range of organisations that captured most of this diversity, but for practical reasons not all types could be covered. Thus some sub-sectors, such as housing associations, were excluded because there were already good support structures and materials in place to help meet their governance challenges. In addition sole traders and partnerships were excluded as their governance challenges were likely to be less complex and more to do with external regulation. The plan was to set up focus groups of people from the following types of commonly recognised social enterprise (see Section 2): co-operatives & credit unions, trading charities, development trusts, fair-trade trade organisations, social firms, work integration social enterprise, leisure trusts, health & social care enterprises, football supporters' trusts, and 'green' or socially oriented small businesses; and a regional group comprising a range of different types of social enterprise. It was also considered desireable to include people from organisations that varied on important dimensions, such as size, legal structure, and origins since these were thought likely to affect the governance challenges they faced.

Data collection was carried out in two main phases. The first phase consisted of two parts: first, desk research aimed at uncovering the main sources of governance support available to social enterprises and secondly, a series of interviews was carried out with staff of infrastructure organisations and advisers familiar with the governance needs of social enterprises in different fields of activity. Appropriate people to interview were identified drawing on the contacts of the projects Steering Group. The interviews focused on the identification of common problems and challenges around the governance of different types of social enterprise and gaps in the provision of support.

The second phase of the research was designed to triangulate findings from phase 1 with data from a series of focus groups and interviews with board members and senior staff from different types of social enterprise. The original intention was to carry out face-to face focus groups with board members and senior managers in a number of sub-sectors. However, the relatively short-time scale of the project and the many demands on the time of potential participants created logistical problems for holding the focus groups, which meant this approach had to be revised. In some cases telephone focus groups were arranged, and where even this proved difficult, individual telephone interviews with members of the potential focus group were conducted. Again this was an opportunity sample drawing on the contacts of the Steering Group, researchers and the interviewees in phase one of the research. These focus groups and interviews explored in more depth the issues identified in phase 1. More than 45 people across 40 organisations were interviewed or took part in a focus group, while others supplied additional insights or resources in 2007. However, given the relatively small sample and the opportunistic way it had to be selected findings should be regarded as tentative.

A semi-structured format was used so interviewers had the freedom to follow interesting issues as they emerged or probe for more detail. Drawing on the review of research outlined in Section 3 of this paper the main areas of questioning included: board recruitment, relationships with management or staff, relationships with stakeholders and funders, balancing social and business goals, board training and development, member relations, legal and governance structure, regulation and accountability.

5 Findings from the research

The findings from the research can be grouped into three main areas, which will be discussed in turn. First, the research revealed a number of governance challenges which were common among many of the different types of social enterprise. In many instances there were also similarities with those governance challenges experienced more broadly in the third sector, but also some differences, for example associated with entrepreneurialism and managing risk. Second, we observed some distinctive governance challenges that stemmed from the different origins and paths of development that social enterprises take. This led us to develop a new typology of social enterprises that reflects their different origins and developmental paths. Third, the distinctive governance challenges of these different types of social enterprise are discussed.

Common governance challenges

Despite the diversity of social enterprises, the following common governance challenges were identified. Many of the themes identified clearly resonate with the governance challenges discussed in Section 3, but entrepreneurialism and financial risk often frame them in distinctive ways:

‘Recruiting’ board members with the right skills and experience

In common with TSOs generally, problems ‘recruiting or electing’ people to boards with the *right skills* and *experience* were frequently reported. Similarly, these problems are often particularly acute among small organisations or those *in disadvantaged communities*. There appears to be a limited supply of people with the right skills willing to serve on boards, and they are in demand, often on several boards. However, the areas of expertise that were perceived to be most commonly lacking are entrepreneurial ones: financial, business and strategic skills, which are likely to be particularly important in social enterprises.

Choosing an appropriate legal and governance structure

Choosing an appropriate legal structure for any TSO is quite a complex activity, often requiring specialist legal advice. In part this is due to the variety of different legal forms and governance structures that can be adopted (Co-operatives UK, 2005b). As Melmoth (2005) notes: 'Struggling with the wrong legal structure can be a time-consuming, complex and costly process.'

However, engaging in social enterprise activity can raise some distinctive challenges. For example if a charity wants to engage in significant trading activities that are not related to its primary mission it is required by law to set up a separate commercial subsidiary. Charities may also set up trading subsidiaries as a way of containing the risks from commercial activities (Sladen, 2008). Interestingly some social enterprises that were established initially as trading operations have then set up charitable subsidiaries to further there social mission. These activities can lead then to more complex multi-level governance structures. As a result choosing and developing appropriate *governance structures for entrepreneurial activity* is complex and difficult and good advice is needed from the start. Governance advisors reported poor decisions coming back to haunt many social enterprises.

Managing external stakeholder interests

Governance structures differ in the extent to which they involve single or multiple stakeholders. In common with other TSOs many social enterprises are choosing to adopt multi-stakeholder structures and the research suggests there is a growing interest in multi-stakeholder structures in social enterprises, even in organisations like co-operatives which have traditionally been single stakeholder organisations. Multi-stakeholder boards have the potential benefit of bringing together the interests of different groups and generating greater social capital. They may also have potential costs. They are potentially more conflictual, and reconciling diverse interests of stakeholders can have large transaction costs. Some participants also noticed the tendency for some board members to act in the interests of the particular stakeholder group they come from, rather than in the best interests of the social enterprise as a whole.

Managing membership

Membership poses similar challenges for social enterprise as other voluntary associations. An active membership can be a source of considerable strength, providing support, resources, candidates for board membership and helping to hold board members to account, but as many co-operatives have found sustaining an active membership often becomes more difficult with increasing size. Research by the Charity Commission (2004: 9-11) suggests that the poor management of membership can lead to more disputes over governance, for example if membership records are not kept up to date or membership declines so it becomes dominated by a particular interest group. Some social enterprises, such as football supporters trusts, have been experimenting with new electronic media as a way of keeping members involved.

The power of boards to control management

As in the third sector generally, the difficulty of some boards being able to control management is a frequently reported theme in social enterprise, possibly exacerbated by the pressures of surviving in the market. Pearce (2006) in research on failing social enterprises notes that the boards of social enterprises may be particularly vulnerable when they take on paid managers for the first time, with inadequate systems to allow them to spot when things are going wrong if managers wish to cover things up.

One option for developing the capability of the board to properly scrutinise managements' proposals is to bring in non-executive directors from outside the organisation's membership who have the necessary business experience. Participants suggested this strategy had been employed in a number of successful social enterprises. Other organisations found it difficult to attract people with the right expertise or were concerned about bringing in business people who may not share the ethos or mission of the social enterprise. Another option is to improve the training available to board members. However, in some cases limited resources for training and pressure on board members' time made this difficult, and sometimes it was felt that some board members were simply not suited for the more demanding regime of entrepreneurial activity.

Social enterprises are often founded by social entrepreneurs who are concerned primarily with developing a new social innovation or developing a new market niche (e.g. fair-trade, recycling, work integration). For some governance may a chore or at least a secondary activity of much less importance. Yet as the organisation grows crucial governance decisions can be made by default, as the social enterprise searches for relevant models for how to structure the growing business.

Perhaps *paradoxically* one of main factors in improving the quality of governance is the attitude of senior management towards driving improved governance. Some senior managers recognise that they are the most powerful figures in many organisations, but there decisions are likely to be improved if they are subjected to scrutiny and challenge. Whilst, in contrast, other managers merely want to ensure a good relationship with their board so that their strategic and operational decisions are not interfered with.

Managing the interdependencies between boards and management

Similar to TSOs in general social enterprises may experience problems managing the interdependencies between boards and managers. The problems are often most apparent in small and growing organisations where the boundaries between governance, management and operational matter can be very blurred. In particular there can be considerable challenges around the influence of founding social entrepreneurs have in relation to boards during the early phases in the life of the organisation. Similarly in these situations staff may lack the time and expertise themselves to effectively support their boards. These problems may be exacerbated in social enterprises by the challenges of starting a new business or operating in difficult market conditions, which may require speedy and hard decisions to be made.

Balancing of social and financial goals

Social enterprises vary widely in terms of the different emphases they place on social and the financial goals. However, they all have to manage the potential *tension between social and business goals*. For example in one children's charity there were tensions over putting up fees, with one side arguing it was necessary to strengthen reserves and other side concerned it would harm the charity's main beneficiaries. There is a constant danger that some social enterprises become too focused on business goals at the expense of social goals or conversely too focused on social goals at the expense of building a strong business.

There was concern that some third sector organisations that had moved into developing new social enterprise activity were not well equipped to recognise and *manage new entrepreneurial risks*. Many organisations and their boards had to cope with a move from a grants culture to contracting regimes, but transforming cultures and practices to match remained a challenge for many. Tough cost-driven contracting regimes combined with the risk of policy shifts eliminating business opportunities were create particularly problematic risks for some social enterprises. There were two recent examples of policy frameworks changing the market: credit unions have been channelled into the financial exclusion market through the Growth Fund; and the Freud report (2007) which advocates large regional contracts with huge potential impact on the market for welfare-to-work (work integration) social enterprises.

Coming to terms with financial and entrepreneurial risk is a major governance challenge for social enterprise, and developing appropriate skills and roles for this is crucial. Participants noted different reactions to risk. In some case boards were not fully aware of the risks being taken, but there was also concern among staff that risk aversion was often the norm among boards, with over-cautious approaches.

A new typology of social enterprises

The rapidly growing social enterprise sector is relatively new, and parallels the extension of the market into more and more activities in the public sphere. 'Transitions' was a repeated theme in the research, as entrepreneurial activity becomes more prominent. One important finding from the research was that the origins and paths of development of social enterprise can also have an important impact both on the way governance structures are constructed and developed, and on the types of issues and challenges that they face. For example those social enterprises that are spun out of the public sector spin-offs typically bring the culture of the public sector with them; they may lack business skills requiring board members and management with business expertise, and may have local authority and union representatives on the board. This suggested that a new typology of social enterprises based on their origins and development path would be useful. (As was noted in Section 2 one of the problems in trying to understand social enterprise activity is the great diversity of the sector.)

The research suggested four main types of social enterprise each with different origins and development paths, summarised in Table 1. One type of social enterprise has their origins in *mutualism*, providing benefits or services to their members, for example credit unions and co-operatives. Another type, *trading charities*, arise out of charitable activity, where a charity engages in trading activity either to directly further its charitable mission or to generate new sources of income that can be used to support it charitable activities. *Public-sector spin-offs* arise when services are s 'spun-out' of the public sector, for example 'leisure trusts' that are formed to take over the recreation and leisure services formerly run by local authorities. *New-start social enterprises* are new businesses created from scratch by social entrepreneurs. Many of these are linked to new social movements for example fair-trade organisations and many green or recycling organisations.

Types of Social Enterprise	**Origins**	**Examples**
Mutuals	Formed to meet the needs of a particular group of members through trading activities	Consumer co-operatives Credit unions
Trading charities	Commercial activities established to meet the charities primary mission, or as a secondary activity to raise funds	Educational or other charities that charge for services. Charities with trading subsidiaries e.g. charity shops
Public sector spin-offs	Social enterprises that have taken over the running of services previously provided by public authorities	Leisure trusts Some health and social care social enterprises
New-start social enterprises	Enterprises set up as new businesses by social entrepreneurs.	Some fair trade and 'green' enterprises

Table 1: A typology of social enterprises

Governance challenges in the different types of social enterprise

This section examines some of the more distinctive challenges faced by these four types of social enterprise.

Mutual organisations

These organisations tend to operate fully in the market place, for example consumer co-operatives or credit unions. They face the classic governance issues of membership associations but these are given a distinctive slant by the necessity of operating in competitive markets. Mutuals often find it difficult to attract members with appropriate business skills to serve on boards; people often get involved because they are interested in the 'cause' rather than governance and the demands of overseeing a business. There can also be problems maintaining membership involvement and commitment, particularly as organisations grow and becomes more professionally led, or if the need the mutual serves looses its relevance or popular appeal. As a result there is a danger that organisations can become dominated by their professional staff and loose touch with members.

Trading charities

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

An important issue facing any charity wishing to undertake commercial activities is constructing an appropriate governance structure. Charity law means that trading charities are often required to establish trading subsidiaries. This means developing multi-level governance structures with overlapping board membership, which can place new demands on board members and those that service them. To operate successfully there needs to be clarity over roles and responsibilities of different boards and how they relate to each other, and coordination of strategic processes. There is always an attendant danger of conflicts of interest between the subsidiary and the main charity.

A number of participants reported problems with board members having to move away from a 'charity' culture, which may be more comfortable thinking in terms of projects and programmes, towards a more entrepreneurial one that needs to think more in terms of developing a sustainable business, and evaluating new business opportunities and risks. It was suggested that board members often lacked understanding of business models and were often *risk averse*. It was also suggested that some organisations were 'over-doing' governance procedures, slowing down decisions and thereby hampering entrepreneurial activity.

However, conversely it was pointed out that there can be big risks associated with contracting, for example over difficulties achieving full-cost recovery, and the dangers of over reliance on a single or few sources of funding, which can threaten the independence or survival of an organisation. There was sometimes a perception that contractors financially exploit the altruistic values of charities.

Public sector spin-offs

Social enterprises spun out of the public sector may face uncertainty about what are appropriate legal forms and appropriate governance arrangements. Choices of different governance structures result in varied challenges. For example some leisure trusts have multi-stakeholder boards, including for example representatives of staff, trade unions and local authorities, while others have chosen staff-led structures staff, with staff exercising the main control on the board, thus resembling worker co-ops with the associated challenges of that form. There are also challenges associated with transferring staff from one organisation to another concerning pension liabilities and terms of employment that have to be negotiated and can lead to difficult periods of transition.

Establishing the legitimacy and market presence of a new form of enterprise, like leisure trusts, can be challenging for boards and senior management. Some larger social enterprises have tried to address the problem by recruiting high profile business leaders to their boards. A related challenge is developing boards and senior management for market challenges and culture change – moving away from bureaucratic processes and structures, and reconfiguring and balancing powerful interests like trade unions, clinicians and managers with users' interests.

For some multi-stakeholder boards an important challenge is to move away from, what one participant called, “delegate syndrome”, that is to say when board members represent particular stakeholder interests rather than act in the interests of the organisation as a whole. This was seen as a particular problem with some board members from local authorities. There were different views on the pros and cons of having main funders as board members – some value the closer relationship and better information, while others feel that it can result in conflicts of interest and excessive monitoring.

A growing concern in some public sector spin-offs is developing appropriate mechanisms to involve users. Despite it being a priority, achieving effective user involvement can be difficult to achieve. Some leisure trusts were also experiencing problems maintaining staff involvement. It was sometimes difficult attracting new staff to become members, although suitable recruitment and induction processes can help.

The demands of operating in public service markets and managing contracting relationships with dominant funders can be extremely challenging for boards. Some participants commented on the problems caused one-year funding cycles, cost-cutting pressures and monitoring requirements.

New-start social enterprises with small business origins

Social entrepreneurs starting new social enterprises face the usual challenges of getting a new small business off the ground, as well as winning support for what is often still regarded as an usual form of business. Understandably entrepreneurs are often more interested in the successful implementation of their business ideas and social mission than broader issues of transparency or accountability. This can lead to governance arrangements being neglected, or only considered when concerns are raised by funders or public service contractors.

6. Conclusions

This study of the governance challenges of social enterprises examined the experience of governance advisors, board members and chief executives in a wide variety of social enterprises. One of challenges facing researchers of social enterprises is the wide variety of organisations that are commonly recognised as social enterprises, which can make developing generalisations difficult. One important by-product of the research was the development of a new typology of social enterprises based on their origins and development path. This suggests that social enterprises can usefully be divided into for main types: *mutuals* (e.g. co-operatives and credit unions), *trading charities* (e.g. enterprises set up by charities to develop revenue), *public sector spin-offs* (e.g. enterprises formed to undertake some services previously delivered by public authorities) and *new-start social enterprises* (e.g. new businesses started from scratch by a social entrepreneur).

Many of the governance challenges faced by social enterprises resonated strongly with those found in voluntary and non-profit organisations more generally, but there were also distinctive aspects particularly stemming from commercial activities, entrepreneurialism, and managing business and financial opportunities and risks. These include: finding and developing board members with the necessary business, financial and entrepreneurial skills and experience; deciding the right legal and governance structures for combining entrepreneurial activity with a social mission; managing diverse stakeholder interests in (increasingly) multi-stakeholder governance systems; balancing business and commercial decisions with the social mission of the organisations; developing and professionalising board roles in small and growing social enterprises.

The research also suggested that the different origins of social enterprises and their paths of development can have an important impact both on the way governance structures are constructed and developed, and on the types of challenges they face. For example the development of commercial activities by charities often requires the development of trading subsidiaries, with the requirement to maintain and manage a multi-level governance structure. Public sector spin-offs face problems particular problems in transferring staff, and developing new governance and management structures. Both types of social enterprise face the challenge of developing a more entrepreneurial and business oriented culture.

Government, policy makers and the general public have high expectations of social enterprises, and while many exceed these expectations, other social enterprises, as they become more entrepreneurial, struggle with diverse and difficult governance challenges. It is hoped this research will provide a better informed basis for supporting the distinctive governance needs of social enterprises, to strengthen the legitimacy, accountability and effective performance of the sector.

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