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## **Corporate governance practices and outcomes in social enterprises in the UK: a case study of South Yorkshire**

### **Abstract**

*Purpose* – This paper explores the growth of social enterprise in the UK in the context of the renewed interest in the creative use of organisations with a social mission to complement public service delivery. Given the impact of globalisation and increased demands for effective social welfare interventions, this paper specifically focuses on the nature and type of social enterprise governance models and how they influence their outcomes.

*Design/methodology/approach*- The study utilises an in-depth multiple case study approach. The data was collected from interviews of key informants and was recorded, transcribed and manually analysed inductively.

*Findings* – The paper finds that the way in which the social enterprise governance structure is designed ultimately influences its outcomes. In particular those with stewardship governance models tend to perform better than those with democratic models of governance. This leads to a conclusion that in the social context of the UK, social enterprise should aim for a paradigm shift in the design and selection of governance models.

*Research limitations/implications* – Comparative regional experiences in other regions or social contexts could enrich our understanding of whether these results are applicable across the board.

*Practical implications* – This article is of potential benefit to researchers and particularly those designing policies for the governance of social enterprise.

*Originality/value* –The study employs innovative analytical theoretical lenses not normally associated with the social economy to increase our understanding of the growth and evolution of social enterprise governance.

**Keywords:** social enterprise, corporate governance, globalisation, innovation, operational efficiency, theoretical application, sustainability

## **Introduction**

Social enterprise is an emerging concept that still suffers from largely unresolved conceptual and definitional issues (Martin and Thompson, 2010). However, scholars generally agree that a social enterprise is a business that seeks to bring people and communities 'together for economic development and social gain' (Martin and Thompson, 2010:6). Historically, social enterprises have been governed through democratic models that emphasise the development of trust and solidarity among those involved and are not necessarily geared towards supporting commercial activities (Low, 2006; Child and Rodrigues, 2004). It is thus surprising that contemporary discourses in social enterprise governance suggest that some social enterprises are drifting towards for – profit governance models. Cornforth (2003), Mason et al (2006) and most recently Harradine and Greenhalgh (2012) argue that this development is a result of the changing economic climate as well as complexities and shortcomings associated with democratic governance models. The key question, though, remains whether the shift from democratic to other forms of governance models of social enterprise actually makes any difference with respect to success or failure of a social enterprise. This paper examines whether the corporate governance model adopted by an enterprise can influence its outcomes.

Discussions in this paper start with scrutiny of corporate governance theory and how this can be applied to social enterprise, followed by a critical analysis of social enterprise governance, underpinned by Agency Theory (AT), Stewardship Theory (ST) and Resource Dependency theory (RDT). The paper concludes by discussing the findings of an investigation on social enterprise undertaken in South Yorkshire region and their implications for policy formulation.

### **Governance of social enterprises**

The governance of firms, and particularly the role of the board and its impact on performance, continues to attract the interest of researchers (Nicholson and Kiel, 2004; Herrala and Haapasalo, 2012). Monks and Minow (1995:1) describe corporate governance as 'the relationship among various participants in determining the direction and performance of a corporation'. The board, according to Daily et al (2003), is the locus of the internal governance of a corporation and performs several key roles. These include performing various functions and making key decisions

regarding the direction and strategic focus of the organisation (Bridge et al, 2009, Nicholson and Kiel, 2004). Zahra and Pearce (1989) summarise the functions or roles of the board as service, control and strategic. These are associated with the Agency, Stewardship and Resource Dependency theories.

Whilst corporate governance is not new in the commercial sector, it is increasingly coming under scrutiny in the social economy (Low, 2006). For example, researchers such as Abzug and Galaskiewicz (2001) and most recently Spear et al. (2009) have undertaken insightful empirical work on social enterprise governance. Traditionally, social enterprises have been governed through democratic models which have roots in the philanthropic organisations of the nineteenth century (Pearce, 2003; Chell, 2007). The boards of directors or trustees of these organisations are unpaid and usually voluntary in nature Paton (2003). Spear et al,(2009) argue that, despite being voluntary, such boards of directors are pivotal to the success of social enterprise because they ensure accountability, legitimacy and transparency in the operations of such organisations. This paper now critically analyses the governance of social enterprise in the context of Agency Theory (AT), Resource Dependency Theory (RDT) and Stewardship Theory (ST) perspectives on of corporate governance.

### **Corporate governance theories and application to social enterprise**

#### *Agency Theory (AT) and Social Enterprise*

Agency theory is considered as one of the dominant theoretical perspectives in the literature on corporate governance (Daily et al, 2003; Muth and Donaldson, 1998). The theory is underpinned by the 'model of man' which assumes that shareholders will lose control as the firm grows and that managers will prioritise their own interests above those of the organisation (Donaldson and Davis, 1991; Muth and Donaldson, 1998). The theory analyses the relationship between the principal (stockholder) and the agent, who is responsible for implementing the tasks delegated by the principal (Eisenhardt1989).

In a commercial sense, a social enterprise has no shareholders or stockholders. Abzug and Galaskiewicz (2001) and Low and Chinnock (2008) argue that it is difficult to identify the principal and the agent. In addition, since the governance of social enterprise is underpinned by democratic and participatory principles, it is highly unlikely that senior managers of such enterprises would engage in self-serving

activities (Mason et al, 2006). Since social enterprises are traditionally driven by democratic models of governance, it is evident that this type of governance contradicts the AT approach, at the core of which is an independent board free from managerial influence (Muth and Donaldson, 1998). Furthermore, McNulty and Pettigrew (1999) as well as Spear et al., (2009), note that a lack of clear separation of powers between the executive and operational staff in non-profits can create a minimalist board and negatively affect efficiency.

Callen et al (2010) and Iecovich (2005) however stress that the AT approach is still relevant to social enterprise. The researchers cite specifically the role that the board plays in protecting the organisation's assets and controlling the activities of managers to prevent misallocation of resources. This view is supported by Fama and Jensen (1983) who suggest that mechanisms to control assets and monitor activities and staff of non-profits are essential, since these organisations do not normally possess residual assets.

#### *Resource Dependency Theory (RDT) and Social Enterprise*

Whilst the AT theory focuses on the board's monitoring and controlling role, the Resource Dependency (RD) theoretical approach explains how directors ensure that their organizations access the resources they need (Daily et al., 2003). This relatively underexplored approach focuses on the exchange relationship between the firm and its external environment (Davis and Cobb, 2009). Bazerman and Schoorman (1983) suggest that the Resource Dependency Theory approach has four benefits in that it focuses on network connections among directors, horizontal coordination, vertical coordination and expertise and reputation. Hillman and Dalziel (2003) refer to these collectively as board capital, consisting of both human and relational capital necessary in assisting an organisation to mobilise key resources.

Since raising capital is a chronic problem in the social economy, the RDT is thus relevant to social enterprise as they are keen to increase the flow of resources and expertise from external constituencies (Callen et al, 2010; O'Regan and Oster, 2005). Strategies include recruiting directors on the basis of their ability to positively influence the outside world to the advantage of their organisations (Callen et al., 2010). The board therefore acts as a link to the external environment, which can facilitate access to resources.

*Stewardship Theory (ST) and Social Enterprise*

Stewardship Theory (ST) is a relatively new approach to corporate governance and is associated with the work of researchers such as Muth and Donaldson (1998), Donaldson and Davis (1991). Under the ST model, which is typical in for-profit organisations, the role of the board of directors is that of an adviser and strategy formulator (Zahra and Pearce, 1989). The role of the manager is that of a ‘steward’ rather than an individual seeking to maximise his/her own utility as agency theory assumes (Muth and Donaldson, 1998; Jenkins et al, 2007). There is little literature, however, on stewardship theory in the non-profit sector. Scholars such as Pfeffer and Salancik, (1978), O’Regan and Oster (2005), Miller - Millensen (2003) and Iecovich (2005) and most recently Low (2006) have written extensively on the nature of non-profit governance and how this affects their outcomes. This work clearly shows that some social enterprises are considering the stewardship governance model particularly due to the complexities of trading associated with democratic governance models. Van Slyke’s (2005) findings in his study on social enterprises involved in public sector contracting show that the stewardship model is becoming a viable alternative for social enterprises seeking to be competitive in a hostile economic environment.

From the above discussion we can draw out three main issues that have a bearing on the central argument of this paper. Firstly effective governance is just as important in the social economy as it is in the commercial sector. The governance of social enterprises therefore has implications for how social enterprises operate and their outcomes (Tranquada and Pepin, 2006). Secondly, contemporary discourses however show that the democratic governance model of social enterprise itself is now being increasingly questioned, given the evolution of the concept and its market relations. For example, Etchart and Davis (2003) and Ridley-Duff (2007) are of the opinion that the democratic governance associated with volunteer-dominated boards is inconsistent with the operations of a modern business. This argument is supported by Dees (2001), who suggests that voluntary board members tend to have a more hands-on approach than those in for-profit organisations, making them difficult to manage.

Thirdly, traditional governance theories can be applied to social enterprise. Although social enterprises have emerged in the context of political, economic and social change as discussed above, they are corporate bodies and therefore suitable for

analysis like commercial firms. The paper also argues that, despite being untested and new in the social economy, stewardship theory is a suitable lens that allows analysis of the governance of contemporary social enterprise. Although this theoretical approach, though, having foundations in neo-classical economic theory (which is also a source of criticism), its use in this paper makes it possible to merge economic and social dimensions of contemporary social enterprises (Laville et al, 2004). Based on the literature review, we can see that the nature of social enterprise governance has a bearing on both their outputs and outcomes.

### **Methods and Data Collection**

The research design employed in this paper was based on a mixed method approach involving the complementary use of quantitative and qualitative data collection methods. Data from a postal survey of 102 self-defined social enterprises was complemented by an in-depth qualitative analysis of four selected cases. Quantitative research was important in identifying numbers and patterns of organisations that described themselves as social enterprises in South Yorkshire, given the paucity of information to this effect. Postal questionnaires were preferred to face-to-face interview techniques due to the geographical focus of the work (Denscombe, 2003; Ghauri and Gronhaug, 2005). The researchers used their knowledge and contacts in key social enterprise support organisations across the region to obtain contact information. In addition to ascertaining the number of self-defined social enterprises in South Yorkshire, the questionnaire obtained data on some of the critical factors affecting their growth and sustainability

The investigation used an in-depth multiple case study approach, utilising qualitative face to face interviews to complement the conclusions from the data collected through the questionnaire survey (Saunders et al, 2009). A semi-structured interview guide was used to collect relevant data from the selected cases. The key informants selected and interviewed were the founders of the social enterprises and senior managers. The case study analysis involved a comparative analysis of four (4) case studies, as shown below in Table 1. These cases were given fictitious names to anonymise them. Two had company limited by guarantee (CLG) legal structures (The Cafe and the

Community Champion) and the remaining two, (The Landscaper and The Trainer), had company limited by shares (CLS) legal structures.

[Insert Table 1 here]

SPSS was used to analyse the quantitative data from questionnaire returns, given the empirical nature and size of the sample that had been obtained. The data collected from interviews of key informants was recorded, transcribed and manually analysed through an inductive process, which enabled the researcher to critically analyse each case study generate codes and manually identify the emerging themes (Bryman and Bell 2003; Yin 1993; Straus and Corbin, 2008).

### **Discussion of results and key findings**

One of the key objectives of this paper is to gain insight into the nature of social enterprises' governance and how this influences the way they operate. Analysis of the composition of the board of directors and the functions of the boards of the cases under investigation painted an intriguing picture.

Table 2 below shows a cross tabulation of description of the organisation and governance of social enterprises.

[Insert Table 2 here]

#### ***Board structure and composition of cases with democratic governance models***

Table 2 shows that the vast majority of these self-defined social enterprises are governed by volunteer boards of directors/trustees and paid staff. This dimension was supported by data from qualitative interviews. For example, the respondent from The Community champion said, '*We are all volunteers; we don't want to get anything out of this...I mean...financially. We are here to help the community*'.

These volunteers are therefore motivated by philanthropic rather than economic considerations in their involvement in the governance of these social enterprises. The respondent from The Cafe made this clear when he said, '*we [the directors] could be doing other financially rewarding things in our life....we want to help the community and this is what brought us together*'.



### ***Board structure and composition of cases with stewardship governance models***

Table 2 interestingly shows that the number of social enterprises with paid boards of directors and staff account for a very small percentage of the sample (3%). These also have for profit governance models. In addition to typical for-profit shareholders, these enterprises have also co-opted owner managers on their boards. This dimension shows a distinct move from traditional forms of participative and democratic management principles as social entrepreneurs take the lead and provide hands-on management of the social enterprise (Low, 2006). This is a characteristic of the stewardship model of governance. This development is supported by results from the qualitative interviews of the respective cases. The respondent from the Trainer said,

*‘As the owner of the project idea, it’s important that I take a leading role ....it’s important that our governance structure allows me to do this’.*

On the other hand, a respondent from the Landscaper, whose board also includes a funder, remarked, *‘Of course having a funder on the board is a good thing...perhaps they will give us more money when they can see how well we are doing’.*

This dimension reveals the need for multi-stakeholder boards in social enterprises so as to adapt and widen sources of investments and expertise, a significant characteristic of the RDT approach.

The paper analyses the governance and board functions of social enterprise by comparing those underpinned by using CLG legal structures with those underpinned by CLS legal structures. This is shown below is Table 3.

[Insert Table 3 here]

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### ***Board Functions of cases with democratic governance models***

It is clear from Table 3 above that cases with CLG legal status have boards that reflect democratic governance principles. The duties of these boards are largely fiduciary, i.e. holding the organisation and its assets in trust. Quantitative research shows that in addition to setting the strategic direction of the organisation and ratifying decisions, the boards of directors of these organisations also control and direct the organisations' day to day activities. These activities, particularly monitoring and control of activities are consistent with the Agency theory. In this case the boards are agents of their stakeholders such as members of the community. This is supported by results from the qualitative interviews. For example, the respondent from The Community Champion remarked, *'the board works closely with the manager and operational staff...we monitor everything because as I have said, our activities are funded and we have to be accountable to funders'*.

Regarding the function of its board, the respondent from The Cafe said, *'Everything is done democratically, but it is our duty to ensure that the staff are doing their duties, because we are accountable to the community and funders'*.

These responses show that, although not usually possessing residual assets, social enterprises do need to protect the assets they have from abuse (Iecovich, 2005). The boards' functions, however, appear to be incongruent with the democratic governance models associated with social enterprise.

### ***Board functions of cases with stewardship governance models***

Table 3 shows that the functions and roles of the board of directors of the enterprises with CLS legal status reveal a drift towards stewardship models of governance. Unlike those with democratic governance models, there is a clear attempt by the board to empower and provide autonomy for senior managers to work in the best interests of the organisation. This dimension is supported by case study interviews. The respondent from The Trainer said, *'We have a good board... they let us do the work. We go to them for advice on issues affecting the organisation... the senior managers here ...we let them get on with it'*.

The respondent from The Landscaper also said, *‘The board members are similar to what they would be in a private company...it’s a practical choice rather than a social choice... They [the board] are responsible for strategic issues including ... help with key decisions’*.

In both cases the lead entrepreneurs perform the CEO role and are also central in the decision making process of the board, as they are part of it. They are mandated to make operational decisions and their expertise is recognised by their respective boards, a point made by a respondent from The Landscaper when he said: *‘I still make the day to day decisions and go to them [the board] for legal and financial advice’*.

This response highlights the role of the board as adviser and strategy formulator i.e. making key decisions and providing the necessary direction and strategic focus required for the organisation to achieve its objectives (Nicholson and Kiel, 2004).

The two CLS organisations also had mechanisms to co-opt individuals or funders onto their boards for the benefit of their organisations. This resonates with the resource dependency theory. The Trainer managed to attract three social enterprises onto its board, two of which actually bought dividend bearing shares valued at £2500 each. The respondent from this organisation said, *‘Yes, they [the social enterprises] also want to grow their capital...and it’s good for us that we can raise finance this way, without seeking a loan’*. He explained further *‘They sit on the board and can vote’*. Although the dividend rate of return of these investments (i.e. 6%), is quite low compared to commercial rates, this is a significant development in the social economy.

### ***Outcomes of social enterprise and governance***

Figure 1 below shows empirically derived information showing how type of governance model of social enterprises influences their outcomes.

[Insert Figure 1 here]

It is clear that for The Trainer, the need to access equity investments influenced the organisation to adopt a CLS legal structure. This in turn resulted in a governance model characterised by elements of both stewardship and resource dependency approaches. This provides opportunities for the social enterprise to access a variety of commercial opportunities that can increase its turnover and cash flows into the organisation and therefore support its social ethos. The respondent from the Trainer supported this positive by saying:

*‘One of our key objectives is to attract investments into our organisation...we also need the right type of people on our board to allow this’*

This position was also shared by the respondent from the Landscaper who *said,*

*‘ We have been very careful about the type of governance we want. We need to attract the investments and people that can drive this organisation forward and leave us to do the work’.*

Such organisations therefore seek to be a sustainable entity with governance models that allow them to integrate the achievement of both financial and social goals in its operations.

On the other hand, it can be seen that the governance models of organisations with CLG legal structures (The Community Champion and The Café), are characterised by an aversion towards material infrastructure and a commitment to democracy and inclusiveness in the running of the organisation.. Their vulnerability to the vagaries of the market and their inability to pursue a wide range of commercial opportunities means that their potential to attain financial viability is limited, as shown in Figure 1. This is confirmed by the respondent from the Community champion who remarked, *‘We value shared ownership because we exist for the community....we generates very little money on our own and that’s why we are struggling at the moment.*

### **Conclusion**

This paper highlights the nature and character of social enterprise governance and makes a significant contribution to our understanding of this phenomenon. This

contribution to knowledge also has policy implications, particularly at a time when social enterprises are facing viability constraints associated with their governance.

This paper argues that democratic governance models of social enterprise are still relevant in the social economy as they conform to the philanthropic ideology underpinning the concept of social enterprise, with a clear desire to protect assets of the organisation on behalf of the community and an aversion to trading. However this also results in a multiplicity of functional problems and organisations with such models struggle to compete in the market for resources and expertise.

The paper argues that the dissatisfaction with democratic governance models explains the increasing interest in the other governance models such as stewardship. Changes in the economic environment for social enterprise appear to have provided the impetus for this shift. For example, as more opportunities for social enterprises emerge, particularly in public service delivery, they are likely to engage more with external stakeholders including suppliers, investors and the community as supported by the work of Lewis et al (2004) as well as Hodgkin and Hughes (2012). This paper therefore argues that innovation in governance models has become an important prerequisite for success in competitive markets. In this instance, consideration of for-profit stewardship models can open up opportunities that traditional social economy organisations cannot exploit. Despite limitations associated with stewardship governance models, they empower individuals in their organisations to be more proactive and business-like. These developments signal a new trajectory that the social enterprise sector is exploring, even though the results of the study in this paper show that the number of social enterprises considering this option is negligible.

It is important to note that the economic environment of non-profits is complex and heterogeneous compared to that of the commercial sector. The authors acknowledge the need for further research to explore the stewardship governance model for social enterprise as this is a dramatic shift from the ideology underpinning the concept. This obviously requires strong state support (Cornelius and Wallace, 2013; Hodgkin and Hughes, 2012).

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**Table 1: Cases under investigation**

Organisation	Thematic Activity	Type of legal structure
The Trainer	Provision of basic education and training	Share capital (CLS)
The Landscaper	Environmental management and consultancy	Share capital (CLS)
The Cafe	Environmental preservation and renewable energy	Limited by Guarantee (CLG)
The Community Champion	Provision of non-accredited skills training	Limited by Guarantee (CLG)

Source: survey data

**Table 2: Cross tabulation of description of the organisation and governance of social enterprise**

Description of organisations	Governance of social enterprise						
	Volunteer board and staff	Paid board of directors and staff	Manager/main entrepreneur	Volunteer board and paid staff	Volunteer board and part-time paid staff	Managed by host organisation	Total
Social enterprise	5	2	9	41	1	-	58
Co-op	1	-	-	1	-	-	2
Community organisation	4	1	4	23	2	-	34
Combination of all three	-	-	1	-	-	-	1
Registered charity	-	-	-	2	-	-	2
Development trust	-	-	-	2	-	-	2
Social firm	-	-	-	1	-	-	1
Not for profit	-	-	-	1	-	-	1
Self financing	-	-	-	-	-	-	1
Total	10	3	14	71	3	1	102

Source: survey data

**Table 3: Cross tabulation of type of legal structure and board functions**

Type of legal structure	Setting strategic direction	Ratifying decisions	Monitoring and control	Holding assets in trust	Empowering CEOs	Mobilising resources	total
Company limited by guarantee	10	7	36	26	-	-	79
Company limited by shares	4	-	-	-	3	1	8
Others	-	-	5	10	-	-	15
Total	14	7	41	36	3	1	102

Source: survey data

**Figure 1: Type of governance structure and influence on social enterprise outcomes**