International Journal of Finance, Insurance and Risk Management
Volume X, Issue 4, 2020

pp. 50-67

Minding the Store: Structured Finance and Risk Governance of 'Third Sector' Organisations

Submitted 10/10/20, 1st revision 19/11/20, 2nd revision 29/11/20, accepted 28/12/20

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Abstract:

Purpose: *This conceptual theoretical review aims to inform readers of the benefits and pitfalls of structured finance, when applied to "Third Sector" organisations.*
Design/Methodology/Approach: *A literature review of existing studies and grey literature are considered in a critical evaluation of the risk governance of structured finance arrangements. Voluntary sector observers inform us, the 'Third Sector' comprises of '…nonprofits, charities, social enterprises, social movements, and other community-based. Clearly civil society organisation (CSOs), non-governmental organisations (NGOs) and supranational organisations should also be added to the list.*
Findings: *'Quality control' and 'Social implications' issues surrounding the effect of structured finance agreements on 'Third Sector' organisations are revealed.*
Practical Implications: *This conceptual theoretical review details the 'Practical implications of Third Sector organisation risk governance' with structured finance. The breadth, depth and remit of these agencies, demonstrates the societal need for risk governance for all such third sector organisations. The paper explains why those needs may differ for larger, more corporate 'Third Sector' organisations.*
Originality/Value: *It has become increasingly clear that structured finance arrangements, have the ability to influence the ethos, focus and legitimacy of 'Third Sector' organisations. Analysis of issues to consider, when implementing risk governance strategy regarding structured finance agreements has become critical.*

Keywords: *Risk governance, structured finance, 'Third Sector' organisations, social enterprises.*

JEL classification: *F35; G18; G32; G38; I23; I25; O3; O19.*

Paper type: *Review article.*

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1. Introduction

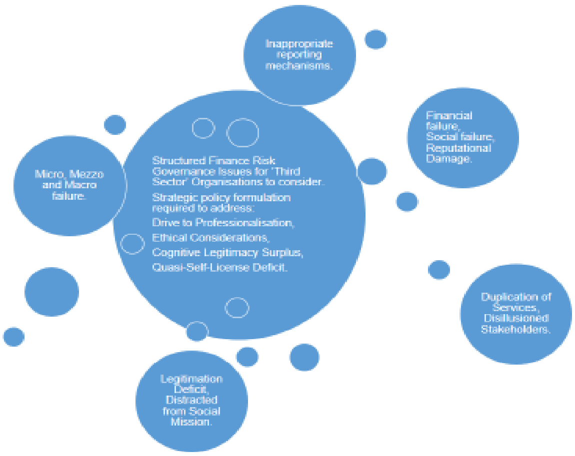
There is a relative paucity of literature on studies investigating, does the influence of '…if and how performance and compliance objectives become constitutive of managerial logics in use' (Giddens, 1976), affect large more corporate 'Third Sector' organisations differently, compared with small grassroots enterprises, as regards risk governance. The risk finance governance community would benefit from an inquiry asking: What aspects of risk governance have the greatest affect upon 'Third Sector' organisations, considering entering into structured finance arrangements. There is literature critically appraising 'Third Sector' funding initiatives, e.g., Phillips and Hebb, (2010), 'Financing the Third Sector'. However, the dichotomy of structured finance arrangements and their interaction with the analysis of risk governance, remains distinctly under-theorised regarding their relationship with 'Third Sector' organisations.

The manner in which a 'Third Sector' organisation is financed, has a significant effect upon how that enterprise delivers its products and services; '…the way social enterprise are financed is a critical issue which reflects both quite distinct socio-economic contexts and the very conceptions of social enterprise embedded in such contexts,…' (Defourny and Nyssens, 2010a). This demonstrates that structured finance arrangements, amongst others, can change the very nature of how a 'Third Sector' organisation operates, influencing for example which social missions an enterprise chooses to address (Scottish Council for Voluntary Organisations, 2020). Social enterprises have a number of particular features, one of which is the perception of questionable financial stability. "Social enterprises are generally viewed as organisations characterised by a significant level of economic risk" (Defourny and Nyssens, 2010a). Given the social purpose of 'Third Sector' organisations, there must be a mechanism which can mitigate financial risk if an organisation fails. Put simply, structured finance can be defined as a financial instrument which can be tailor made to suit the funding needs various enterprises. These are institutions where more mainstream funding wouldn't be appropriate (European Commission-Organisation for Economic Co-operation and Development, 2017). Social enterprises have a level of corporate social responsibility, a requirement to indemnify third party creditors if adverse events occur. Structured finance acts as a social glue delivering the indemnity and responsibility required, enabling communities to recover if a 'Third Sector' organisation collapses (Community Foundation, 2020).

This paper borrows heavily from Nicholls' (2010) 'Institutionalizing social entrepreneurship in regulatory space' study. Nicholls (2010) indicates two research avenues by which structured finance arrangements and risk governance within 'Third Sector' organisations can be investigated. There will be discussion on the controlling aspects of accounting as a governance practice, which act to reinforce hegemonic forces. There will be analysis of governance processes implemented by societal stakeholders, who have coalesced around a normative if not paradigmatic position. Discussion along these avenues, help to signpost how current disclosure and reporting mechanisms have developed. Current audit practices, employed by 'Third Sector' organisations have been legitimised, becoming convention and accepted practice. Conceptualisation of how power structures and institutional behaviour, influence interactions between structured finance arrangements and risk governance policy formulation will be articulated (Milbourne and Cushman, 2013).

The paper draw upon aspects of Nicholls' (2009) 'Blended Values Accounting' work, to provide a theoretical underpinning for the research. Nicholls' (2009) study acts to contextualise the practical and social implications of structured finance arrangements and risk governance considerations. Policy recommendations included, are designed to enable 'Third Sector' organisations to operationalise effective risk governance. Fig 1 is a graphical abstract, a roadmap, included to visualise the issues discussed and where they fit in the risk governance conceptual landscape.

Fig 1 - Structured Finance: Risk Governance Issues for 'Third Sector' Organisations Roadmap



2. Competing Definitions of Risk Governance

There is an early complication in this conceptual discussion, there are numerous definitions of risk governance. Benn *et al.'s* (2009) definition of governance is broad and contemporary, with a focus upon '…where public-private interaction enables sustaining coordination and coherence between a wide variety of actors' (Pierre 2000 cited in Benn *et al.*, 2009). 'Sustaining coordination' introduces the concept of economic and social risk. Enterprise risk management (ERM) is a similar related risk governance definition. Tekathen and Dechow (2013) inform the reader that "COSO defines ERM as set of activities that lead to organizational alignment and accountability, given structured work with stable, mobile and combinable information objects." COSO is a quintet of US based professional associations, which focus upon three interrelated themes: 'ERM, internal control and fraud deterrence' (ibid: 101). Discussion on ERM is included as it has a generic function, helping to signpost some of the key concepts in formulating risk governance strategy. Literature analysis suggests that Nicholls (2009; 2010) would argue the COSO definition of ERM is too simplistic. Nicholls' (2009; 2010) critique would probably be COSO has a one-dimensional definition of accountability, alongside a limiting benchmarking ethos. Similarly, literature analysis indicates that Defourny and Nyssens, (2010a) would also be critical of ERM for a different reason. Defourny and Nyssens, (2010a) argue ERM is flawed as it's designed to integrate and align strategic corporate objectives, an approach imbued with neoliberalism. "Neoliberalism is a political economic concept, a set of ideas, or even a framework used to describe the commodification of all sectors of society" (Cahill *et al.*, 2012). There are numerous other modern definitions of neoliberalism. The above serves to contextualise some of the themes conceptualised in risk governance in this discussion (Bach-Mortensen and Montgomery, 2018).

3. Competing Definitions of Social Enterprises

Aka 'Third Sector' organisations

The definition of a social enterprise is also complex as it differs significantly from one country to another. In the UK in 2002, the Department of Trade and Industry (DTI) defined a social enterprise as: "a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners" (DTI, 2002, cited in Defourny and Nyssens, 2010a).

Other 'Third Sector' observers view social enterprises as a special category of NGO, saying '…social enterprises are not-for-profit organisations driven by social mission' (Sullivan Mort *et al.*, 2003, cited in Sakarya *et al.*, 2012). The US definition of a social enterprise is an organisation that trades for a social purpose. This is a market driven neoliberal approach, complete with an 'earned income' concept of social enterprise. In this sense the US definition is very similar to German or UK approach, countries who view social enterprises as a business first and foremost. That said, it is also recognised that currently, businesses are expected to deliver economic and non-economic fringe benefits to their shareholders. Businesses gain legitimacy by being seen to sponsor various good causes or events, perceived as solving a social problem of mutual concern. Such enterprises are valued by various constituencies, some of who have financial interest in the business concerned (Smith 2007, cited in Sakarya *et al.*, 2012). Most European definitions of social enterprise have different degrees of emphasis on the common theme, of social enterprise being about outcomes e.g. 'social, environmental or financial that add considerable value to their community'. This approach is sometimes referred to as 'blended value' (Phillip and Hebb, 2010; Nicholls, 2009). The central initiative should be focussed upon addressing social and societal challenges, such as disadvantaged groups being unable to access stable employment (Defourny and Nyssens, 2010a; EC SBI Report 2019).[2]

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[2]*This report is dated October 2018. The European Commission inform us, updates have been added since first publication of the SBI final report. This version was published on 14 August 2019.*

4. Third Sector Organisations Governance of Risk: Themes, Criteria and Dimensions

Defourny (2001) informs the risk finance and governance community, that 'Third Sector' initiatives have four common themes which demonstrate their economic and entrepreneurial dimensions. These four criteria are: a continuous activity producing goods and/or selling services; a high degree of autonomy; a significant level of economic risk; a minimum amount of paid work (Defourny, 2001, cited in Defourny and Nyssens, 2010). Research needs to investigate, to what extent and in what ways do each of these economic and entrepreneurial dimensions, influence risk governance assessment. Research needs to expand further into the feasibility of structured finance for 'Third Sector' organisations, in relation to the risk governance issues to consider. The research needs to identify which aspects make a proposed structured finance arrangement being considered feasible. For example not overlapping with a nearby institution, in socio, political or economic terms. Such research would provide the voluntary community with a direction finder, a decision making tool by which to assess a structure finance proposal. The research would assist the reader to locate risk governance, relative to the entrepreneurial, economic and social dimensions of 'Third Sector' organisations (IRGC: Oberle *et al.*, 2019).

Defourny (2001) also informs that to encapsulate the social dimensions of 'Third Sector' initiatives, five criteria for social enterprise have been proposed. These are: an explicit aim to benefit the community; an initiative launched by a group of citizens; a decision-making power not based on capital ownership; a participatory nature, which involves various parties affected by the activity; a limited profit distribution (Defourny, 2001, cited in Defourny and Nyssens, 2010a). Defourny's (2001) work is supported by numerous other studies, which have commented on how the perception of good governance is increased, by aligning the expectations of very different stakeholders. The tools and processes researchers have observed being used towards managing well-functioning stakeholder relationships, have in part employed facets of Defourny's five criteria of social enterprise (Azbug and Galaskiewicz, 2001; Balser and McCluskey, 2005; Brown, 2005; Herman and Renz, 2008; Hsieh, 2010; Kilby 2006; Ospina *et al.*, 2002; Studer and von Sturneibein 2012, cited in Wellens and Jegers, 2014). The voluntary community needs to know, the nature in which each of these social dimensions affect the risk governance of 'Third Sector' organisations. The Defourny (2001) and Wellens and Jegers' (2014) studies are underpinned by the 'communicative action' approach (Habermas, 1984). Here, social actors, discuss social challenges collaboratively, reaching a common understanding and consensus as to how and which societal problem should be addressed. Key to such discussions, would be issues which belong in the economic, entrepreneurial and social dimensions of 'Third Sector' activity (Smith and Neal, CNPR 2019, 3 September 2019).[3]

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[3]*Smith and Neal presented this paper at the Charities, Nonprofits and Ngos: (Re)building and Legitimacy (CNPR) 2019 Conference, at the Queen's University, Belfast, 3 and 4 September 2019.*

Research has tended to focus upon the relationship between corporate governance, economic risk and reward. This approach comes from the neoliberal tradition, being hierarchical in approach, with an emphasis upon growth and investment return. Here 'Third Sector' organisations are viewed as a business. Risk governance also needs to consider the wellbeing of the organisation, how it interacts with the people in the area where it serves. "For success and survival, in shaping its strategies, a business enterprise has to take into consideration its interactions with the non-market component of its environment, comprising of public, government, stakeholders, media and public institutions" (Baron 1995; Baron 2010; Hemphill 2005, cited in Sakarya *et al.*, 2012).

There needs to be research to investigate, should risk governance focus upon the economic risk in an organisation; or should other factors be considered e.g., transparency, or closeness of fit with societal objectives (Blaser and Carmin, 2009; Christensen and Ebrahim, 2006, cited in Wellens and Jegers, 2014; De Cooman *et al.*, 2011; Moynihan and Pandey, 2007). The arrival of the COVID-19 global pandemic, brought issues of flexibility and fitting in with societal needs into sharp focus. Many 'Third Sector' organisations globally changed their normal service, e.g. usually supporting people with no access to affordable childcare, to food bank delivery. Similarly local mutual aid groups have seen a significant upturn globally in their membership and activity, due to the Coronavirus crisis (Local Government Association, 2 June 2020; Mutual Aid Networks, 24 March 2020; World Economic Forum Civil Society, 29 May 2020).

5. Practical Implications of Third Sector Organisation Risk Governance

LaBelle (2012) reaffirms an earlier part of this discussion that risk governance has more than one definition. In part this is due to how the relationship of governance operates differently between stakeholders. "The term governance must be broken down to more precisely account for the different activities of institutions and actors" (LaBelle, 2012). The most apt definition of stakeholder can be found in Freeman's (1984) seminal work on stakeholder theory, which defines stakeholders "as any group or individual who can affect or is affected by an organisation's achievements" (Freeman, 1984, cited in Wellens and Jegers, 2014). It is important to realise that different stakeholders have different remits, dependent upon their relationship with the organisation in which they have an interest. As such, '…there is no reason to expect that all stakeholders have identical objectives' (Balser and McCluskey, 2005; cited in Van Puyvelde *et al.*, 2012).

Hawkey *et al.'s* (2013) discussion on urban energy systems, demonstrate how local or municipal authorities are key social actors in structured finance schemes, and for resulting models of risk governance adopted (Hawkey *et al.*, 2013). The types of 'Third Sector' organisations investigated in Hawkey *et al.'s* (2013) study, are typical in illuminating how risk governance operates differently, between small community-based social enterprises and larger 'Third Sector' organisations. This is particularly important when analysing the effectiveness of internal auditing, or other reporting mechanisms as tools to assess risk governance (Ball, 2016; Charity Finance Group, SORP 13 February 2020).[4]

Risk governance can also be said to come in two forms, behaviourally and relationally (Gidron, 2010).[5] The behavioural patterns of an organisation, its fiscal arrangements, its efficiency and growth strategy, form part of an organisation's behaviour. The interaction between an organisation and the institutional ownership relationships in the locality, is another area where how an organisation's behaviour manifests itself has to be taken into consideration. Bulmer *et al.* (2007) give us an indication of the influence of institutional behaviour. "Institutions shape the preference of actors and shape the policy making process and how policy making implementation is carried out." Behaviourally, an organisation's relationship with its shareholders and other local stakeholders, is important in the assessment of risk governance (Claessens and Yurtoglu, 2013). These relationships can be very sensitive at the micro level, especially with small 'Third Sector' organisations such as advice centres for disabled persons, lesbian, gay, bi-sexual, transgender (LGBT) people, substance abusers, or food banks. Often relationships develop as a result of the involvement of stakeholders in the decision-making process, applying a democratic perspective (Comforth, 2003, cited in Gidron, 2010). Here a broad, value-based, lay approach is used, as opposed to an 'expert-dominance' process; during governance discussions on changes in goals, perspectives, or the very ethos and ideology of an organisation (Gidron, 2010). More mainstream auditors recognise the relational aspects of stakeholder involvement in their risk assessments (Kaplan Bank, 2020).

Another issue 'Third Sector' organisations need to consider regarding the suitability of a structured finance arrangement is, would participation in a specific scheme, affect the relationship(s) with another current funder(s) (Eikenberry and Kluver, 2004). Similarly, internal and external stakeholders may no longer be willing to volunteer or to make donations; if the social enterprise they previously supported; has now engaged with a funding stream they do not approve of. For example arms manufacture, pharmaceuticals tested on animals, blood diamonds, products made from ivory, or fracking (Guo, 2006; cited in Gidron, 2010). There is a globalisation facet to this element of structured finance, which influences risk governance of the 'Third Sector'. Some of the external stakeholders and/or funders could be internationally based, in relation to the social enterprise. When considering entering into a new structured finance arrangement, risk governance has to assess the existing political or regional landscape, which might include a military alliance. 'Third Sector' organisations need to have robust risk governance systems in place, to analyse sensitive complex situations. There needs to be careful consideration before deciding whether to proceed with a particular project using structured finance. A proposal that could destabilise effective working relationships, which currently exist inter-regionally, or

[4]*SORP is an acronym for Statement of Recommended Practice.*
[5]*Benjamin Gidron's study was on non-profit organisations (NPO).*

geographically between countries at the mezzo-level (Becker 2001; Sztompka 1994; cited in Sakarya *et al.* 2012; see locally ESRC ILG, Chapman *et al.*, 2018).[6]

In most developed countries the formal task of risk governance, in smaller voluntary 'Third Sector' organisations, will be carried out by internal auditors. Analysis of the role of an internal auditor reveals an entry to the problem constellation. "Current governance regulations are not designed to regulate the activities of internal auditors" (Archambeault *et al.,* 2008; Holt and DeZoort, 2009; Messier 2009; cited in Roussy, 2013). Further investigation informs the reader that the internal auditor's role can be split in two. A protector role, which itself can be subdivided into a keeper of secrets and a protective shield. There is also a helper role, which can be subdivided into a guidance role and an organisational performance role (Roussy, 2013). Melanie Roussy's (2013) study is on the public sector. I argue Roussy's (2013) research, also applies to any 'Third Sector' organisation that is required to conduct internal audits as well (CIPFA: Diana Melville, 17 May 2019; NHS Guidelines, September 2017).[7]

The internal audits as described by Roussy (2013) are reporting practices that are '…consistent with the 'bricolage' evident in social entrepreneurship' attitude to problem-solving more generally' (Nicholls, 2009). A brief discussion on reporting practices has become germane, when analysing the governance of structure finance agreements. Reporting practices act as mechanism to describe any structured finance arrangements a 'Third Sector' organisation has. They double as a panopticon, analysing the existing risk governance strategy, reporting back on potential risks not considered (Association of Chartered Certified Accountants, 8 June 2020). Palmer and Vinten's (1998) study on charity reporting, provides an analysis of approaches that can be adapted to demonstrate how the financial wellbeing of a 'Third Sector' organisation, can be disclosed and audited. Financial reporting can be *'positivist'* (i.e. reporting data represents empirical reality (Whittington, 1986); *'critical theorist'* (i.e. reporting data activates control mechanisms (Chua, 1986; Lukes, 1974; Power and Loughlin, 1986); *'interpretative'* (i.e. reporting data acts as a symbolic mediator or space for discussion between organisational practice and stakeholders (Gambling *et al.*, 1993; Ryan *et al.* 1992, all from Palmer and Vinten's (1998) study, cited in Nicholls, 2009).

Financial reporting or accounting mechanisms being 'a symbolic function' and thus effectively being subject to interpretation, is mentioned by numerous researchers e.g. Hester *et al.* (2009), cited in Wellens and Jegers (2014). It's this theoretical chaos of to some stakeholders valid, and to others contested, interpretations of how the financial standing of a 'Third Sector' organisation can be reported that's problematical.

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[6]*ESRC ILG is an acronym for Economic and Social Research Council Institute for Local Governance.*

[7]*Diana Melville is governance adviser at the Chartered Institute of Public Finance and Accountancy (CIPFA).*

Considering a structured finance arrangement and whether any changes should be made to the organisations current risk governance strategy is challenging. A 'positivist' audit practice could be accepted by some, yet deemed to be misleading by others. 'Critical theorist' auditing increases the propensity for stakeholders to ask, at what level should control mechanisms kick in, should it be a, b, or somewhere in between. An 'interpretative' audit could be accepted, except for those claiming this is creative accounting. Roussy's (2013) and Palmer and Vinten's (1998) studies amongst others, demonstrate how problematical it is in practice, to implement effective risk governance. Analysis of structured finance agreements in 'Third Sector' organisations is quite complex, especially if a 'blended value' accounting approach is preferred (Nicholls, 2009; see also Structured Finance Association, 6 June 2020).

Nicholls (2009) 'Blended Value' accounting study is underscored by many other studies. There are a surfeit of complimentary studies, demonstrating the effects of neoliberalism in the form of inappropriate Government focus on performance management on governance. Alexander, Nank and Stivers (1999) argued the emphasis on outcomes and targets, impeded non-profit organisations (NPOs) from pursuing their social objectives. They also argued that the Government-led impetus to professionalise how a NPO delivered its service, resulted in some clients not being stimulated to participate. This had a negative impact on risk governance of the 'Third Sector' organisation, as stakeholders were not being involved in decision-making and policy-making (Wellens and Jegers, 2014). Guo (2007) raised similar concerns arguing access to government funding is very time-consuming, often resulting in a lowering of grassroots community representation in favour of professionalisation.

This has a debilitating effect upon the monitoring quality of the NPO, as the primary objective of ameliorating a societal challenge has been undermined. Nowland-Foreman (1998) also argue there is a loss of volunteer support when a NPO engages with government funding. Suarez (2011) warns of negative side-effects associated with creeping professionalisation e.g. increased difficulties with risk governance (all cited in Wellens and Jegers, 2014). Nicholls (2009; 2010) and other researchers up to 2011, demonstrate there has been a dislocation between the grassroots and the 'Third Sector' organisations. Ordinary people are less likely to choose to engage, due to a neo-liberalistic motivated drive towards professionalism. Research from Van Puyvelde *et al.* (2012), Sakarya *et al.* (2012), Claessens and Yurtoglu, (2013), and Wellens and Jegers (2014), illustrate the unintended consequences of such impetus. There is an existential threat that onerous or practically irrelevant risk governance scrutiny afforded to structured finance arrangements, could impede voluntary engagement. Overly burdensome scrutiny, the drive towards professionalisation have become constituents of an already burgeoning problem constellation in the 2020s (Edmiston and Nicholls, 2018; Northern Ireland Department of Finance, 7 May 2020).[8]

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[8]*The Northern Ireland reference clearly supports a neoliberal approach to governance and risk, whilst the Edmiston and Nicholls contribution acts as a critique.*

6. Social Implications

There is little emphasis on how poor risk governance can lead to valuable social goods, not being delivered by local voluntary community groups. Social resources no longer being available due to the failure of a 'Third Sector' organisation. Lack of oversight on a structured finance arrangement, could lead to the closure of important amenities. Social resources such as youth, substance misuse or domestic violence hostels, with added support to aid re-housing could fall. Here flawed risk governance has caused organisational failure at the micro level (Becker 2001; Sztompka 1994, cited in Sakarya *et al.*, 2012). In the event of such failure, large voluntary groups could make the operational decision to avoid structured finance arrangements. Such a decision by community enterprises would lead to less social goods being delivered at the national level. This is market failure caused by poor risk governance of large 'Third Sector' organisations. Essentially this is voluntary group organisational failure at the macro and meso level (Wauters, European Commission, 2017).

Inappropriate risk governance of structured finance schemes is paralleled in PFI (Private Finance Initiatives) review discussions. Froud (2003) effectively argued that it's implicit that PFI schemes, which can be described as a structured finance arrangement, increase the likelihood of organisational and/or market failure. The attractiveness of PFI schemes to the private sector, act to undermine the Government's social responsibility of being the service provider and risk bearer of last resort (Froud, 2003, cited in Asenova and Beck, 2010). PFI schemes appear to be set to cost the UK £301billion pounds, with annual repayments averaging at approximately £6billion, peaking in 2017-18 at £10.1billion (Campbell *et al.*, 2012; see also BBC News 18 January 2018). The potential for the social debacle of important amenities brought into being by PFI funding subsequently closing is abundantly clear. The growing reality that many such PFI projects will in all likelihood fail, serves as a warning to 'Third Sector' organisations. Structured finance schemes albeit on a smaller scale than PFI can go awry, if risk governance strategies are not properly formulated.

Kerr (1998, cited in Asenova and Beck, 2010) makes a contribution in the PFI review discussion, which can be seen to have a dual purpose. It also acted as a precursor to Nicholls (2009) 'blended value' work. Kerr (1998) argues that enterprises considering PFI, are forced to go through organisational transformations and appraisal methods which are neoliberal in nature. Kerr (1998) describes how organisations are moulded by the PFI compliance process, along a road of objectification, professionalisation and marketisation to implement service delivery. Kerr's (1998) critique, has profound accountability policy implications to this day in the 2020s. PFI schemes foster neoliberalism, market-based approaches, with the potential to erode socially conscious labour practices that exist in the public sector. "This in turn can lead to a situation where public expectations of fairness and social justice are no longer met" (Kerr, 1998, cited in Asenova and Beck 2010). We can see that Kerr's argument has come to pass. Kerr (1998) is echoed not just by Nicholls (2009; 2010), but more recently, by Claessen and Nyssens (2013), Sakarya *et al.* (2012), Van Puyvelde *et al.* (2012)

and Wellens and Jegers (2014). It can be argued that O' Hara (2018) provides the most critically reflective critique of PFI. What is perhaps most surprising, is that worrying aspects of PFI are presented from research commissioned by the Tony Blair Institute for Global Change. Tony Blair was the UK Prime Minister from 1997 to 2007.

There are ethical considerations. The source of a structured finance scheme might offend some voluntary group's stakeholders e.g. arms manufacturers, blood diamonds or fracking (VolResource, 2019). An inappropriate choice of structured finance agreement, might encourage a boycott of a 'Third Sector' organisation's products or services. "From an institutional perspective, legitimacy is a vital resource for a firm and can be obtained by abiding with the normative, coercive and cognitive pressures emerging from the institutional environment" (DiMaggio and Powell, 1983; Palmer and Biggart, 2002; Strang and Sine, 2002, cited in Sakarya *et al.*, 2012).

7. Quality Control: Trust Indicators in 'Third Sector' Risk Governance

The problem constellation brought to our attention by Palmer and Vinten's (1998) charities study, can be partly offset by 'systems trust' (Giddens, 1990; cited in Nicholls, 2009). 'System trust' is where certain approaches become recognised practice, as alluded to in Roussy's (2013) study on internal auditors in the public sector. Here 'systems trust' provides a proxy for personalised interactions, this could be between internal or external stakeholders. Similarly the recognised practice could be assimilated by service users, the wider public, and/or other social purpose organisations (Power, 2007; cited in Nicholls, 2009). As discussed earlier, auditors Kaplan Financial Knowledge Bank (2020), consider personal interactions between stakeholders during risk assessments. 'Systems trust' also helps underscore Gidron's (2010) description of relational aspects of risk governance.

Third Sector organisations are given trust for a number of reasons. Principally due to their stated purposes identified in social mission statements and organisational form, observers can see a non-for-profit approach. In this context, enterprises activities '…have traditionally acted as risk mitigation proxies for the efficiency and effectiveness of management and operations…' (Edwards and Hulme, 1995; Edwards and Hulme, 1996; cited in Nicholls 2009). Organisations with a non-distributive requirement are also given trust, such enterprises have less of a need for reporting practices such as internal audits (DiMaggio and Anheier, 1990; cited in Nicholls, 2009). Trust is also given to voluntary groups, especially those awarded charitable status. 'Third Sector' organisations credentialised by charitable status, now have a certain level of trust conferred by assimilated proxy. Charitable voluntary groups due to risk governance compliance procedures, now convey they are acting responsibly in their financial affairs (The Governance Group webinars Parts 1 and 2, 13-14 May 2020).

Some 'Third Sector' organisations are NGOs, who are given trust in the form of being '…granted a societal mandate to represent the public interest on specific issues by virtue of their stated independence' (Nicholls, 2009). Trust given in this manner for these reasons, is described as 'cognitive legitimacy surplus' (Jepson, 2005; Lister, 2003; Nicholls, 2008; Schumann, 1995; cited in Nicholls, 2009). Cognitive legitimacy surplus, which essentially is a tacitly agreed convention for many 'Third Sector' organisations, operates on multiple levels. It could act to influence an organisation decisions regarding funding sources proposed in a structured finance arrangement.

Cognitive legitimacy surplus decision making can also extend to consideration of the type of scrutiny a 'Third Sector' organisation undertakes. For example an area wide decision could be agreed, that all qualifying voluntary organisations should not be subject to a positivist critical audit. This enables the risk governance strategy formulated for an organisation to be less incisive, if present at all. Cognitive legitimacy surplus has had two main effects upon 'Third Sector' organisations, one it reduces public accountability (Jacobs, 2006; Jepson, 2005; cited in Nicholls, 2009). The other effect is it motivates a lack of scrutiny. There has been reduced incentive for 'Third Sector' organisations to become more efficient with future operational improvements, or be strategically innovative (Egholm *et al.*, 2020; Nicholls, 2009; see also The National Council for Voluntary Organisations, UK Civil Society Almanac 2019).

Potentially, cognitive legitimacy surplus, could be an addition to the problem constellation, acting to undermine the work of 'Third Sector' organisations. Due to a perceived lack of candour and transparency, lenders or auditors risk assessments could become less favourable. In turn this '…could, ultimately, have serious negative resource implications' (Jepson, 2005; cited in Nicholls, 2009). The potential for cognitive legitimacy surplus to be very damaging to 'Third Sector' organisations, demonstrates the importance of robust risk governance. The requirement for critical scrutiny which is fit for purpose of voluntary groups becomes particularly acute, especially if structured finance arrangements are involved. The discussion has also revealed that whatever reporting practices are adopted, they need to fully disclose how societal challenges are being met, and accurately represent the financial health of the 'Third Sector' organisation in focus.

The normative logic contained in some of the social policy drivers behind the UK legislation of CIC34 (Community Interest Company 34) reporting requirements are supported. The social policy drivers include '…good governance, sound fiscal policies and a transparency of *operation'* (CIC Regulator 2006; cited in Nicholls, 2010). The discourse used by CIC Regulators then and in the 2020s now, is evidence of wider normative power structures. By definition the discourse is paradigmatic in nature. That is not necessarily a negative outcome, if it helps 'Third Sector' organisations to access sufficient funds to deliver societal needs (Figueiredo, 2019, Good Governance Institute Blog; GOV.UK, Office of the Regulator of Community Interest Companies, 2 June 2020b; Pantzerhielm *et al.*, 2020).

There is a critique that some reporting practices contribute towards inappropriately legitimising the logics of social enterprise (Dart, 2004; cited in Nicholls, 2009). This results in bad practice which is a form of poor risk governance. The societal benefit of CIC34 reporting, is that cognitive, normative and pragmatic legitimacy is delivered. Underpinned by the necessity to include the social remit of the 'Third Sector' organisations activity (Nicholls, 2010). CIC34 reporting also places a statutory duty on UK based 'Third Sector' organisations, to consult with stakeholders (BIS, 2013; GOV.UK, CIC34 company report example, 2 June 2020a).[9] Yes hegemonic and paradigmatic forces are at play, and are being reinforced by the operational mechanics of CIC34 reporting.

However earlier discussion has revealed what could potentially happen to a social enterprise if there is insufficient oversight. The unintended consequences of disclosure and auditing being absent, could produce cognitive legitimacy surplus potentially resulting in market failure. 'Third Sector' organisations and the wider society benefit, from being afforded the protection delivered by CIC34 reporting, irrespective of the neo-liberalistic discourse. The importance of 'Blended Value Accounting', a variant model of which is used in CIC34 reporting, can't be understated (Nicholls, 2010). This is especially apparent when structured finance arrangements and the policy formulation of risk governance strategy are being considered (Third Sector Interview: Stephen Hale, CEO Refugee Action, 2 April 2020).

8. Conclusion

In practice, small 'Third Sector' organisations, due to insufficient turnover, do not have to report their economic performance. Essentially many voluntary and community groups self-report. A number use an amalgamation of the 'signification' and 'legitimisation' dimensions of structuration (Giddens 1984; Giddens 1991).[10] Still others use a social constructivist (Gergen, 2002) 'systems trust' relationship approach to demonstrate compliance with common shared values. By recognition from their peers, many community-based enterprises are given what can be classed as a quasi-self-audit licence. This quasi-self-audit licence, is conferred by other stakeholders which helps to underpin the legitimacy of the enterprise in receipt. Peer approval helps reinforce both the receiver and the giver, of their status of being one of the many types of 'Third Sector' organisation (Phillips and Hebb, 2010). The quasi-self-licence I have described, is similar to the 'SLO' (social licence to operate), acquired from local communities by mineral developers in Canada (Prno and Slocombe, 2012). However my quasi-self-license operates at a much smaller scale, at the grassroots level. The quasi-self-licence is a logical extension of legitimacy theory, where an enterprise must have legitimacy in the form of a social *"licence to operate"* (Deegan, 2002; cited in

[9]CIC34 report example is dated 9 March 2009, the GOV.UK website page was updated 2 June 2020.
[10]Giddens explains structuration theory, in a book chapter volume edited by Bryant and Jary (1991).

Hahn and Kuhnen, 2013). The process by which 'Third Sector' organisations receive a quasi-self-licence can also be seen through the lens of neo-institutionalist theory (DiMaggio and Powell, 1991; Contrafatto, 2009; cited in Contrafatto, 2011). Prno and Slocombe's (2012) 'SLO' study and Giddens (1984) 'communicative action' theory provide further support. They help to conceptualise how there has been a paradigm shift in factors to be assessed in risk governance policy formation. There is widespread recognition that the needs of non-state actors in 'Third Sector' organisations must be prioritised, if societal challenges are to be met (The King's Fund: Wenzel and Robertson, NHS Commissioning 19 September 2019).

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