

A Question of Definition: an attempt to Operationalise Definitions of the Sector

Background

The sector has more often been defined in relation to not being something else – not private sector and not government. The ‘Third Sector’ that mops up what has been left behind once the private and public sectors have been removed. This is deficient in a number of ways, not least because it is historically inaccurate – the sector probably came first with the growth of market economies and the state being later developments. It also suggests that the sector is some sort of sticking plaster, merely plugging failures in the other two sectors.

The Third Sector, Voluntary and Community Sector, Charitable Sector and Civil Society are just some of the names that have been used to define the sector. Yet an all encompassing definition in the UK has proved elusive. Indeed, it is arguable that there is no distinct sector, or no distinct boundaries to the sector. However, there is a practical need to define the sector in some shape or form. This need arises from the growing emphasis placed on building the evidence base of the sector in order to draw conclusions and make policy recommendations based on those conclusions. If there is no clear definition there is a danger of misallocation.

One example is that the size of the General Charity Sector is estimated to be £27.7 billion by the NCVO Voluntary Sector Almanac. The social enterprise sector is also estimated at approximately £27 billion by the Social Enterprise Coalition. These two figures are often aggregated to arrive at a figure of approximately £54 billion as the size of the sector. However the NCVO estimates that approximately half the social enterprises also fall within the General Charity estimate, thereby seriously over-stating the size of this part of the sector.

Underlying Philosophy of the Sector in the UK

The UK sector sits on the fault line of two traditions (Westall, 2005). The American ‘non-profit’ tradition is based along philanthropic lines. Any surplus is retained to further the charitable objectives of the organisation. It is not set up to benefit its members, but the wider community, or sections of the community.

The European ‘Social Economy’ has a tradition where making a surplus is acceptable, it is how this surplus is distributed that differs from traditional capitalism. Generally, workers or members benefit in a democratic way from the derived profits, rather than capitalist investors seeking to maximise return on their investment. Cooperatives and Industrial and Provident Societies are examples of this type of philosophy.

While both types of organisations exist on both sides of the Atlantic, it is in the UK where the mix is greatest with both a vibrant social economy and non-profit sector.

Need for Definitions

The Office of the Third Sector has emphasised the need to build the evidence base of the sector (Reichardt *et al.* 2007, p. xi). There are also currently a number of well-resourced initiatives to better establish the size and scope of the sector, for example by Northern Rock, the Office of the Third Sector and the Economic and Social Research Council.

With this injection of resources and interest comes a need to better establish what to measure. For example an interest in examining 'the Third Sector' in Northern England begs the question of what is contained within the Third Sector. Previously studies of the sector (e.g. Shah 2006, Whatmough 2000) have used their own definitions, normally according to the needs of the study. However this has led to isolated pockets of research around the country which have been unable to be compared systematically to a large proportion of similar research.

Therefore to simply declare the sector indefinable creates a barrier to researching different areas of the sector in any comparable way.

Mapping the Sector

In order to overcome this barrier it is first necessary to look at the existing entities generally thought to be contained within the sector. Beginning with the two traditions that have developed in the UK as mentioned above, separate streams of regulation have been enacted to oversee them.

The first is the Charity Commission which can be seen as the heir to the American 'non-profit' tradition of retaining all surpluses.

The second regulatory body is part of the Financial Services Authority and this oversees Industrial and Provident Societies, Credit Unions and Building Societies, which can be seen as the heir to the European 'Social Economy' tradition.

There are also a number of other regulatory bodies in three further strands. The first is companies house, which regulates for-profit corporations. A number of entities traditionally identified within the sector have decided to register as a company to obtain certain benefits such as limited liability.

The second strand is a number of bodies or organisational forms set up to specifically regulate parts of the sector. These include the Housing Association to regulate social landlords, the Certification Office which regulates Trades Unions and HM revenue and Customs which have a special organisational form for community amateur sports clubs.

The third strand is charities that have specifically been excluded the need for regulation by the Charity Commission, commonly known as excepted charities. These are normally charitable institutions that have been granted their status directly by parliament or the monarch, such as the older universities or the Boy Scout movement. However with the charity act 2006 these are being folded into the Charity Commission.

Therefore there are a number of different regulatory elements to the sector. What complicates the picture is that often organisations can choose which regulator they fall under, they may be able to register under more than one, and some are obligatory while allowing organisations to register under other legal forms as well.

Appendix 1 attempts to map the various organisations onto different regulatory bodies and forms. There are clearly grey areas around organisations on the edges of some of the definitions and changes in the Charities Act 2006 will mean that the status of excepted organisations will change.

Defining the Sector

The rationale behind this paper is that while it is probably futile to try to establish one definition for the entire sector, it is a worthwhile exercise to try and establish a range of definitions of different parts of the sector.

There are a number of approaches that have been taken when attempting a definition.

Functional approach

The functional approach is based on the primary function of the organisation, even though many organisations perform more than one function. This is based on the idea that the sector fulfils certain niches in society, an idea that is becoming less tenable as the sector increasingly engages in service delivery and market based activities. Despite this the functional approach is often used as superficially it provides an easy base for classification.

Economic Approach

The Office for National Statistics uses an economic approach to dividing sectors. They seeks to group participants in the economy according to their economic behaviour rather than the source of organisational support. Essentially, entities which charge economic prices for their output - market producers - are placed in the market sectors (either as non-financial corporations or financial corporations). This includes Charities' trading companies which sell goods and services. The market sectors will include entities which are non profit distributing as long as they are charging economic prices. Entities which are mainly funded by donations or transfer payments (i.e payments which are not in

return for goods or services) are regarded as non-market entities. There is also a further classification by control. This is not dependent on the source of the donation or transfer payment as funding does not equate to control. Although many international guidelines from governments describe the general government sector as including those entities which are 'controlled and mainly financed by government', the ONS interpret this as including those entities that are controlled by general government and ignore 'mainly financed'.

Legal Approach

The legal approach defines the sector through organisations that take on a particular legal form. The varied legal forms that organisations in the sector can take, as described above, has the potential to sub-divide the sector. However the difficulty with this approach is that some organisations can take different legal forms or more than one legal form. For example many registered charities are also companies limited by guarantee. There is also a degree of regulatory arbitrage where organisations adopt a form that best suits their purposes rather than through any *a priori* reason for adopting that form.

Structural-Operational Definition

The approach by Lester Salamon at Johns Hopkins University (JHU)¹, which has been adopted by the UN, use what they term a Structural-Operational definition. This approach identifies characteristics which organisations should possess in order to be included in their 'non-profit' sector. These are that organisations should be:

- *Organised* - People and their activities have a structured organisational form
- *Private* – not part of apparatus of the state (but could be funded by them)
- *Not profit distributing* - not returning any profits generated to their owners or directors but ploughing them back into the basic mission of the agency;
- *Self-governing* - equipped with their own internal apparatus for governance;
- *Voluntary* - involving some meaningful degree of voluntary participation, either in the operation or management of the organization's affairs.

NCVO uses this approach for their 'general charities' definition, though using slightly different criteria. The starting point is that organisations must be registered with the Charity Commission. They must be organised, not profit distributing, self-governing and voluntary in agreement with the Johns Hopkins definition. They must also be:

¹ see <http://www.jhu.edu/~ccss/>

- *Independent (rather than private)* - Organisations are constitutionally and institutionally separate from the statutory and private sectors
- *For public benefit* - Organisations do not exist solely for the benefit of their own members

This has resulted in a relatively clear definition that has allowed meaningful comparison over time. However it is acknowledged that this definition is narrow.

Method

The approach taken in this paper begins by setting out a number of criteria that can be used to differentiate various parts of the sector. They are not mutually exclusive – different organisations may be in some or all of the categories. It uses as its starting point the Johns Hopkins structural-operational (S-O) approach by having a number of criteria that entities can be judged by, but builds and amends the S-O criteria where it is felt change is needed. There is also a crucial difference in that if an entity ‘fails’ a criteria, it does not mean it is automatically not part of the sector. It may be that it fits into a different part of the sector. Entities are then mapped against these criteria.

The next stage is to take the terms in common use for the sector or parts of the sector and decide which set of criteria are needed to be passed in order for an entity to be included in each one. This decision is based on current usage of definitions.

The third stage is to match up these different definitions to the different entities, based on the entities passing all the criteria needed to be in each one, and thereby produce a schema of which entities are within which definitions. While some organisations may not fall under any, others may be included in a wide range.

Stage 1 – Categories to be used for definition

The following categories are proposed:

1. Organised:

An organisation doesn’t necessarily need to be incorporated by any body as long as it has a set of written governing rules. Proposed categories:

Organised:

- pass criteria: the organisation is formally organised, consisting as a minimum a set of written governing rules.
- fail criteria: the organisation does not have a formal organisation.

2. Profit Distributing

Some profit distribution is a common feature of the European social economy tradition and therefore a dichotic profit / non-profit split is too simple. Boundaries have also blurred as beneficiaries have increasingly been engaged in running organisations, making public/private benefit distinctions difficult.

There is a difficulty with partnerships such as KPMG, John Lewis and smaller mutuals which have similar structures but, for example, KPMG is traditionally thought of being 'out' of the sector, while smaller mutuals 'in'. This may be solved by using a 'primary purpose' criteria to distinguish between organisations, but this may still not provide a clear distinction.

It could also be solved by needing to have profit distribution decided democratically by all members or employees. Organisations such as KPMG have a small group of partners which are separate from a group of salaried employees with no role in the running of the organisation. This is also true of many law firms with partners separated from salaried employees. Having a criteria of those organisations where every member or employee is part of the partnership may get round the distinction.

A possible method of deciding a limited profit distribution criteria could be the Department for Trade and Industry's criteria for CICs. This states:

Although investors have the possibility of making a modest return, this will be restricted in order to ensure that the main beneficiary of the CIC is the wider community.

The Cap on return has three elements:

- The maximum dividend per share limits the amount of dividend that can be paid on any given share. Currently, the limit is 5% above the Bank of England base lending rate.
- The maximum aggregate dividend limits the total dividend declared in terms of the profits available for distribution. Currently, the limit is 35% of the distributable profits.
- The ability to carry forward unused dividend capacity from year to year to a limited extent. Currently the limit is 5 years.

Bona fide cooperatives and mutuals may fail the second bullet point as they could distribute more than 35% of their profits to their members. Therefore any categorisation would need to take this into account. One way to do this is that

the distribution of profits in bona fide cooperatives and mutuals is decided upon democratically by all members².

It is proposed that this category is split into three groups:

non-profit distributing:

- pass criteria: the organisation does not distribute profits
- limited criteria: the organisation distributes limited profits*
- fail criteria: the organisation has no restrictions on profit distribution

*limited profit distributing is where profits are distributed within the boundaries of the CIC definition, or the distribution of profits is democratically decided by all members.

3. Independence

The perception of independence is clearly different from actual independence in many cases. Independence is often only clarified through close examination of the governing documents. Even then there may be differing opinions at the boundaries where independence is unclear. Proposed categories:

Independent:

- pass criteria: The organisation is free to act as an independent body
- fail criteria: The organisation is controlled by another non-sector entity

4. Volunteering

This has traditionally been thought of as a defining feature of the sector. While many organisations in the sector still have volunteers, if only as trustees, increasingly this is not the case. An example is the new CICs that can pay their trustees, and some cooperatives where every member shares in the profits or benefits. Proposed categories:

Organisation uses volunteers:

- pass criteria: The organisation has regular volunteering
- fail criteria: The organisation has no regular volunteering

² They normally have three options, to reinvest any surpluses back into the cooperative, to choose to invest it for the benefit of the community or to pay a dividend.

5. Benefit (rather than Public Benefit)

This category is based on the idea that organisations benefit the public in some way - a key plank of the new Charities Act. However this would exclude certain organisations traditionally in the sector which were set up to provide mutual support among a group of people with a need, such as bona fide IPSs.

Therefore the categories need to encapsulate these distinctions. proposed categories:

Benefit:

pass (public benefit)	The organisation is set up to benefit society
limited benefit	The organisation is set up to benefit all of its members or employees
fail criteria:	The organisation is not set up with a social purpose

6. Trading

This is a new category proposed, designed to capture the trading nature of much of the sector. There are a number of ways that a criteria of this sort can be approached. Firstly a simple 'does the organisation trade' criteria. Secondly a criteria based on a percentage of income coming from trading (possibly using a charitable incorporated organisation criteria). Thirdly where an organisation prices goods or services at market prices. Fourthly distinguishing between primary purpose and non-primary purpose trading.

The difficulty with stipulating that a certain percentage of income must be from trading activity is that there is no neat cut-off point or clustering of organisations at certain points along the scale. There is a smooth gradient from organisations that obtain 0% of their income from trading to organisations that earn 100%. This creates difficulties in deciding where the cut should be and therefore a simple majority would be the most obvious in the absence of any better guide. It also doesn't distinguish between those organisations that are set-up to be a trading enterprise from those for whom trading is incidental to their main goal. There are also complications around, for example, organisations given grants for a number of years and are then switched to contracts by a local government yet do exactly the same thing.

Therefore we propose a need to organise this category around primary purpose trading. Primary purpose trading is trading that relates to the organisation's charitable mission. Secondary purpose trading is trading that does not. At present Charity Commission Limits on secondary purpose trading are 25% of a company's turn-over or £50,000 turnover, whichever is the smaller. If a charity exceeds this it must set up a trading subsidiary. Proposed categories:

Trading:

Pass criteria: An organisation engages in primary purpose trading and obtains over 50% of its income from this source

Fail criteria: An organisation does not engage in primary purpose trading or, where it does, this makes up less than 50% of its income

not included: Governance

There are a number of methods of governing organisations:

- no formal governance (such as informal groups)
- single governance (such as a single entrepreneur building up a business)
- multiple governance (such as a group of trustees)
- all employee governance (such as cooperatives)

Does adding a governance criteria add more to the classification system than is taken away by the increased complexity? It is proposed that this classification is not included.

not included: Membership

Some organisations are open to all, some restricted. On what basis should we separate these out? For example restricting membership to those in a geographic location, with a disability or with significant need may be acceptable whereas those based on black-balling may not be. On what criteria is acceptable discernment based?

Does adding a membership criteria add more to the classification system than is taken away by the increased complexity? It is proposed that this classification is not included.

Stage 1: Applying the categorisation to entities

Using these six proposed categories, the next step is to test different entities to see where they are placed against each criteria. Although in theory these criteria could be applied to any entities, the table below has focussed on those traditionally thought to be in the sector. Also included are a supermarket and the Home Office as two samples traditionally thought to be outside the sector as a test to see whether entities clearly not part of the sector are excluded using this method.

Some entities (such as co-operatives) will encompass a range of different organisations that will be on both sides of certain categories. These would be marked by having more than one attribute in a box.

The literal going through and marking each cell has not been carried out as it is the theory that is the focus of this paper rather than the detail.

Each cell would be filled in according to how each entity match the criteria.

Table 1: Mapping entities onto classification criteria

Classification	Organised	Non-profit distributing	Voluntary	Independent	Benefit	Trading
Categories	Y/N	Y/L¹/N	Y/N	Y/N	Y/L²/N	Y/N
Recognised faith groups						
Recognised political parties						
Unincorporated registered charities						
Trusts						
IPs – bencom						
Housing associations						
Trade unions						
Museums						
Independent schools						
Universities						
Social enterprises						
Sports and social clubs						
Cooperatives						
Mutual societies						
Building societies						
Credit unions						
IPs – bona fide						
Community interest companies						
Local community organisations						
Individual civil action						
Test organisations						
A supermarket						
Home Office						

¹ - L = limited profit distribution

² - L = Benefits to members only

Stage 2: Assigning terms to different sets of categorisations

The next step is to go through each of the terms in common use to describe the sector or parts of the sector and decide which criteria need to be satisfied in order for organisations to be included in the terms. I have derived these from common uses of the term. Further terms could be added as needed or are felt useful.

Table 2: Mapping different terms onto different sets of categories

Classification	Organised	Non-profit distributing	Voluntary	Independent	Benefit	Trading
Categories	Y/N	Y/L/N	Y/N	Y/N	Y/L/N	Y/N
Charitable Sector						
Voluntary and Community Sector						
Third Sector						
Non-Profit Sector						
Social Economy						
Social Enterprise Sector						
Civil Society						

Stage 3: Applying the terms to different sets of entities

The third stage is to match up these different definitions to the different entities. This is done automatically by combining the first two tables and is based on the entities passing the criteria needed to be in that definition. While some organisations do not fall under any definitions, others are included in a wide range.

Table 3: Mapping entities onto terms

Classification	Charitable Sector	Voluntary and Community Sector	Third Sector	Non-Profit Sector	Social Economy	Social Enterprise Sector	Civil Society
Recognised faith groups							
Recognised political parties							
Unincorporated registered charities							
Trusts							
IPs – bencom							
Housing associations							
Trade unions							
Museums							
Independent schools							
Universities							
Social enterprises							
Sports and social clubs							
Cooperatives							
Mutual societies							
Building societies							
Credit unions							
IPs – bona fide							
Community interest companies							
Local community organisations							
Individual civil action							
Test organisations							
Supermarkets							
Home Office							

Conclusion

This methodology is essentially an extension of the Johns Hopkins structural-operational method. Rather than having simply one term and one set of criteria, this method uses multiple terms and multiple criteria to map different parts of the sector. While it is recognised that it will still fall short of mapping the entire complexity of the sector, it is believed that it is a progression on what has gone on before. It will also inevitably lead to entities being included or excluded from certain terms that some stakeholders will perhaps be unhappy with.

However given the need for better definitions of sector, this is an attempt to move the debate forward.

References

Reichardt, O. *et al.* (2007) *The UK Voluntary Sector Almanac 2007*. London:NCVO

Shah, R. (2006) *An Assessment of Scottish Civil Society*
http://www.civicus.org/new/media/CSI_Scotland_Country_Report.pdf

Westall, A. (2005) *Exploring Diversity: the links between voluntary and community organisations, social enterprises, and co-operatives and mutuals* in Robb, C. (ed) *Voluntary Action: Meeting the Challenges of the 21st Century*. London: NCVO

Whatmough, P. *et al.* (2000) *A Survey of the Voluntary Sector in Mansfield*. Division of Public Health Sciences, Queen's Medical Hospital, Nottingham

Appendix 1: Map of Civil Society Entities

