

# TIMES OF CHANGE

## What grant-makers and philanthropists need to know about public sector commissioning

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We originally prepared this briefing on public sector commissioning for the trustees of the Henry Smith Charity; but as many funders grapple with the role they can and should play within a wider funding context, together we agreed that this advice should be more widely shared.

Drawing on NPC's existing knowledge and experience, as well as other data sources, we explain the rapid changes in public sector commissioning and the potential implications for funders, and also provide discussion points to facilitate important conversations within organisations. This paper does not address the wider debates concerning the circumstances under which grant or contract funding is appropriate, although these are also important areas of consideration.

### Introduction

Public sector commissioning is a reality for many charities, and is therefore a significant part of the funding landscape that other funders need to understand. The government's austerity drive has involved the increased outsourcing of public services to private and voluntary sector organisations. These changes have already had a major impact on charities, with a gradual but accelerating shift from grants to contract funding across the sector.

Some funders worry that a charity's quality of work is adversely affected by this new way of working. Contracts can be bureaucratic to operate, diverting a charity from its mission, and entering into a sub-contracting relationship can imply uncertain volumes of work and unstable funding. Participating in some government programmes may mean supporting compulsory activity which could affect the relationship between charity and beneficiary. In addition, the financial incentives created by some contracts can make it less attractive to support the most vulnerable clients because positive results are harder and costlier to achieve.

Spending cuts have fallen heavily on local authorities, and this has in turn particularly affected charities working in areas where there is no statutory duty for a council to provide a service. Funders may be concerned that grants to charities are used to directly replace local authority funding. They may also fear that by funding a charity that is also competing for government contracts, they risk effectively subsidising the government, by allowing the charity to price services below cost, or private profits, if a charity is sub-contracting from a private provider.

However, although government funding has sharply declined, it still accounts for one third of the sector's income. Many charities have become skilled in managing government funding in a way that is congruent with their mission; effective contract management requires high standards of managerial capability that may benefit the organisation's activity. Nor should it be forgotten that in many cases government funding aims to achieve social outcomes that are aligned with charities' missions—getting unemployed people into work, for example.

Given this environment, negotiating the relationship with government funding is complex, and hard and fast rules cannot be forced. Choosing not to award grants to charities that receive government funding, for example, could disqualify a substantial part of the sector—including many excellent organisations and effective interventions. Funding opportunities are therefore better considered on a case by case basis, placing above everything else the ability of the applicant to achieve social impact.

# What is commissioning?

## Commissioning cycle

Commissioning is the whole process through which a public body identifies and delivers services. It is undertaken by national and local statutory agencies, and involves assessing the needs of people in a local area, designing services to meet those needs, and selecting the appropriate partners to deliver them. It is often described as a five-stage cycle:

1. **Analysis of needs, policy and resources:** commissioners need to understand a particular community in order to best support the needs of its citizens.
2. **Development of the market:** commissioners need a cohort of capable and robust providers and should—if necessary—help them to develop the skills and capacities needed to participate in commissioning.
3. **Procurement of services:** purchasers will often award a contract through a competitive tendering process, although they have other tools, including grants, at their disposal.
4. **Delivery of service:** the selected delivery partner(s) carry out the commission, and the commissioning body monitors performance.
5. **Review of quality and impact on needs:** at the end of the commission period, the commissioning body evaluates the service and any impact it has had on the level of need. This feeds back into stage one by informing analysis and re-commissioning decisions.

In practice, this cycle rarely occurs in full. Some charities successfully draw on close relationships with key decision-makers to influence commissioners. However, most of the time there is little meaningful market development; limited performance management while the contract is being delivered; and a lack of skills to effectively identify changing needs or opportunities to improve service design.

## Procurement

Procurement is a specific part of the commissioning cycle that describes purchasing the service and awarding a contract to the delivery partner. One feature of the expansion of public sector commissioning has been the creation and consolidation of procurement units separate to commissioning teams. In a local authority, for example, a commissioning team will identify a commissioning strategy, undertake needs analysis, and prepare a brief for the commissioning process. The procurement team will translate that brief into the specification through which the service is procured.

A key concern of procurement teams is the management of risk, ensuring that services are obtained in line with procurement law, rooted in EU law, so that their purchasing decisions cannot be challenged in court. EU law is based on the presumption of a fair procurement process that is open on an equal basis to all qualified providers. It is for this reason that procurement teams often prefer competitive tenders, which fit easily within procurement law—rather than a more co-developed approach—and appear to drive towards value for money.

Procurement professionals, therefore, influence the way services are purchased. Their professional incentives to minimise risk (including the risk of legal challenge) can mean that they favour established procedures, and do not actively seek opportunities to procure services in more flexible or innovative ways. In reality, the [new EU regulations](#) permit more flexibility than might at first appear, and we have produced guidance for both charities and procurement teams on how to make the most of this opportunity.<sup>1</sup>

## Where do charities fit within the current environment?

### Different types of commissioning

When working with the voluntary sector, commissioners can provide funds for a number of different purposes:

- **Outsourcing of statutory responsibilities:** services that the commissioner is required by law to provide, but prefers not to deliver directly. Examples include health and social care support through home visits, day centres or residential homes. These services could be delivered by any provider with the appropriate skills, and a competitive process is often appropriate.
- **Non-statutory public services:** services that the commissioner chooses to invest in without a statutory requirement. Examples include investment in early intervention services, such as programmes with young people who are at risk of becoming NEET (not in education, employment or training). These services, too, could be delivered by any provider with the appropriate skills and a competitive process may be appropriate. However, as these services rely on voluntary participation of individuals (ie, they may be beneficial but not essential to the individual), organisations rooted in the community are often well placed deliver services.
- **Community capacity and support:** the commissioning authority may choose to target funding at a specific organisation, such as BME or refugee forums and tenants associations. This is not usually procured through a competitive process—although it may still be funded through a contract or service level agreement.

### The charity sector's involvement in commissioning

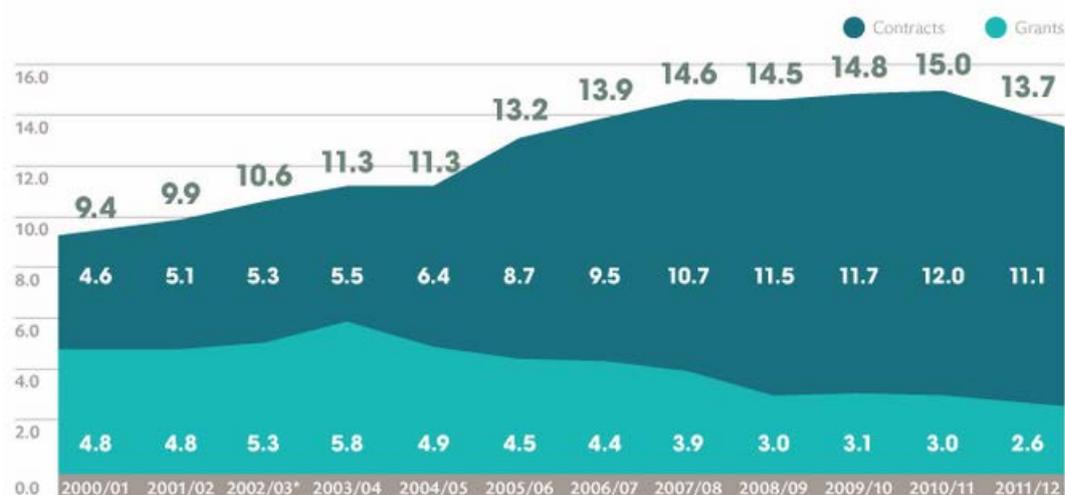
Government funding is the second largest source of income for the voluntary sector (after donations from individuals), comprising more than a third of the total. Within this, income from contracts has become increasingly important relative to grant income, which has decreased both in proportion and as an absolute figure over the past decade. In 2011/12, £11.1bn (80%) came from government contracts and £2.6bn from government grants. Overall, 28% of total charitable income currently comes from contracts.

Although the data on government spend is not directly comparable due to different data collection methods, it gives a good indication that approximately 7% of the government's total spend on goods and services goes to the voluntary sector; and within that figure, 4% of the grant spend goes to the voluntary sector—making charities a small but important part of the supplier landscape. Larger charities are more likely than smaller to be in receipt of this funding, but a significant proportion of charities of all sizes receive substantial government income.

However, we need to place this within a wider context. As shown in figure 1, after a decade of almost uninterrupted growth<sup>2</sup>, the year 2011/12 saw the impact of austerity hit charity accounts for the first time in the form of a £1.3bn drop in income on the previous year.<sup>3</sup>

**Figure 1: Voluntary sector contract and grant income from government (£billions, 2012 prices)**

Source: Data and graph from the [NCVO Almanac](#).



Our 2012 [research into commissioning experiences](#) of larger organisations (income over £800,000) found that a third had experienced a fall in government income, and almost two thirds had closed services or expected to do so in the next year. Nine in ten charities felt they face more risk than they did in the previous year.

For almost half of survey respondents, the main reason for a fall in government income was *'A cut in the level government agencies were willing to pay for the services commissioned'*. Charities of income under £2m were more likely to experience *'Non-renewal of grants'* than larger charities. Charities of income between £2m and £10m income were more likely to experience *'Loss to private sector companies'* and *'A total cut of contracts'* than others. More than three fifths of all charities had used or expected to use their reserves to cover shortfalls in income, with small charities more likely to be in this situation.<sup>5</sup>

## Reflections and implications

The charity sector is a small but significant supplier of services to government at all levels, particularly the local level. Government income is a normal and important part of the funding mix for charities, and contracted income is a majority of government income for charities of all sizes. This trend is likely to become more pronounced since the transition from grant to contract income shows no signs of abating.

Most charities do not seem concerned that contracts may cause mission drift, although some commentators believe this is more of a problem than charities care to admit. A large proportion of charities have experienced a drop in government income, and have needed (or expect) to use reserves to cover a funding shortfall (although we cannot be certain that a reduction in government income was the direct cause). This seems to be more pronounced among smaller charities, although we do not know if the same applies to charities with an income below the lower band of our survey sample (£800,000).

Not all commissioning is carried out through competitive contracting, although this is often the preferred model. Sometimes it is appropriate to procure community activity through contracting arrangements.

When public funders move from grants to a contract model, the formal, legal relationship changes. Under a grant, organisations propose a way to meet the funder's objectives and funders choose whether to support them. Under a contract, an organisation is legally obliged to deliver a service according to a specification. In practice, the distinctions are not so clear cut and there is a lot of 'grey area' in how the arrangements are implemented. In some cases, the transition from grant to contract has little impact on the established relationship between the funder and provider organisation.

If charities put their beneficiaries at the heart of what they do—and those beneficiaries' lives are highly influenced by the public services they receive—then choosing not to participate in commissioning conversations risks marginalising that charity's influence. As a funder, restricting your exposure to charities delivering contracts could significantly limit the range of charities you can work with, including highly effective charities delivering crucial work for communities.

Funders should also bear in mind that, although charities are increasingly undertaking the delivery of public services, this is not the only—or perhaps not the most important—way for charities to get involved in commissioning.<sup>4</sup> The charity sector is uniquely placed to influence the design of services (see discussion points from page 9), but this work is rarely supported by government or other funders. Charities also often deliver charitably-funded activity to the same people the commissioner wants to support, and should stay engaged with commissioners to create effective referral pathways and so provide a non-duplicated and easy to navigate service.

## What changes have we seen to the legislative context?

The Local Government Association predicts that by 2020 councils will confront a funding gap of £16.5bn.<sup>6</sup> Local authorities have been subject to cuts over the past decade but, following the 2010 Comprehensive Spending, reductions have reached as high as 30-40% (although with significant local variation). This challenge is set to continue, with the announcement that local government budgets<sup>7</sup> will be reduced by a further 10% in 2015/2016.<sup>8</sup>

The changes occurring across national and local commissioning bodies represent a seismic shift in the way that public services are delivered. In 2010, NHS Chief Executive Sir David Nicholson described the current health reforms as a change management process so big ‘*you could probably see it from space*’.<sup>9</sup> Much of the current discussion focuses on how commissioning can be designed to ensure that the voluntary sector is not systematically excluded from the new arrangements. Many charitable organisations are struggling to navigate the quickly shifting landscape, and are disadvantaged in comparison to large commercial organisations in terms of their capacity and resources.

### Payment by results

In payment by results (PbR) contracts, a service is paid for only when and if the provider achieves certain outcomes; thereby transferring the risk of failure or under-performance from commissioners onto providers. High-profile examples include the [Work Programme](#), [Transforming Rehabilitation](#), and the [Troubled Families](#) programme, but the approach is permeating the public sector more broadly. Some PbR contracts operate a mixed payment mechanism; a small fee for the service and only a portion of payment tied to results. In some cases, the level of payment received by providers depends on the extent and quality of the outcomes achieved in a sliding scale; elsewhere, payment is binary and only received when an outcome is achieved. More than half of charities believe that PbR has a negative impact on financial security.<sup>10</sup>

PbR risks creating perverse incentives whereby beneficiaries who are most likely to achieve an outcome are prioritised, and those less likely to do so are neglected (known as “creaming and parking”). A review found that this was happening in the Work Programme<sup>11</sup>, and major charities including Mind, Crisis and Drugscope have voiced their concern that the programme leaves the most vulnerable behind.<sup>12</sup> A second key challenge of payment by results is cash-flow: organisations need to subsidise activity costs with income from other sources until results-based payments are triggered. The government has been clear that organisations need to make their own arrangements for solving this cash-flow challenge, and continues to promote social investment—repayable finance made available for social purposes—as a solution.

### Centralised commissioning and larger contracts

Two of the government’s flagship public service reforms—the Work Programme (welfare to work) and Transforming Rehabilitation (prisoner rehabilitation and probation)—are notable not only for their PbR mechanism, but also for their centralised nature. Both replaced local agenda setting with a standardised national approach administered through large contracts (18 in the case of the Work Programme; 21 in the case of Transforming Rehabilitation). Contracts are delivered by large ‘prime’ contractors, and smaller providers, including charities, are subcontracted as second or third tier providers.

The Work Programme has been mostly operational since 2011, and [preferred bidders for Transforming Rehabilitation](#) were announced in late October 2014. The Work Programme does not contain any fully charitable prime contractors, and Transforming Rehabilitation has one not-for-profit prime that is public sector rather than charitable, although charities are involved as minority partners in a number of winning bids.

The challenges presented by centralised contracts to small providers are exacerbated by the PbR mechanism. A number of charities have withdrawn from the Work Programme for practical or mission reasons,<sup>13</sup> or have even faced closure as a result of the delayed results-based payments.<sup>14</sup> We have heard of risk being passed down from a prime contractor to small subcontractors that lack the capacity to manage it, and also of small organisations

providing specialist services in a supply chain that have received far fewer referrals than expected, and therefore cannot generate the expected income.

Yet many others have been able to make the contract work in a way they feel comfortable with. In preparation for Transforming Rehabilitation, the Ministry of Justice has taken a more active approach to ensure charities have a place within the supply chain—although many still found it difficult to engage with the prime contractors bidding for these contracts, and we do not yet know what role charities will play once contracts are awarded and supply chains assembled.

Aside from these flagship programmes, there is a broader trend for commissioners to let fewer, larger contracts. As commissioning departments shed staff, they see this as a more manageable way to supervise services. As a result, charities that lack the scale or expertise to take on the whole contract have to invest heavily in building partnerships or consortia or in entering into subcontract arrangements.

## The Social Value Act

The [Public Services \(Social Value\) Act](#), passed in 2012, requires that public bodies consider how the procurement of services would contribute to the economic, social and environmental well-being of the area. The Act provides useful encouragement to public bodies to consider these concerns when making purchasing decisions, but does not require that they are prioritised over cost. The impact of the Social Value Act is still emerging; awareness is not yet high enough among key decision-makers,<sup>15</sup> and it is often ignored where commissioners are not minded to prioritise social value. A [recent review](#) identified three key barriers to take-up of the Social Value Act: lack of awareness, varying understanding of how to apply it, and a need to develop the measurement of social value. The government has made recommendations for how to address these barriers.<sup>16</sup>

## New health commissioning structures

The [Health and Social Care Act 2012](#) introduced Clinical Commissioning Groups, of which there are now 211, responsible for 60% of NHS budgets. The same Act created Health and Well-being Boards: local vehicles for strategic collaboration among health bodies, local authorities and voluntary sector organisations. In most places, these do not have budgets, but are expected to become increasingly important vehicles for setting local priorities.

Since 2013, public health budgets have been held by upper-tier local authorities and ring-fenced—originally for two years but now extended to 2016. The annual public health budget is approximately £2.8bn nationwide, and while priorities are set locally, the focus is on supporting people to make informed choices to promote health.

The role of the charity sector in delivering and influencing services in this new environment is subject to much discussion, as outlined in our recent paper [Supporting good health](#).<sup>17</sup>

## Personalisation

An increasing number of people who qualify for health and social care support now manage budgets for their own care through 'personal budgets'. This means that providers need to adjust to 'micro-commissioning'—developing one-to-one relationships with individuals, where previously these budgets would be distributed through grants or block contracts. Many charities feel this is a positive move, ensuring that individuals are in control of their own care. In practical terms, local authorities are moving at different speeds in implementing this. A key challenge for commissioners is the time and support needed to build a market of suppliers who offer genuine choice to people with personal budgets. For providers, there are real challenges in changing the model of cash-flow from block contracts to individual payments, and uncertainty about the number of people who will now be using the service. Funders may want to talk to their potential grantees about these challenges and explore whether there are ways to help them at this time of transition; for example, by providing interest-free loans to support cash-flow.

## The Localism Act

The [Localism Act](#) came into force in 2011 with the intention of shifting power from central to local government, and from local government to communities. For the voluntary sector, key innovations include the Community Right to Bid: when community assets come up for sale, the community has a period of time to prepare a bid and raise finance to take over and run the asset; for example, a community centre, library or pub. The Community Right to Challenge gives community groups the right to express an interest in running local authority services and, if the local authority accepts the challenge, triggers a procurement exercise in which the community group can bid. However, it is not guaranteed that the community group will secure the contract, and many communities have been wary of triggering a procurement exercise where a commercial provider might be successful.

### Reflections and implications

The commissioning environment is changing rapidly; the opportunities for charities in different commissioning contexts, and their ability to participate, could change equally quickly. The tone of political discussions is favourable to the involvement of charities in delivering public services, and both central and local governments are investing some resources to help charities participate on a level playing field—although the level of support remains inadequate. The implementation of opportunities afforded by the Social Value Act, Localism Act and health reforms will vary significantly between local areas depending on strategic priorities and individual commissioners.

Other developments are potentially problematic for charities, particularly PbR. The suitability of these contracts for charities hinges on the detail of payment arrangements.

There is little data on whether the type and size of organisation delivering public services changes when a commissioner moves its funding from grants to contracts. However, undoubtedly many commissioners seek cost savings by allocating funds through fewer, larger contracts. These arrangements favour larger providers, or require smaller providers to collaborate or consolidate to be in with a chance of winning.

With the rapid pace of change and the degree of local variation, funders will need to stay alive to the changing environment and the evolving implications for their strategy.

## How will commissioning look for charities in future?

Broader trends in commissioning will shape the environment in which charities deliver public services. Although we can expect some nuance depending on the outcome of the 2015 election, the broad direction of travel seems unlikely to change.

### Commissioning for outcomes

Public services are increasingly awarded and monitored on the basis of outcomes (changes seen in individuals in receipt of services) rather than outputs (activities undertaken). This is a positive development, focusing on what the contract aims to achieve and giving the provider greater flexibility over how it is achieved. In practice, however, outcomes based commissioning can be difficult to implement; outcomes usually refer to longer-term changes that are difficult to demonstrate within contract reporting timelines, and commissioners can feel more comfortable if providers report on concrete outputs. In addition, some social outcomes are extremely challenging to track accurately and measurement is difficult.

## Hollowing out the commissioning profession

Staff cuts within commissioning departments have created a vacuum of expertise and a dearth of individuals with the experience and confidence to try innovative approaches. In many places, those who remain are likely to be inexperienced or too thinly spread across multiple priorities. This lack of experience among commissioners can have unintended consequences, particularly when commissioners use complex payment mechanisms such as payment by results. Commissioners may wish to include charities in the market, but implement contracts in a way that makes it difficult for charities to participate (due to cash-flow challenges, for example).

## Integrated commissioning models

Vulnerable people often have regular contact with multiple agencies, each addressing one aspect of the challenge faced by that individual. Some local areas are beginning to realise that without better coordination, including joint commissioning between departments, this can be inefficient and costly, and may not produce good results for the individual.<sup>18</sup> This is a positive development, but it further complicates the commissioning environment.

## Co-design and co-production of services

Co-production is ‘a relationship where professionals and citizens share power to plan and deliver support together, recognising that both have vital contributions to make in order to improve quality of life for people and communities’.<sup>19</sup> Commissioners can co-produce with beneficiaries directly, or co-design with organisations representing those users. Co-production can be challenging as it implies a relinquishing of control over service design by the contracting authority. Full co-production is rare, but many areas are taking steps in this direction.

## Independence of the voluntary sector

Charities are often valued for their independence and how this enables them to take a unique perspective on issues—rooted in ‘real’, front-line experience. There have been increasing concerns about the eroding of this independence due to a range of factors, including the Lobbying Act, and the [Panel on the Independence of the Voluntary Sector](#) was established to investigate. The panel’s final report cites the failure of commissioning and procurement processes to foster and value independence, and raises concerns about ‘gagging’ clauses within the Work Programme, Transforming Rehabilitation and local authority contracts where charities receiving contracts are not allowed to criticise.<sup>20</sup> Undoubtedly, even without gagging clauses, providers may feel uncomfortable ‘biting the hand that feeds’ publicly. This is a difficult relationship to negotiate and few commissioners have the confidence to recognise that charities can both deliver services and act as a critical friend. In some cases, the tension is successfully negotiated; for example, the [Council for Disabled Children](#) (part of National Children’s Bureau) is funded to ‘speak truth to power’; its independent voice is seen as a core part of its value as a partner.

## National and local charities

The charity sector competes not only against public sector providers, but increasingly other charities too. The competition is often between local charities and national charities to deliver local contracts. Local charities often resent this competition from large organisations with more professional bidding apparatus, but national charities feel they can deliver high-quality services, and that this should be the foremost concern of commissioners.

### Reflections and implications

The direction of travel in commissioning is unlikely to change substantially, regardless of the result of the upcoming election. There are many challenges for providers and the loss of experience within the commissioning profession makes it increasingly difficult for charities to engage in meaningful dialogue. However, many of the developments are potentially positive for beneficiaries and for charities hoping to work in this field. Notably, co-production has the potential to give vulnerable people a voice in the services they receive, and charities can be well placed to facilitate this.

## Discussion points

### Opportunities in commissioning

#### Beneficiary voice

Charities are often said to occupy the middle ground between the state and beneficiaries, whilst remaining separate from each. Indeed, they are often uniquely placed to act as a 'conduit' between the two—as charities command higher levels of public trust and confidence than many public and private institutions.<sup>11</sup> This puts them in a strong position to gauge the opinion of beneficiaries, and to represent those views at a local and national level. At the same time, many have developed closer relationships with the state via their role in public service delivery. By choosing not to engage with the public service agenda, charities may miss out on a powerful opportunity to use this unique position to influence the design, as well as the delivery of services, so that they work in the best interests of their beneficiaries. They can also be particularly strong in supporting the co-design and co-production of services directly with beneficiaries by acting as a bridge between the formal structures of commissioners and the needs and preferences of beneficiaries.

#### Ubiquity of government funding

Some funders favour charities that do not receive contracts from government because they prefer to support grassroots community activity. However, government contracts are found among organisations of all sizes, and funding non-commissioned charities provides an imperfect proxy for identifying this kind of community-rooted organisation, and could put the funder at risk of disqualifying a range of organisations delivering activity it wants to support. Where a charity's mission aligns with the interests of the funder, the success it has in achieving its aims offers the best guide for funding decisions. In some cases, a charity's success in securing commissioned work could be an indicator of a well-run organisation that can evidence its success in supporting people who both the commissioner and funder aim to help.

#### Influence of charities in the commissioning market

Where charities are active in commissioning, they can act as a check on how that market might otherwise operate. Even if unsuccessful in securing the contract, their presence in the market, and the service quality they offer, can encourage commissioners to expect more of other providers and force private providers to up their game. At the very least, they can act as a bulwark against a 'race to the bottom' on costs and quality. Private sector providers are forced to recognise that charities in the market offer this kind of competition, and ensure their own quality of service or care does not drop below standards advocated by charitable providers.

The success of this approach depends on the commissioner recognising the quality argument, and there are certainly occasions where it has been unsuccessful. For example, Reed worked closely with charities in its bid to deliver the Work Programme, but failed to win any contracts. This dynamic can work informally, but may become more explicit as the Social Value Act encourages commissioners to recognise value alongside cost.

The lives of vulnerable people are highly influenced by the quality of the public services they receive and many charities want to take on a delivery role to ensure high standards are met. Yet if the charity could influence the contract specification to reflect the needs of (and appropriate solutions for) communities, it might matter less whether the charity itself delivered the work. The charity sector is uniquely placed to deliver this role because it is often rooted in the community and has a detailed understanding of the needs of its beneficiaries, but the work is rarely supported by government or other funders.

#### Positive organisational effects

Commissioning can be a positive influence for charities. The discipline of competing for contracts requires excellent internal financial and operational management, which can benefit all aspects of the charity's work. The move to larger contracts and more integrated service delivery can also encourage partnership working between

organisations with complementary expertise, to build a more joined-up experience for the beneficiary. Furthermore, the high expectations of commissioners can encourage charities to improve their impact measurement and build a strong case that their work achieves the outcomes commissioners care about. This information can also be useful in making a case for support to other funders.

## Issues to consider

### Substitution

There is a risk that funding a charity to deliver activity will enable government to reduce provision in that particular area and direct money to where it may be less well spent. This is a challenge funders have always faced, domestically and abroad, and is not specific to the transition from grant to contract funding.

### State withdrawal

The state is withdrawing from areas it previously occupied, with austerity measures seeing a cut in non-mandatory services alongside more conservative interpretations of statutory minimum responsibilities.<sup>21</sup> This has an effect both on who has access to state support (ie, tightening eligibility criteria), and the level of support they receive (ie, how many hours of social care someone with certain needs would qualify for).

There is no consensus among funders about how to respond to state withdrawal. Some stand back and claim the government should face the consequences of failing to support its citizens. Others put their mission to support beneficiaries first, and are more willing to replace lost income. The loss of state provision is not exclusively a concern within the commissioning context; it can apply equally to the loss of grant funding.

It is extremely difficult for funders to absolutely prove additionality—ie, what would have happened if they had not intervened.

### Leakage of charitable funds

Many funders worry that their charitable funds will be used to subsidise the public sector or the profits of private sector prime providers. Even if bids are scored on quality, price is always a factor, and charities rarely have the scale or infrastructure to deliver services at a lower cost than other providers. Their ability to deliver competitively priced bids depends, to some extent, on the financial health and other resources of the charity. Some charities take on contracts knowing that they will need to raise extra money to deliver the service quality they want; Marie Curie Cancer Care, for example, is very open about this.

This approach needs to be explicitly addressed in the charity's business model so that it does not become a drain on reserves. Most charities have huge demands on their unrestricted funds and the decision to 'top up' statutory services must be carefully considered. This challenge is less acute for charities that use volunteers, rather than money, to 'top up' the service. Nonetheless many worry that this risks alienating volunteers and other funders. In some cases, this can be managed by carefully delineating which elements of the service are statutory, and which are additional (although this distinction is not always practical).

Charities sometimes decide that they cannot endorse the government's approach if a contract is believed to offer a quality of service below that of the authority's minimum responsibilities—and is therefore in conflict with the charity's mission. Leonard Cheshire has publicly campaigned against the commissioning of 15 minute social care visits and achieved success in securing recommendations that these short visits are not acceptable under most circumstances.<sup>22</sup>

Funders will vary in their response to funds being used to subsidise under-priced contracts, or to 'top up' the quality of services for contracts which require only a minimum standard. Funders can manage this risk (if it is seen as such) through the conditions of a grant—for example, by designating funding for a specific purpose.

## Quality: organisation and project level

The key question from a quality perspective is whether the contract from a specification perspective, or from a behaviour perspective, prevents the potential grantee from working effectively with vulnerable people.

The delivery of public services through a contract rather than a grant may have implications for the type or quality of service delivered under that contract—for example, the contract may require a certain method of delivering a service which, if the organisation had the flexibility of a grant, it might choose to adjust. In a more challenging example, a payment by results contract may create perverse incentives for a charity which aims to support the most vulnerable. It might also affect the nature of the relationship between the beneficiary and the charity: if beneficiaries are aware that the charity is paid when they achieve certain outcomes, this could undermine the ability of the charity to build relationships of trust with its users.

Yet regardless of the arrangements of a specific contract, many charities deliver a range of high-quality charitably-funded activity alongside contracts. Private funders may have doubts about whether those contracts are the best way to use those public funds, and yet still feel that the charity will be able to effectively use its funds in a way that meets both the funder's objectives and the charity's mission.

In some cases, however, a funder may feel that the contracts affect the overall quality of the work of that charity and its ability to deliver on its mission; primarily if the culture or the detail of the contract acts as a muzzle on the charity's ability or willingness to advocate on behalf of the vulnerable people it supports. Some commentators have also expressed concern that the public service contracting culture can undermine volunteering.<sup>23</sup>

## Hollowing out of the charity sector

Some commentators are concerned about a 'hollowing out' of the charity sector, whereby large charities have the scale to compete for contracts or partner with those that do, and small charities can still keep going through remaining grants for grassroots activity and voluntary action, but medium-sized charities struggle to find grant or contracting opportunities at a scale that suits their operation. Without government income in the funding mix, some fear that many medium-sized charities will go bust. Others, including NCVO, warn that small organisations are more likely to face cuts in government income and will struggle to replace lost funds.<sup>24</sup> There is little data available to test this concern, and it is probably too early to see any clear effect.

## Final thoughts

The decentralised nature of commissioning means that there is huge local variation and it is very difficult to establish generalised rules. The commissioning and wider funding environment is changing rapidly—and it is an issue that will continue to evolve and affect the charitable sector in different ways over time. Grant-makers and philanthropists may find it most practical to identify their concerns and constraints, and decide the circumstances under which they would and would not feel comfortable funding organisations that receive income from government contracts.

The issues covered in this paper are common across many areas of NPC's work—with charities, with commissioners, and with philanthropists and grant-makers. If you are grappling with commissioning and its impact on your work, we would be happy to discuss and consider how we can best support you. Please get in touch via [info@thinkNPC.org](mailto:info@thinkNPC.org).

The subjects discussed in this briefing do not reflect the views of the Henry Smith Charity. We are grateful to the charity for allowing us to share this briefing for the benefit of other funders and charities.

## References

- <sup>1</sup> Bagwell, S., Hookham, L., Osepciu, L., Nicholls, J. (2015) [Reforming the relationship](#). New Philanthropy Capital
- <sup>2</sup> NCVO (2014) [UK Civil Society Almanac](#).
- <sup>3</sup> NCVO (2014) [UK Civil Society Almanac](#).
- <sup>4</sup> Sheil, F. (2014) [Failing the public?](#) New Philanthropy Capital.
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- <sup>6</sup> LGA (2012) [Funding outlook for councils from 2010/11 to 2019/20: preliminary modelling](#).
- <sup>7</sup> HM Treasury (2013) [Spending Round 2013](#): pp. 10–11, Tables 1 and 2.
- <sup>8</sup> Osborne, G. [Spending Round 2013, Statement to Parliament](#), 26 June 2013. This reduction is offset somewhat by other reforms, such as Council Tax freezes, meaning that at the time of the 2013 Spending Round, actual local government spending was predicted to reduce by around 2%.
- <sup>9</sup> Nicholson, D., [Speech at the NHS Alliance conference](#), 18 November 2010.
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- <sup>11</sup> Rees, J., Whitworth, A and Carter, E. [Support for all in the UK Work Programme? Differential payments, same old problem...](#) Third Sector Research Centre.
- <sup>12</sup> The Panel on the Independence of the Voluntary Sector (2014). [Independence undervalues: the voluntary sector in 2014](#). Baring Foundation
- <sup>13</sup> Centre for social and economic inclusion, [Charities leaving the Work Programme](#), 19 June 2013.
- <sup>14</sup> Civil Society, [25-year-old charity closes, blaming the Work Programme](#), 25 July 2012.
- <sup>15</sup> Social Enterprise UK (2014) [The Future of Social Value](#).
- <sup>16</sup> Cabinet Office (2015) [Social Value Act review – report](#).
- <sup>17</sup> Bagwell, S., Bull, D., Nicholls, J., Sheil, F. (2014) [Supporting good health: The role of the charity sector](#). New Philanthropy Capital.
- <sup>18</sup> Bromsgrove & Redditch Councils and Stoke-on-Trent City Council, see: <http://redditch.whub.org.uk/cms/council-and-democracy/reshaping-public-services.aspx>
- <sup>19</sup> Co-production practitioners network, About co-production: <http://www.coproductionnetwork.com/page/about-coproduction>
- <sup>20</sup> The Panel on the Independence of the Voluntary Sector (2015). [An independent mission: the voluntary sector in 2015](#). Baring Foundation
- <sup>21</sup> For example, several local authorities have outsourced library services, but Sheffield is now under judicial review for doing so. See Public Library News, [Ed Vaizey v. Sheffield Council: battle is joined](#), 18 September 2014.
- <sup>22</sup> Leonard Cheshire's *Make Care Fair* campaign: <http://www.leonardcheshire.org/>
- <sup>23</sup> NCIA Inquiry into the Future of Voluntary Services (2014), [Working Paper 8 The impact of commissioning and contracting on volunteers and volunteering in Voluntary Services Groups](#)
- <sup>24</sup> The Panel on the Independence of the Voluntary Sector (2014). [Independence undervalues: the voluntary sector in 2014](#). Baring Foundation

## TRANSFORMING THE CHARITY SECTOR

NPC is a charity think tank and consultancy which occupies a unique position at the nexus between charities and funders, helping them achieve the greatest impact. We are driven by the values and mission of the charity sector, to which we bring the rigour, clarity and analysis needed to better achieve the outcomes we all seek. We also share the motivations and passion of funders, to which we bring our expertise, experience and track record of success.

**Increasing the impact of charities:** NPC exists to make charities and social enterprises more successful in achieving their missions. Through rigorous analysis, practical advice and innovative thinking, we make charities' money and energy go further, and help them to achieve the greatest impact.

**Increasing the impact of funders:** NPC's role is to make funders more successful too. We share the passion funders have for helping charities and changing people's lives. We understand their motivations and their objectives, and we know that giving is more rewarding if it achieves the greatest impact it can.

**Strengthening the partnership between charities and funders:** NPC's mission is also to bring the two sides of the funding equation together, improving understanding and enhancing their combined impact. We can help funders and those they fund to connect and transform the way they work together to achieve their vision.

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