The governance of hybrid organisations

Book Section

The Governance of Hybrid Organizations

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Introduction

The focus of this chapter is on the governance of third sector organizations (TSOs) and the challenges that are raised by hybridity. In particular it will focus on the question how does hybridity affect governance structures and processes and the challenges that governing bodies face?

A number of factors are driving the growth of new hybrid forms of organizations in the third sector. Government policy has increasingly sought to create a mixed economy of welfare, by encouraging both private and third sector organizations to engage in public service delivery. Indeed government has invested heavily in capacity building and infra-structure in the sector to help make TSOs better able to take on this new role. At the same time many TSOs have been looking to diversify their income streams, and have seen trading as an important way to do this. Figures from the Voluntary Sector Almanac in 2006 showed earned income of voluntary organizations growing from 33% in 1994/5 to 47% in 2003/4, to become the largest single source of income (Wilding et al, 2006) and in 2005/6 the earned income of general charities rose to over 50% for the first time (Reichart et al, 2008).

Alongside this growth in commercial activity, there has also been a growth in TSOs that identify themselves as social enterprises, these are hybrid businesses that trade in the market but pursue social or environmental goals (Nyssens, 2006). Some of this growth has been stimulated by top-down government policies, such as the encouragement of social enterprises in the areas of health and social care (Walsham, et al, 2007). Others have come out of grass-roots initiatives, such as the movement for fair-trade. Responding to these developments the government has created a new legal form, the community interest company (CIC), which was designed to meet the needs of some forms of social enterprise, and a new regulator for CICs.

Government has also increasingly sought to create new partnerships at a local level between organizations in the public, third and private sectors to tackle social problems and deliver joined-up services. Taken together these changes are leading to an ever more complex and varied organizational landscape in the third sector. At the inter-organizational level there is a growth of partnerships, federations, collaborations and alliances. At the organizational level many organizations are adopting more complex structures with, for example, one or more trading subsidiaries. Organizations may also adopt a variety of legal forms and are subject to different regulatory regimes. All of which have implications for organizational governance.

Unfortunately research on the governance of TSOs has not kept up with this growing complexity. A preponderance of research has taken place in North America and has often focussed on the boards of medium- and large-sized non-profit agencies that work in the field of human services (Ostrower and Stone, 2006). It has tended to ignore other aspects of the governance system such as membership, audit or regulatory requirements, or how other wider contextual factors influence governance. The focus has also been primarily on unitary organizations with single boards, rather than the more complex governance structures that many hybrid organizations adopt, such as charities with trading subsidiaries. Little attention has been paid to how partnerships between organizations in different sectors are governed, or the impact of partnership working and receiving government contracts is having on governance practices at the organizational level.

This chapter starts to address this gap by exploring some of the implications of hybridity for organizational governance. It begins quite broadly by focusing on the different types of governance structures employed within TSOs. It suggests that the governance of TSOs varies quite widely from the ideal type of the membership association outlined in Chapter 2. Three broad types of governance structure are identified and their potential strengths and weaknesses are discussed, particularly in terms of accountability. It also explores the different governance challenges of organizations with few or no staff compared to those with an established professional staff structure (that Billis in chapter 2 calls entrenched hybrids).

The chapter then goes on to examine governance in particular types of hybrid organization. However, the diversity and complexity of the sector means that not all types of hybrid can be examined. Hence a selective approach has been taken. First, it will examine trading charities as an important example of third/private sector hybrids. It notes that one of the main ways of coping with the potentially different requirements of charitable and trading activities is by separating or 'decoupling' them from each other. Secondly, it will examine public/third sector hybrids that are created when services are 'spun-out 'of the public sector, for example leisure trusts that have taken over the leisure and recreations services of local authorities.

However, before looking at these different examples it is important to say more about what is meant by governance and the characteristics of organizational governance arrangements in the private and public sectors. The reason for doing this is to explore whether and how governance practices in private and public sectors are influencing those of hybrid organisations.

Governance in the private and public sectors

The term governance has become an important concept in a variety of different disciplinary and practice arenas including management, economics, public administration, public policy and politics. It has its roots in a Latin word meaning to steer or give direction. However, as Kooiman (1999) notes in a useful review article the term is used in a number of different ways, which can lead to confusion. He suggests one useful way of distinguishing between different usages is in terms of levels of analysis. The focus here is on the organizational level and how organizations are governed. The term corporate or organizational governance is often used to refer to governance at this level, and can be defined as the *structures, systems and processes concerned with ensuring the overall direction, control and accountability of an organization* (Cornforth, 2004). The body with the main responsibility in an organization for carrying out governance functions is the organization's board or governing body. However, the corporate governance system is wider than this and includes the framework of broader responsibilities and accountabilities within which organizations operate, including regulatory and reporting requirements and relations with key stakeholders.

It is important to distinguish organizational governance from political governance, at a higher level of analysis, where it is used to refer to new patterns of government and governing. In particular the shift away from a unitary state to a more fragmented and arms-length system of government where a range of non-governmental bodies participate in the delivery of public services and policy formulation (Rhodes, 1994). Of course these new patterns of political governance and public service delivery are an important part of the context in which many TSOs operate. Indeed one of the main themes of this book is whether the growing dependence of many TSOs on the state in terms of funding, and the tightly-specified performance requirements that often go with this, are undermining their missions and independence.

The language used to refer to an organization's governing body and those that serve on it varies widely between and within the different sectors. In this chapter, for the sake of simplicity, the term board will be used to refer to the governing body, and board member for those elected or appointed to the board. There are also other important differences between governance arrangements in the private, public sectors and third sectors. However, there has been a growing trend for governance practices in one sector to influence those in another sector, another sign of hybridity. For this reason corporate governance arrangements in the private and public sectors are examined briefly below before looking in more detail at the third sector.

The private sector

In the private sector modern systems of corporate governance evolved with the increasing separation of ownership from control in companies (Learmount, 2002:7-8). As shareholders became separated from those that managed companies they appointed boards to act on their behalf. In addition, systems of reporting, regulation, accounting and audit were developed to try to ensure corporations were run in their owners' interest and subject to constraints of the law. In the UK public companies have 'unitary' boards consisting of executives and independent or non-executive directors (NEDs) elected by shareholders, who are responsible for running the company and safeguarding shareholders' interests. The voting rights of shareholders are in proportion to the number of shares they hold, so large shareholders are able to exert more influence than small shareholders.

The requirements on quoted public companies that are able to sell their shares to the public are more demanding than for private companies and many of the recent corporate governance reforms in UK have been aimed at them. Prompted by concern over governance 'failures' in a number of large corporations these reforms started in earnest with the report of the Cadbury Committee in 1992 (Cadbury, 1992) and have been developed further into a combined code of good practice in a series of subsequent reports. The main thrust of the code has been concerned with strengthening the position of NEDs, so they are better able to hold executives to account. Important recommendations include separating the Chair and Chief Executive roles, ensuring that a majority of board members are NEDs and that audit and remuneration sub-committees are established consisting of NEDs. The code is not mandatory on listed companies, but if they deviate from the code they have to explain why. However, critics of this system suggest that boards too often become self-perpetuating elites dominated by executives and that the majority of shareholders are too passive to hold boards effectively to account (Monks, 2005).

The public sector

There are some parallels with the private sector in the development of governance arrangements in the governmental or public sector. As public institutions developed it became necessary to put in place people who could oversee and control these institutions on behalf of the public. In a democracy these 'governors' are elected through a public vote of eligible citizens and are expected to be publicly accountable. The elected 'governors' are expected to decide policy which is then carried out by public officials.

However, in practice governance arrangements across the public sector are much more varied. Public services may be delivered by central government departments, by local authorities, by arms length agencies or through contracts with private and third sector providers (Europe Aid, 2009). Since the 1980's central government has reformed the way many public services are delivered and governed. There has been an increase in the formation of public bodies that operate at arms length from government with their own boards and a move away from elected to appointed board members, or some combination of elected and appointed posts. In 2003 Steele and Parston (2003: 5) estimated that just under a third of the governors of public bodies in areas such as health, police authorities, schools and housing associations were appointed. These reforms also reflect a degree of hybridisation. Many of these governance reforms were modelled at least in part on private sector practices and the language of corporate governance has become commonplace in many parts of the public sector. More recently some changes have been influenced by practices from the third sector. For example, the new NHS Foundation Trusts are modelled in part on mutual and co-operative traditions found in the third sector, with local members of the community and staff electing the majority of members on a board of governors, who then appoint the NEDs onto the board of directors (Ham and Hunt, 2008).

One important difference between organizations in the public sector and those in the private sector is that the former are not usually fully independent, but are subject to a degree of political direction and control from government. Hence, the governing bodies of public service organizations are often constrained in their ability to set policy and strategy for the organization, for example by central government funding decisions and priorities. This can lead to tension between local and central accountability. There are also considerable differences in governance arrangements between public bodies in different fields. So for example a private sector model for boards of directors was adopted in health, with executive and non-executive directors on the board, whereas in schools a multi-stakeholder model prevailed, usually involving elected parent governors, local education authority appointees, staff governors and co-opted governors. Although it is now more common for executives to have a place on governing bodies of public organizations they are usually very much in the minority on the board.

Governance in the third sector

In chapter 2, David Billis argued that the ideal typical TSO is the membership association run by its members and volunteers, reliant primarily for resources on membership fees and voluntary donations of time and money, and where the governing body is elected by the membership in 'private' elections. TSOs are set up to serve a social mission, rather than being profit seeking or serving a statutory purpose, and it is the duty of the board to safeguard this mission.

There are a number of distinctive characteristics of organizational governance in 'pure' membership associations. Firstly, there is a two-tier power structure where a small group of people who are responsible for overseeing how the organization is run (sometimes called the board of trustees, board of directors, governing body or management committee) are accountable to a larger group of members. Board members are elected by this wider membership in 'private' elections on the basis of one person one vote. Secondly, board membership is voluntary i.e. it is unpaid. Thirdly, unlike boards in the private sector, and some public sector organizations, board membership does not usually include paid executives of the organization, although board members may be people who work as volunteers in the organization.

However, it is important to note that there are considerable variations in the governance arrangements of TSOs, and many vary from this model of a pure membership association. These different governance structures are examined in detail in the next section. There are also other important variations concerning who are the beneficiaries of TSOs that have implications for governance. It is useful to distinguish between those organizations set up to benefit the wider community or public, and those set up primarily to benefit their members, such as many co-operatives and mutual societies. As mutual and co-operative societies are primarily trading organizations, they are perhaps better regarded as third/private sector hybrids. For reasons of space they will not be considered in this chapter, (although it should be noted that they face many similar governance challenges to other membership associations).

It is also important to recognise that governance arrangements and practices can change over time. In another important sign of growing hybridity there has been considerable debate in the voluntary sector about whether private sector practices, such as the payment of board members and allowing executives to serve on boards, should be adopted. Advocates have seen these practices as a way of improving the quality and commitment of board members, while detractors have argued they would undermine some of the key principles of TSOs. While in many parts of the third sector these changes have been rejected or resisted in some hybrid organizations, such as housing associations, they have become common place.

Three models of third sector governance

This section examines some of the main governance structures adopted by TSOs. While the membership association is an important ideal type for TSOs it is argued that in practice there are considerable variations in governance structures and three main types are identified. The following section then goes on to consider how the development of a staff hierarchy, typical of what Billis (chapter 2) calls 'entrenched' hybrids, impinges on governance processes and membership control.

At the level of the 'unitary' organization (i.e. an organization without subsidiaries) there are three main types of governance structures employed by TSOs: the 'pure' *membership association*, the *self-selecting board* and the *mixed* type, which combines feature of the two previous types.

As noted above, in a *membership association* there is essentially a two tier structure at the organizational level: the membership, which may consist of individuals or organizations (and is wider than the board), and a board, which is democratically elected by the members[1]. The board is responsible for overseeing the day-to-day running of the organization and is expected to account to the membership at annual general meetings or extraordinary meetings that are called for special purposes. Some voluntary organizations may also have people associated with the organization that they call members, but do not have voting rights. Indeed there has been a growing trend to 'commoditise' membership and see it primarily as a source of funding and support rather than a mechanism for control and accountability. For our purposes organizations that only have non-voting members are not regarded as membership associations.

As a governance structure the membership association has various potential advantages: it provides a mechanism for keeping the board accountable to the wider membership; the membership can act as a potential pool of volunteers, donors, campaigners and board members and can provide a

[1] In practice the governance structures of many membership associations are more complex than this simple model. Some large associations have a nested, hierarchical governance structures with branches, local associations, affiliates or regions which may have their own elected boards as well as an overarching board at the level of the organization as a whole. Some organizations may have a federal structure where individual organizations are largely autonomous, but come together to form a federation. There may also be different categories of membership with different rights and responsibilities. For a review of research on the topic see Tschirhart (2006).

source of feedback to the board on the needs of beneficiaries or users. However, it can also lead to potential governance problems. Research by the Charity Commission (2004: 9-11) suggests that there is more scope for governance disputes in membership associations, for example: if membership records are not kept up to date and so it is unclear who are voting members, member relations are not managed effectively, the membership lacks diversity or is dominated by particular interest groups.

In some organizations the membership is restricted to board members; hence the governance structure is effectively reduced to a single tier with a *self-selecting board*. This has the advantage of being a very simple structure to operate. It gives the board greater control over who is selected to serve on it with the potential that board members can be chosen for their experience and skills. This process may also help to reduce conflicts of interest between competing membership groups. However, it has a number of potential disadvantages: there is a danger the board may become self-serving or subject to group-think; there is a potentially important loss of accountability as the board is no longer formally accountable to a wider constituency, although regulatory controls may provide some reassurances the board is acting in the interest of its intended beneficiaries, and it may deprive the organization of a potential source of support and resources. As David Billis notes in chapter 2 the commitment of staff and volunteers to the values of an organization may 'compensate' for the absence of a active membership by placing demands for accountability on the board and helping to maintain the organisation's mission and values.

The third type of governance structure, the *mixed type*, contains a mixture of the features of the previous two types. There is a wider membership, but the membership only elects a proportion of board members and the others posts are appointed, for example people may be co-opted to the board to fill skills gaps or nominated by particular 'stakeholder' organizations. This mixed type of governance structure has the potential to harness the advantages of both the two previous types of governance structure, ensuring a degree of democratic accountability to members and harnessing member support, but still allowing the board to recruit some members to ensure it has the necessary skills and experience. However, there are also potential disadvantages: the role of elected members can be marginalised if other board members are perceived to have greater expertise; involving board members from external stakeholder groups, such as funders, can lead to conflicts of interest and uncertainty over whether board members are acting in the best interests of the organization or the stakeholder group that they come from, and it may be more difficult to reach agreement on decisions in multi-stakeholder boards where a diverse range of stakeholder interests are involved.

It is important to remember though that in practice the differences between governance structures that involve a wider membership and those where the board is self-selecting may not be quite as clear as at first appears. Over time membership may decline or become inactive and in some organizations boards may control who is nominated for election. As a result boards may still exercise a considerable degree of influence over who becomes a board member. Michels (1949) formulated the 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; Cornforth, 1995).

It is difficult to obtain accurate figures on the frequency of these different governance structures in the third sector. However, the Charity Commission (2004) estimated that about 80,000 charities, or roughly half those on in its register, have voting members, (and a further 20% of charities have non-voting members). This suggests that pure membership associations and those with mixed structures make up about half of all registered charities, and so presumably those with self-selecting boards also make up about half. Of course these figures exclude the very many voluntary and community groups that are not registered as charities; by and large these are likely to be small organizations without paid staff, such as residents or sports associations, and are more likely to be membership associations.

Governance in organizations with and without staff hierarchies

In chapter 2 David Billis distinguished between associations that are run mainly by their members and employ relatively few or no paid staff, and voluntary agencies (entrenched hybrids) that employ a larger number of paid staff and are managed by a professional managerial hierarchy. These differences have important implications for the practice of governance. Much of the research on the governance of voluntary and non-profit organizations has focussed on these larger voluntary agencies. A great deal of this research has been undertaken in the US and focuses on the role of boards in non-profit organizations providing human services. Important topics for research have been: governance functions and board roles, the determinants and consequences of board composition, the relationships between boards and management, and the determinants and consequences of board effectiveness (Ostrower and Stone, 2006). As Rochester (2003) notes there has been a high degree of consensus on the different governance functions and board roles and how they are distinct from those of management or other paid staff.

However, in TSOs with few or no staff the boundaries between governance, management and the ordinary work of the organization are much more blurred as there are few or no managers or staff for board members to delegate work to. As a result board members are likely not only to get involved in governance but management and operational matters as well. It is no accident that the governing bodies of these organizations are often called management committees rather than boards or governing bodies.

Once TSOs start to employ staff a new dynamic occurs (Wood, 1992). Case study research by Cornforth and Edwards (1998: 38-9) suggests that the transition to employing a paid staff hierarchy can lead to tensions and conflicts between boards and management as they struggle over redefining their respective roles and responsibilities. Rochester (2003), based on a study of small voluntary agencies employing less than five staff, suggests these organizations face three distinctive problems with respect to governance compared to larger organizations with an established paid staff. First, they experience greater problems in recruiting and retaining board members, and those they do recruit are more likely to lack relevant experience and expertise. This finding is supported by results from a survey of charities in England and Wales which showed that difficulties in recruiting board members were inversely related to organizational size (Cornforth and Simpson, 2002). Second, the ability of these boards to carry out the commonly ascribed governance functions was limited. For example, Rochester observed that the boards were only involved fitfully in determining policies and that this was often done reactively in response to particular problems as the emerged. Third, senior staff found it difficult to find the time to properly service, support, and help develop the boards of their organizations. He suggests these problems are not unique to small voluntary agencies but that they are felt in a particularly acute form.

Drawing on the work of Billis (1993) Rochester characterises these small voluntary agencies as hybrids combining elements of the pure membership association with that of a bureaucracy. While not disagreeing with this analysis a question remains whether by itself employing a paid staff hierarchy should be regarded as a sign of 'entrenched' hybridity, in the sense of adopting private or public sector practices? While paid staff are more common in the public and private sectors they also occur commonly in the third sector, and conversely it is not unusual for some public organizations to use volunteers. The motivation to employ paid staff in the third sector appears often to be one of needing to scale up and coordinate activities or draw on professional expertise, rather than an adoption of private or public sector approaches, so the degree to which this is an indicator of hybridity is open to question. However, it is true that maintaining a staff structure can lead to greater pressures on voluntary organizations to seek government funding or grow commercial activities which can lead to greater hybridisation, but this is not inevitable. This is an issue that is taken up next as we examine the growth of trading activities in charities and the implications for governance.

The case of trading charities

Over more than a decade there has been a growing trend for voluntary organizations to earn more of their income from trading activities. The UK Voluntary Sector Almanac in 2006 reporting on data from 2003/4 concluded that 'social enterprise activities are driving the sector's economy' (Wilding et al, 2006). Income from trading activities was estimated to increase from 33% in 1994/5 to 47% of total income in 2003/4 surpassing voluntary income from donations and grants at 45% of total income. As a proportion of total income the public sector provided 38%, which was a small increase from 2001/2, compared to 35% of income from individuals. The growth in earned income also reflected a shift in public sector funding from grants to contracts, with 53% of public sector income into the sector coming from fees. This suggests that at the time about 25% of total income was coming from public sector contracts. At the same time income generation was concentrated in the larger charities with 2% of charities (numbering approximately 3200) generating 66%

of the total income. In 2005/6 the earned income of general charities rose to over 50% for the first time (Reichart et al., 2008).

This growth in commercial activity among charities raises important questions. Is trading leading to hybrid forms of organization and new governance structures? What challenges does this raise for charity trustees and how are the managing them? In order to consider these questions it is important to examine first the different types of trading that charities may engage in and the legal requirements that exist to safeguard a charity's assets and mission.

Trading activities by charities may be divided into three types: *primary purpose trading*, which directly furthers the charity's objects or mission, like St Mungo's carrying out government contracts for the homeless; *ancillary trading*, which is indirectly related to the charity's mission, for example a café in a charitable museum; or *non-primary purpose trading*, which is not related the charity's mission but designed purely to raise funds, such as many charity shops (Alter, 2006). These distinctions are important because legally charities can only carry out primary trading within the charity itself, apart from small-scale exemptions for ancillary and non-primary purpose trading. If a charity wants to engage in significant trading that does not directly further its charitable objects it is required by law to establish a trading subsidiary. Charities may also decide to set up trading subsidiaries as a way of protecting their charitable assets from commercial risks and for tax reasons (Sladden, 2008).

Interestingly a number of social enterprises that were established to trade in the market have 'moved in the opposite direction' towards the voluntary and community sector by establishing charitable subsidiaries where they have social goals that qualify as charitable. This has the advantage again of helping to protect their social mission and means that their charitable activities are better able to attract grants and tax relief (Social Enterprise Coalition, 2007:15)).

Subsidiaries and governance

One of the main ways then for a charity to manage the risks from trading activities is to separate out or 'decouple' trading from its other operations and manage it within a commercial subsidiary. Trading charities can be regarded as third/private sector hybrids, as the charity owns the subsidiary, with the charity fulfilling the social or charitable mission and the subsidiary being run as a commercial business to generate funds for the charity. This has important implications for how the organization is governed; leading to more complex, hybrid governance structures than in a unitary organization, as each subsidiary will need to have its own board as well as the charity as a whole.

This can lead to new challenges for trustees as Sladden (2008) notes:

> 'Charity trustees have a fair understanding of their responsibilities but may struggle with a full understanding of how trading subsidiaries fit into the governance picture. The problem lies in the fact that trading companies are established to generate a profit whereas charities are set up to serve the needs of beneficiaries.'

An important governance challenge is that trustees of the charity and the directors of any trading subsidiary have separate and distinct responsibilities. Hence a trustee that becomes a director of the subsidiary needs to be aware of these separate duties. This can of course lead to conflicts of interest. In order to mitigate these the Charity Commission (2006) recommends that the board of any subsidiary should contain at least one director who is not a trustee or employee of the charity, and the charity should have at least one trustee who is not a director of the subsidiary. There also needs to be a complete separation of assets and resources, so if a subsidiary uses any of the charity's assets or resources it should be on a clear commercial and contractual basis. When establishing a subsidiary trustees need to treat it as any other investment and consider whether the investment is justified and in the best interests of the charity, and set up arrangements for monitoring the subsidiary to evaluate it success, with contingency plans should it not succeed.

Of course these legal safeguards can not eliminate all problems and there can still be tensions been the social and business goals of the charity. Exploratory interviews with board members, staff and advisers of trading charities by Spear et al (2007: 34-41) revealed a number of perceived problems. For example in one children's charity there were regular discussions about putting fees for services up because of concerns about reserves. However, the charitable side of the organization resisted these proposals because of the likely negative impact on some of the charity's main beneficiaries. Another potential problem is that trustees may not be familiar with commercial operations and be ill-equipped to evaluate business propositions and risks. Some interviewees commented that their trustees were too risk averse or had established procedures and governance structures that were too cumbersome for commercial operations. There can also be problems recruiting directors with the necessary business skills. Again this problem is often felt most acutely in smaller organizations.

Public sector spin-offs

As well as TSOs 'moving closer' to the public sector through being contracted to provide public services, there are hybrid organizations being formed in a transition in 'the opposite direction' from the public sector towards the third sector. That is when services that were once provided by public authorities are transferred or 'spun-out' into independent charities or social enterprises. Common examples include housing associations formed by the transfer of council housing stock, leisure trusts (LTs) that have taken over the recreation and leisure services previously provided by local authorities, and social enterprises formed to take over some social and health care services. Indeed the Department of Health has been actively promoting the establishment of social enterprises as a way of encouraging innovation in the health sector and bringing services closer to patients and the community (Walsham et al, 2007). The governance challenges of these new organizations are still emerging as these health quasi-markets are being constructed, with varying practices of service commissioners, and considerable variety in the configurations of provision: including single organizations, partnerships, consortia, and looser networks.

As a result there is very little research on the governance structures and challenges faced by these particular hybrid organizations. However, Spear et al (2007: 51-54) carried out some exploratory interviews with people involved in public sector spin-offs which revealed a number of different governance challenges associated with multi-stakeholder boards and the culture change necessary in order to enable boards and staff to face market challenges and move away from bureaucratic processes and structures common in the public sector.

Many public sector spin-offs have multi-stakeholder boards embodying a variety of sectional interests, often including staff, users, and trade union and local authority nominated members. As one interviewee in a LT noted this can lead to 'delegate syndrome', where board members act as if they are delegates for the particular stakeholder group they come from rather than act as a team in the best interests of the organization as a whole.

In some cases staff members are the largest group on the board. The need to gain staff and trade union commitment to any transfer out of the public sector may be an important reason for their representation on boards. As another interviewee commented this can lead to a particular type of delegate syndrome where staff initially get involved to protect their own interests:

> 'When we transferred from being council employees … the people (staff) that put their names forward (for the board) were the ones that were cynical, suspicious of the organization. One of them was making sure that their rights were being protected so they're actually going in it for the wrong reasons, so they're not putting the best interests of the company forward but I was quite happy with that because it's better to have them on the inside rather than causing problems on the outside. Within a year they realised that there was no hidden agenda and that this was about doing things much, much better.'

In health services the picture is often more complex where some categories of staff can be particularly powerful, like clinicians, who can be sensitive about the involvement of other groups on the board. Negotiating a balance between the clinical governance concerns and enterprise governance has been a perennial challenge. One interviewee noted 'clinical people don't think in a business way…marketing is on another planet'. There may also be problems in small health social enterprises of having access to the necessary expertise to manage clinical risks.

Tensions may also occur with other stakeholders such as users. Developing a range of mechanisms to involve users at board and other levels is often specified as a priority in public service delivery, but can be difficult to achieve effectively. Users may find it difficult to move beyond representing narrow sectional interests or feel they do not have the expertise and skills to effectively influence many board decisions, particularly with respect to commercial or financial matters.

The research also revealed contrasting views on the value of having someone from the main funding body on the board, for example local councillors on the boards of Leisure Trusts. On the one hand some interviewees pointed to difficulties with councillors wearing their local government hat and being unable to fully appreciate the different interests of the trust. However, other interviewees felt that having a local authority nominee on the board can be an advantage:

> '… it works much better when you've actually got somebody who is interested in leisure and running leisure from a political point of view in a district that is also one of our stakeholders because you get to know exactly the priorities of the council and in which direction they are going…'

Some LTs have grown and operate in a number of localities so that they are no longer so dependent on their 'parent' local authority, but others still operate only in one locality. This dependence can create tensions that may threaten the sustainability of LTs. As one interviewee noted:

> '…some local authorities are now wanting a cut of the surplus … or they threaten to cut the grant the next year – this is not good for investment and future planning … in some cases these grants are on a one year basis and decisions are made very late… the impact on governance is massive.'

Ensuring the independence and sustainability for relatively small social enterprises in public sector markets continues to be a key challenge both for board members and management.

Conclusions

The growth of trading activities by TSOs, often stimulated by the contracting out of public services, and the growing involvement of TSOs in partnerships with organizations in the public and private sectors has lead to more complex governance arrangements at both inter-organizational and organizational levels. To date research on the governance of TSOs has focussed primarily on the boards of unitary organizations and has not kept pace with this growing complexity and the emergence of hybrid forms of organization.

In addressing the considerable complexity of governance arrangements in the third sector and the impact of hybridity, this chapter has attempted to clarify the main governance structures used by TSOs and how they differ from governance structures in the public and private sectors. Three main types of governance structure were identified for unitary organizations: the pure *membership association*, where the board is elected by and accountable to the membership; the *self-selecting board*, where the membership and board are the same, and the *mixed type*, where some board members are elected by the membership and others are selected or nominated by stakeholders. It also examined some the of the distinctive governance challenges of TSOs as they move from being entirely voluntary associations to taking on paid staff, including the potential for conflict in differentiating board and staff roles, the difficulty of recruiting and retaining suitable board members and staff not having the time to adequately service the board.

At the organizational level an important strategy for dealing with hybridity is to decouple trading activities from those related to the organization's social mission through the creation of subsidiaries. This has lead organizations to adopt more complex, multi-level governance structures, with main and subsidiary boards. For many charities that wish to engage in secondary trading the law requires them to set up trading subsidiaries in order to protect their charitable status and assets. Interestingly some social enterprises, established as businesses, have subsequently set up charities separate from their trading activities to further their social missions and to improve their tax efficiency and eligibility to seek grant funding. However, little is known about how these more complex governance arrangements work in practice. This raises a range of important questions that deserve more in-depth research. How do main and subsidiary boards divide up their responsibilities and manage relationships between themselves? How are board members 'recruited' to the different boards and how do their different backgrounds and identities affect the way they interpret and perform their roles? How are differences and conflicts between subsidiary and main boards, and between social and commercial goals managed?

Hybrid organizations have different origins or roots (see Billis chapter 2) and have to make different transitions. Some hybrids are formed when charities undertake trading activities to raise funds and others may be spun out of the public sector. While others may be started from scratch as social enterprises by social entrepreneurs. These different transitions can raise particular challenges for organizations and their boards. Public sector spin-offs, such as Leisure Trusts, often have to deal with staff and trade union fears that the change will impact adversely on terms and conditions of employment, and their dependence on one key funder that may also be represented on the board. Charities that wish to engage in secondary trading to raise funds need to find a way of protecting their charitable assets and managing the risks associated with trading. Social enterprises started from scratch have to face all the challenges of establishing any new business, while at the same time furthering their social mission, and establishing the legitimacy of what is still a relatively poorly understood form of business. This suggests that many of the important challenges that face hybrid organizations and their boards are shaped by their different origins, the legal structures they adopt, the different regulatory requirements they face and the paths they take as they develop. It also highlights the fact that hybridity is not a fixed characteristic of organizations, but evolves over time in response to changing pressures and demands. Another important direction for further research is to examine in more depth what drives organizations to adopt characteristics from other sectors and how the different origins and paths hybrids take influence the governance structures they adopt and the challenges they face.

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