

# Marketisation of the UK Charity Sector: Implications for Governance and Legitimacy

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## Abstract

The UK charity sector is in a period of significant uncertainty. Sectoral changes and reforms, including the creation of new charities after the contracting out of public services, have been categorised by Bruce & Chew as a marketisation effect (2011). Whereas previously, statutory funding was delivered by way of grants, now the sector is witnessing a move toward the use of contracts and a competitive bidding process.

The work of charities in the UK is under threat from reputational damage and a crisis of public confidence (Weakley, 2016), despite explicit policy rhetoric from government (Alcock, 2010; The Conservative Party, 2009) and legislation (DCLG, 2012; Teasdale et al., 2012). There is societal demand for adequate regulation in the charity sector, not least due to the special allowances enjoyed by charities, such as tax relief and a lighter touch legal framework. The public need to have confidence that increasingly commercialised larger charities are deserving, not only of their donations, but also the significant fiscal and statutory benefits bestowed upon them.

This research study analyses and evaluates the current state of ‘marketisation’ of the UK charity sector and considers the implications for governance and legitimacy. A robust regression analysis is conducted of financial statement data, taken from a full set of the Charity Commission England & Wales database, over three years from 2011 to 2013. The total income analysed represents £151 billion and constitutes 27,424 sets of financial statements.

Clear evidence is found of marketisation as a mechanism for change, yet it is only weakly correlated with efficiency gains; fundamentally, marketisation may not be delivering required efficiencies or improvements. It is also generating unwanted side effects such as commercially aggressive stances around fundraising. To facilitate bi-directional flows of resources, including donations, talented employees, and volunteers and contract income, legitimacy needs to be restored to the model.

Robust governance practices can provide those in positions of responsibility with comfort and assurance that they are doing what is expected and required of their position, and afford them some defence if things go wrong. The concept of socio-marketisation is proposed where marketisation is guided by societal aims through various governmental ‘steering media’ including overarching principles, codes of conduct, legislation and regulation.

**Keywords:** Charities, Governance, Regulation, Public Policy, Socio-marketisation, Legitimacy

## **Introduction**

The question as to whether charities should be independent from government is a thought-provoking one. As part of a societal lifeworld (Husserl, 1936; Habermas, 1987) the charitable 'sub-systems' are subject to the steering media, brought about by that society, in order for it to function. These include legislation and regulation presented by government. Under such circumstances charities, as sub-systems of the whole, are never going to be wholly independent from government. Broadbent and Laughlin (2005) advocate the application of a Habermasian view to social interactions. In work emanating from German Critical Theory in 1984 and 1987, Habermas explains that we may '...conceive of society simultaneously as a system and as a 'lifeworld' (Husserl, 1936; Habermas, 1987) where the lifeworld is a driving force behind society and may be seen as '...represented by a culturally transmitted and linguistically organised stock of interpretive patterns' (Habermas, 1987, 124).

## **Have Charities Become Agents of Public Policy?**

The changes in government funding of charities, which has moved from grants to contracts, have been accompanied by greater performance monitoring and inspection (Cornforth, 2003). Bruce & Chew (2011) suggest that charities may need to adopt private sector governance and management systems to remain economically viable, and this may also affect their overall aims and objectives leading to 'mission drift'. However, donors of charitable organisations may not wish to see financial reserves supporting low value contracts and hence diverted toward the achievement of politicised aims of individual governments. The objects of a charity provide a degree of protection here for donors, by preserving the focus of delivery of key objectives. The Trades Union Council cited Charity Commission research showing that '...charities that deliver public services are significantly less likely to agree that their charitable activities are determined by their mission rather than by funding opportunities...' (House of Commons Public Administration Select Committee, 2011, 18). Hyndman & Jones (2011) state that a 'serious consideration of beneficiaries and their views' constitutes a 'vital' element of good governance in charities and that involvement of beneficiaries in decision making can help guard against mission drift.

In light of the growing governmental influence in the charity sector, and the devolution of powers to organise and deliver public services, we also need to consider the influence of 'political governance' on charitable bodies (Rhodes, 1994; Cornforth, 2010). 'There is a danger that charities may become agents of public policy, subject to targets and

incentives and thereby becoming an extension of the state.’ (House of Commons Public Administration Select Committee, 2011, 19).

### **Governance ‘Steering Media’: Habermasian Theory**

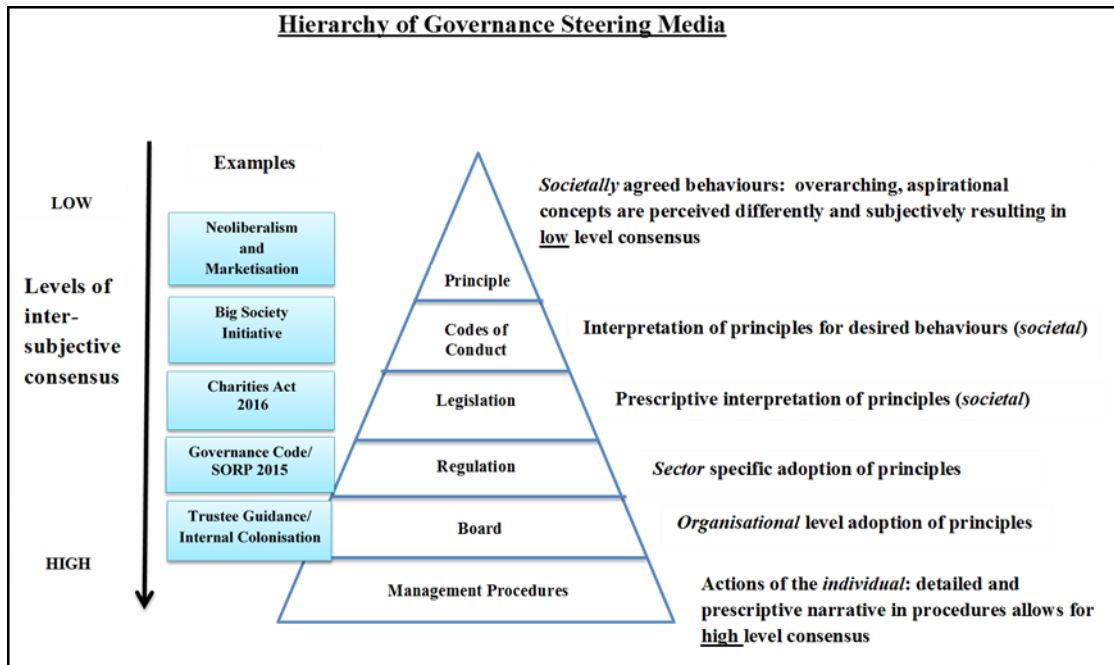
A conceptual reflection of this issue may be seen in the Habermasian view of society (1987), its sub-systems and steering media: where the charitable organisations are subsystems and steering media include regulators and governmental bodies. In translation of the Habermasian approach in their paper from 2005, Broadbent & Laughlin consider that all human interactions are subjective, and open to the interpretation of the individual. Where there is sufficient consensus achieved in the ‘societal lifeworld’, through the ‘discursive agreement and development of interpretive schemes’, then this allows for societal systems and sub-systems to be created. The term ‘interpretive schemes’ is defined by Bartunek (1984) : ‘...the cognitive schemata that map experience of the world, identifying both its relevant aspects and how we are to understand them...as shared fundamental (often implicit assumptions) about ...how people are to act in different situations’ (Bartunek, 1984, 355). So, the assumption is that all social interaction is open to interpretation, with only certain aspects of life being agreed by a sufficient number of the population to achieve a ‘consensus’ of opinion and provide us all with a ‘map’ for how to behave in certain situations. Without this social ordering the living world would be entirely chaotic. The ‘systems’ of ‘lifeworld’ (Husserl, 1936; Habermas, 1987) are societal organisations and the behaviour of these organisations is influenced by ‘steering media’ (Habermas, 1987; Broadbent & Laughlin, 2005).

The pyramid diagram on the next page (**FIGURE A**) is a visual representation of the relationships between layers of governance steering media within society. It aims to stratify aspects of governance with a view to analysing and interpreting their purpose and application. There is also an aspect of primacy in its arrangement, such that a higher layer will impact the layers below. The highest level is concerned with overarching principles and the application of concepts and ideology (for example Neoliberalism). The nature of this social discourse is highly subjective and topics are open to debate. Principles and ideology are further defined for the next layer of governance where concepts are interpreted to provide societal guidance for desired behaviours.

Codes of Conduct are derived that aim to guide behaviour, rather than prescribe it: an example of this might be the Big Society Initiative offered by UK Prime Minister David Cameron in 2010.

Taking desired behaviours and enforcing them through legislation at a national level, such as the Charities Act 2016, is the next layer of stratification in governance steering media. The move here is from desired behaviours to prescribed actions at a societal level.

**FIGURE A: Hierarchy of Governance Steering Media**



Source: Author (After Habermas, 1987)

A sector specific set of prescribed behaviours is applied within the next layer of governance steering media; regulation. The absence of a regulator-based, explicit governance code at this point in the structure may result in the internal colonisation of governance practices at an organisational level in the strata below. A weak, self-regulation style governance code here dilutes the delivery of governance media from the higher levels whilst a stronger, prescriptive code would reinforce those messages. The level of inter-subjectivity around the desired behaviours in the governance code should reflect its position in the hierarchy for it to be effective. Too much ambiguity results in direction that is hard to interpret and follow, and also means that requirements are open to wider debate.

The following two layers describe governance steering media at an organisational level. The stratum immediately below that of the regulator is for the trustee board. At an organisational level the trustee board is responsible for compliance with all steering media above them in the pyramid, including codes of conduct, legislation and regulation. It must also provide strategic and policy decisions that ‘direct and control’ management actions below them in the governance hierarchy. It is the task of the board to attempt to combine all of the higher

level steering media into institutional strategies and policies (board level) and operational procedures (operational, individual level). This may present charity boards with a complex undertaking. In certain organisations there may be an ‘internal colonisation’ of steering media where a version of governance unique to that organisation develops internally, perhaps as the result of ambiguous steering requirements that are open to interpretation.

Governance steering media are used to increase the levels of inter-subjective consensus and so increase societal trust that organisations are operating ‘legitimately’ in a way that is in line with societal expected behaviours and ‘norms’. Societal trust relies on explicit values and objectives being firstly identified, and subsequently informing new steering media through the ‘...discursive agreement and development of interpretive schemes...’ (Broadbent & Laughlin, 2005). Without these explicit and agreed frameworks for action, society would be chaotic and it is the evolution of governance steering media that allows society to operate in an increasingly complex and sophisticated environment. Only when agreed behaviours have been defined may society trust that they will be adhered to. The trust is placed in the governance ‘steering media’ rather than individuals. In terms of this research study, individual charities are societal systems.

### **Charity Governance Code 2017**

There is societal demand for adequate regulation in the charity sector, not least due to the special allowances enjoyed by charities, such as tax relief and a lighter touch legal framework. The public need to have confidence that increasingly commercialised, larger charities are deserving, not only their donations, but also the significant fiscal and statutory benefits bestowed upon them.

‘...this is the sector’s code. The Commission does not aspire to own or enforce it, or pronounce on what it should say.’

(Charity Commission, 2017, 3).

This statement raises questions over why the regulator is so unwilling to become involved in governance oversight. The findings of this study would argue for the legitimate right of a government appointed regulator to determine governance steering media over societal capital in the form of modern charity assets. Evidence from this study would suggest that marketisation of the UK charity sector is delivering only ‘loosely coupled’ efficiency gains and also generating unwanted side effects such as commercially aggressive stances around fundraising. To facilitate bi-directional flows of resources, including donations, talented

employees, volunteers and contract income, legitimacy needs to be restored to the model. There is a conceptual re-alignment in governance that needs to accompany the shift in the economic model: the move is from the traditional moral legitimacy, which is intrinsic to philanthropic activity, to a more balanced legitimacy that also includes pragmatic and cognitive legitimacy. Embedding legitimacy in governance mechanisms is key to building trust and confidence in the sector and thereby facilitating bi-directional resource flows to provide a healthy 'market'.

The right of democratic government to intervene in markets with a social purpose needs to be upheld and the pure, neoliberalist aspiration modified accordingly. Liberalist theory is supplemented by Habermasian (1984; 1987) influences to generate a marketised charity sector with societal 'steering' through layers of democratic-led governance. The concept of socio-marketisation is proposed where marketisation is guided by societal aims through various governmental 'steering media' including overarching principles, codes of conduct, legislation and regulation.

### **Socio-marketisation**

A synthesis of current issues and problems within the UK charity sector, derived from extant literature and empirical findings from this study, is presented visually in **FIGURE B** (next page). The synthesis is analysed through sections one to five. Research problems are addressed through the application of theory, in sections six to eleven, to generate an alternative approach to governance in the sector. An accompanying summary narrative is provided below:

#### **Synthesis of Current Problem: Sections One to Five**

##### 1. Neoliberalist Ideology

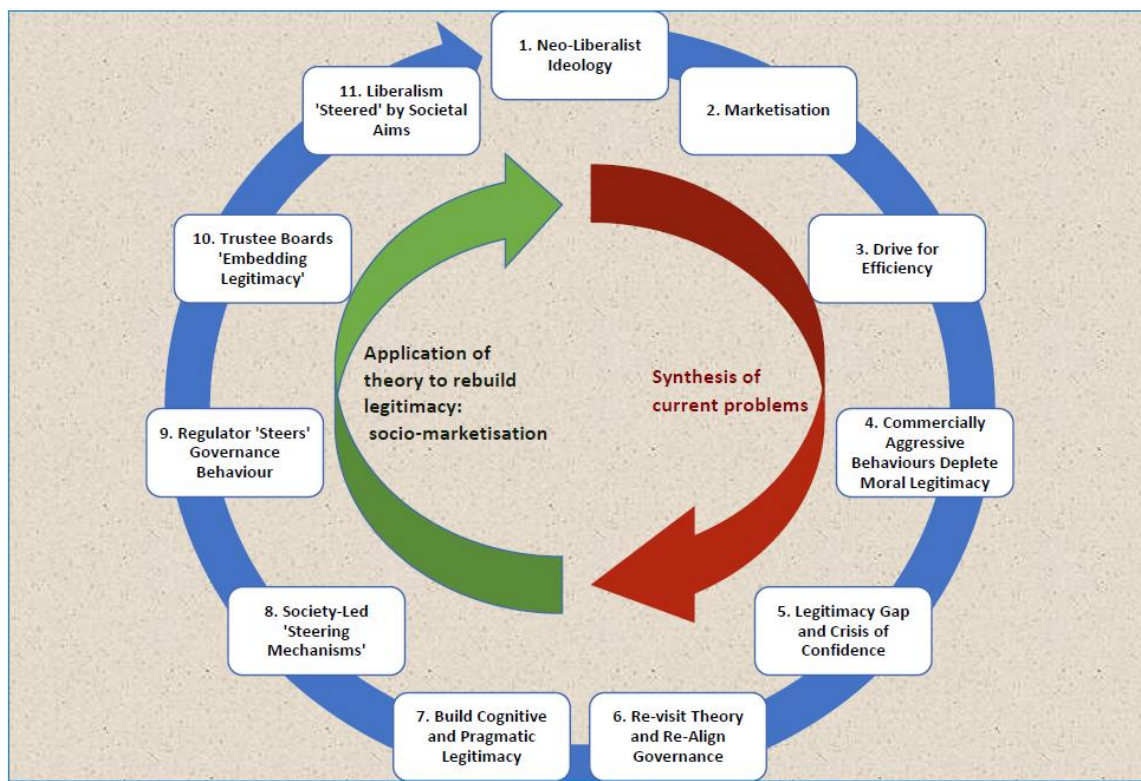
Governmental influence in developed western economies over the last thirty years has been fuelled by neoliberalist ideology to introduce 'market-like' mechanisms into public service provision (Eikenberry & Kluver, 2004). This has been achieved through the decentralisation of service delivery and the promotion of competition. This has affected the UK charity sector as third sector organisations have been encouraged to bid for contracts to deliver public services as a way to marketise the sector.

##### 2. Marketisation

The changing profile of the charity sector and the creation of new charities after the contracting out of public services has been categorised by Bruce & Chew as a marketisation effect (2011). Whereas previously statutory funding was delivered by way of grants, now the

move is toward the use of contracts. This creates a sector that is moving toward a ‘quasi-public’ model, not unlike that of housing associations and health and leisure trusts. The marketisation trend in the UK echoes that of other developed western economies, such as the US (Eikenberry & Kluver, 2004). In 2009, NCVO identified that 70% of all government funding in this area was delivered via fulfilment of a contract. The basic strategy of marketisation is to ‘strengthen governance by competition’ leading to greater efficiency (Hansen & Lindholst, 2016).

**FIGURE B: Socio-marketisation Approach**



Source: Author

### 3. Drive for Efficiency

In this study evidence has been found of marketisation and it has been shown to be delivering ‘loosely coupled’ financial efficiencies in the UK charity sector. Results of the regression analysis of the full financial data set showed a weak-form correlation between the level of contract income and operational efficiency, as defined by the traditional passthrough metric, with a 0.9% increase in efficiency observed for a corresponding 10% increase in contract income, significant at 1%. This would suggest that charities driven by contractual obligations are marginally more likely to ensure the majority of income is passing through to beneficiaries rather than cost savings contributing toward surplus funds. It would point toward a focus of attention on charitable goals rather than the commercial behaviour of creating

margins. Having to focus on priorities identified by the contract, and provide considerable amounts of performance data under contractual terms and conditions, appears to be to some extent increasing the focus on beneficiary outcomes. However, weak-form and intermittent efficiencies alone do not adequately explain the continuing drive of marketisation in the UK. The institutional model and the need for 'legitimacy of form' provide an explanation for the continued push toward internal markets.

#### 4. Commercially Aggressive Behaviours Deplete Moral Legitimacy

Traditionally, moral legitimacy has been inferred upon philanthropic organisations due to their charitable ethos. However, UK charities have recently become the focus of public scrutiny following high profile, organisational failures. The collapse of Kids' Company in 2015 led to high profile news coverage of its financial mismanagement of £46 million of public money (BBC, 2016). Well known, large, and previously popular charities are not exempt from this type of behaviour. Commercially aggressive behaviour was exhibited by the RSPCA and British Heart Foundation as they 'secretly screened millions of their donors so they could target them for more money' (Information Commissioner's Office, 2016). This wealth screening was used to pass donor details on to third parties and other charities so that they could be targeted for further fundraising. Age UK also brought the sector into disrepute with its commercially aggressive relationship with E.ON plc for which it received a commission of £6 million (Siddique, 2016). It would appear that larger charities, although having a similar size and commercial footprint to their corporate counterparts, are less astute when it comes to protecting their reputation and brand.

Moral legitimacy is sociotropic; it rests not on judgements about whether a given activity benefits the evaluator, but rather on judgements about whether the activity is "the right thing to do" (Suchman, 1995, 579). Gaining moral legitimacy may be undertaken through conforming to ideals and setting goals that align with ethical behaviours (Suchman, 1995).

#### 5. Legitimacy Gap and Crisis of Confidence

Commercially aggressive behaviours within the UK sector have challenged the public's perception of charities and there has been a crisis of confidence. Public trust in charities is at its lowest since records began in 2005 and charities are trusted less than members of the general public (Weakley, 2016). Suchman (1995) suggests that repairing moral legitimacy in individual organisations might be achieved through replacing senior management, implementing new practices and reconfiguring systems of work. Whilst this might be a way



forward, public trust generally needs time to become re-established. In the interim, charities are faced with a legitimacy gap and stakeholders that are unwilling to transact with them.

### **Application of Theory to Rebuild Legitimacy: Sections Six to Eleven**

Research problems are addressed through the application of theory to generate an innovative approach to governance in the sector: socio-marketisation is offered as a proto-type design of governance institution.

#### **6. Re-Visit Theory and Re-Align Governance**

The UK Government is becoming increasingly concerned about the way the sector is governed: ‘It is vital that we prioritise investing in organisation and development, building stronger leadership and governance’ Rob Wilson, Minister for Civil Society (Sharman, 2016). These thoughts are also echoed by governance consultancies in the UK ‘Our leading charities have developed the footprint and influence of multinational businesses yet from the information disclosed it appears that their governance frameworks may not have kept pace’ (Grant Thornton, 2013). Governance practices need to be re-aligned to address the perceived legitimacy gap and bring charities in to step with the marketized nature of the sector. Turning back to the theoretical model and Suchman’s strategies (1995), a lower moral legitimacy might be supplemented with higher levels of both cognitive and pragmatic legitimacy. The previous moral legitimacy of charities was significant and therefore levels of both cognitive and pragmatic legitimacy will both need to be improved to fill the significant legitimacy gap; ways to achieve this are discussed further in the next section.

#### **7. Build Cognitive and Pragmatic Legitimacy**

Developing the theoretical model further alongside Suchman’s legitimacy strategies (1995), it might be shown that a lower moral legitimacy could be supplemented with higher levels of both cognitive and pragmatic legitimacy. Combining the theoretical analysis of trustee roles with Suchman’s legitimacy strategies (1995) it is possible to construct a set of example behaviours that may be embedded within organisational practices to help to improve overall legitimacy for UK charities. Interestingly, the strategic model to gain pragmatic legitimacy includes the advice to select the market it wishes to engage in carefully and ‘locate friendly audiences’ (Suchman, 1995). This might be indicative of the ‘mission drift’ (Bruce & Chew, 2011) that is experienced by charities tempted into delivering services outside their core areas due to better contractual terms or safer ‘audiences’.

To increase levels of pragmatic legitimacy charities would need to be more responsive to their 'audiences' by consulting opinion leaders and building their reputation by advertising both product and image (Suchman, 1995). Gaining pragmatic legitimacy involves ensuring delivery of what audiences need and demand (Suchman, 1995). Audiences for charities are key stakeholders and so to gain pragmatic legitimacy charities need to be more responsive to key stakeholder wishes. He suggests consulting opinion leaders and co-opting constituents. This is not dissimilar to engaging with service beneficiaries through scrutiny groups (opinion leaders) and creating service user board memberships (co-opting constituents). Also advised is the advertising of the product, and importantly the image, that is to be projected (Suchman, 1995). He calls for organisations wishing to gain, and maintain, pragmatic legitimacy to 'communicate honestly' and 'stockpile trust'.

This approach is similar to that of another sector with previously high levels of moral legitimacy, the UK banking sector, after the financial crisis in 2008. Banks that were maintained by the state, such as RBS and Lloyds, received new senior management, implemented new practices and reconfigured systems of work (repairing of moral legitimacy) followed by a re-alignment of service to more closely address the needs of stakeholders and greater advertising of the new image (gaining pragmatic legitimacy). Also, greater regulation and stricter accounting and reporting rules were introduced (gaining cognitive legitimacy). Applying a similar theoretical approach to improving the overall legitimacy of UK charities might prove fruitful.

For larger charities bidding for public contracts, the ability to deliver formalised and certified levels of service generates greater cognitive legitimacy in the eyes of the contractee, i.e. those governmental offices delivering public services. The 'stockpiling of interconnections' (Suchman, 1995) is offered as a way of maintaining cognitive legitimacy and this translates into networking with important contacts to ensure a ready flow of local grants, contracts, talented employees and enthusiastic volunteers. New models of working are popularised through promotion of the charity's proactive image.

To gain further cognitive legitimacy charities might formalise operations and operate to higher standards. They might seek greater certification and mimic other organisations perceived to be of high cognitive legitimacy (Suchman, 1995). It is important to add at this point that the current mimetic isomorphism, where charities simply reproduce what they perceive to be commercialised behaviour, is not the solution here. It is important that charities emphasise their own values. A focus on achievement of organisational objectives, to retain a

focus on what is important to charities, is paramount. In this way, the formalisation of governance structures adds to cognitive legitimacy, as something that is ‘accepted to be necessary’ through a process of reasoning.

#### 8. Society-Led Steering Mechanisms

The drive of neoliberalist ideology to create markets where they didn’t naturally occur, has generated a crisis of confidence in the UK charity sector emanating from commercially aggressive behaviours. The liberalism currently exhibited needs to be additionally steered by societal aims to offer a new configuration: socio-marketisation.

In a democratic society, the elected government implement the public’s wishes and general opinion regarding acceptable behaviours through various steering media. Research is now incorporating a broader concept of ‘accountability’ due to a realisation that organisations have an impact on a wider variety of groups in society, and in reflection of this, there has been a broadening of research looking at transparency and stakeholder inclusivity. There are no ‘owners’ of a charity and no residual assets after a dissolution, so we cannot discuss the charitable model in a commercial way. Socio-marketisation has a specific role to perform in the charity sector where residual assets upon dissolution belong to no one organisation or individual and are a form of societal capital and there is a potential oversight void where owner interests or institutional shareholders might have played a role in the oversight of corporations in traditional markets.

#### 9. Regulator Steers Governance Behaviour

Legitimacy agents, mediators and guidelines are all types of ‘steering media’ that allow complex societies to function effectively and avoid chaotic and random actions with undesirable social outcomes. Legitimacy Agents are those bodies specifically established to bestow legitimacy on a particular set of organisations. An example of this would be a sector regulator (Durand & McGuire, 2005). Legitimacy Mediators are social actors conveying legitimacy assessments as a side effect of their operations. An example of this is the general media (Deephouse & Suchman, 2008). Legitimacy Guidelines are abstract constructs embedded within society such as norms, values and social rules (Deephouse & Suchman, 2008). Reflecting back to the Habermasian (1984; 1987) approach discussed earlier in the text, these terms add to the general narrative around social constructs and what our society determines to be acceptable behaviour and why.

It is interesting to observe that as the regulator (legitimacy agent) takes a step back from steering behaviour directly through a definitive governance code, then legitimacy mediators (general and social media) become increasingly involved in, and critical of, behaviours exhibited in an attempt to influence charitable organisations and the way they are governed. The ‘self-regulating’ approach to governance is potentially lacking and leaving trustees exposed. Rather than binding charities in bureaucracy, a little clearer direction, as with the private sector UK Corporate Governance Code, might be of use to the larger and more complex charities in the UK. Internal controls and administrative structure can provide those in positions of responsibility with some comfort and assurance that they are doing what is expected and required of their position, and actually afford them some protection if things go wrong. Larger charities could benefit from the establishment of an Audit Committee with specific terms of reference, as mandated in the private sector UK Corporate Governance Code. The use of similarly named committees with diluted sets of powers should be avoided in larger charities. These organisations face very similar internal control and risk management issues to their private sector counterparts with a similar size and complexity. Also, listed, private sector counterparts have to engage an internal audit function or justify why not on an annual basis. Although the charity code specifies that a system of internal control must be established and maintained, the code doesn’t go as far as mandating an audit committee or internal audit function.

#### 10. Trustee Boards Embedding Legitimacy

The role of the trustee in charity governance is changing as the dynamism of the sector increases. The skill set of the trustee board needs to reflect the demanding environment within which it operates and it is important to maintain an awareness of factors that might influence the planning horizon, such as regulatory changes and the risk of reputational damage. ‘Executive leadership has improved immeasurably, but board leadership hasn’t changed’ Sir Stephen Bubb, Chief Executive of ACEVO (Civil Society, 2016). Combining the theoretical analysis of trustee roles with Suchman’s legitimacy strategies (1995) behaviours may be embedded within organisational practices to help to improve overall legitimacy for UK charities (Toothill, 2018) .

#### 11. Liberalism Steered by Societal Aims

Liberalist theory is supplemented by Habermasian (1984; 1987) influences to generate a ‘marketised’ charity sector with societal ‘steering’ through layers of democratic-led

governance: socio-marketisation. Marketisation is guided by societal aims through various 'steering media' including overarching principles, codes of conduct, legislation and regulation. The right of democratic government to intervene in markets with a social purpose is upheld and the pure, neoliberalist aspiration is modified accordingly. Following this conceptual line suggests validity in the role of government when 'steering' behaviour in this way by influencing principles, codes of conduct, legislation and regulation.

Socio-marketisation has a specific role to perform in the charity sector where residual assets upon dissolution belong to no one organisation or individual and are a form of societal capital. There is an oversight void where owner interests or institutional shareholders might play a role in the oversight of corporations in traditional markets.

## **Conclusion**

The lifesaving work of charities in the UK is under threat from reputational damage and a crisis of public confidence. The charity sector needs to be protected. This can be achieved, not through a 'protected' laissez-faire approach to governance, but conversely through the integrity of robust practices. Governance structures and internal control can provide those in positions of responsibility with comfort and assurance that they are doing what is expected and required of their position, and afford them some defence if things go wrong.

There is societal demand for adequate regulation in the charity sector, not least due to the special allowances enjoyed by charities, such as tax relief and a lighter touch legal framework. The public need to have confidence that increasingly commercialised larger charities are deserving, not only their donations, but also the significant fiscal and statutory benefits bestowed upon them.

The findings of this study would argue for the legitimate right of a government appointed regulator to determine governance steering media over societal capital in the form of charity assets. Evidence from this study would suggest that marketisation of the UK charity sector is delivering only 'loosely coupled' weak-form efficiency gains and also generating unwanted side effects such as commercially aggressive stances around fundraising. To facilitate bi-directional flows of resources, including donations, talented employees, volunteers and contract income, legitimacy needs to be restored to the model. Socio-marketisation is offered as an alternative proto-type design of governance institution to address current problems in the sector.

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## **APPENDIX**

### **Linear Regression Model Specification**

Linear regression is used to analyse panel data for the years 2011-2013 and measure the effect of the independent variables on charity performance.

The following data model was estimated prior to the findings:

$$PERF = \alpha + \beta_1 CONT + \beta_2 LEV + \beta_3 VOL + \beta_4 GOV \\ + \beta_5 ADV + \beta_6 SIZE + \sum_{i=1}^T \beta_{Sect\ i} + e$$

### Dependent Variables (DV)

There are two dependent variables included in this data analysis as proxies for performance (PERF):

#### ***DndV1. Allocative efficiency*** [aEFF]

Reflecting the utilisation of charity funds for beneficiary services  
 =  $\frac{\text{Total costs of charitable activity provision}}{\text{Total revenue}}$

A ***higher percentage*** indicates a greater allocative efficiency.

In terms of the regression model it would be expected that where we see a positive correlation between [aEFF] and the independent variables this would indicate a *positive* correlation with performance. Donors typically want to see a high passthrough ratio, which represents the proportion of a charity's income that is ultimately distributed to beneficiaries, and this is a standard indicator within the charity sector of how organisations are performing (Hyndman & Jones, 2011).

#### ***DndV2. Technical efficiency***

Percentage of operating expenses compared to total revenue

=  $\frac{\text{Total operating expenses}}{\text{Total revenue}}$

A ***lower percentage*** indicates a greater technical efficiency.

In terms of the regression model it would be expected that where we see a positive correlation between [tEFF] and the independent variables this would indicate a *negative* correlation with performance. The use of this particular metric represents more of a commercial approach to performance. The idea, of not expending all incoming resources, supports the concept of generating an accounting surplus or profit and is so inherently capitalistic in its nature.

### Independent Variables (IndV)



**TABLE I** provides a summary of the independent variables in the regression model with their mode of calculation and rationale for inclusion in the model.

**TABLE I: Independent Variables in the Regression Model**

Independent Variable	Description
<b>CONT</b>	Proportion of income derived from charitable contracts
<b>LEV</b>	Proportion of debt to total assets
<b>VOL</b>	Proportion of total workforce comprised from volunteers
<b>GOV</b>	Proportion of total expenditure assigned to governance
<b>ADV</b>	Proportion of expenditure to facilitate voluntary income
<b>SIZE</b>	Control for size: Ln(TA) Reflection of size using total assets (natural log)  Ln(TINC) Reflection of size using total income (natural log)
<b>SECT</b>	Control for sector: Charity Commission classifications ranging from 101 to 116

***IndVI. Contract Income (CONT)***

Proportion of income derived from charitable contracts defined as:

$$\equiv \frac{\text{Charitable contract income}}{\text{Total income}}$$

**Independent Variable [CONT]: Rationale for Inclusion in the Model**

The marketisation trend in the UK echoes that of other developed western economies, such as the US, where market-based principles have been applied to reform public services (Eikenberry & Kluver, 2004). Whereas previously statutory funding was delivered by way of grants, now the move is toward the use of contracts (McKay *et al.*, 2015). In 2009, NCVO identified that 70% of all government funding in this area was delivered via fulfilment of a contract. The proportion of income derived through

contractual obligations is an indicator of the level of marketisation (Bruce & Chew, 2011) experienced by charitable organisations. The changes in government funding of charities, which has moved from grants to contracts, has been accompanied by greater performance monitoring (Cornforth, 2003). The introduction of market-like mechanisms was ultimately to improve performance.

Inclusion of this variable tests for correlation between increased marketisation and improved performance.

***IndV2. Leverage (LEV)***

Proportion of debt defined as:

$$\frac{\text{Long term debt}}{\text{Total net assets}}$$

**Independent Variable [LEV]: Rationale for Inclusion in the Model**

There is an argument that organisations holding debt are monitored and evaluated by the debtholders, and so this provides an additional governance mechanism, through this set of key stakeholders (Reddy *et al.*, 2013; Agrawal & Knoeber, 1996; Begley & Feltham, 1999; Jensen, 1986). The proposition is that the additional governance associated with debt leads to greater operational efficiency.

**Independent Variable [GOV]: Rationale for Inclusion in the Model**

Bruce & Chew (2011) suggest that charities may need to adopt private sector governance and management systems to remain economically viable.

Inclusion of this variable tests for improvements in performance generated through a greater organisational focus on governance.

***IndV5. Advertising and non-trading fundraising (ADV)***

Proportion of expenditure used to facilitate voluntary income defined as:

$$\frac{\text{Voluntary income costs}}{\text{Total operational expenditure}}$$

**Independent Variable [ADV]: Rationale for Inclusion in the Model**

Hind states that the annual income of charities in England and Wales alone was in excess of £50 billion in his paper of 2011. This has created an increasingly competitive ‘market’ for charities in terms of attracting donors, other funding, volunteers and sector specific resources. It is speculated whether increased competition, through such marketisation, leads to greater operational efficiency. The proxy used for competition is the level of costs associated with raising donations, such as advertising expenditure, which should rise as charities compete for donor income. Inclusion of this variable tests for improvements in performance generated through increased competition in the sector.

***IndV6a. Control for Size - ASSETS (Ln (TA))***

Reflection of size using total assets defined as:

Natural log (Ln) of Total assets

***IndV6b. Control for Size - Income (Ln (TINC))***

Reflection of size using total income defined as:

Natural log (Ln) of Total income

**Controls for size (Ln (TA) and (Ln (TINC): Rationale for inclusion in the model**

The data set represents financial information from around 8,000 charities over the three years from 2011-13. The total number of charity-years is 27,424. Within this set the size of organisations varies considerably. To control for size within the model two measures are introduced: Total Assets (TA); and Total Income (TINC).

**TABLE II: Descriptive Statistics of the Full Financial Data Set**

Variable	Mean	Median	Minimum	Maximum	Interquartile range
<i>Dependent</i>					
<b>tEFF</b>	1.16	1.11	-0.31	68.90	0.99-1.27
<b>aEFF</b>	0.84	0.90	-0.53	60.02	0.72-0.98
<i>Control</i>					
<b>CONT</b>	0.50	0.56	0.00	1.02	0.00-0.94
<b>LEV</b>	0.47	0.00	-0.10	1,589	0.00-0.04
<b>VOL</b>	0.18	0.00	0.00	1.00	0.00-0.25
<b>GOV</b>	0.02	0.01	-1.63	1.00	0.00-0.02
<b>ADV</b>	0.034	0.000	-0.19	1.66	0.00-0.02
<i>Size</i>					
<b>TINC</b>	£ 5,495,812	£ 1,404,885	£0	£ 951,392,000	£0.79bn-£3.6bn
<b>TA</b>	£ 12,901,623	£ 1,443,850	£0	£ 15,041,152,752	£0.45bn-£5.74bn

CONT is the proportion of total income derived from charitable contracts.
LEV is the proportion of long term debt against total assets.
VOL is the proportion of total workforce comprised of volunteers.
GOV is the proportion of total expenditure assigned to governance.
ADV is the proportion of expenditure used to generate voluntary income
Ln (TINC) is the natural log of the charity's total income.
Ln (TA) is the natural log of the charity's total assets.

**TABLE III: Robust Regression Results: Full Financial Data Set**

	aEFF	Std.	tEFF	Std.
	$\beta$	Error	$\beta$	Error
Intercept	1.060**	0.012	1.370***	0.020
(t-value)	(88.48)		(68.85)	
<b>CONT</b>	0.085 ***	0.003	0.076***	0.004
(t-value)	(33.34)		(18.00)	
<b>LEV</b>	-0.001 ***	0.000	0.000	0.000
(t-value)	(-8.56)		(-1.15)	
<b>VOL</b>	-0.025***	0.003	0.041***	0.005
(t-value)	(-8.62)		(8.48)	
<b>GOV</b>	-1.273**	0.017	-0.528***	0.027
(t-value)	(-76.88)		(-19.22)	
<b>ADV</b>	-1.021 ***	0.009	-0.045***	0.016
(t-value)	(-109.15)		(-2.92)	
<b>Ln(TINC)</b>	0.003***	0.001	-0.017***	0.002
(t-value)	(2.92)		(-10.28)	
<b>Ln(TA)</b>	-0.016***	0.001	-0.001	0.001
(t-value)	(29.84)		(-0.81)	
<i>Residual Standard</i>				
<i>Error</i>	0.127		0.210	
<i>Degrees</i>				
<i>of freedom</i>	27,400		27,400	

CONT is the proportion of total income derived from charitable contracts.
LEV is the proportion of long term debt against total assets.
VOL is the proportion of total workforce comprised of volunteers.
GOV is the proportion of total expenditure assigned to governance.
ADV is the proportion of expenditure used to generate voluntary income
Ln (TINC) is the natural log of the charity's total income.
Ln (TA) is the natural log of the charity's total assets.
*, **, *** significant at the 10, 5 and 1 percent levels respectively

