Lessons of Mondragon's Employee-Owned Network

Karen Thomas

Last November I joined a group of 15 people from the US and Canada for a one-week study visit of an employee-owned business network in the Basque region of northern Spain. The Mondragon Cooperative Corporation, or the MCC, is named after the town of Mondragon where many of the 100-plus firms in the network are located. The MCC has developed the concept of employee ownership as a regional economic development strategy much more broadly than has been realized yet in the US. In addition to owning their employing firms, MCC employee-members own a group of associated cooperatives including a bank, three research institutes, a university, a corporate training center, and various entities for strategic planning, auditing, job retention, and management of their profit-pooling funds.

Growing from one small employee-owned business in 1956, today the complex includes firms engaged in automotive components, domestic appliances, machine tools, industrial components, engineering, construction, and retail distribution with a workforce of 42,000 worldwide and over 5 billion euros in annual sales. MCC employment accounts for 14% of the industrial employment in their province, and 6% of the total employment.

Comparable to highly democratic ESOPs, MCC members each hold one member share in the corporation they own, have direct authority for governance of their employing firm on a one-person, one-vote basis, and elect representatives to a Cooperative Congress that has final authority at the corporate level of the MCC on policies governing all the member firms and their associated organizations.

Employment and wealth creation for the community as a whole is their primary corporate mission. They are not successful because of their business drive or their ideas about sharing ownership but because they link both ideas. The Mondragon experience demonstrates that democratically governed businesses are high performance businesses, that capitalism combined with community responsibility creates real prosperity for a region, and that successful economic development is all about grass-roots efforts that involve interlinked, locally based, research, education, and financial partnerships.

Karen Thomas, OEOC, visits MCC headquarters with Jonathon Rosenthal and Rink Dickinson, the founders of Equal Exchange, an employee-owned coffee distributor.

Though Mondragon has served as an inspiration to me and the others in our study group, we were all very skeptical whether the reality would match our ideal vision. We knew that the MCC now invests in plants in low-wage countries, employs increasing numbers of non-members (now 30%), has joint ventures with conventional firms, sells non-voting stock to outside investors, and no longer supports local cooperative start-ups. We knew that the cooperatives have democratic processes for governance but use traditional methods to organize and manage their work. The members I met struggle with the realities that business people face in our global marketplace. Transforming their workplace culture is as important to them as it is for employee-owners in Ohio.

We landed in Bilbao, the region's largest city. Situated on the Atlantic coast, Bilbao reminded me of Cleveland—an industrial city with an aging steel industry and a new tourist-magnet on its waterfront, the Guggenheim Museum. We traveled inland by bus encountering heavy traffic along steep mountain roads and hillsides of grazing sheep next to construction sites for high rise apartments. Fifty years ago when the first cooperative was started here, poverty was widespread in the aftermath of Spain's civil war. A recession in the 1980s and early 1990s and the removal of protective tariffs in Spain resulted in the closing of many local businesses. But a recent upswing in the economy in Spain and the rest of the European Union has brought more jobs and immigration to the region. Unemployment is at 15%; the lowest in 20 years.

In a valley surrounded by mountains lies the old/new town of Mondragon with a population of around 30,000. A bronze dragon overlooks a sprawl of new development along the valley. Remnants of medieval walls encircle a central business district with busy shops and narrow cobblestone streets. Families walk outdoors together to shop and visit in the early evening.

We walked too. On our first visit we climbed upwards from the MCC's engineering school campus, past the headquarters of their jointly-owned insurance company, past one of their research institutes, past a student cooperative that manufactures educational equipment, past a new data processing center, past the headquarters of their bank which is now the 38th largest banking institution in the world, to reach their MCC corporate headquarters, a rather unassuming building.

How Mondragon Works

Mountain bicycle racing is a popular sport in the area, and one of the Mondragon firms makes top-of-the-line racing bicycles. Much like the gears on a bicycle, the member firms in the Mondragon network interlink for leverage to achieve greater heights of business success. A unique and innovative blend of principles, practices, and structures are carefully aligned for their mutual success.

"We balance capitalism and co-operativism," explained Mikel Lezamiz, a staff member at the MCC executive education center. "We think about both the economic and the community benefits in making our decisions."

Cooperative values of democratic decision-making, profit-sharing, and community responsibility are combined with entrepreneurial practices in structuring the business. This strategic philosophy, which is unusual in a corporation the size of the MCC, is due to the influence of Don Jose Maria Arizmendiarrieta, a local priest, who preached Catholic social doctrine and led the then-impoverished citizens of the town to build an engineering school fifty years ago. When five of the first graduates found few job opportunities, this priest helped them borrow money and start a business making oil stoves. When they needed more capital for expansion, he helped them to start a community-supported credit union. The one small business multiplied into other related businesses at a rapid rate during the 1960s. Arizmendiarrieta provided a model for visionary leadership that is both community-minded and entrepreneurially-minded. He recognized the shared values around which community members would collaborate.

Financial Rights and Benefits

The financial benefits of workers' membership within the MCC network, which include job security and profit-sharing, provide reciprocal benefits back to the employing firms. Members' share purchase and profit-sharing are reinvested for continual business growth; employee turnover is minimal.

Financial benefits also accrue directly to the broader community. Cooperative businesses in Spain gain a tax advantage for sharing profits with their members and community. While Spain has a 32.2% corporate tax rate, the tax rate for a cooperative business is only 20% if the coop contributes 10% of profits to philanthropic purposes. By member firms' agreement, the year-end profits of each MCC business is distributed 10% to community projects; 45% to members; and 45% is retained in the firm for business needs.

Members' rights extend beyond job security and annual profit-sharing to include a direct voice in governance within their employing firm. Each member has a vote on major policies of pay, financing, MCC membership, and pooling with other firms. Members have representation in governance and management of their bank, research institutes, the university, and other service organizations.

The MCC has a no-layoff policy and transfers workers based on demand. Cutbacks are achieved through reassignment to other coops or the nonreplacement of retirees.

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Mikel Lezamiz,
MCC Otalora Corporate Training Center

Each worker-member has an internal capital account in the cooperative which holds annual profit-sharing, the 75% recoverable portion of the member share, and accumulated interest earnings. An unrecoverable twenty-five percent of each member's share purchase price is placed in the cooperative's reserve fund. The structure of internal capital accounts, which was Mondragon's innovation, has been widely adopted and codified elsewhere including the State of Ohio's cooperative legislation.

Democratic Governance and Control

All the members of each cooperative meet yearly as a General Assembly, the body with the highest authority in each firm. This assembly elects the board and votes on company-wide policies. Board candidates are nominated 1/3 by open nomination, 1/3 by worker representatives, and 1/3 by top managers. At Mondragon University the board is nominated 1/3 by students, 1/3 by faculty, and 1/3 by collaborating institution. The bank board must have a majority of directors from among the member firms that own the bank but the General Assembly is split 50/50 between bank employees and representatives of member firms. In retail stores, the customers can be members too and must hold the majority of seats on each store council.

Functioning much like unions, "social councils" within each firm have elected representatives who decide on wages, health and safety, work design, technology, and operating policies. But unlike most unions, the social councils in these close-knit communities have historically not challenged management.

Pooling Resources to Build a Cooperative Economic Sector

Synergy, through the sharing of financing, research, and educational resources, are key elements to support the growth of each small business. Firms with related products, customers, and markets pool between 15-40% of their profits for development and new business promotion. Another intercooperative investment pool, funded by each firm's annual contribution of 10% of profits, provides funding for projects which promote job creation, internationalization, profitability, worker involvement, or customer satisfaction. Yet another intercooperative fund pools 20% of annual profits from member firms in a reserve fund which supports troubled firms and protects all firms against insolvency.

With community support in 1959 a community credit union (the Caja Laboral) was formed, which continues to involve thousands of local people, and is now rated among the 100 most efficient financial institutions in the world. In the early years it held the member businesses together in its orbit under a contract of association that standardized the structures for intercooperation. The bank provided patient venture capital for the rapid expansion of many small firms throughout the 1960s and also provided audit and advisory services to enforce sound business practices. Now the bank must meet the regulatory standards of the banking industry in Europe, so it can no longer serve as a friendly financier and technical consultant.

Research and education for the continual application of new technologies and ideas is supported through several institutions owned by member firms. The engineering school is now part of Mondragon University. Each member firm contributes 5% of annual profits into an intercooperative fund which subsidizes collaborative research and education projects.

The old adage that "knowledge is power" is conveyed by the MCC's Otalora Corporate Training Center in a renovated, 14th century, mountain-top fortress. The battlements have been replaced with conference rooms and computer labs. The staff of Otalora, who hosted our visit, offer executive management education through MBA programs and seminars which combine business content with cooperative values.

The MCC cooperatives have created thousands of jobs, anchored capital in the region, and created businesses that specialize in housing development, urban planning, and renovation. Their 10% philanthropic allocation supports hospitals, schools, and Basque culture.

The success of this network of affiliated employee-owned firms is due to the factors described above but also to what might be termed the "hothouse" economy in the region during its formative years. These optimal economic conditions were provided by Spain's protective tariffs and major efforts of Spain's government toward a national economic recovery during the 1950s and 1960s. But the marketplace has changed.

Local Economic Development in a Global Economy

Since the late 1980s many MCC member firms have been in a "compete or close" situation. They directly compete with the world's top corporations to survive. Instead of developing new, local businesses they are trying to strengthen the businesses they already own and expand into broader markets.

Three internal strategies support this outward focus. The network has become a holding company; firms are grouped within product sector divisions; and education for cultural change toward greater teamwork among managers and workers is encouraged.

Inverted Conglomeration

The new legal structure of firms within the MCC corporate structure is called an "inverted conglomerate" because each individual firm retains its legal autonomy. Designed for greater market access, firms merge strategic planning, profit-sharing, and technology investments at division levels. The members of each firm, through their General Assembly, can vote to join or leave the MCC at will.

Unlike most large corporations, authority at the top is limited. The CEO and senior management have influence but the power to make decisions resides within the individual firms. Though senior management must implement corporate-wide strategies they have to continuously negotiate with member firms in order to achieve them.

A 650-member Cooperative Congress, representing each member firm, holds member firms together around common policies. Each of the three divisions has its own Governing Council and together they elect the corporate-level board which appoints the CEO and oversees the MCC.

Strategies for Growth

Individual firms and sub-groups now partner with firms outside the Basque region throughout Spain, Europe, and elsewhere. We learned about this expansion strategy at the neighborhood Eroski Hypermarket, one of the flagship stores of the MCC's Distribution Division. The retail division is the profit leader among MCC firms accounting for 55% of total sales from their 1,000 stores, 500 supermarkets, a distribution franchising partnership with 2,000 corner grocery stores, gas stations, and numerous other retail services throughout Spain. The Eroski group plans to move into France and Portugal and open a total of 500 new stores in the next five years. Today the MCC is the largest Spanish retailer in Spain.

The Eroski retail cooperative was originally developed to sell local consumer goods on a local scale. We saw refrigerators made by Fagor Electrodomesticos lining the aisles in the store's domestic appliance department; another store department sells furniture made by other local member firms.

Eroski's phenomenal expansion is the focus for concerns about whether the cooperatives are failing to maintain a balance of co-operativism and capitalism. The cooperative ideal is to stay small and local. But, the big fish eat the little ones in the European grocery industry.

While purchasing is centralized for the Eroski group, the operations in each Eroski store are decentralized. Customers may join as members of Eroski; and only elected customer-members at each store can preside over the store's council meetings. Members get daily store performance results. Part-time store employees join for a lower member share price and non-member temporary workers earn 25% of the profit-sharing bonus earned by members.

The economic crises have opened members' thinking about what it means to thrive in global markets and what it means to be employee-owned.

No new employee-owned member businesses, large or small, have been started within the Mondragon network since the 1970s. Instead, the businesses in which they have already invested sizable resources over the past fifty years are being strengthened internally and externally.

We visited one of the local Fagor Electrodomesticos plants to learn more about this strategy. Fagor was the largest of all the firms in the network (until the retail expansion), has had the greatest technology investment of all the firms, and has prevailed through the greatest sacrifices of its membership. High hopes have enabled it to grow and survive but times have changed. Highly profitable during Spain's protected economic era, now it faces fierce competition. Consolidation within Europe's appliances sector has left six domestic appliance manufacturers; Fagor is the smallest.

We toured the refrigerator plant, with HR regional director, Jesus Labayen, where 1,000 people work in three shifts. He explained that the older workers in this plant have significantly lower internal capital account balances (on average about one-eighth) than the balances of newer workers. Big losses during the early 1990's recession emptied the older members' accounts. These members took out loans and used their own money to save the firm.

Fagor produces three major brands, and bought the rights to produce White Westinghouse appliances in order to expand into the European marketplace. They have also purchased a plant in Poland. Here in the local plant, long assembly lines have been replaced by short assembly lines manned by multi-skilled work teams. Above the workstations are digital signboards of the production defects and performance measures per shift. This plant delivers on orders in 48 hours.

The economic crises have opened members' thinking about what it means to thrive in global markets and what it means to be employee-owned. People are very aware that total quality depends on their ability to work together. Firms are starting to engage their members in dialogue about ways to transform organization practices through greater cooperation.

Irizar, an assembler of custom tour buses, responded to the crisis by introducing cooperative workplace practices. Irizar was nearly bankrupt in the early 1990s from dwindling demand for its products. A new CEO, who was brought in to reengineer operations, organized meetings with the members and sought their input on the firm's future. The workers decided that they wanted to compete at the highest level of technology for luxury coaches in the European market and agreed to overhaul their entire work process to integrate continuous quality improvement processes with cooperative values. They eliminated supervisors and created five-person self-managed work teams that negotiate with suppliers, plan their work schedule, and take full responsibility for quality. They reduced production time by 50% and now are the #2 luxury coach manufacturer in Europe but #1 in profitability. They export to 35 countries. While most reengineering efforts involve cutting jobs, they have doubled their local workforce.

They also engage in technology transfer, selling the technologies and expertise to build their older model coaches through joint ventures in developing countries where there is a growing market. They have built plants in Morocco, China, and Brazil. We visited the day before their all-employee fiesta to celebrate their plant opening in Mexico to enter the US market.

Are Mondragon's Cooperative Ideas Transferable to Ohio?

The Mondragon approach demonstrates an economic development model based on the support of small business start-ups through the creation of a small business network which essentially serves as a small business incubator. Its effectiveness stems from a number of innovations.

One innovation is employee ownership. Firms avoid the costs associated with providing high returns to outside investors by employee ownership. Employee ownership means that the employees have a stake in the business and reinvest their ownership share and profit-sharing to finance its growth. By itself, employee ownership is often risky, but the risk can be shared broadly among all the employee-investors within all the businesses in the network.

The Mondragon model suggests that the optimal size of an employee-owned firm is small to mid-sized but that the optimal size of an employee-owned business network is large. While most Americans have not been oriented toward forming small business networks, a growing number of U.S. firms are involved in group purchasing cooperatives which achieve economies of scale through pooling resources. The floral industry's FTD cooperative is one example.

Eroski retail hypermarket in Mondragon, Spain, owned by employees and customers. A customer-member must head the store's council and represent the members at regional and annual assemblies for stores within its division.

A credit union or bank, owned jointly by all the member firms, is another innovation. In Mondragon's case it enabled community members to provide patient venture capital for local development and generate reciprocal support for the development of hospitals and schools. We see the opposite dynamic in many U.S. communities where small business development programs rely mainly on federal funds while bank consolidation has made the hometown bank an endangered species.

Local credit unions and community banks can provide financial support for local small businesses through: (1) exploring ways to create community investment pools that are owned and governed by a broad spectrum of community stakeholders; (2) encouraging the creation of patient venture capital investors through tax savings for those making a corresponding philanthropic investment to local community development funds.

The Mondragon retailing system, which integrates producers, employees, and customers as members, business partners, and co-investors, is another innovation. Local businesses can bring more of their stakeholders, including employees, customers, and local suppliers into the business. Businesses which receive local tax abatements and other government assistance could be required to share ownership rewards with the employees and the community.

Investment in community-based, jointly-owned research and education institutions is another innovation which supports startups and existing businesses toward higher performance. Local technical schools could partner for the philanthropic support of local businesses in providing business incubator services for students. Economic development efforts could focus on managerial and employee education.

One last and all-encompassing innovation is the "open business organization." The Mondragon model decouples governance and management within business organizations through (1) broad-based ownership encompassing many stakeholders, and (2) the development of open and independent boards. The MCC's inverted conglomerate formalizes the spirit of employee empowerment. The MCC's flexibility and economic success attest to the virtues of democracy in economic life.▫

Mondragon's web site is http://mondragon.mcc.es

Karen Thomas is coordinator of Ohio's Employee-Owned Network. She visited Mondragon on a study tour sponsored by the Cooperative Charitable Trust.