

FUNDING COMMISSION

Paper 4 – Public Sector Funding – Findings and Emerging Recommendations

Between June and September 2010 the Commission published eight papers on its website on different aspects of its work. Comments were invited on these papers. The emerging recommendations in the papers have subsequently been amended as the Commission's thinking developed. However, the findings in the papers contain much of the evidence on which the final report is based. Details of all those consulted during the preparation of the papers are given in Annexe 2 of the main report.

This is the fourth paper to be published by the Commission (August 2010) – on Public Sector Funding.

1. Introduction

Since 1997 civil society organisations (CSOs) have taken on a greater role in delivering public services, leading to a significant increase in government funding to the sector during this time. It has not always been an easy process; longstanding problems, such as the difficulties faced by many different types of organisations in engaging with contracts or securing grant support, remain. There have also been tensions between different policy goals. On the one hand, a move towards achieving economies of scale, with fewer, larger contracts has made it harder for CSOs to compete in some areas. On the other hand, more local, personalised services suggests more of the specialist and niche provision that many CSOs deliver.

It is clear that the Government has identified public service reform as a priority, but whereas the expansion of public services, of which the sector was a part, occurred at a time of economic growth, we are now entering a period of severe retrenchment. The priority for the Government will be how to square the circle between improving services and cutting the deficit.

2. Key trends

Over the last decade, the government has attempted to do much to facilitate greater delivery by the sector. This has included two cross-cutting reviews in 2002 and 2005, to address the barriers preventing organisations from delivering more services, as well as investment in capacity building in the form of skills (Changeup and Capacitybuilders) and loans (Futurebuilders). This has contributed significantly to the sector's growth over this time.

Government funding of charities has increased year on year, from £8.4 billion in 2000/01 to £12.8 billion in 2007/08¹. As a proportion of all income to the sector it now accounts for just over one third (36%), although as a proportion of government expenditure it is much less significant at 2%. Some 40,000 charities have a financial relationship with the public sector, but it is still the case that most charities (75%) have no direct financial relationship with the state.

¹ NCVO Almanac 2010. This data, in the main, relates to charities, excluding housing associations, faith groups, trade associations, independent schools and those charities that are not independent of government, such as NHS charities.

Much of this increase reflects the sector's greater role in delivering services under contract: earned income from statutory sources increased by 128% between 2000/01² and 2007/08, whilst grant income declined by 10% over the same period. It is now an important source of funding for organisations working in the fields of employment and training; housing; education; and social services. Indeed, 70% of income for employment and training now comes from statutory sources and 23,000 charities rely on local government finance for more than half their funding.

At local level, organisations like rape crisis centres are heavily dependent on public sector funding with 72% coming from local authorities and associated partnerships, central government, and from other local and regional public bodies. Similarly, local support and development organisations, such as councils for voluntary service, are heavily reliant on local statutory funding. (See Annexe 1 for further details of scope of public sector funding).

Resilience

However, while it has driven growth in these sub-sectors, government funding has not helped them to become more resilient. Charities working in these areas have very limited reserves or assets to call on. As a consequence, they are potentially vulnerable to cuts in public spending; changing political priorities; and / or changes to the way services are commissioned and procured.

Arguably this is because a 'grants mentality' continues to influence the way services are commissioned from CSOs, with contracts awarded on the basis of cost, often with 'claw back' clauses requiring any unspent funds to be repaid. Although the commitment to full cost recovery established the principle that services delivered under contract should be fully costed and paid for, it did not change this mindset. This point was made by the Public Administration Select Committee in its review of commissioning services from the third sector, which stated that:

*'Commissioners need to lose the habit of grant funding when dealing with third sector organisations in competitive procurement processes. The onus should always be on the bidding organisation to decide how much they want to charge.'*³

Enabling CSOs to bid for services on the basis of price, rather than cost would make it possible for them to generate a surplus from contract income, should they wish to do so. This, in turn, would help them to become better capitalised and therefore more resilient. It also has the potential to facilitate more mature relationships with commissioners.

Financial context

Many government contracts have already been squeezed over the past two years by as much as 10%; delivering more for less is now a common practice for many CSOs. In the June 2010 Emergency Budget plans for reductions of £90bn over the next five years were announced. This will involve cuts of 25% or more in most government departments and in local

² In 2003/04 earned income, including trading on the open market, became the most important form of income for charities, accounting for 49% of their total income by 2007/08. Over three quarters (77%) is earned through charitable activities.

³ *Public Services and the Third Sector: Rhetoric and Reality – Government Response to the Committee's Eleventh Report*, Thirteenth Special Report (Session 2007-08).

government. Even the protected departments of health and international development will have to find major savings in management and administration costs.

This will inevitably impact on charities, possibly resulting in cuts of well over £3bn if the cuts are applied proportionately across all parts of the sector, although the Government's stated aim is that CSOs should end up getting more of a smaller cake. (See Annexe 2 for further details of the implications of these trends and cuts).

3. Squaring the circle

The need to achieve better value for money becomes even more important in the current economic climate. But this cannot be achieved under the present system. Only by radically changing the way that public services are commissioned and procured will it be possible to square the circle of securing better services and cutting costs.

The current system encourages isomorphism, requiring providers to comply with contracts that are tightly defined and monitored using narrow performance measures. While this approach aims to promote accountability and reduce risk, it also:

- crowds out innovation, experimentation and the ability to respond to the needs of services users;
- produces similar outcomes, irrespective of who is delivering the service⁴;
- focuses only on the direct outcomes for service users and does not recognise the wider value that a service or organisation may deliver; and
- carries high transaction costs, in terms of creating, supervising and enforcing specifications.

It is by no means clear that this system is an effective means of ensuring probity and avoiding risk. Not every eventuality can be anticipated in advance, and the more details that are specified in the contract, the less discretion there is on either side to respond to changing needs and circumstances. Even in a highly competitive market, once a contract has been awarded it becomes a blunt tool to promote quality or improve performance, particularly where the cost of breaking a contract may be high.

Strategies for reducing costs

Barry Quirk, Chief Executive of the London Borough of Lewisham, has suggested four possible responses to the need to make cuts of, in Lewisham's case, 22% :

- 1) Downsizing i.e. simply doing less and reducing quality (e.g. 10 libraries instead of 15)
- 2) Smarter collaboration i.e. cutting out duplication and overlap through pooling of funds and place based budgeting
- 3) User directed change i.e. give (less) money to the public and let them decide how to use it to meet their needs (individual budgets and personalisation)
- 4) Sponsored disruptive innovation i.e. break up the current patterns of service delivery through bringing in new providers (like CSOs, public sector staff social enterprises and private suppliers) and accept that there will be a degree of chaos, but that new ways of doing things will emerge.

⁴ *Measuring Outcomes for Public Service Users* (MOPSU) looked at outcomes from the user perspective, and in doing so was agnostic of which sector users were served by. It found little difference in direct outcomes for users, but focussed on only directly attributable outcomes. See <http://bit.ly/mopsu>

Lewisham is planning to go for Option 4, on the basis that Option 1 will just mean everything getting worse and worse; Option 2 sounds attractive, but is very difficult to make work in practice because of all the bureaucratic barriers and vested interests involved; and Option 3 involves high transition costs and could turn out to be more, not less, expensive.

The 2020 Public Services Trust's Commission's interim report (March 2010) states:

- 'short term spending constraints are tightening, long term pressures are growing, and the limits of incremental reform are clear'
- 'Three, mutually reinforcing, systemic shifts are required: a shift in culture from social security, to social productivity; a shift in power – from the centre to citizens; a shift in finance- reconnecting financing with the purposes of public services'
- 'In a second future...New types of social resources are mobilised. Investing for the long-term, public services expand individual and collective capabilities. This encourages self-reliance, enabling citizens to work together to solve new problems. Diverse problems are allowed to find diverse solutions, responding dynamically to changing demands. These changes improve outcomes for citizens, at lower cost'

Reports applying these principles to education, health, welfare and public safety were due to be published in July and September 2010.

NESTA, the Innovation Unit and The Lab have published a report, 'Radical efficiency', which suggests that, on the basis of the case studies they have looked at around the world, savings of between 20 and 60% are possible, alongside better outcomes. They have identified five conditions for those wishing to develop radically efficient public services:

- 1) Make true partnership with users the best choice for everyone
- 2) Enable committed, passionate and open-minded leaders to emerge from anywhere
- 3) Start with people's quality of life, not the quality of your service
- 4) Work with the grain and in the spirit of families, friends and neighbours
- 5) Manage risks, don't just avoid them.

In order to put these ideas into practice, they recommend inviting 20 pioneering localities to form 'radical efficiency zones' with barriers to innovation removed and tough new requirements to produce different, better and lower costs services.

Outcomes-based commissioning

If public expenditure is to deliver maximum impact for individuals and communities, then procurement processes need to facilitate this. What is needed is a system that focuses on delivering better outcomes; contracts should set out what is to be achieved, not how services are to be delivered. And there needs to be greater emphasis on trust, rather than compliance. This approach would be consistent with the strategy of 'sponsored disruptive innovation' above.

Recent debates have given rise to a much greater emphasis on value and impact. This has led to calls for CSOs to measure their outcomes and demonstrate their impact more systematically (see Paper on Effectiveness). It is right that they should do so, but it is only one side of the equation. Commissioners also need to review what it is they value in service delivery, and how that is recognised and rewarded through the procurement process.

An outcomes-focused approach has the potential to play to the sector's strengths; the case for giving CSOs a greater role in public service delivery has largely rested on their ability to deliver a range of direct and indirect benefits to individuals and communities⁵. However, it has not been clear whether commissioners are willing to pay for this or how this value should be defined and measured. A system that encourages both commissioners and providers to focus on the full value that a service should provide would act as a catalyst for transformational change.

Trust based contracting

In New Zealand, the Ministry of Social Development has recently signed four 'high trust' contracts with community based organisations, which replace lengthy tick boxing paperwork with a simple results based contract.

Having satisfied the Department that their organisations are well run and have the necessary financial viability, the high trust providers then have a single contract for a number of different services, which only requires them to report once a year to Government.. The model requires regular communication, but allows CSOs the flexibility to decide how their funding can best be used to serve the immediate and long term needs of the community.

Such an approach would maximise the impact of public spending, without undermining procurement rules that require openness and fairness; all providers, regardless of their sector, would have the same opportunity to demonstrate their full value when tendering for contracts. It is 'sector blind'. At a recent Reform policy conference, Aidan Connolly, Sodexo Chief Executive UK and Ireland, also called for a greater focus on trust and flexibility in commissioning and procurement.

A Modernising Commissioning White Paper, aimed at supporting the achievement of the Government's efficiency and Big Society agendas is currently being developed. The scope of the White Paper is:

- To increase the role of both small and medium sized enterprises (SMEs) and CSOs in public services
- To modernise commissioning at all levels (local, national)
- To focus on modernisation of the 'buyer' side, rather than provider capability and capacity

The White Paper provides an opportunity to take forward the recommendations in this paper.

Consortia

Contracts are likely to continue to get bigger in order to achieve economies of scale and reduce transaction costs. As a result CSOs are developing consortia, sometimes of national and local CSOs (like Third Sector Consortium), sometimes of a number of local CSOs and sometimes with private sector providers (like Serco and Catch 22 and Turning Point). Even with individual budgets, consortia of providers are likely to develop in order to provide the range and choice of services required and to finance the investment in new marketing and financial systems for managing the new funding environment. Consortia will need development capital to enable them to set up and compete, whilst their subcontractors will need to ensure their price is not being squeezed too much by the prime contractor.

⁵ HM Treasury, 2005, *The role of the third sector in public service delivery and reform: a discussion document*

4. Creating new incentives – payment for prevention

The deficit has underlined the need to find cost-effective solutions to social problems and a means of creating incentives that will enable providers to focus on prevention and on achieving long term benefits and cost-savings. For this reason recent governments have given greater prominence to paying providers on the basis of the results they achieve, including through new mechanisms such as Social Impact Bonds.

Payment by Results

Payment by results is about ‘rewarding people for work well done’⁶. In this model, funding is linked to outcomes delivered and therefore is only paid once results have been achieved. The concept was first introduced to the NHS in 2000, was taken up by the DWP and the Legal Services Commission in 2008 and will be rolled out more widely under the Government’s plans for public service reform. However, this will present new risks to CSOs without access to development and working capital or a means of managing cash flow. Further work is needed to identify what mechanisms need to be in place to enable CSOs to manage these risks appropriately (see Paper on Trusts and Foundations).

Refugee and Migrant Justice (RMJ)

A high profile casualty of a new payment regime was in early 2010, when Refugee and Migrant Justice went into liquidation. The Legal Services Commission (LSC) changed their funding model to one where payment was only made when cases were closed. This required providers to ensure they had a good balance of short and more complex cases. However, RMJ’s mission was to support asylum cases which tend to be long and complex and are heavily dependent on getting responses from government departments; as a result, the cases can sometimes take 9-18 months.

RMJ estimated that the new system would require them to have working capital of £6m over one year (their turnover was £9m pa). The LSC recognised that the new payment regime required transitional, ‘buffer’, payments, but there were difficulties over the claiming and payment arrangements for these in the case of RMJ, which eventually led to their demise (see Paper on Trusts and Foundations for a possible way of addressing the need for working capital).

Social Impact Bonds

Reducing the demand for services is an important way of reducing costs, addressing the root causes of social problems and not just the consequences – for example working with offenders to reduce recidivism or with young people to promote healthier lifestyles. A barrier to this is the up-front investment needed to pay for such interventions at the same time as providing the services needed today.

Social Impact Bonds (SIBs), now being piloted by Social Finance in Peterborough prison with the involvement of CSOs, have been developed as a means of raising voluntary, and

⁶ David Cameron 8 July 2010, speech to *Civil Service Live* conference

potentially private, investment to fund services up-front. Investors will receive a return on their investment from Government equivalent to a proportion of any savings made as a result of the intervention. This has a number of advantages, including:

- giving CSOs a stable revenue stream that focuses on outcomes, rather than outputs, with financial risks borne by the investor;
- enabling government to only pay out when success has been achieved;
- and, if the pilot succeeds, potentially attracting private investment into the public and voluntary sector.

However, two of the critical issues regarding SIBs are, first, agreeing the metrics to demonstrate success; these can be particularly difficult when multiple outcomes are involved, as is often the case. And secondly, actually realising the savings from the preventative action; empty prison cells don't save money- something has to be closed and some staff have to be laid off before funds are saved.

For these reasons, it is likely that the best potential for SIBs will be at the local level in the context of place based budgeting, where it may be easier to overcome these two challenges.

5. Beyond public service delivery

CSOs contribute to society in a number of ways, providing information advice and support; delivering services; giving people the opportunity to participate in their communities and to have a say in decisions that affect their lives; and helping people to help themselves. In order to do this, and to do it effectively, CSOs themselves need financial and other forms of support.

The Big Society envisages local community and neighbourhood groups playing a bigger role in their local communities; it also implies that non-statutory services will have to rely on more voluntary income than in the past. All these developments will need support to help make them happen; much of this support already exists in various forms, but it needs modernising and strengthening. This will require one off investment and then sustained grant support, albeit at lower levels than in the past (see Paper on Effectiveness).

There is also a need to promote local giving and to build relationships with donors and businesses at a local level. There is an important role here for community foundations to develop funding for the sector at this level (see Paper on Trusts and Foundations).

6. Emerging Recommendations

RECOMMENDATION 1 – Commissioning for User and Social Outcomes

Background

- **Outcome commissioning still tends to be about outcomes for existing services, rather than inviting providers to say how they would deliver a particular set of outcomes for a particular set of users. As a result, the service configuration remains broadly the same, rather than innovative solutions being put forward to replace the current range of services**
- **There need to be radical changes to the way that public services are commissioned and procured: the current system does not allow for the level of innovation needed to secure real improvements and cut costs.**
- **Contracts are becoming ever more risk averse, detailed and bureaucratic, as well as larger in volume and scale. Payment by results creates the need for working capital, which currently only the largest CSOs have access to.**

Proposal

- **Outcome-based funding: all government funding should be directed at achieving better outcomes for people and communities, for example through greater use of social clauses and more pooling of funds.**
- **User outcomes: service users, and the CSOs that represent them, should be involved in specifying user outcomes at the outset of the commissioning process**
- **User led providers: service users should also be involved in the actual delivery of the service, building on the experience of the Expert Patient Programme and peer led mentoring**
- **Procurement: Service users, and the CSOs that represent them, should be involved in selecting preferred tenders, provided they are not also part of the system of provision**
- **Price not cost: CSOs should tender for contracts on the basis of price not cost, determining for themselves how much to charge for their services and expertise.**
- **Coalitions: National and local organisations, especially local community groups, should form coalitions to work with local people to develop new forms of services**
- **Trust-based commissioning: the relationship between commissioner and provider should be based on trust, not compliance: contracts should set out what is to be achieved (outcomes) not how services are to be delivered (process).**

Benefits: All CSOs involved, or potentially involved, in contracting to provide public services.

RECOMMENDATION 2 – Building the Big Society from the bottom up with grant support

Background

- **Small, below the radar, CSOs are the life blood of the Big Society**
- **Appropriate public finance, including grants, is needed to help people help themselves; small, easy to access, grants, which enable voluntary activity to flourish, are an essential ingredient of the Big Society**
- **There are already a range of networks and organisations that provide this type of support, but they need to be modernised and strengthened; proposals for developing the Big Society should work with the grain of existing communities and not be imposed.**

Proposal

- **A range of publically funded grant programmes, providing small, easy to access, grants, should be put in place by central and local government, to help people to help themselves**
- **Big Society initiatives should work with existing organisations and networks that are currently providing support to individuals and build links within and between communities.**

Benefits: Smaller, local CSOs

RECOMMENDATION 3 – Prevention is better than cure

Background

- **Reducing the demand for services is an important way of reducing costs e.g. prevention of re-offending, health promotion and personal development and training for disaffected young people**
- **The biggest barrier to developing more preventative work is the up front cost of funding it and the difficulty of first proving and then realising the saving in practice.**
- **Place- based budgeting and the Social Impact Bond have the potential, together, to transform the financing of preventative services at the local level.**
- **Payment by results presents new risks to CSOs without access to development and working capital or a means of managing cash flow**

Proposal

- **Social Impact Bonds should be piloted within the context of place based budgeting as a means of achieving multiple user outcomes**
- **Further work is needed to identify what mechanisms need to be in place to enable CSOs to manage the risks involved in payment by results appropriately**

Benefits: All CSOs involved, or potentially involved, in delivering public services.

Annexe 1 – Scope of Public Sector Funding

1. What is funded by the public sector?

- 1.1 Public service delivery. This is defined as those services provided by CSOs that are funded directly or indirectly (e.g. through benefits) from the public purse. Services can be statutory or discretionary and can be funded in whole or in part from public funds. Payment by individuals ('self-payers') is now the norm for most social services, especially for services for older people.
- 1.2 Development of civil society. This covers campaigning, awareness raising and influencing, as well as community development, community action and self help. The last three types of activity form an important aspect of the Government's Big Society initiative, but the first three may struggle to secure funding for their work.
- 1.3 Support and development of CSOs. This covers the range of different types of infrastructure and support discussed in the Effectiveness paper.
- 1.4 In overall terms, 40,000 (25%) charities have a financial relationship with the public sector and 36% of the sector's funding comes from the public sector (NCVO Almanac 2010). 23,000 charities rely on local government for more than 50% of their funding. The turnover of the sector has increased by 40% in the last 10 years; much of this growth is all accounted for by growth in public sector contracts and individual giving. It is not possible to identify the exact amounts of public funds spent on public service delivery, development of civil society and support and development of CSOs, but it is clear that the vast majority is on public service delivery.
- 1.5 At the same time, the sub-sectors that are particularly reliant on public funding include infrastructure bodies (1.3 above) and law and advocacy groups (part of 1.2 above), making them vulnerable to any cutbacks. For example, Wakefield Voluntary Action has been informed by its local authority that its funding is being cut, retrospectively, by 70% from April 2010 and Compact Voice has highlighted a number of areas where cuts are being made without any reference to the Compact.

2. How is funding being provided?

- 2.1 Categories of Funder. The majority of public sector funding comes, directly or indirectly, from national, regional or local government, but this can take a number of different forms, in addition to direct funding by a particular part of government, including: Non-Departmental Public Bodies (NDPBs), such as BIG and Capacitybuilders; funds administered by independent bodies, such as Futurebuilders; grant programmes, such as OCS' proposed Communities First fund; Local Strategic Partnerships and Local Area Agreements; joint local council/ PCT authorities; total place pilots; individual budgets; social impact bonds ; and housing associations. There are also european and international funding streams. The main trend is towards the devolution of funding to the local level – and, of course, major reductions in funding are taking place. There are also signs that housing associations may be using more of their, considerable, resources to fund CSOs in their areas
- 2.2 Commissioning process. Funding arrangements for CSOs can take a number of different forms; Julia Unwin (in 'The Grant Making Tango') differentiates between giving, shopping and investing. The commissioning process is essentially about determining needs, deciding on desired outcomes from addressing those needs and

selecting the appropriate procurement process; this might involve a tendering process (shopping), but could also involve an open (or solicited) invitation to apply for grants (giving/investing). Strategic commissioning involves a greater emphasis on co-design and co-production of services, as well as market development. There continues to be wide scale concern in the sector about the quality of the commissioning process, as well as acceptance that the sector itself needs to develop its skills in this area (see Effectiveness paper).

- 2.3 Funding mechanisms. Depending on the category of funder and the commissioning process, the funding mechanism may involve a contract, grant, fees, charge for a service (individual budgets) or mixed funding (public, private and voluntary). Funding could come from more than one public sector source. Three important trends are an increase in the size and scope of contracts (economies of scale), a shift from grants to contracts and the development of more mixed (public, private and voluntary) models of funding. Individual budgets are only likely to be available for people assessed as having very high needs, and then there are issues about how appropriate they are for emergency care or for those with particularly severe needs.
- 2.4 Funding approaches. Funding can take a number of different forms including contracts, grants or fees, loans, quasi-equity and guarantees, although the first category is still by far the most common (See Capitalisation and Social Investment paper). Other issues include the length of funding agreements (more than one year funding is becoming more common), full cost recovery, price rather than cost, claw back, monitoring and reporting, lead funder arrangements, social return on investment/impact reporting and payment by results.
- 2.5 Funding forms. Funding need not always be in the form of payments. Other forms of support include the transfer of community assets at below commercial value, secondments and pro bono support, as well as different forms of social investment underwritten by public funds.

3. Who is being funded?

- 3.1 Range of sizes. All sizes of charities receive funding from the public sector. Large charities (with turnovers of £1m to £10m) get 38% of their income from this source, followed by major (over £10m) who get 37%, medium (£100k to £1m) 35%, small (£10k to £100k) 22% and micro (less than 10k) 5%. Most of the public sector income received by small charities currently comes from central government.
- 3.2 Geographical scale. CSOs can be international, national, regional, local and community in scale. Their scale does not necessarily equate to their size. There are lots of small or medium national organisations as well larger local ones. However, their ability to access different types of funding, and therefore their degrees of vulnerability, will be limited by their scale. The Government has stated that it wants to be: ‘super local, seriously neighbourhood-based and almost microscopically granular’ (Francis Maud).
- 3.3 Types of CSO. The civil society sector includes charities, voluntary organisations, community groups and social enterprises. A recent development has been the number of ‘spin-outs’ from the public sector e.g. leisure trusts, arts trusts and health enterprises. Some Non Departmental Public Bodies, such as the British Waterways Board, may be becoming CSOs. This trend is being further encouraged by the Government. Another important trend is the development of consortia of CSOs and prime contractor/sub-contractor partnerships to bid for larger contracts.

Annexe 2 – Implications of cuts and trends

1. Implications for the civil society sector

- Differential impacts. The sector is being affected in a number of different ways by these developments:
 - Local organisations are being affected by the shift from grants to contracts
 - Medium sized organisations are being squeezed – too big to benefit from localism and the Big Society; too small to compete for large scale public service delivery contracts
 - National organisations are having to contract with multiple local bodies, instead of having national contracts
 - National networks, like Citizens Advice, are being reduced in scope, through loss of individual local contracts in competitive tenders
 - National providers are having to broaden their offer, e.g. through sub-contracting, in order to win larger, more broadly specified, contracts
 - More consortia of CSOs are developing in response to these developments
 - There is increased competition from the newer spin outs from the public sector and from private sector contractors like Serco (but also some sub-contracting opportunities)
 - Consortia and sub-contracting can disadvantage smaller groups e.g. through landing them with the most difficult clients and squeezing their margins, unless protocols are developed from the outset
- Role tensions. The changes in funding arrangements, coupled with the increased role envisaged for CSOs bring a number of tensions for CSOs:
 - How independent can the sector be when so much of its funding comes from the state, especially if other types of funding become harder to secure?
 - Some of those parts of the sector with the lowest levels of reserves (infrastructure bodies and law and advocacy groups) have the greatest need to ensure they are independent in their work, but have the least resilience
 - How compatible are the roles of delivering public services and developing civil society? The Big Society plans envisage growing numbers of community activists and community groups, who will often be campaigning for particular causes- yet some government ministers have expressed doubts about the campaigning role of charities
 - CSOs will need to be much more flexible in their approach to providing services in response to personalisation, individual budgets and self payers. Instead of receiving services for life, people will dip in and out of different types of support, according to their needs.
- Reduced resources. The financial situation impacts in a variety of ways and requires a number of responses:
 - CSOs involved in delivering public services can respond through reducing costs and/or increasing income
 - CSOs will need to have very clear policies as to how and when they use voluntary income and volunteers for the provision of public services. Deciding exactly what the statutory element of a service is, and what may be discretionary, will have to be carefully considered. CSOs will need to be careful to distinguish between the need to charge the right price for the service commissioned by government; and the extras which they may be prepared to fund through voluntary income (even where they were

previously funded by the state). Otherwise they will find themselves in an increasingly unsustainable position, as happened with many CSO providers before the advent of full cost recovery.

- There will be expectations from the Government, especially in the context of the Big Society, that CSOs will be able to do more with less
- Raising more voluntary income for these purposes will be challenging; the public will expect a clear rationale for what they should be supporting and what the state should be supporting, especially if they themselves are experiencing cuts or increased. Will there be a need for a new 'social contract' which redefines what the state should pay for and what should be funded voluntarily?
- Involving volunteers more in providing public services is another option, but, to be cost effective, volunteering needs to be for substantial numbers of hours and lengths of time – otherwise, according to charities like WRVS, the cost of recruiting, training and supporting volunteers can outweigh the costs of full time, low waged, employees
- There may be more community assets that can be transferred to CSOs to manage; this can provide opportunities to support other CSOs, generate income and build social capital, but care has to be taken to ensure these assets do not become liabilities; according to the Development Trusts Association, finance is the major issue in the transfer of community assets
- There may also be assets already being managed by CSOs, such as Children's Centres, which, according to Action for Children, who manage 150 of them, could become local community hubs, if the current financing arrangements were made more flexible
- Need for investment and time. A lot of the changes which CSOs need to make to respond to the current context require investment and time:
 - Modernising services e.g. through assistive technology for disabled people or through digitalisation of some arts products, in order to reduce costs and/or generate income
 - Collaborative working, consortia or merger to scale up, whilst also achieving economies of scale
 - Restructuring services in response to personalisation and individual budgets
 - Developing more locally responsive structures to engage better with localism
- Need for advice. Both existing and new CSOs (e.g. those formed through spin outs from the public sector) will need advice as to how to respond:
 - Most infrastructure support is currently provided on a 'supply' model, which does not always meet demand. Capacitybuilders developed a demand model for the delivery of the Modernisation Fund. See paper on Effectiveness, which suggests that a mixture of the two models is most appropriate
 - There are also new types of infrastructure support developing in response to demand; for this trend to develop further the demand needs to be backed by resources

2. Implications for the public sector

- Urgency of cuts. The timescale in which cuts are having to be made means that:
 - There could be a tendency for public bodies to cut funding to external bodies, such as CSOs, and ‘protect their own’
 - There may be insufficient time to discuss how best to approach the financial situation with the sector
 - Salami slicing of budgets is likely to be the default position, rather than considering new ways of delivering services at lower cost
 - The potential for investment to help make changes (see above) is likely to be very remote given the scale and urgency of the cuts.
- New sources of funding. Any sources of ‘new’ funding or support will be very attractive at the present time:
 - There may be potential for local CSOs to develop new types of relationships with housing associations, many of which have very strong balance sheets.
 - Public bodies could identify more community assets for transfer, working in conjunction with the Development Trust Association and other partners
 - Some public sector staff could be seconded to the CSO sector to help the sector develop new approaches to the current challenges
- Strategy. It is particularly important at the present time for all parts of government to work with the sector to develop a shared strategy for supporting and developing the roles of CSOs, covering:
 - Strategic commissioning approaches, which include market development and social value clauses
 - Agreement about how to specify and operationalise shared outcomes
 - Special funding measures needed to ensure those CSOs seen as having the biggest role to play get the support they need (e.g. small grant programmes for community groups) and have the opportunity to bid for services (e.g. by not necessarily having larger and larger contracts)
 - Better sharing of risk – there will be a tendency to try and transfer risk to providers. Models like the Social Impact Bond provide other approaches)
 - Joint discussion about how best to achieve savings – as is being done in Merton and in Thurrock.

**Funding Commission
August 2010**