Business Series

Silent Revolution

Creating and Managing Social Enterprises

First Edition

by Rory Ridley-Duff
First Contact Software Ltd

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Introduction

Acknowledgements

No book can be written without the support and co-operation of many people. This one is no different. The number of people and events that have shaped my thoughts and approach to business are too numerous to mention, but I want to take this opportunity to thank you all.

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The European Social Fund and Leeds University Business School deserve their place among the credits. It was their money and teaching skills that enabled me to make a success of my research project. I received answers to questions that had puzzled me for a decade. Credit must also go to all those who participated in my research, often busy people in great demand who nevertheless gave generously of their time. Their experience helped me map out a new option for social enterprises – I hope some will benefit from it.

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That leaves just my colleagues and family. To Bob Munro and Mike Haywood, I thank you for your support throughout 2001. Your stamina, dedication and professionalism kept me going and convinced me we were doing the right thing. To my wife and

children, I will be forever in your debt for the time you have allowed me to start a new business venture and complete this book. I hope one or the other brings sufficient reward for you to feel the sacrifices were worthwhile.

In the course of this book I present a number of theories used in the teaching of business studies. As I draw directly from my own experience when commenting on their application in the workplace I have occasionally changed the names of people or companies to protect their identity.

Foreword

When studying for my first university degree, a book called "What is History?" by E.H. Carr was recommended to all students on my course. It was a short, thought provoking book that challenged its reader to move beyond the certainties of A-level thinking, to the less certain world of academic opinion. We looked at historical events from a variety of perspectives to improve our understanding of change in societies and the subjective nature of knowledge.

When starting my latest degree, I half-expected a book called "What is a Business?" to be on the initial reading list. Three years on after sitting through hundreds of hours of lectures and dozens of late nights of study, this initial and fundamental question has still not even been asked, let alone answered.

It seems extraordinary that in taking a course in Business Studies, we are not expected to think about the fundamentals of what we are studying. Maybe lecturers on the subject believe the answer is so obvious that the question does not need to be asked. And yet, what is the difference between a business and other types of organisation?

Over the last 15 years, I have been lucky to work with a wide variety of organisations. The *similarity* in the way larger businesses, trade unions and charities run themselves has often struck me. More recently, I have become much more aware of the substantial *differences* between outwardly similar organisations operating in the same markets, sometimes even for the same customers.

What is a business? What is a share? What is a market? What is value? What is management? These are some of questions we will explore. Although this book is aimed at people who wish to develop a practical interest in business, the academic community may wish to ask itself how well it equips students to find practical answers to the above questions.

Just as "What is History?" was more interested in posing questions, so this book aims to ask questions about the nature of business.

So, what larger purpose does this book serve? When I joined ContactSoft Ltd in 1989 I had already formed the view that sustainable economic and social change will only be achieved through changes in business practice. Politicians can help or hinder, activists can argue and agitate, but the heart of any society is how its citizens organise work.

Time in the Labour Party, as a union representative, and debating with members of political groups soon dispelled any idea that political movements were equipped to bring about this change. Indeed, it seemed that change brought about by forces outside the workplace might actually damage the prospects for successful change.

If we examine the historical record, political movements usually arise out of profound social changes that are already taking place. Our first task, therefore, is to effect change, not engage in politics. Our task is to establish a new type of business. It needs to compete successfully with existing businesses so as to become a role model. It needs to deliver substantial benefits to its employees and stakeholders so that they will want to sustain and grow it.

Upon joining ContactSoft Ltd, I read to enlighten myself about co-operative enterprise. My first foray into the world of books eventually led me to Robert Oakshott's *The Case for Co-operatives*. It offered me sufficient evidence that I was not a crackpot for joining one. It also provided enough ammunition for the occasions when I met anyone who thought that I was.

My second foray took place when undertaking a research project at Leeds University Business School. After 10 years of what can only be described as moderate success, the evidence in *The Case for Co-operatives* was in need of re-examination. Searches for a good book on management practice in democratic enterprises came up blank. In fact, as I searched in vain for *any* book written by someone with *actual experience* of running a successful democratic business, it seemed that the only people interested in writing about co-operatives were those with a theoretical or academic interest.

With my head full of questions about why ContactSoft Ltd had not enjoyed more commercial success, I began studying business in the expectation that my interest in democratic business would wane. To satisfy myself that there *are* inherent problems with democratic business forms I continued with my research and narrowed down its focus.

The answers were unanticipated. Not only were there more commercial successes than expected (particularly outside the United Kingdom), but also significant diversity in the business forms adopted. There also appeared to be a consistent link between the forms adopted and the likelihood of success.

Interviews with a representative sample of social enterprises led to more surprises. Cause and effect were not clear. Was the

business form the *cause* of success or an *effect* of the choices made by the people who established them? Organisation, delegation and decision-making were fundamentally different in the more successful businesses. Clearly, management matters.

First Contact Software Ltd is my own contribution to finding a better business solution - to create an enterprise in which commercial and social success can go hand-in-hand. It is *not* a social experiment - but a hardheaded pragmatic choice made as a result of the research combined with considerable reflection on my experiences at ContactSoft Ltd.

Managing an enterprise that actively promotes employee ownership and participation presents challenges that conventional business can ignore. Particular attention must be given to understanding motivation, leadership and group working in order to reconcile members' expectations with the practicalities of participation. We also need information on effective decision-making, leadership and individuality within team-based organisation structures that promote participation and accountability.

And so to this book. The first chapter considers fundamental questions about business, shares, markets and value. Chapter 2 looks at the role of the manager, and what constitutes good management. Chapters 3, 4 and 5 help us to see the business as it is viewed by its individuals, its leaders and its work groups. Chapters 6, 7 and 8 consider issues from an organisational perspective, and look at constitution, organisation design and business development.

Each organisation has to work out its own way of inducting new staff and this book is a key resource for the managers at First Contact Software Ltd. It provides the source material from which we build our management induction programme. Each chapter builds on the previous one to clarify the issues involved in the creation and management of a new social enterprise. It is my aim that, as a result, you will be able to develop practical policies and management systems that work for you.

I have deliberately kept this book short. I hope you read it quickly but that it stays with you for life. If you put this book down with a better appreciation of the challenges and knowledge required to run a business well, then it will have served some purpose. If it causes you to think again about whether conventional business forms maximise the chances of commercial success then it will have found its mark. I hope you – and the businesses you create or improve as a result – will contribute to a silent revolution that will democratise the workplace and bring lasting economic and social benefits.

- *Rory Ridley-Duff, January 2002*

About the Author

Rory Ridley-Duff is a director and Chief Executive of First Contact Software Ltd. Educated in music at London University in the early 1980s, Rory earned income as a student developing software programmes. Upon leaving university, he spent nearly 2 years at Procter & Gamble (HABC) Ltd and was promoted to Data Centre Manager before leaving to become a director of ContactSoft Ltd. A specialist in the design and development of business administration systems, Rory qualified as a Microsoft Certified Professional in 1998, and established First Contact Software Ltd in 2001 after winning a DTI Award for innovation in database design.

Rory spent 12 years at ContactSoft Ltd (a co-operative enterprise), initially as a consultant to Third Sector organisations advising on the use and impact of computer technology. From 1993 onwards, he spent increasing amounts of time designing and developing business systems. He led the development of a database system now used by leading non-profit organisations including the National Council of Voluntary Organisations and the Royal National Institute for Deaf People.

First Contact Software Ltd is not just a pioneer in the field of relational database systems. It is also a pioneer in the development of modern social enterprise – the first technology business to adopt a new equity-based structure and issue Value Added Shares to investors and employees.

Rory lives in Penistone, South Yorkshire, England with his wife Caroline and two children Natasha (aged 8) and Bethany (aged 4). He studies at Leeds University Business school.

Chapter 1 - What is a Business?

The First Rule

Three months after joining ContactSoft Ltd, it struck me that there is only one underlying rule to running a business. You must not take more than you can give back. We obscure this simple idea with many words – jargon like insolvency, bankruptcy, receivership, liquidation is useful to experienced practitioners - but to most people they obscure the simplicity of the *first rule*. When you strip away the jargon, you are left with a fundamental truth that so long as you do not take more than you can give back, then you can carry on trading as long as you like.

In fact, the *first rule* is true of all organisations and people, and is not exclusive to business. No organisation is allowed to take from its suppliers more than it can get back from its customers. No person is allowed to buy more than s/he can afford to pay back.

***Bankrupt* is just another way of saying you have broken the *first rule*.**

You may think this is the wrong way around? Businesses initially buy (give money) before they sell (take money). This is true if you view business through the eyes of the customer. However, our task – initially - is to view the world through the eyes of the business. Businesses take the products of others, add something to them, and then supply them to someone else. The products offered must be more valuable (to the customer) than the ones they bought (from the supplier) otherwise the business will never be able to keep to the *first rule*.

In its early years ContactSoft Ltd attempted to run itself as a non-profit making business – its goal was to provide a range of computer services to the emerging Third Sector in London. It aimed to pay a living wage and balance the books at the end of each year. Its founding members soon learned that it is not easy to run a business on a non-profit basis because fluctuations in income leave you continually at risk of breaking the *first rule*. The *first rule* requires that you must always be able to pay your debts. Operating on a non-profit basis increases the risk of not being able to pay your debts.

It can be argued that all organisations that wish to develop themselves must run on a profit-making basis. Businesses trade. Charities fundraise. Trade unions seek members. Governments

tax. Over the lifetime of the organisation, all must obtain an income that exceeds expenditure if they want to be viable. If any organisation spends more than it receives (over its entire life) then it breaks the *first rule* and will – with the exception of government - be forced to close unless it can quickly find a way to put itself back into surplus.

***Solvent* is a term that describes an organisation that – at any point in time – is able to pay off its debts.**

So the dynamic in all types of organisation that intend to develop and grow is to create a buffer that shields the organisation from income fluctuations so that they can observe the *first rule.* Many people believe that what separates business from other organisations is that they make profits. This is not the case. All organisations *have* to make a profit in order to keep developing themselves. What makes them different – perhaps - is the way they *distribute* profits.

Creditors

You might think that it should be straightforward to run a business on this basis. Surely it is easy to ensure that you do not take more than you give. The difficulty arises from the fact that businesses have to take before they can give. They incur debts before they are in a position to pay them.

All businesses trade. All businesses buy materials and services and use labour in order to create something of value and then sell it. Some businesses borrow in order to buy. Some businesses ask people to invest in order to buy. Some businesses demand money in advance of supplying products and services, in order to buy them.

Anyone who gives anything to an organisation in the expectation that one day they will receive something back becomes a *creditor* of the organisation.

Debtors

Sometimes an organisation will supply something to someone in advance of receiving payment. Sometimes an organisation will invest substantial amounts of money in another organisation in the expectation that they will get back more than they have invested. Both businesses and charitable trusts do this.

Anyone that asks an organisation to supply something on the understanding that they will pay something for it becomes a *debtor* of the organisation.

Trading, Surpluses and Profits

Trading is not unique to business. First Contact Software Ltd helps a wide variety of organisations – including those that call themselves 'non-profit' – to trade more effectively. We do this by

developing software systems that assist with marketing, enquiry management, sales and after-sales service[1]. In terms of the processes involved – delivering quality services and products in a cost-effective way – they all operate like businesses and have the same interest in working efficiently.

Charities may not think of themselves – or be regarded - as profit making, but often their aim is to create a surplus that will fund an increasing number of activities that raise their profile. A higher profile enables them to increase their income from donations and access to public and private sources of funding[2] more easily. This results in growth – both in size and influence.

Also, whenever people give money to buy charity merchandise they typically expect the charity to make a profit; they expect the charity to send them something that costs less to produce than the price demanded. The same is true when people give money to a business. They expect the business to send goods that were produced at a lower cost than the price demanded. They expect the business to take a profit.

What is different, perhaps, is the attitude of the purchaser. When we buy something from a charity, we *want* the organisation to make a profit (in order to channel more money into charitable projects). When we give the money to a business, we are less happy that it takes a profit – in fact a sizable minority resent businesses making profits, even though they also need to fund new projects.

As we stated earlier, all organisations need to create a surplus to fund their development. A business that does not create a surplus cannot employ more people. If it does not make a profit, it does not pay tax. It is in the public interest that businesses make profits so that they can grow and pay tax so that part of their surplus is returned to the community.

Is there a difference between surplus and profit? Yes – surpluses can be spent before they appear as 'profit' in the end of year accounts. If the income of an organisation is ahead of expectations, then additional spending may be authorised *in order to keep profits down* or as a genuine additional investment in the future of the organisation or its staff. Profits are the declared part of the surplus – the part that has not been spent before the end of the trading year.

So, trading with suppliers and customers is not a defining characteristic of business. In fact, the only difference we can generally observe is that consumers often change their attitude to 'profit' depending on who they are buying from. We will return to this question later.

What is a Share?

Every organisation has to answer the question "how will you distribute your income?" Some income may go to employ staff (wages); some income may go to save for the future (reserves);

some income may be used to compensate the people who put their money at risk in order to create or develop the organisation (dividends).

If an organisation is wound up, it must also decide how to distribute its assets. Typically, the assets are distributed among the legal owners. However, the 'owners' in a legal sense may be private individuals, the community (or a selected part of the community) or the state depending on the legal structure of the organisation.

Shares are a popular mechanism used by companies to decide how to represent ownership and share out wealth.

State, Common and Individual Ownership

Typically politicians and the media describe the world in terms of public and private ownership. This is an over-simplified view. Companies can be owned by the state, the community or by individuals. The true test of ownership can be determined by answering the question "*who benefits* if the company is dissolved?" In some cases, the state receives any proceeds from the sale of assets. In other cases, the proceeds must be distributed to other similar organisations. In many cases, the proceeds are distributed to the individuals and organisations who risked money to finance the venture (shareholders).

Many organisations that are classed private are in fact community owned. For example, the Barnsley Business Innovation Centre – one of the largest and most successful business incubators in the country - is run by a company (BBIC Ltd) that was established by Barnsley Metropolitan Council and the Coal Board Trust. Its legal form (a Company Limited by Guarantee) is used by both commercial and non-commercial enterprises. In all cases, when we ask, "who benefits" we find that the assets typically have to be distributed to the community. In this regard, they are more *public* than private. They are (erroneously) classed as private simply because they are not wholly owned by the state.

Are state-owned enterprises 'public'? Frequently, in the running of state institutions, the relationship between the state and its citizens is *not* one that allows citizens access to the institution. Many 'public' bodies are far more secretive that 'private' organisations are allowed to be.

Are privately owned organisations 'private'? Most organisations that are classed as private must publish their rules, financial statements and annual reports. They are frequently open to scrutiny (by the state and their shareholders) in ways that 'public' organisations are not.

An organisation that is commonly owned cannot be sold by its members for personal gain. Common ownership has been used for public sector projects that involve the creation of a company to run a public facility. The theoretical advantage of a commonly

owned company is that the assets it creates are owned by the community and cannot be taken over by corporations or wealthy individuals. Because of this, wealth is spread more widely and equitably. We will examine whether this theoretical advantage works in practice in Chapter 6.

Most businesses are established by individuals who invest their own money (or borrowed money) in a company. Many businesses are small, perhaps owned by only one person or a family. In these cases, questions of ownership are simple and relatively uncontentious. However, when several unrelated people come together to form a business, it is necessary to have a mechanism to determine what share of the company each person owns. For this purpose, the company issues shares.

The concept of buying and selling shares – i.e. the stock market – is widely known and understood. What is far less well understood is the role that shares can play *when a company is created*. On the stock market, shares are simply bought and sold. In contrast, when establishing or expanding a company, shares may be issued for a variety of benefits that help the venture into existence. The division of shares is a matter of choice amongst the members of the business.

In creating First Contact Software Ltd shares were issued for a variety of reasons to both individuals and organisations.

a) in exchange for money invested

b) in exchange for equipment and books

c) in exchange for access to intellectual property

d) in exchange for professional services

e) in exchange for unpaid labour

One company (part of the research presented in Chapter 6) requires each new member of staff to purchase their shares by working for two months without pay. Companies can also swap shares to cement a close working relationship. In effect, each takes a stake in the future of the other, and can only realise that stake by helping the other business succeed.

Shares are a mechanism by which a company exchanges a share of its future wealth for an immediate benefit.

Equity

Shares are sometimes referred to as *equity*. A quick browse through a thesaurus gives us an insight into the meaning of equity:

- Even-handedness
- Fairness
- Justice
- Fair play
- Impartiality

- Justness

While it is tempting to bring forth many instances of people becoming wealthy from a timely investment in a small company, we should never lose sight of equity's essential purpose. It is a tool that allows a company to distribute its wealth fairly in proportion to the contributions made by its stakeholders.

Like all tools, it can be misused and abused. Human beings sometimes misjudge situations and when benefits appear to be disproportionate to contributions, this may simply be a reflection of misjudgements made during the set up of a company. Sometimes shareholdings may have been subject to the bargaining power of each founding member. Lastly, if the founder members of a company give away a significant amount of equity to a particular stakeholder when a company is created, this may look disproportionate in future years (particularly if the company is successful). However, the benefit may simply reflect the value the founding members put on a stakeholders' contribution when the company was formed[3].

In recent years, many leading companies have created all-employee share ownership plans (ESOPs). While there are several reasons for the popularity of these plans, there is a growing consensus that extending the franchise for shares to all employees is good for business.

Employee Ownership

Allowing employees to hold shares in their own company is a relatively recent development (historically speaking). Although some forms were observed in the 19th Century, it is really only since World War II that it has gained popularity. They have established a significant presence in the US where they have a successful track record (commercially speaking). In the UK, most top companies have now introduced All Employee Share Ownership Plans (AESOPs).

Employee ownership should not be confused with common ownership. Outwardly they may appear to be similar. In both types of company, employees hold shares and may have to give them up if they leave. However, when we ask the test question, "who benefits if the company is dissolved?", in an employee-owned firm the employees benefit. In the commonly owned firm they do not. In practice, shares in a commonly owned company confer control, rather than ownership, rights.

What is a Market?

Most people in the western world take markets for granted. Describing a market is not easy. In fact, to get a sense of what markets are, and what they contribute to society, it is helpful to imagine what life would be like without them.

Imagine if:

- you could not freely choose what goods to buy in shops
- you had to join a waiting list whenever you wanted a valuable good (such as an expensive household appliance, a house or a car)
- you had no choice whether to work for others, be self-employed or create a business
- civil servants determined what job you could do and whether you could change jobs

We take for granted the freedom to choose how we spend our income and choose our careers. The former Eastern Bloc gave us an insight into what happens when you try to eliminate the market. People lose the freedom to make choices that affect many aspects of their daily lives.

Markets exist wherever people come together to exchange their products, time, skills and money for mutual benefit.

In a market, a seller offers their skills, time or products in exchange for an income. A buyer offers their income in exchange for the products or skills they want to acquire.

While we talk about living in a market economy, most of us do not think about all shops being markets. In every shop there are goods from different suppliers that compete for our attention. We make our buying decisions based on the information we can obtain about those goods.

Lessons from the Eastern Bloc

One of the enduring memories of the collapse of the Eastern Bloc was the way people in East Germany abandoned the queues and poor quality goods made in their own country for better quality goods that were readily available in West Germany. For many years, people with left-of-centre political ideals held up the Eastern Bloc as an example of alternative economics. However, even in the most advanced Eastern Bloc economies consumer goods were of such poor quality that almost any western consumer goods compared well in terms of value and quality.

While public records suggested that the Eastern Bloc had education, health care and public welfare systems as good (or better) than their western counterparts, the same could not be said of the quality of goods that were manufactured in their factories, or harvested in their fields.

Many commentators blame the devastation of the Eastern European economies on the market. In fact, it would be more accurate to blame it on *the effects of having to adjust to the realities of allowing citizens to choose what goods they want to buy.* Indeed, it is because the market made manufacturers accountable for the quality of their goods that so many could not survive.

Case Study

Markets are often perceived as unfair, but this is a side effect of a system that has an in-built tendency to correct distortions when demand does not meet supply. I am reminded of a conversation with a friend about two schools - one that provides its pupils with a good education and excellent social skills, another that provides a poor education and ignores social skill development.

Without a market, the only way to improve quality is to introduce a system of monitoring which will reveal a poor education service. The monitoring authority will typically report problems to the school so that they can be addressed. Unless the problems are extreme, it is unlikely that the monitoring authority will have any powers to make changes in the way the school is run to improve its service. There is no market dynamic forcing the school to improve so advances depend entirely on the professional integrity of the school's staff.

If the schools operated in a market, parents and pupils will take their custom elsewhere and (over time) there will be a transfer of pupils from the poor school to the good school. The good school will expand to meet demand, and if the poor school does not redress its faults - and *communicate* that it has improved - then it will not be viable.

If we are interested in providing the best education, which model should we follow? Undoubtedly, both approaches have merits and problems. If you ignore the market, you have to set up an expensive mechanism that identifies and addresses faults as they become apparent. If you rely on the market, the faults will manifest themselves only in falling numbers, by which time problems may be so deep-rooted that they are very difficult to rectify.

However, what is the most desirable outcome? That we continue to support a sub-standard school and prop up poor educational establishments? Or that we support excellence and the expansion of schools that provide high quality teaching? Were it not for the fact that closing *any* school causes a raft of social difficulties (unemployment, long journeys, the loss of local facilities etc.) decisions about school closures would be quite straightforward. Herein lie some crucial discussion points regarding the economic benefits of markets.

Over the long term, markets force corrections because when a supplier fails to provide what is wanted, individuals are free to go to another supplier. When a correction takes place, however, the market is not required to make provision for the social upheavals that result. We can see both from the macro economic example (the collapse of the former communist states) and the micro economic example (the closure of a school), that a third party - government - is necessary to help communities cope when the market creates a short-term problem.

Problems with Markets

Markets are far from perfect. A primary problem (illustrated amply by the examples above) is that they react to events so fast that it can be difficult for communities to cope with the changes that result. When the Berlin Wall collapsed, the market for East German goods collapsed also, causing massive unemployment and poverty. When a large factory closes, the knock on effects can take years for a community to recover from. And yet – as we see from the former Eastern Bloc - if you support inefficient and uncompetitive enterprises for a long time, the economic shocks that will eventually result will cause far greater hardship when the correction is made.

Let us briefly consider the bombing of the World Trade Centre in September 2001. This event caused millions of people to change their behaviour overnight. Many companies and tens of thousands of jobs were lost within weeks because the market for many goods and services changed dramatically. In real terms, many people's everyday lives were devastated by an event over which they had no control.

Therein lies the second problem with markets – they focus on the here and now at the expense of the future. In satisfying immediate needs, it can be difficult to plan for contingencies, focus on innovation, undertake long term projects, or projects with high risks.

Companies will be extremely cautious about supporting projects that require long term finance because to do so may result in breaking the *first rule*.

The contrast between France and the UK over funding for the Channel Tunnel is worth mentioning here. In France, where public sector support was much higher, the rail links were completed by the time the tunnel was opened. In the UK, where far greater attempts were made to involve the private sector, the rail links are still not complete even now (nearly 10 years after the tunnel was opened).

Of course, in the longer term we may find that the market driven approach in the UK ensures a much closer match between actual needs and the provision of rail links and terminals - because no finance will be supplied unless demand can be established. Nevertheless, we can foresee a major problem in market driven economies – that the potential benefits of a project are too distant or too risky to undertake and projects of great benefit may be abandoned as a result.

The last major problem with markets also stems from their responsiveness. Suppliers are accountable. The market forces them to supply goods that people want at prices they can afford. Herein lies a problem for suppliers – they can only afford to produce what people can afford to buy. What happens if a section of the population needs something they cannot afford to buy? Too bad – the market cannot satisfy their need because to

do so would involve breaking the *first rule* (they would have to take more value out of the market than they can put back).

As a consequence, for markets to work well, wealth needs to be distributed equitably amongst the population so that the choices made by individual buyers actually incline suppliers to produce goods that can be purchased by everyone. Some variation is fine – goods can vary in quality (and price) substantially and still perform their basic function satisfactorily.

However, if income differentials between individuals or geographical regions grow too large, suppliers will begin to supply those individuals and areas where there is most money. As a result, despite a large amount of money getting spent on particular types of goods and services, the needs of substantial numbers of people will be ignored because it is not possible for suppliers to make goods at prices that can be afforded.

A common (and far from satisfactory) response is for public authorities to purchase on behalf of sections of society who cannot afford goods at market prices. For example, health care is bought by the government on behalf of its population, or public housing is created for people who would otherwise not be able to afford a home.

An uncomfortable truth can be observed – that those who are unable to purchase goods from the market are either unwilling or unable to sell their skills to it. Unpalatable as it may be, the price for not taking an interest in your own (or your child's) education may be isolation from the market in later life. This applies at any stage in our working lives to any person in any profession. A person who is highly skilled at 30 and who then ignores their continuing education may find they have few skills required by the market when they are 45.

While there is an accountability of sorts here, and a dynamic that causes many people to continue their education (and many parents to support and encourage their children), people who cannot take advantage of education opportunities will also not be able to participate effectively in a society based on a market economy.

People who suffer illness, or learning difficulties, or are too distracted by issues of survival in homes that are violent, or short of food – all these may result in a failure to learn sufficient skills needed later in life. Once again, public authorities are needed to pro-actively help develop the skills of citizens, or provide for them, where the market cannot provide solutions.

Conclusions

Do these problems mean that we should not support market economies? Before we comment on this, let us summarise our findings so far:

- Markets promote individual choice

- Markets promote accountability (particularly of suppliers)
- Markets benefit people who learn skills that producers want
- Markets benefit suppliers who make products that people want
- Markets react quickly and cannot make provision for the social consequences of their reactions
- Markets may not encourage production that meets long term needs or provides long term benefits
- Markets are incapable of meeting the needs of people who cannot or will not learn skills that the market requires.

Markets are honest – that is both their greatest asset and their worst problem. Markets are honest in the sense that they are a simple reflection of millions of buying decisions made by ordinary people every day of their lives.

Over the short term, markets can be manipulated. For example, when Toy Story was released, the impression was given that there would be a shortage of available merchandise for the Christmas market. The black market that arose as a result had a knock on effect on retail prices. Later, when goods became available, many people paid a higher price as a result.

Over the long term, however, markets force businesses to make goods that people value and want – if they do not do this, they will break the *first rule* and have to cease trading. Because of the above, a secondary effect is that markets force people to invest in skills that are wanted by producers.

Markets therefore have a positive role in promoting accountability – people who do not learn how to produce what (other) people want cannot thrive in a market economy because their skills will not be in demand. The same is true for businesses: unless they produce what people want, they too will not thrive. In a sense, markets hold up a mirror that shows us what we are really like. We may not like a substantial part of the reflection but it is an honest reflection of the needs and wants of the people buying from that market.

What we can take with us into our later discussions is an understanding that markets have a generally positive role to play in keeping people and organisations producing what is wanted. History has taught us that markets create a dynamic that improves the quality and value of consumer products much more rapidly than economies where the state controls the production process.

Balanced against this, we can see there is an ongoing need for political institutions and intervention to address short-term problems created by corrections in the market. They are needed also to act on behalf of people who are excluded when goods cannot be supplied to people who cannot or will not participate in the market.

What is Value?

Value and cost are not the same thing. Most producers, most of the time, try to persuade you that their goods are worth more than they cost to produce. Producers are trying to maximise the value to themselves of making the sale. Most buyers, most of the time, try to obtain the most valuable goods at the lowest possible price. Buyers are trying to maximise the value to themselves of making the purchase.

The world is full of people who do not appreciate (or deliberately understate) the value of products they buy in order to maximise the value they get from them. The world is also full of suppliers who go to great lengths to persuade you to pay more for something than it cost to produce.

Cost is *objective* and determined by the supplier. Product costs will vary in accordance with the skills of suppliers to make and supply products efficiently. *Value* is subjective and determined by the buyer. Value will vary depending on the buyer's ability to utilise a product efficiently and extract benefit from it.

Let us look at an example. You are considering the purchase of a computer for your business. If you have no experience or do not believe a computer will bring you benefits, it will always appear expensive to you and you will place a low *value* on its purchase. If you can understand or have concrete experience of the benefits a computer can bring, you will consider it inexpensive and place a much higher value on its purchase.

Each time you exercise choice in making a purchase, you deem that product to be more valuable to you than the price you pay for it (otherwise you would not make the purchase). Suppliers – as we mentioned above – spend a lot of time persuading you that their goods are more valuable than the cost of producing them. It is the *buyer* who validates this by agreeing to make the purchase.

Even when you accept that a purchase of a particular type of product will be valuable to you, it is likely that you will still want to maximise the value it brings. In the case of a computer, you will assess the purchase price, system specification, service agreements etc. in order to work out which purchase will enable you to derive the maximum amount of value.

In economics, many theories assume that producers will always try to maximise profit (i.e. price – cost). On the other side, there is a consumer, who wants to maximise value (i.e. perceived value – price).

Why is Value Important?

A good buyer will take an interest in products they wish to purchase in order to maximise the value that can be derived from them. A good supplier will take a keen interest in what buyers

find valuable in order to make goods that they are more likely to buy.

A business that does not attempt to understand what buyers find valuable *or* that does not effectively communicate the value of what it supplies, will perform less well in a market than its competitors.

We should note that both *establishing* and *communicating* value are equally important. If you have a (potentially) valuable product but do not bother to communicate its value, buyers will choose products - maybe less good products - from suppliers that are able to communicate the value of theirs. If you communicate that your product is valuable when in fact it is not, the buyer will return the product and ask for a refund or go elsewhere when purchasing the same goods in the future.

The extent to which we understand value will influence the priority we give to marketing. The more we understand value, the more we appreciate that marketing must be a primary activity within the business.

Value and Price

Price matters. When a supplier drops the price of a product they increase its value to a buyer. When a supplier raises prices, they decrease value to a buyer. Of course, the reverse is also true; when the supplier drops the price of a product they are decreasing the value to themselves (as a seller) and vice versa.

Some years ago, a major bank produced advice documents about starting and expanding businesses. It cautioned against dropping prices to make up a shortfall of income. A supplier needs to assess if the increased value to the buyer is greater than their potential increased loss. This is rarely the case and frequently suppliers make the situation worse by dropping their prices.

If, however, there is a nett gain from each unit sale, it is quite possible that increases in demand due to lowering the price may more than offset the drop in value to the supplier. More than one entrepreneur has created a new market and earned their fortune by introducing an established product at a significantly lower unit price.[4]

Summary

Let us briefly return to the question we asked at the outset of the chapter – "What is a business?"

We have already discussed the fact that any growing organisation will produce a surplus. Are businesses different because of the way they distribute surpluses? Perhaps. Businesses can distribute their surpluses in a wider variety of ways than charities and governments. Charities must now put their surpluses back into developing the organisation and account to donors how their

contributions have been spent. Local government is subject to a claw back system if it does not spend monies allocated to it, as are many agencies funded by public bodies.

There is still more scope within private business for surpluses to be taken out of the organisation for personal benefit. This, at least in part, is deliberate in order to encourage people to create new businesses (still a highly risky undertaking). Companies are given considerable freedom in determining how to distribute their surpluses. If decisions are perceived as unfair or self-serving, then they will be justly criticised.

Part of our agenda in the construction of a social enterprise is to bring a new level of accountability to the distribution of surpluses. We should not deny investors a fair share of the surplus as we recognise their important role in financing new projects. Neither should we deny directors, managers or staff fair remuneration for their contribution, particularly when it is their work that creates the surplus.

What we will need is a system whereby rewards are seen to be equitable and in proportion to each stakeholder's contribution. We will consider the mechanisms for this in the later stages of the book.

So, we have had a brief tour of a number of key concepts. Perhaps now we can begin to establish core business values that will guide us through the creation of our new company. We will aim:

- to provide products that people want
- to ask a price that exceeds the cost of production
- to ask a price that people will be prepared to pay
- to understand what buyers find valuable
- to communicate what is valuable in our products
- to maximise the value of our products to buyers (in order to maximise the value of selling them to our business).
- to ensure that surpluses are distributed equitably to all stakeholders

In the next three chapters we begin our look at management, and how to understand the organisation as it is viewed through the eyes of its staff, its leaders and within work teams. After this, we will return to the issue of how to constitute a business in order to maximise surpluses that can be distributed in a responsible and fair way.

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1 'Non-profit' organisations frequently provide a range of information services, and sell publications, training courses and subscriptions.

2 Councils and government departments frequently fund charities to provide services. There are also about 2000 charitable trusts in the UK and many corporate

businesses that actively support the sector. Established charities employ full-time fundraisers and sophisticated computerised fundraising systems.

3 It may be – for example – that without that stakeholders' contribution the company may not have been formed at all.

4 In my own field, Amstrad and Clive Sinclair come to mind.

Chapter 2 – Business Management

Overview

Later in this book, we will consider a body of research that establishes with reasonable certainty that employee-owned organisations have the potential to outperform all other forms of social enterprise. However, recent studies also indicate that employee-owned organisations significantly outperform *conventional* businesses. Before we look at issues in detail, let us review three authoritative sources so that we can proceed with confidence.

Allen (2000) cites data from Capital Strategies in a draft report for Social Enterprise London[1]. He found that between 1992 and 2000 share values in UK employee-owned enterprises increased nearly 4 times more than the market average.

The US National Center for Employee Ownership conducted a review of 12 earlier studies into employee-ownership. They concluded:

"The case is closed with regard to the benefits of employee-ownership and participative management. Results this consistent are very rare indeed. We can say with certainty that when ownership and participative management are combined, substantial gains result."

Conyon and Freeman (of Harvard University/London School of Economics) conducted their own review. They examined the extent to which employee-ownership and profit-sharing results in measurable improvements in productivity and profitability. Their report suggests that improvements can be as large as 20%[2] and that there is, indeed, a consistent positive link between ownership, participation and profitability[3].

As business people, we can now set out our stand about the type of enterprise we should create. It should:

- be Limited by Share (i.e. be equity-based)
- Actively promote employee-ownership
- Promote participative management techniques
- Promote profit-sharing
- Promote accountability to the market

The first two of these are technical matters that will require us to create a business with good business rules. We consider this in Chapter 6. The third and fourth are less dependant on the rules. Instead, they depend almost entirely on developing the abilities of the management team to organise and develop company staff so that they can contribute in a positive way to the organisation.

In the remainder of this book we will develop our knowledge of organisation behaviour and business development so that we can lay the foundations for a successful social enterprise. Thereafter, any success will depend on the extent to which you can apply the knowledge to develop staff that will effectively sell your products in a competitive marketplace.

The material has been selected for its relevance to the management of social enterprises. It is now clear that major mistakes were made in the UK in the 1970s because insufficient attention was paid to social science and business practice when creating model rules. A generation of potential was lost because social enterprises and their leaders tried to put into practice ideas and advice based on false assumptions. In short, the political was given more priority than the practical and this made it substantially harder to achieve commercial success.

The insights you will gain from the remainder of this book may challenge many of your assumptions about motivation, leadership, and decision-making. It is my hope that as a result, you will be able to create better management systems and enterprises that work in practice.

Before we embark on our journey through the labyrinth of the individual, the team and the organisation, let us first consider a crucial question.

What is Management?

Many people – particularly those working in social enterprises - find the idea of 'management' emotive. Let us start by considering what a couple of writers say management is, and what it is for.

Henri Fayol wrote in the early twentieth century that managers perform a number of key functions for the organisation. They plan, organize, command, co-ordinate and control. These have been rationalised over the years and today textbooks used to teach business courses typically identify four key functions:

- **Planning** – defining the organisation's goals and formulating strategy and plans to achieve them.
- **Organising** – deciding what tasks needs to be done, how they are grouped, and ensuring that resources (human, financial and physical) are made available to do them.

- **Leading** – communicating plans effectively, motivating people to achieve them, and resolving conflicts that arise during implementation.
- **Controlling** – ensuring that things go as they should by monitoring actual results against the plan, and ensuring that corrective actions are taken if there is variance from the plan.

"Controlling" is the aspect of running an organisation that – for some people – conjures up images of discipline and the manipulation of staff. However, if we think of it in terms of monitoring, comparing and correcting variances from the plan, then we can see that it is actually a benign role for the organisation that has the potential to create conflict if members frustrate or endanger the fulfilment of the organisation's plans.

Robbins (2000) put it much more succinctly,

"Managers get things done through other people."

- Robbins S, Organization Behaviour (p. 2)

This is the essence of the manager's task – to get the organisation's work done by organising, developing and supporting staff.

In a social enterprise, it is important for managers to perceive their role as a service to the organisation and individuals within it. It is a service to the organisation in that it provides a set of skills that are vital if the organisation is to run itself well and fulfil its purpose. It is also a service to members of staff that provides them with a work environment that enables them to do their job well.

What is Good Management?

To manage well, managers need to know what they are aiming to achieve. Perhaps the single greatest potential for poor management stems from poorly defined or inadequately communicated organisational goals. If managers themselves cannot or do not clearly define organisational goals, the lack of clarity will ripple through the organisation and affect all staff.

Business plans also need to contain opportunities for employees to fulfil their personal goals. One way to assist this is to involve employees in the formulation of business goals so that everyone is aware of how individual interests can be matched to business objectives. If employees do not psychologically buy into the organisation's goals and find ways to enjoy contributing to them, the vacuum will be filled with the pursuit of personal goals that may damage the organisation.

Getting things done through other people requires more than a likeable, persuasive manner. On a technical level, managers must have excellent product knowledge in order to bring the best possible products and services to market. On a human level,

managers need to understand how people work best, what work arrangements are liked by staff and likely to deliver effective and efficient business performance.

It is the human dimension that this book is primarily concerned with. The technical disciplines are learned through experience and direct involvement in creating products. They vary enormously from organisation to organisation, depending on industry sector and job role. The human skills, however, are more transferable. They are also more often ignored when considering the selection of (potential) managers.

Many organisations select candidates for management positions based on their technical skills without regard for their human relationship skills. However, when we consider the management functions above, we begin to realise that successful management requires the application of human skills in the pursuit of technical goals. It is the combination of human/technical skills that influence a person's suitability for a managerial role. If a person lacks technical competence, it is unlikely they will be able to define or organise good technical solutions (regardless of how good their human skills). If they lack human skills, they are unlikely to be able to organise and motivate people to pursue a technical goal (even though it may be an excellent solution).

The topics we have selected for special consideration are:

- **Motivation** – to understand what is important to people and how their workplace provides opportunities or obstacles to the realisation of personal goals

- **Leadership –** to understand what qualities make people effective leaders and followers and how leadership differs from management.

- **Team Working** – to understand how working with other people affects our individuality and decision-making behaviour. We will also consider what skills different people can bring to the work team to make them more effective at solving problems.

- **Organisation Design** – to understand how different choices in organisation design can affect individual and organisation behaviour and affect our ability to achieve business goals.

Each of these are large subjects in themselves, so it has been necessary to select theories and material that go to the heart of current thinking and which are relevant in a discussion of participative management.

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[1] Capital Strategies, www.esop.co.uk/press/2010800.htm

[2] Conyon and Freeman, 2001, *Shared Modes of Compensation and Firm Performance: UK Evidence, p32.* In their results, they report a 22% improvement in company performance for companies that *introduced* all-employee share ownership, compared with only a 5% improvement for companies that *withdrew* schemes.

[3] Ibid, p21, 22, 33. They also cite the Capital Strategies data and compare it with their own analysis of 299 firms (1990-1998). Their analysis shows a 350% increase in share prices for employee-owned firms compared with a 250% for the FTSE overall. They confirm in their conclusions that increased employee-share ownership is accompanied by greater information sharing and consultation.

Chapter 3 - Motivation

Overview

People join organisations for a reason. Their reasons may vary widely from trying to satisfy basic needs (like obtaining an income to pay for housing, food, leisure etc.) to fulfilling life goals such as becoming recognised as an expert in a particular field. Studying motivation theory helps us appreciate how motivations are dynamic and change over time as people move through their working life.

What motivates someone when they join an organisation may no longer motivate them after working in it for two years. The organisation may not have changed, but if we are interested in retaining the services of an individual we need to concern ourselves with maximising the alignment between their personal goals with those of the organisation.

This chapter, and the next, consider how motivation and leadership theories compare to working practice in social enterprises. After looking at popular theories and concepts in each area, we will consider research on co-operatives and draw on real life examples.

What is Motivation?

Buchanan & Hyczynski (1997) define motivation as an "internal psychological process of initiating … goal-directed behaviour"[1]. They discuss three different uses; firstly goal-setting behaviour, where an individual desires a specific outcome; secondly, cognitive processes that individuals use to make decisions; lastly, pro-active processes, where individuals seek to motivate other people.

At the start of this century, it was widely believed that money was the chief motivating factor in the workplace, and that productivity was a function of the workplace environment. A series of studies in the 1920s (called the Hawthorne Studies) was instrumental in changing opinion by revealing that productivity did not always depend on improving the work environment.

A personnel department was investigating environmental factors and productivity (music, lighting, length of work breaks etc). Initially their investigations gave them the results they expected: they changed the working environment and found that productivity improved. However, when they changed the environment back to its former state, they found that productivity

improved again. When they could not explain the results, they involved external researchers in an attempt to improve their understanding.

These studies were among the first to establish that simply by asking people how to improve their workplace, their motivation and productivity can improve.

What do you want from your job?

Imagine you are applying for a new job (internal or external). Below are characteristics that research has shown to be important (in no particular order):

A **Leisure** - short working hours and much free time
B **Salary** - high income
C **Promotion** - chances for advancement or in the organisation
D **Security** - little danger of redundancy
E **Conditions** - pleasant and safe working environment
F **Benefits** - pension scheme, or other workplace benefits
G **Trade Union** - active union, and staff representation
H **Fulfilment** - meaningful work and opportunity for personal development
I **Training** - opportunities for training and education
J **Prestige** - job has high status within the community

Fill in the blank squares in the grid below. In each case, compare which characteristic is more important to you, and write the letter of that characteristic in the grid. For example, in square AB, if Salary (B) is more important than Leisure (A), write B.

In the TOTALS column, write how many times each letter appears in the whole grid, then put a rank against each characteristic.

Job Characteristic	(A) Leisure	(B) Salary	(C) Promotion	(D) Security	(E) Conditions	(F) Benefits	(G) Union	(H) Fulfilment	(I) Training	(J) Prestige	**TOTALS**	**RANK**
(A) Leisure	X											
(B) Salary	X	X										
(C) Promotion	X	X	X									
(D) Security	X	X	X	X								
(E) Conditions	X	X	X	X	X							
(F) Benefits	X	X	X	X	X	X						
(G) Trade Union	X	X	X	X	X	X	X					
(H) Fulfilment	X	X	X	X	X	X	X	X				
(I) Training	X	X	X	X	X	X	X	X	X			
(J) Prestige	X	X	X	X	X	X	X	X	X	X		

Review the results.

What motivates you?

Do you expect the same thing to be as important 5 years from now?

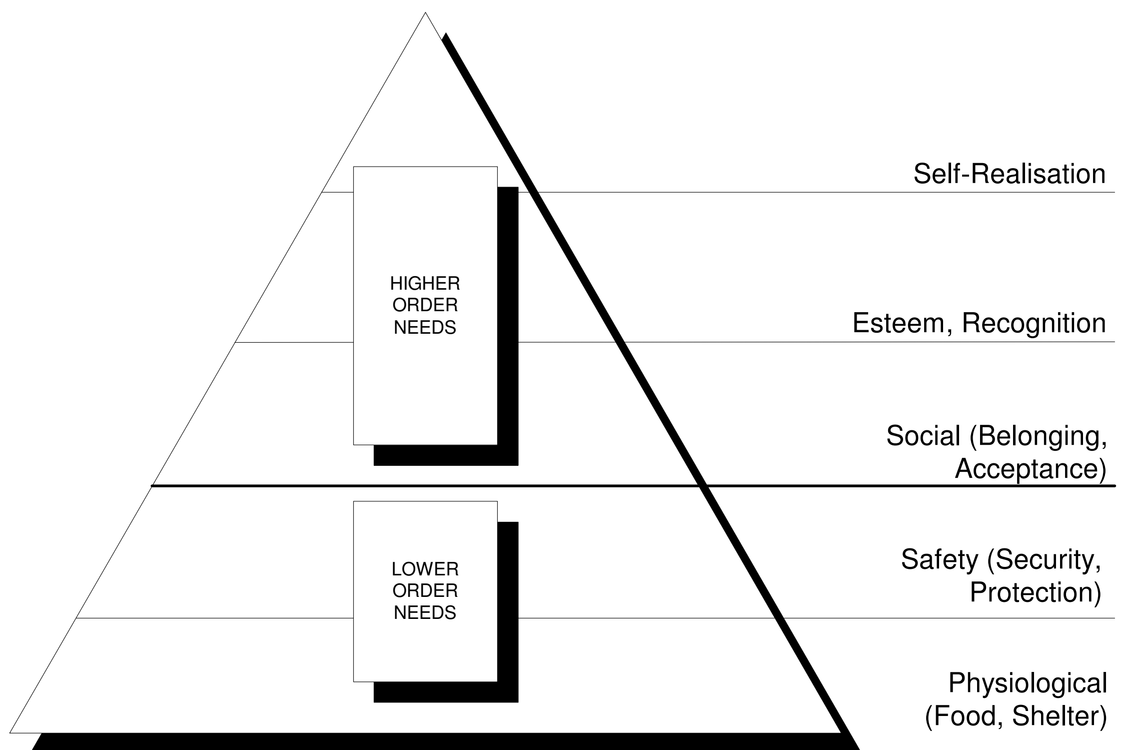
Did the same thing motivate you 5 years ago?

Do you expect your colleagues will be similarly motivated?

When we conducted this survey in our management induction program we found that most people who had been through higher education valued *fulfillment* the highest. Those who had not been through higher education valued *security* the highest. If you repeat this survey in your own organisation you may find similar or dissimilar results. The principle thing we can learn from conducting such surveys is that people are not all motivated by the same thing and that their situation and background will affect what motivates them.

Maslow and Alderfer

Early research defined the difference between biological determinants of human behaviours (drives) from learned social behaviours (motives). In 1943, Maslow published "A Theory of Human Motivation" which proposed a pyramid of needs. In Maslow's theory, a person who satisfies their drives is increasingly motivated by social needs, then personal fulfilment. Maslow's original nine levels were simplified in many texts to five, with a division between primary (lower order) needs, and secondary (higher order) needs.



In Maslow's model, a person who fulfils their physiological needs then moves onto attempting to fulfil their need for safety. They continue satisfying their needs at each level and move up the pyramid.

Alderfer simplified Maslow's model into three categories of need:

- Existence

- Relatedness
- Personal Growth

He also argued that they were not necessarily hierarchical. A person may choose to place more importance on one or other category. When we consider the application of Alderder's comments, it helps us to recognise that a person may be prepared to sacrifice life's basics for the chance to develop their career, or feel fully satisfied having good friendships without feeling the need to climb the corporate ladder.

The theories of Maslow and Alderfer are *content theories* that seek to identify needs that people strive to satisfy. Their value to managers are that they provide a framework within which we can formulate policies that tap into the motivations of people at different stages of their life. People at the start of their working life, particularly those entering the job market, will be more concerned with lower level needs. People who have established themselves in the workplace will be concerned with higher level needs.

Both Maslow and Alderfer have been criticised for the fact that their models are not always validated by empirical research. Herzberg, however built his content theory from a totally evidence-based research method. His findings have had a significant impact on management thinking and policies.

Herzberg

Herzberg studied over 3,500 workplace incidents that led to extreme satisfaction or dissatisfaction. He found that the leading motivators (in order of frequency were):

- Achievement
- Recognition
- Work Content
- Responsibility
- Advancement

He also found that the above factors had much more potential to satisfy than dissatisfy. For example, being recognised for an achievement was cited much more frequently as extremely satisfying than lack of achievement was cited as extremely dissatisfying.

He found that there were aspects of the workplace that were more often cited on the dissatisfaction side of the equation, and which had a limited ability to satisfy. These were (in order of importance):

- Company policy and administration

- Supervision
- Relationships with supervisors
- Work conditions
- Salary

He concluded that satisfaction and dissatisfaction are not opposites. The opposite of satisfaction is *no satisfaction*. The opposite of dissatisfaction is *no dissatisfaction*.

His research cast doubt on the welfare policies that had become popular with personnel departments in the 40s and 50s. It suggested that recognising achievement is the single most important way of motivating people and giving them a sense of well-being.

Recognising Achievement in Social Enterprises

In my experience of working in and with social enterprises, I have found that sometimes they give a low priority to the recognition of achievements. Where collective management predominates, there may even be a social dynamic that denies or deliberately under-recognises achievement in order to limit the influence (or salary) a person can acquire through recognition of their specialist skills and abilities.

If this culture is endemic, and Herzberg is right, these organisations will not be able to retain ambitious and able staff (those most likely to guarantee the long term viability of the enterprise). ContactSoft – which never formally recognised qualifications or achievements in its reward system - lost a succession of highly skilled people in the 1990s who each went on to earn substantial salaries (in some cases, six-figure salaries). The idealised view that no-one is more special, more important or more entitled to respect does not recognise the fundamental reality that people do *not* contribute equally. Certainly, a re-examination of our attitude to equality is necessary if our commitment to it results in the loss of quality staff. Do we support equality of opportunity or equality of outcome?

If we set an organisation goal to achieve equality of outcome, we may never be able to motivate people over the long term. What will be the long-term result if we take away or undermine the sense of well-being that individuals get from recognition of their achievements?

Herzberg's work suggests that managers should be constantly finding ways of helping staff achieve new skills and competencies. It is in their own – as well as their staff's – interest to take a keen interest in personal goals and career development. So long as they can be achieved within the constraints of the business plan, there is every reason to help individuals pursue them.

Recognition may vary from simply remembering to say "well done" to the offer of a pay rise. Whatever the action, the ability to set achievable goals and then remember to thank people when they achieve them is a key management skill

Herzberg's finding on the motivating potential of salary has been corroborated by other studies. When you consider the importance that salary often has in casual office or social conversations about work, its low rating in Herzberg's research as a motivator does not instinctively feel right. However, when you consider that a pay rise is one of the most powerful ways to thank a person for their contribution then perhaps the position of salary in the motivation equation can be better understood. It may be that the *message* ("you did a good job") is more important than the pay rise itself. If this is the case, then graduated pay scales that provide more opportunities for saying "you did a good job" will be important in the construction of a social enterprise.

Criticisms of Content Theories

Content theories have been subject to two main criticisms. Firstly, they do not offer scope to predict behaviour; secondly empirical evidence does not always support the theory. Nevertheless, Alderfer's less strict interpretation is supported by evidence from working at ContactSoft.

In the early-1990s ContactSoft experienced increased competition from new suppliers. Economic pressures made individuals choose between relatedness needs and subsistence needs. Maslow's pyramid, because of the hierarchy, is not as useful as Alderfer's model. In ContactSoft's case, some staff accepted hardships to remain part of the company and fulfil their personal goals (relatedness and growth). Others, particularly those with family, set these aside to prioritise their subsistence needs – or more accurately the subsistence needs of their children. Individuals exercised choice as to which needs were the most important.

Expectancy Theory

In considering their actions, it is helpful to consider the work of Vroom and Lawler. Victor Vroom established *expectancy theory* in 1964[2] in which motivation is understood as a cognitive process. Individuals are motivated if they foresee that they can achieve a desired outcome. Vroom used a formula to express motivation.

(M)otivation = (E)xpectancy x (V)alence.

E is a value between 0 and 1, and V is a value between –1 and 1. Valence is more readily understood as *desire*.

Edward Lawler later modified Vroom's theory to bring out the complexity of decision-making. He argued that workers consider

a range of outcomes, not just one. He modified Vroom's formula to

$$M = \Sigma(E \times V)$$

where motivation is the sum of a range of outcomes, and the person's desire for each of them.

Of course, people do not go around doing calculations in their head to work out if they are motivated to do something or not. And yet, if we consider real situations, the theory can be helpful.

Consider a person who wants a promotion, but does not feel they will get it ($M = 1 \times -1 = -1$)....

.... or a person who does *not* want a promotion, but feels they may be offered it ($M = -1 \times 1 = -1$)....

.... or a person who wants a promotion, and feels they will get it ($M = 1 \times 1 = 1$)....

Vroom and Lawler's work offers an insight into *de*motivation. If we accept their theory then we need to exercise care when putting staff into a position where they cannot meet their personal goals, or perceive no personal benefit from undertaking a particular role.

Hackman and Oldman

Both Vroom and Lawler correctly stress perception as an important factor in motivation and this was developed further in theoretical work by Hackman and Oldman (1974)[3]. They devised a Job Diagnostic Survey to examine the extent to which various jobs give scope for meaningfulness, responsibility and feedback. Their conclusions are embodied in the concept that each job has a *motivating potential score* (MPS).

$$MPS = \frac{\text{skill variety} + \text{task identity} + \text{task significance}}{3} \times \text{autonomy} \times \text{feedback}$$

Hackman and Oldman identified five core job dimensions that they felt contributed to motivation:

- Meaningfulness
- Identity
- Significance
- Autonomy
- Feedback

Like other situational theories, perception is critical. A job may be significant and important, but unless its owner perceives it as such, then the motivating potential of the job will be low. The role of manager as a communicator is therefore important to motivation, so that staff understand the significance of their role within the context of the business's overall plans.

Hackman and Oldman's work raised the profile of job design and team working by promoting jobs that included variety, completeness, and a visible contribution to the goals of the organisation. Its impact can be discerned in Tom Peters' *Thriving on Chaos* (1993), in which he argues against extreme specialisation, and in favour of semi-autonomous teams[4].

Motivation in Social Enterprises

Social enterprises are frequently founded upon the principles of self-management and collective team working. Research evidence on staff motivation in them is, therefore, relevant to the debate about how far autonomy and responsibility can improve motivation and satisfaction.

Oakshott (1990) reviewed co-operatives in a number of European countries and concluded that individual equity played a significant role in motivation, particularly in the Mondragon group of co-operatives[5]. However, the strength of his argument rests largely on the commercial success of the group[6] rather than empirical research.

Rothschild and Allen Whitt (1986) conducted research into satisfaction levels in three American co-operatives. They found high levels of staff satisfaction[7] but their review of other literature revealed a less conclusive picture. Although some writers supported Oakshott's contention that equity results in increased motivation, Hochner (1981) found that workers who perceived their co-operatives as democratic were no more satisfied than those that did not.

Rothschild and Allen Whitt report that 'doing something worthwhile', 'collective ownership' and 'freedom from supervision' were the most satisfying aspects of co-operative working. Maslow's higher order needs feature significantly[8], and there is also support for Oakshott's equity arguments.

All the co-operatives studied showed attributes of Hackman and Oldman's 'core job dimensions'. Workers were satisfied by feelings of "doing something worthwhile" (significance) and "freedom from supervision" (autonomy), "accountability to co-workers" (identity, feedback), "a sense of equality" (identity), "recognition from co-workers" (identity, feedback) and "appreciation from clients" (meaningfulness, feedback).

Cornforth

In the UK, an important study of motivation in co-operatives was conducted by Cornforth et al (1988). Using exchange theory (Homans, 1950; Thibaut and Kelley, 1959, Tynan and Thomas, 1981) he examined the costs and benefits of co-operative working. Instead of trying to measure or compare satisfaction levels, he argues that it is more relevant to examine how motivations change over time.

Cornforth also found evidence of the motivating force of Maslow's higher order factors[9] particularly amongst founder and long serving members. He concludes that co-operative working "satisfies a person's basic self-esteem and identity needs" (p 97). Variety through job rotation and enrichment were also prevalent. Interestingly, he found that even managers appreciated an environment that promoted the sharing of pressures and responsibilities.

However, Cornforth also reports increased stress as a result of financial and business worries, and conflicts between individual and group interests. Rothschild and Allen Whitt report similar findings[10]. Executive stress, it seems, *is* a price linked to ownership, and it affects some sufficiently to cause them to seek employment elsewhere. Responsibility and ownership can *demotivate* as well as motivate. Forcing responsibilities onto people who do not wish to have them can result in alienating them from the workplace.

The impact of stress and the demotivating potential of unwanted responsibility are supported by experience at ContactSoft. One member left the company saying that discussing financial problems at General Meetings had deeply unsettled him. Another declined directorship, and left soon after to pursue a technical career. Over a period of 12 years, whenever there was a downturn in the business's fortunes that led to deferred or reduced wages, it would be accompanied by one or more members leaving when they realised that they could not cope with responsibilities linked to directorship.

Job Rotation/Variety

Cornforth also found that while job rotation helps variety and motivation in low-skilled jobs, skilled workers dislike it. Indeed, his finding that - over time - co-operative workers increasingly disliked job-rotation points towards a need to re-evaluate each worker's job content regularly to find the right balance between variety and specialisation.

Almost all the co-operatives studied by Cornforth that initially practiced job rotation to spread skills and increase job satisfaction found that in the long term the reverse - limiting job rotation and creating opportunities for specialisation - increased efficiency and satisfaction.

ContactSoft's own experience of office administration illustrates how difficult finding the correct balance can be. In the 1980s office reception was rotated amongst all workers. When staff grew progressively less satisfied, a full-time office administrator was appointed. They also grew dissatisfied and turnover of staff in this position remained a problem for many years. Not until a job-share arrangement was introduced with each worker combining reception with another 'whole' job did the company finally manage to satisfy office administration staff[11].

Horizon Clashes and Equity Devaluation

Co-operatives have two specific problems to overcome when it comes to achieving long term motivation that arise out of the business forms they adopt.

Horizon Clashes

Horizon clashes occur during decision-making due to members' different perceptions about how long they will stay with the enterprise. The problems of horizon clashes are most acute in co-operatives that are commonly owned, or in which members must give up their shares upon leaving.

When considering an investment that may take 5 years to deliver full benefits, members who do not expect to stay that long will have an (undeclared) incentive to oppose the investment, while those who intend to stay longer will tend to support it. In a conventional private business – where all parties involved in major investment decisions will probably be shareholders – there is no horizon clash as all parties will benefit from a successful investment whether they stay, leave, work in the enterprise or not. The merits of the investment and individual motives for investment differ in each type of enterprise.

Where an investment involves loans from members or 'sweat equity' (capital reserves built up from deferred wages or underpayment of staff), then there will be resistance from those who believe they will leave before it is possible to re-coup their investment. In these cases, resistance may be strong and appear irrational – it is unlikely staff will admit they are planning to leave during a discussion about long-term investment.

Vanek argued – on the strength of extensive research into co-operatives in Yugoslavia – that horizon clashes result in co-operative members under investing and overpaying themselves. He attributes this directly to business forms that do not allow ex-members to retain a share in the future success of the business.

Equity Devaluation

Major (1996, 2000) argued that where co-operative members are prevented by the organisation’s rules from extracting the true value of their labour, their equity is devalued. The worst problems occur in enterprises that do not issue shares to their staff, or restrict the trading of shares, because members cannot adequately benefit from past decisions, risk-taking and investment. If members cannot hold shares, or the shares do not accrue in value, members cannot benefit from the increasing value of the company they have created.

Where there are rules regarding wage ratios/rates that do not relate to the local market, members cannot benefit from the market value of their own skills. This is another form of equity

devaluation because a personal investment in acquiring skills is not rewarded (unless the member leaves).

There is ample research evidence backed up by my own personal experience to validate the theory of equity devaluation. First Contact Software Ltd (my own company) was created to resolve the equity devaluation problems that occurred in ContactSoft Ltd. A number of staff were willing to invest in the venture, but not until the company was able to issue shares.

In my own research (see Chapter 6) I talked to a number of people with years of commitment to co-operative working that forced a change in their business rules to address equity devaluation problems. In short, they were fed up with the benefits of their past efforts being handed over to those who were just joining the enterprise. They wanted a more equitable reward system.

The actions of these personal contacts are very common within the co-operative sector. When Guy Major conducted a survey of co-operative enterprises in 2000, he found that over 15% of companies listed as co-operatives - obtained from a database of social enterprises - had converted to conventional businesses.

In the context of a discussion on motivation, it helps to recognise that our behaviour now is deeply affected by perceptions of the future. Any member who perceives they are unlikely to benefit from their current actions will become progressively demotivated. Therefore, addressing the equity question is an important question for social enterprises.

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1 Buchanan D & Hyczynski A (1997) Organizational Behaviour, Third Edition: Prentice Hall Europe, p 68

2 Luthans F (1981), Organizational Behaviour, McGraw-Hill International Book Company, p 186-187

3 Buchanan D & Hyczynski A (1997), Organizational Behaviour, Third Edition, Prentice Hall International, p 88

4 Peters T (1991), Thriving on Chaos, Harper Perennial, p 364

5 Oakshott R (1990), The Case for Workers' Co-ops, 2nd Edition, Macmillan, p165-214

6 Between 1960-1976, 62 co-operatives employing over 14,000 people were created in the Mondragon region without a single business failure.

7 Rothschild & Allen Whitt (1986), The cooperative workplace, Cambridge University Press, p 151-157

8 ibid, p 153. Table 6.1 Satisfaction of co-op members.

9 Cornforth et al (1988), Developing Successful Worker Co-operatives, Sage Publications, p 97-103

10 Rothschild & Allen Whitt (1986), The cooperative workplace, Cambridge University Press, p 151

11 ContactSoft eventually employed two staff: one doing 50% reception and bookkeeping, the other 50% reception and office management. There was stability in these positions for over 4 years.

Chapter 4 - Leadership

Overview

"Lead, follow – or get out of the way"

The above quote – the origins of which I cannot track down – is one that I have found useful in understanding leadership problems in the work place. Staff who are unable to lead, and who do not want to follow, often 'get in the way'. An organisation cannot thrive if people make a habit of getting in the way of change. The previous chapter provides us with a body of knowledge we can apply in practical ways to reduce resistance to change.

In this chapter, we consider concepts and research that have shaped current ideas about leadership and we then look at how evident these are in social enterprises. In the next chapter, we will consider how leadership is exercised in groups to provide a framework within which participative management can operate effectively.

Peter Drucker once defined leadership as[1]:

"the lifting of a man's vision to higher sights, the raising of man's performance to a higher standard, the building of a man's personality beyond its normal limitations"

Providing we update the language (to include woman's vision, performance and personality), it is an accurate summary of what managers in the workplace can achieve through good leadership. However, leadership qualities do not come stapled to a job title – many managers are better administrators than they are leaders; many employees are better leaders than their managers[2].

The definition of a leader as visionary, persuasive and motivating is common to all writers on the subject. However, Cornforth (1988) argues that "leadership is not some mysterious personal quality" (p 146) but a set of skills[3] that include the ability to perceive opportunities and threats, conceptualise courses of action, and motivate and mobilise people and resources in pursuit of a solution.

Engineers, administrators, salespeople and many others are also able to perceive opportunities and threats and work out effective solutions. Therefore, a capable manager should recognise the value of allowing others to exercise effective leadership in their specialist role to maximise efficiency and job satisfaction.

Secondly, they should always be on the look out for those who deliberately block the good ideas of others and find ways to help them change or, as a last resort, remove them from the enterprise.

Leader Types

Arnold (1995) discusses early *leader focussed* theories[4]. In the 1950s two American universities (Michigan and Ohio) conducted research into leadership characteristics. Their work gave rise to a distinction between leaders who are task-oriented and relationship-oriented. Task-oriented leaders focus on organising people around the requirements of a job, while relationship-oriented leaders focus on developing the trust, respect and ability of their colleagues and subordinates.

Management Centre Europe surveyed 1000 senior and middle managers about the key characteristics[5] of good leaders and came up with a top five:

- team-building
- listening
- independent decision-making
- knowing how to retain good people
- surrounding one-self with the right top people.

Apart from one cognitive ability (independent decision-making) it is noteworthy that all the remainder are relationship-oriented activities.

Situational Leadership Theories

Fielder (1967, 1974) devised a questionnaire to measure a manager's attitude to his or her least-preferred co-worker (LPC). A high LPC score indicates a relationship-oriented manager, while a low LPC score indicates a task-oriented manager. As he could not draw an accurate correlation between the scores and group performance, he began to look at other factors. His conclusions provided the foundation for *situational* or *contingency* leadership theories that hypothesize that different styles of leader are more effective in different situations. Fielder found that low LPC score leaders were better for groups in very favourable or very unfavourable situations.

If we accept this research evidence, we conclude that there are times when attention to the task in hand is more important to good organisation performance than the people involved in it (when things are going very well or very badly). At other times (when things are going moderately well), attention to people and relationships are more important to good organisation performance.

Fielder's work has been subject to criticism, particularly that the LPC score may be a reflection of the workers selected by his

subjects, rather than the attitude of their managers. Secondly, whereas Fielder concluded from his research that different leaders should be selected for different situations, Vroom and Jago (1988) developed a contingency theory that contradicted Fielder. They concluded that effective leaders change their behaviour from situation to situation and self-consciously use a range of consultative or autocratic behaviours to facilitate decision-making.

Peters, Hartke and Pohlman (1985) on re-examining Fielder's research data, concluded that Fielder's theory was well constructed, and gave it partial support[6]. It therefore remains influential and should provide us with some guidance when considering what type of leader is best for a social enterprise.

Leaders as Facilitators

Some of the most radical changes in management and leadership style have been popularised by Tom Peters (1993). He argues that to hasten the change to self-managing groups, senior managers should take on a completely different role[7]. We will consider his recommendations later when we look at self-management in organisation design, but it is worth noting here that he advocates that managers act as facilitators, rather than supervisors.

Sources of a Leader's Power

Having considered types of leader and the qualities they possess, it is also worth taking into account the sources of a leader's power. French and Raven (1958) pinpoint five sources of power[8]. Three derive from a manager's position (reward, coercive and legitimate power), and two derive from personal skills and qualities (referent and expert power).

Reward Power - power derived from a person's ability to reward another worker (with higher salary, better work etc.)

Coercive - power derived from a person's ability to discipline another worker for poor performance

Legitimate - power derived from the authority implicit in a person's job title and position

Referent - power derived from past achievements, which engender the respect and admiration of others

Expert - power derived from having an in-depth knowledge of a subject, and the ability to articulate and use that expertise.

The exercise of these powers is constrained (or enabled) by the structure of the organisation and its operating policies. In many organisations, managers are only accountable (in a real sense) to their own managers and therefore orient their behaviours towards satisfying needs in only one direction. We need to ask

ourselves whether this model is likely to deliver optimum results for the enterprise.

If a manager fails to provide the support required by team members, should we endow both his/her line manager *and subordinates* with sufficient 'reward power' and 'coercive power' to effect the necessary changes? Similarly, if a member of staff is not performing well, should we empower both managers *and colleagues* with enough power to influence their behaviour? We will look at ways of designing the organisation to achieve this in the final chapter.

Leadership in Social Enterprises

At ContactSoft - as within many enterprises of its type - there are strict limits on the extent to which individuals can exercise reward and coercive powers[9]. These powers, if given at all, are delegated by a General Meeting and revoked after a period of time. In this environment, referent and expert power are particularly important to the practice of leadership.

Before we consider how leadership can be exercised in social enterprises, it is worth considering the general environment. The legal foundations on which social enterprises are built[10] have considerable impact on the way management is organised. In co-operatives, management may have a problem of legitimacy[11]. People from 'alternative' movements founded many UK co-operatives in the late 1970s. Their alienation from big business and desire for democratic decision-making led to collective management forms. On the other hand, in rescue co-operatives that converted from conventional businesses to safeguard jobs – workers have often created a co-operative as a last resort. Their previous experience of management is inevitably poor, and this can create a 'never again' mentality.

However, as co-operatives mature and grow, they usually evolve management structures based on representative democracy. In rare cases, they find ways to maintain collective management as the organisation grows. Managers are significantly more accountable to the enterprise's workers than is the case in a private limited company. This has a profound effect on the style of management and the manner in which leadership can be exercised.

As we have noted already, some co-operatives limit (or prevent) managers' use of coercive or reward power to influence their subordinates. Their legitimacy rests more on the referent and expert power that they can establish. Even though decision-making is formally based on a consensus approach, in practice experienced members are usually able (even required) to lead discussions and decision-making.

Structurelessness

Freeman (1972) attacked the 'tyranny of structurelessness' and argued that power is always exercised in groups[12]. The absence

of a formal hierarchy allows informal hierarchies to develop and Freeman criticises this as unsatisfactory because of the difficulty of holding informal hierarchies to account.

Experience at ContactSoft both supports Freeman but qualifies her conclusions. Certainly, informal hierarchies develop, and this may annoy those who have difficulty influencing decisions. However, one benefit is that the *only way to gain power and influence* is through the demonstration of commitment and ability. As members demonstrate these attributes, so their referent power increases. Similarly, as skills are acquired, expert power increases.

Lord, Fot and De Vader (1984) observed that staff often recognise management qualities and then single out those people for leadership roles by giving them support. Clearly, in a collective management environment where formal power is restricted, able people can be 'promoted' quickly as the need arises. In the early 90s, a member of staff at ContactSoft was accused of sexual harassment and two members were 'promoted' to conduct an investigation. Upon conclusion of the investigation, consent was given for one of the investigators (acting for the company) to negotiate the terms of a settlement with the parties involved. Then their powers were revoked.

Any benefits of this approach need to be balanced against the situation where a team member has a special aptitude for management and leadership. In the previous chapter we reviewed Herzberg's research on the link between recognition of achievement and motivation. Quite apart from the debate about whether the social enterprises and their members are better served by employing managers, we must acknowledge that a failure to recognise a person's management skills may result in them becoming demotivated. If there are deliberate attempts to limit or block the development of these skills, they may leave the organisation.

Participative Management Models

While a number of writers have observed the management processes that take place in social enterprises, only Cornforth (1988) considers what makes a good social enterprise manager, and how members can provide them with effective support. He advocates that managers should play the role of educator, communicator and consultant to the workforce. In turn, he defines how members can reciprocate: by encouraging the supply of information, providing managers with supportive feedback, and by focussing on the extent to which proposals serve the business's interests[13]. Cornforth's ideal manager sounds rather like Tom Peters' ideal manager[14].

The doughnut form of management used at Suma (see Chapter 6) provides a structure within which participation in decision-making can be maximised across an enterprise of considerable size. Again, the idea of a doughnut structure with teams around

the edge fulfilling various functions and a central body facilitating and co-ordinating them sound remarkably similar to Tom Peters 'self-managing teams [that] should become the basic organizational building block' with managers acting as facilitators[15].

Participative/Democratic Leaders

The field of study that considers participative/democratic approaches to leadership has become mainstream in the study of organisation behaviour. Some of the theories that have arisen provide useful guides to action.

There appears to be a correlation between an individual's own level of knowledge and effective decision-making. Where a leader is 'low' on information, participative (inclusive) leadership is more likely to lead to good decision-making. Where a leader is knowledgeable, independent decision-making usually leads to better decision-making.

A good leader, therefore, needs to be self-aware. If they try to make quick decisions in areas where they do not have expertise, they will increase the likelihood of making a poor decision. Equally, consulting widely when the knowledge to make a good decision is already possessed may be wasteful. It may even be alienating if those consulted sense their opinions are not needed or will be ignored.

A growing body of opinion advocates managers and team-based structures with managers/leaders as:

"coach and sounding board, facilitator, seller of ideas, and helper of teams to develop their own ideas"[16]

"educator, communicator, consultant"[17]

We will find in the next chapter that there are limitations on the ability of groups to make good collective decisions so it is important not to see team-based working as a panacea, or allow situations to develop where it is possible to pass the buck and avoid responsibility.

Stress

Fielder studied the impact of stress on decision-making. He found that cognitive skills led to better leadership in low stress situations, but that experience was better in high stress situations. This too, is a useful guide to action for managers of any enterprise.

Building a network of experienced mentors and advisors may pay dividends if quick decisions are needed during busy periods. During the construction of First Contact Software Ltd, we have consciously assembled a network of advisors:

- Business Advisor

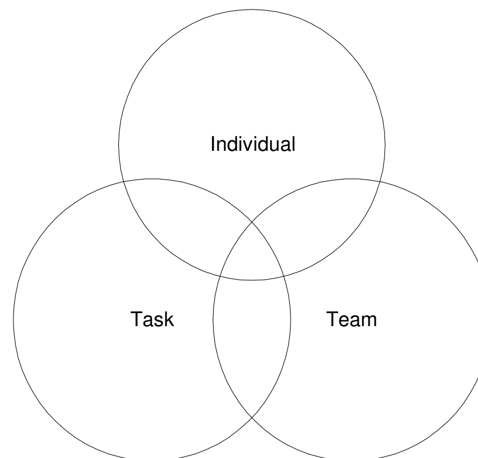
- Marketing Consultant
- Accountant/Financial Advisor
- Business Banking Advisor
- Technical Consultants
- Solicitors/Legal Advisers

Some even appear on our organisation charts, and there is a conscious effort to involve our advisors in the induction of new staff.

When the enterprise is particularly busy, calling on the combined experience of a support network reduces the need to consider new situations at great length (thereby reducing the cost to the business of having to deal with complex, unfamiliar situations).

Achieving a Balance of Interests

Adair created a useful visual model for conceptualising the leadership dilemma.



A manager - indeed all team members – are faced with keeping a balance between achieving the task in hand, the cohesion of the team and the aspirations of each individual. If any are allowed to dominate too much to meet short-term objectives, the *long-term* interests of the others will suffer.

For example, if individual interests are given too much attention (allowing individuals too much choice or flexibility), we may damage team spirit and frustrate fulfilment of the task. If too much attention is given to creating a happy team (bonding, socialising, friendship), then too little attention may be given to organising the task or satisfying individual needs. If the task is allowed to dominate, then the social fabric of the team may disintegrate or the needs of its individuals be ignored.

We can test out the veracity of this by considering situations outside the workplace. In communist societies, the rights and needs of individuals can be (and frequently are) subordinated to the needs of society, which can result in the oppression of individual freedoms (such as when Russia used forced labour to help rebuild the country's infrastructure). Similarly, in a capitalist society, the rights and freedoms of individuals can (and frequently do) damage communities – such as when the right to carry guns results in pervasive violence, or an individual closes a business for personal gain putting large numbers of people out of work. In war, the task (achieving victory) is given overriding importance and may destroy many lives and communities before achieving its objectives.

The balance between individual, team and task is constantly shifting and always needs attention. When we get it right, individuals can pursue their aspirations in pursuit of a team objective that contributes to an organisational goal.

Conclusions

Social enterprises and conventional businesses frequently start from very different perspectives on leadership, but there is evidence of convergence on management theory and practice. While conventional business leaders have been slow to appreciate the business benefits of participative leadership and initiating proposals at team level, co-operatives often started from these premises, but lacked the experience and management skills to make them work effectively.

As research has established the veracity of the participative leader approach, so conventional businesses have moved more towards self-management. Social enterprises have needed to overcome resistance to the legitimacy of management before they have been able to benefit more from its exercise, and satisfy their organisational goals more effectively.

Desirable Leadership Skills

Cornforth succinctly summarises the qualities of a good social enterprise leader.

- **Educator**: committed to narrowing the ‘competence’ gap between managers/managed. Active teaching of business management skills.
- **Communicator**: commitment and ability at presenting information that increases knowledge and competence, and which helps good decision-making
- **Inclusive**: consults and includes members in policy formation. Evaluates costs/benefits of different options
- **Briefings/Reports**: uses a variety of face-to-face and written skills to disseminate information

- **Information Systems**: Systems that facilitate and elucidate complex data to assist employees to contribute to good decision-making.

What Makes a Good Follower

Cornforth also considers the role of a good follower. As we commented earlier, leadership is not stapled to a job description. An astute manager will sometimes see the virtue in becoming a follower if a team member has a good idea they are well placed to develop.

The following behaviours may encourage success:

- encourage them to provide you with information
- encourage them to explain their actions in an understandable way
- provide support and feedback, and be honest and fair in any criticism
- ask questions
- avoid overstressing your own need for influence
- focus on evaluating and assisting good ideas
- give credit and recognition (i.e. allow the team member's achievements to be recognised by other group members).

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1 Drucker P (1955), The Practice of Management, Heinemann, London, p195

2 Nowhere is this more evident than in the resolution of potential industrial disputes.

3 Cornforth et al (1988) *Developing Successful Worker Co-operatives*, Sage Publications, p 146-147

4 Arnold J et al (1995), *Work Psychology*, 2nd Edition, Pitman Publishing, p 284-285

5 ibid, p 603.

6 Arnold J et al (1995), Work Psychology, 2nd Edition, Pitman Publishing, p 294-295

7 Peters T (1991), Thriving on Chaos, Harper Perennial, p 357-365

8 Buchanan D & Huczynski A (1997), Organisational Behaviour, Third Edition, Prentice Hall Europe, p 607-608

9 Berry J and Roberts M (1984), Co-op Management and Employment, ICOM Publications, p 13-17. Industrial Common Ownership Movement publications often caution against 'one-manager' approaches and also recommend that the power to hire and fire should always be subject to group control.

10 Most UK co-operatives have common-ownership built into their constitution to prevent outside ownership. On the continent, non-voting shareholders are more common, but workers retain operational control using a one-member one-vote system.

11 Cornforth et al (1988), *Developing Successful Worker Co-operatives*, Sage Publications, p 134.

12 Cornforth et al (1988), *Developing Successful Worker Co-operatives*, Sage Publications, p 140.

13 ibid, p 152-153. Cornforth draws attention to the problem of members overstressing the need for equality of influence, and argues that focussing on judgement of the proposals serves collective interests better.

14 Peters T (1991), *Thriving on Chaos*, Harper Perennial, p 363. Tom Peters advocates managers in the role of coach and sounding board, facilitator, seller of ideas, and helper of teams to develop their own ideas.

15 ibid, p 357

16 Tom Peter (1993), Thriving on Chaos

17 Chris Cornforth (1993), Developing Successful Worker Co-ops

Chapter 5 - Group Working

The Problem With Teams….

"There were 4 team members named: Everybody, Somebody, Anybody and Nobody. There was an important job to do and Everybody was asked to do it. Everybody was sure Somebody would do it. Anybody could have done it, but Nobody did. Everybody was angry about that because it was Somebody's job. Everybody thought Anybody could do it, but Nobody realised that Everybody wouldn't. In the end, Everybody blamed Somebody when Nobody did what Anybody could have done."

- Anon

Overview

So far we can have considered behaviour mainly from the standpoint of the individual. We have considered what motivates individuals, the difference between management and leadership and how leadership is exercised. In this Chapter, we begin to examine these issues in the context of the group. Working in a team is not straightforward. It is a complex process and this brief introduction is necessarily selective in order to highlight those aspects of group behaviour most relevant to social enterprises.

So much of our lives are devoted to living or working in groups (whether family, friends or workplace colleagues) that a great deal of study has been devoted to it. With the increasing attention paid to industrial democracy and participation a good understanding of the dynamics of work groups, their strengths and weaknesses, is crucial if we are to construct effective organisations. After a brief history that puts group studies into a historical perspective, this chapter summarises four chapters on group formation, structure, control and effectiveness from the book Organizational Behaviour (Buchanan D & Hyczynski A, 1997).

History

The issue of whether production is better planned by managers or workers has shifted several times since the industrial age. In the 1900s, 'management' - as understood today - did not exist. Managers controlled terms of employment, pay and discipline, but craftsmen and apprentices organised production, even in industrial settings.

This changed with the advance of Taylorism early in the 20th century. Taylor demonstrated how managers who worked out the optimum way to do a task, and then rewarded staff who adopted new practices, could achieve phenomenal increases in productivity. Taylorism found its lasting expression at Ford[1], where highly paid workers worked on mechanised assembly lines to produce reliable and cheap consumer goods. The culture developed (still prevalent in many workplaces) whereby managers 'do the brainwork' and workers 'follow orders'. In short, there was a quantum shift away from workers towards managers working out how best to organise the production process. The age of the modern manager was born.

However, in the 1960s/1970s, the emergence of the Japanese, with their greater reliance on team-working and strong social cohesion, shifted the balance back again. In the West, widespread literacy and education was producing a workforce with higher expectations of involvement and fulfilment. The result was the rapid development of management theory and practice to exploit workers' creative talents. Team working, synergy, empowerment and brainstorming became new buzzwords. Employee-ownership started in the US in the 1950s and spread to Europe in 1980s – today more than 11 million US workers, and over 3 million UK workers, own shares in their company.

In the last three decades, however, social science has researched many of the assumptions on which team working is based, and has revealed a much more rounded picture of its benefits and pitfalls. Some assumptions about the benefits of team working have been shown to be untrue. In addition, even when cohesive groups are achieved, there are some side effects that are undesirable[2].

Research has repeatedly suggested that teams make decisions that are different (and sometimes far worse) than the same individuals would have put forward personally. Synergy, the idea that a team performs better than its best individual, is unsupported by available research. Brainstorming, when undertaken as a group activity, has been found to inhibit, rather than increase, individual contributions. As a result, management theory no longer gives uncritical support to team working. Will individual or team working accomplish a task more effectively? There is a new willingness to consider this question.

Group studies and their importance to the workplace is one of the lasting legacies of the Hawthorne studies in the 1920s. In these studies, a Personnel department examined the relationship between the physical environment and productivity. When the studies revealed that the behaviour of group members bore no relation to changes in the environment, academic researchers were invited to study the phenomenon. The programme went on to study inter-worker relationships (both formal and informal) and how these manifest themselves in friendships and social activities. The main conclusions have had a lasting effect on personnel management:

- People are motivated by more than pay and conditions
- Work is a group activity; individuals should be viewed as group members
- Recognition, security, and belonging all influence morale and productivity more than physical conditions
- Groups (through informal norms and values) exert strong controls over work habits and attitudes of group members. Therefore, groups have a significant impact on staff motivation
- Management needs to align official objectives with the informal social needs of groups.

Stages of Group Development

Sheriff found that the development of groups has a well-defined pattern irrespective of the group members' social background and the context in which the group is formed. There are five recognised stages of development:

1. **Forming**

2. **Storming** as issues of personal status, influence, communication and friendship are resolved

3. **Norming** in which the group resolves the questions of who will lead and starts to develop norms of behaviour, rewards and discipline

4. **Performing** in which relations are regularised and each member becomes committed and able to contribute to group goals.

5. **Adjourning**

There is no guarantee that a group will go through all stages – it can get 'stuck' in a stage and never mature. The most common stages for a group to become stuck are the storming and norming stages. The reasons for getting stuck can be best understood by considering the complex issues that groups must resolve.

Atmosphere/Relationship: how formal/informal, close and friendly

Participation: how much expected, all equally, some more than others?

Goals: do members need to understand goals? Do they need to be committed to them? Everyone? Some more than others?

Listening/Sharing: How is information shared? Who needs to know what? Who should listen to whom?

Conflict: Need to resolve? Brush aside? Handle by dictate?

Decisions: Consensus? Voting? One-person? Ballot?

Evaluation: Mutual appraisal? Some appraise others? Is it to be avoided?

Feelings: How to express? Only about task? Openly/Directly?

Division of Labour: How to decide? Voluntarily? By discussion? By Leaders?

Leadership: Who? How? Shared? Elected? Appointed?

Monitoring: How? Feedback? Formal Procedures? Avoiding direct discussion?

Structure, Status and Power

Structure is the stable pattern of relationships among group members. Relationships can be broken down along many axes: status, power, liking, role, leadership and communication. Each group member will evaluate other group members along each of these axes creating a complex pattern of inter-relationships. Relationships may or may not be reciprocal. For example, group member A may accord group member B a higher status than themselves and defer to their leadership without actually liking them. Group member B may like group member A and accord them peer status (although member A is not aware of this).

Status

There is a consistent research finding that groups develop an informal hierarchy with leaders and followers (whether in gangs, social groups, democratic groups or corporate teams). Status can be looked at from two angles:

Formal status is the rights/obligations conferred on a position.

Social status is the measure of a person's standing by others in the group.

If individuals perceive themselves to have higher or lower status than that accorded by others in the group, this can have a significant impact on group behaviour. For example, someone promoted to a formal leadership role, but who is not accorded a high social status by group members, will not be able to function effectively as a leader. Similarly, if an individual tries to take a leading role when other group members do not desire this, tensions and problems are likely.

Power

We considered the sources of power in Chapter 4 (Leadership). We identified a person’s sources of power as

- Reward Power
- Coercive Power
- Referent Power

- Legitimate Power
- Expert Power

It is worth adding here the importance of perception. A person cannot use their expertise to influence another group member if their expertise is not recognised. Similarly, if person A can involve person B and C in particularly interesting work, but B and C are unaware of this, A will have less influence over the behaviour of B and C.

Liking Structure

It is possible to study who likes who in a group using a sociometric test that asks four questions:

1. Who would you prefer to work with/not work with?

2. Who would you prefer to study with/not study with?

3. Who would you prefer to play with/not play with?

4. Who would you prefer to live with/not live with?

The results can be mapped onto a diagram to show which group members are the 'stars', 'pairs', 'trios' and 'isolates'. Stars get many votes; others vote for each other (pairs/trios); some get few or no votes (isolates). This approach can be used by managers to reveal deep-rooted problems in the social structure of a team. However, care must be used as group members can distort results easily. The main benefit of sociograms has been to help academics understand the social relations in productive/unproductive groups so that managers can learn what social relations they should be trying to encourage.

Role

Role is the behaviour that is expected of a member: it can be thought of as a script for an actor. If a group member takes on a particular role (formal or informal), other members then expect a certain set of (assumed) behaviours. After a while, an individual’s behaviour (at first chosen) becomes expected by others. Eventually, this may act as a constraint on an individual who wishes to change role.

Role Specialisation

Robert Bales (1950) developed Interaction Process Analysis (IPA): a way of describing behaviour within a group. Bales found that, when a group tackles a problem, it will always have initial communication/organisation problems (orientation), followed by an evaluation period resulting in individuals taking on specific roles.

He commented that all groups (social, work etc.) face two broad problems:

1) Intra-group Communication - establishing a workable common way of viewing a situation; reaching a common judgement (how important, how to tackle, whether to tackle); role of communication in establishing group roles/common agreement.

2) Group Organisation/Maintenance - avoiding disintegration requires the resolution of leadership, individual roles and individuals' prestige/ranking. When they are not resolved they create tension and require management time.

He has found that people show a preference for a fairly narrow set of behaviours and that within (successful) groups two types of leader emerge: one with a focus on achieving the task, another with a focus on maintaining the social/emotional needs of the group's members.

Team Role Theory

Belbin (1981, 1996) worked on relating group behaviours to group roles. He found that team roles are frequently unrelated to functional roles even though people are usually appointed for their functional role, not their team skills.

In meetings, he identified the following behaviours

- Proposing
- Building
- Supporting
- Disagreeing
- Giving Information
- Seeking Information

Outside meetings, the following roles were identified

Plant: creative, imaginative, problem solver

Resourcer: enthusiastic, communicative, explores, develops contacts

Co-ordinator: mature, confident, good chair, clarifies goals, promotes decision-making, delegates

Shaper: challenging, dynamic, has drive, courage to overcome obstacles

Monitor: sober, strategic, discerning, sees options, judges accurately

Team worker: co-operative, mild, perceptive, diplomatic, listens, averts friction, calms

Implementer: disciplined, reliable, conservative, efficient

Completer: painstaking, conscientious, anxious, delivers on time

Specialist: single-minded, self-starting, dedicated, knowledgeable, supplies skills in rare supply

He observed that a wide variety of team roles do not necessarily imply that each group needs many people, simply that effective groups consist of people that can play these roles effectively.

Belbin also drew five more conclusions:

1. Team members typically take on one/two roles consistently
2. Individual preference can be predicted with psychometric tests
3. When members are combined correctly, teams are more effective
4. Roles are not necessarily associated with a functional role
5. Self-recognition/awareness is a factor in team effectiveness

He suggests that managers need to be concerned with creating balanced teams (by including members that can fulfil all roles) in order to make them effective. The impact of such research can be seen in the recruitment practice of some large companies that place more emphasis on evaluating team skills than subject knowledge.

Group Leadership

Leadership is a function of group structure. However, what makes an effective group leader? Consider the following two statements:

"Usually a group makes a leader of the person who has a special capacity for coping with the group's particular problem".

"Leadership in a group is the performance of those acts which help the group achieve its preferred outcomes" - Cartwright and Zander (1968).

There is a debate about the extent to which leadership is a floating activity passing between group members or a static status associated with an individual. An important aspect of group leadership is that a group leader only obtains influence when group members consent to being influenced by them. In short, group members give (and can take away) a leader's influence. In this respect, leaders are *made by the group* and not the other way around.

Bales and Slater found that task and people oriented leaders emerge *within the same group*. Leadership splits occur after the 'task' leader is agreed (by appointment/consent). This supports the contention that leadership is not a single role - it contains two important aspects. Firstly, it includes the ability to help the group achieve its task(s); secondly, it includes the ability to facilitate productive relationships between group members.

Leadership Styles

A major study in the 1930s, 40s and 50s conducted by White and Lippitt (1960) examined authoritarian, democratic and laissez-faire leadership styles. Group leaders were trained in different styles of leadership and then studied working with their groups. Authoritarian style leaders were directive and told group members what to do. Democratic style leaders consulted with group members, but ultimately took responsibility for making decisions. Laissez-fair group leaders took a more back-seat role encouraging group members to come to their own decisions through consensus.

The studies were mainly conducted within after-school clubs, so care should be used in making generalisations applicable to the workplace. However, the studies – conducted over 30 years - draw conclusions that have far reaching implications for effective social enterprise management:

1. Laissez-fair climates are not the same as democracy
    - Less work is done and it is of poorer quality
    - There is more play in 'laissez-fair' groups
    - 95% of group members prefer a 'democratic leader' to a 'laissez-faire' leader
2. Democracy can be efficient
    - Although the quantity of work can be greater under autocratic leadership....
    - Work motivation is stronger, particularly when the leader is not present
    - Originality is greater in democracy
3. Autocracy leads to
    - hostility, aggression and submissive behaviour
    - rebellion or people dropping out of the group
    - more discontent than in democracy
    - loss of individuality

Group Influence and Control

Groups have their own process of socialisation. Donald Roy (1960) was a researcher who worked in a factory to observe the informal pressures to adhere to the group norm. A passage in his book reveals how successive workers advised him of the maximum acceptable productivity. He was told of stories where other workers had worked harder (initially earning more) then management changed prices so that the harder workers had to continue to work harder to get normal rates of pay. Those

workers were then stuck with these jobs, as nobody else would do them. Eventually, he learned the maximum work rate for the job, even though this was considerably lower that it was possible to achieve.

The important point here is that there can be a wide gap between what group members (or managers) decide as group policy, and what the group members actually agree through the informal 'norming' process. Of the two, the group 'norming' process exerts much more influence and is likely to prevail.

Rewards and Sanctions

Group members are subject to complex and subtle rewards and sanctions. In the Hawthorne studies both under and over productive workers were 'binged' (flicked on the arm or ear to indicate that their behaviour was unacceptable). The most important sanctions used in the Hawthorne experiments were sarcasm, binging and ridicule. In addition, 'clique membership' is a common instrument of control; this is a mild form of ostracism. This is a universal social process of control (it is as common place in school playgrounds as the workplace).

Members who deviate from group norms have several options:

- Argue for a change in the group norm
- Conform to the original norm
- Leave the group (if circumstances permit)

Their status within the group will affect their ability to argue for a change. If they do press for change, they can expect one of three reactions:

- Group members accept the argument
- Group members reject the group member (even if they recant)
- Group members tolerate the deviation to avoid losing the member

Several factors influence this process. Firstly, a member will consider the sanctions the group can exercise, and the degree to which they value membership of their group. In reacting, group members will consider the extent to which they value an individual who deviates.

Conformity and Rebellion

Among the most startling experiments in the history of social science are those that reveal the extent to which individuals modify their behaviour within a group. Asch (1950) studied the extent to which individuals yielded to group norms. A group of 7 members was asked to judge which of three lines were equal in length: 6 were stooges, 1 was a real subject. When the group

lied together, the subject was much less likely to disagree. However, if one stooge disagreed (1 of the 6), the subject was much more confident in disagreeing.

The research shows how difficult it is for individuals to express opinions not in line with other group members, even on something as unambiguous as the length of a line. 75% agreed with the majority view, rather than promote their own judgement. It has been argued that this can contribute to group ineffectiveness. The best decisions are not made because group members are more concerned with fitting in with the views of other group members, rather than working out the best solution for the group.

Asch found that individuals usually changed their mind because when all others disagreed they doubted their own judgement. In some cases, individuals did not doubt their own judgement, but agreed with other group members to avoid the appearance of fallibility or inferiority. Individuals did not acknowledge the extent to which the group's behaviour modified their own judgement and continued to believe that their judgement was independent of other members. However, there are two important conclusions that have implications for the effectiveness of group decision-making:

- Members are inclined to follow group consensus and allow it to prevail over their own judgement
- Members may lie to avoid appearing foolish or in error

In another groundbreaking experiment Sherif asked groups of three workers to estimate how much a light moved in a dark room. Initially the estimates varied widely. After the workers had the opportunity to discuss the experiment, their estimates varied much less, until all members of the groups were giving similar estimates. When the group was split up and tested individually, they continued to estimate in the way the group had decided. In fact, the light never moved – all estimates of movement were derived from the perceptions of group members. The experiment provided important insights into the way interactions between group members may affect decision-making:

- Norming will narrow down the range of opinions
- A consensus will emerge as group members interact more frequently
- Erroneous judgements can occur due to group process

Milgram (1974) - and the controversial 'electric shock' experiments – revealed the extent to which individuals will follow authority (against their own judgement). The experiment involved trainee 'teachers' administering shocks to 'learners' when they made mistakes. 66% of 'teachers' administered shocks that were marked *fatal* when told to do so by the experimenter. This confounded many eminent psychiatrists/psychologists who estimated before the experiment

that only 1 in a 100 would do so. These results showed how even intelligent individuals defer to authority[3]. Only when individuals worked alongside planted 'teachers' who argued and defied the experimenter did a majority of the participants refuse to continue administering shocks. Once again, we must consider these results when we consider the merits of individual and group decision-making.

- Individuals often accept authority unquestioningly
- Playing 'devil's advocate' may help individuals who are unwilling to rebel or express their real opinion

Group Effectiveness

When should group working be considered? The following is a set of considerations we can use as a guide.

1) Better end result likely
2) Where meaningful to those involved
3) Mixture of skills required
4) System requires frequent adjustments in activities
5) Competition between individuals leads to less effectiveness rather than more
6) To reduce individual's levels of stress

Is a happy group an effective one? Early research suggested, “Yes”. More recent research suggests that it is conditional on the norms established by the group. If they are consistent with the goals of the organisation, then “Yes”, but if not, then productivity can fall (Seashore 1954). Indeed, the equation has been turned around, "does increased productivity lead to satisfaction?" If higher productivity is recognised formally (verbal recognition, increased pay, promotion) then the combination has been found to significantly increase job satisfaction.

Are groups better at achieving tasks than individuals? This is a key question, and through the 60s/70s the assumption was that groups were better. However, a large body of research now suggests that this is often not the case. Indeed, many studies suggest that key assumptions about the superiority of group working (e.g. the merits of brainstorming and synergy) are simply not true. Some studies have reached even more far-reaching conclusions, namely that the very cohesiveness that is strived for can have side effects that compromise the ability of a group to function well.

Positive Aspects of Cohesion

Highly cohesive groups influence their members more (can be positive). If norms are in alignment with management

expectations and desires, a cohesive group will perform well. Members have fewer anxieties and appear better adjusted. There is lower absenteeism and turnover, and fewer tensions between staff.

Over the years, despite some expressions of caution, there has been an acceptance of the superiority of cohesive group working over individual activity. These, in particular have led to two important concepts/activities: synergy and brainstorming

Synergy is the ability of a group to outperform even its best member

Brainstorming is a technique that encourages group members to put forward ideas without censure or judgement until all ideas have been listed

Jay Hall (1971) advises that to obtain the best possible benefit from brainstorming sessions group members should:

- Avoid arguing for their own opinions too early (present positions clearly, then listen and consider before pressing a point)
- Not assume that someone must win/lose (look for the next most acceptable alternative for all parties)
- Not change their mind to avoid conflict (if agreement comes too easily be suspicious and confirm the reasons)
- Avoid conflict-reducing techniques (majority voting, averaging, coin-flipping, bargaining) – in particular, don't have a quid-pro-quo mentality rewarding dissenting members by giving them their way later.
- Remember that difference of opinion is natural (seek out different opinions and try to involve people in the decision-making process to increase the chance of hitting upon the best solution).

Problems with Cohesion

Is synergy likely? Is brainstorming more effective in a group? These are questions that have been examined in many studies.

Jay Hall (1971), when studying synergy, found that effective groups seek out points of disagreement and encourage conflict in early stages of discussion. Ineffective groups reach consensus too easily and use simple conflict-reduction techniques (e.g. voting). However, while groups usually solve problems more effectively than most of its individuals, they rarely do as well as their best member could do alone.

Similarly, brainstorming has been questioned on two fronts. Firstly, it rests on the assumption that if you produce a torrent of ideas there are bound to be some good ones. Secondly, it associates quantity of ideas with quality. Both of these assumptions have been questioned. Lamm and Trommsdorf

(1993) reviewed twelve studies of brainstorming v individuals working together independently, and found that 9 of the 12 studies concluded that individuals working in a loose association produced more (or better) ideas. Barbara Maginn and Richard Harris (1980) also concluded that individual brainstorming is more effective, if lonelier.

Group Polarisation (the Risky Shift) and Groupthink

Perhaps more problematic for advocates of team working is the tendency of groups to polarise when faced with decisions. The Risky Shift is a term given to the tendency of a group to make decisions that are polarized (more extreme) than the same members would recommend individually.

Until the 1950s, people believed that groups made cautious, conservative decisions. Stoner (1961) questioned this assumption. He found that groups took decisions that involved greater risk than individuals would recommend. Various hypotheses have been put forward, but the phenomenon has been confirmed by over 300 further studies (Myers and Lamm 1976, Myers, 1990). The most important hypothesis (as far as social enterprises are concerned) is the 'diffusion of responsibility hypothesis' – that individuals do not feel individual responsibility for group failure and therefore will contemplate and agree to more risk.

‘Groupthink’ is another phenomenon that has been much studied. Groupthink is a mode of thinking when group members strive for unanimity at the expense of realistic alternatives. The most influential studies arose out of US foreign policy disasters. Janis (1982) found that group members were often over optimistic, discounted warnings and marginalized opposition. There is self-censorship by members who do not wish to deviate from group consensus and as a result there is an illusion of unanimity when in fact there is none. The main problem with Groupthink is that it substantially lowers the probability of a successful outcome to decisions.

Conclusions

Group cohesion has positive benefits, but also leads to negative behaviours that reduce the effectiveness of decision-making. Group loyalty can stifle questioning and creative thinking and lead to bad decisions. Within a group, individuals show a marked tendency to follow someone else’s lead rather than promote their own. The result can lead to serious errors of judgement, or over-cautious or risky decisions.

In short, there is now sufficient doubt about the effectiveness of team working to question long held assumptions about its benefits. For enterprises that use teams extensively, this body of research makes difficult reading. However, once its implications

are absorbed, the process of re-evaluation and re-design can begin.

Increasing the Chances of Group Performance

In constructing our enterprise, we can mitigate the problems that arise in team-working by ensuring there is a balance between autonomy at the operational level and accountability in decision-making. As we will discover in the next chapter, when groups are empowered to create and develop proposals that are subject to approval by an experienced manager, we have a model that enhances the chances of commercial success.

Also, if we want our teams to perform well, we must plan them in advance so that we understand the skills (both technical and human) that will be required if the team is to perform well. We can lay down some markers that will guide us in their construction and enhance their chances of success.

1. Pre-work

Identify the task, establish objectives and decide on levels of authority

2. Create Performance Conditions

Create performance goals; locate resources (money, information, people, systems)

3. Form and Build the Team

Form boundaries, clarify membership, get members to commit to the task, clarify expected behaviours and task allocation

4. Provide On-going Help

Help the group overcome any problems, achieve a high level of functioning, replace non-contributing members, replenish non-human resources.

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[1] And has become better known as Fordism in popular culture

[2] Undesirable in the sense that they may lead to poor business management and decision-making.

[3] The subjects of the experiment were undergraduates

Chapter 6 - Business Forms

Social Enterprise

We take as our starting point that we want to create a thriving business that will transform the working environment and alter the relationship that people will have to their workplace. Conventional private business forms which create a division between owner and employees – and which do not allow employees to become owners - perpetuate relationships that will always limit the extent to which people can participate in building the enterprise.

Social enterprises set out to change this relationship in order to maximise the involvement and participation of the enterprise's workers in the development of the business. However, this too can have its problems. If employees get carried away with the exercise of their rights to individual involvement and participation without due regard for their responsibilities to the business as a whole, they can damage rather than help commercial success.

Attempts at changing the relationship – and discussions about the merits of doing so - are not new. Co-operatives and mutual societies have existed for over a century, and in some EU countries the co-operative sector is thriving, creating many thousands of jobs each year, while in others (such as the UK), there has been a decline until very recently.

In the UK, co-operative enterprises became popular in the late 1970s but went into decline from the late 1980s onwards. We will examine why in order that we may understand their failure. We can then build a new model of enterprise development that is likely to maximise the chances of commercial (and therefore social) success.

In the last few years model company rules have become available that allow social enterprises to separate voting rights and equity (i.e. the employees have voting rights, while investors purchase shares). In comparing and re-evaluating the UK experience we will compare the general performance and decision-making environments of different forms of social enterprise. In particular, we will contrast common ownership and equity based enterprises, and draw conclusions about their potential based on interviews with service sector businesses in the London area.

The evidence suggests that company rules restricting ownership or the issue of equity can damage business development. The

link between company rules and the availability of supportive finance is strong, but management styles and structures are mostly a matter of choice. Anecdotal evidence suggests that consensus decision-making between staff-teams and senior staff can lead to higher levels of participation and better business performance.

This chapter is based on research undertaken at Leeds University Business School between January and July 2000.

Introduction

We will examine the relationship between company rules and organisation development in worker co-ops within mature market economies. In particular, we will explore the impact of different business forms and how these affect access to finance and management structure.

Why Study Co-operatives?

Before we can answer this question, we need to establish a definition for 'co-operative enterprise'? Should it include businesses where most staff own shares? If so, should their shareholding constitute a controlling majority? Should the definition depend on voting rights rather than ownership? In this study, we have included organisations in which over 50% of *voting rights* belong to *employed* staff:

"an enterprise engaged in the manufacture or trading of goods and services in which over 50% of voting rights are retained by its employees"

This definition includes various forms of self-managing enterprise, but excludes agricultural and consumer co-ops and other membership-based societies in which external members have more voting rights than staff employed by the organisation. It also includes new forms of social enterprise (such as First Contact Software Ltd) in which employees have a majority of voting rights, but not necessarily ownership of the enterprise.

In this century, the co-operative sectors of many market economies have been expanding. Their aspirations, experiences and potential offer evidence of the extent to which worker-controlled businesses can compete in a modern economy. In the UK, a new company called Democratic Business Ltd has fuelled the debate about the role of equity and ownership in worker-controlled businesses. Their contribution has relevance beyond the co-operative sector, and re-opens questions about how best to create a 'stakeholder' economy. It is, therefore, both timely and necessary to re-evaluate the impact of different company rules so that those with an interest in creating the 'stakeholder' businesses of the future are able to make informed choices.

The Development of Co-ops in Europe

Historically, perceptions of co-ops have been negatively influenced by prominent figures. Marx (1984, p. 440) commented, "they naturally reproduce in their actual organisation all the shortcomings of the prevailing [capitalist] system". The influence of Marx's comments can be found in the ideology of many left-wing parties which argue that political activity should concentrate on the working class - creating business alternatives is a distraction.

Sidney and Beatrice Webb (1914, 1921) also marginalized co-ops by claiming they would always suffer from worker-indiscipline and poor management. Both Cornforth (1988) and Rothschild and Allen Whitt (1986) criticise the Webbs for failing to support their claims with empirical evidence. Cornforth examined the failure and survival rates of British co-ops between 1978-1986 and found that over the period they performed relatively well. Only 60% failed compared with 66% for conventional businesses. He also found that 58% of co-ops survived five years, compared with 42% for conventional businesses.

Rothschild and Allen Whitt criticise the Webbs for equating 'good management' in conventional businesses with 'good management' in co-ops, arguing that they may be entirely different in nature. They found only a few studies comparing management outcomes in conventional and co-operative businesses, and these were contradictory in their conclusions. They cite a study by Jones (1980) in which a positive link between participatory management and technological innovation in UK shoe co-ops and contrast this with Abell (1981) who found comparatively poor financial management.

While the failure rates of UK co-ops bear comparison with conventional businesses, job creation in continental Europe reveals their potential. Oakshott (1990) reviewed the co-ops at Mondragon (in the Basque region of Spain). Between 1960 and 1976 sixty-two co-ops were created employing 14,000 people. Whilst commentators in the early 1980s postulated that this might be due to a unique set of circumstances, when Holmstrom (1993) reviewed job creation in Spain and other parts of Europe, he found other successes. In Catalonia, he found that 36,000 jobs have been created in an area of high unemployment in the ten years to 1987. The Italian co-operative sector created almost 200,000 jobs in the five years between 1976-1981.

Clearly, worker co-ops *can* overcome obstacles to commercial success. It seems more relevant, then, to ask why patterns of development differ greatly from the UK. The most influential organisation promoting and servicing UK co-ops is the Industrial Common Ownership Movement (ICOM). Established in 1971, it created its first set of model rules in 1976. In the following ten years, 1176 co-ops were created employing 6,900 people - an average of six staff per co-op. In contrast, ten years after the constitution of the Mondragon co-ops was regularised, 48 co-ops were created employing 8,570 people (averaging 179 staff).

When you consider that the Mondragon region is just half the size of Wales, the magnitude of this achievement is apparent. The pattern of development, and the way in which company rules and ownership may influence it, is one of the central questions of this study.

We shall consider this question in the following sections. Firstly, we will discuss the models used to create worker-controlled businesses in different countries, and the way in which these have influenced their ability to obtain finance. Next we will look at the methodology and results of interviews with 12 UK businesses. Analysis and Recommendations follow.

Literature Review

As our interest is in co-ops trading within mature market economies, our literature review does not discuss the experiences of Russia, China and South America. This is not because they are any less interesting, but simply that studying them will not be as valuable a guide to action as studying co-ops within the EU or US.

UK and American Co-ops

In the United Kingdom, although there is no specific company law covering co-ops, ownership structures since the 1970s have usually been based on model rules available from the Industrial Common Ownership Movement (ICOM). Following the publishing of model rules in 1976[1], there was a revival in the worker co-operative sector. From a low of only 40 or so co-ops, over 1,200 'New Wave' co-ops were established between 1976-1986, employing over 8,000 people (Cornforth 1988). There was a similar movement in the US creating over 5,000 co-ops employing about 30,000 people (Rothschild and Allen Whitt 1986)

ICOM's rules restrict ownership to the workers in the enterprise. After serving a probationary period, members pay £1 for a share of the business. When they leave, they give up their share. The rules go further than this, however. Not only is external share-ownership prohibited, each member's share cannot accrue in value and they cannot gain financially from the sale of business assets. These characteristics have become regarded as *common ownership* rules.

In the late 1980s, modifications were made to allow the creation of a Company Limited by Shares, taking advantage of legislation for Employee Stock Ownership Plans (ESOPs). Later (1997), after several years of debate about non-voting shares, they created new rules that allowed voting and non-voting shares. However, the underlying principles of limited return on capital and common-ownership of assets are retained in all ICOM model rules.

ICOM had a virtual monopoly on registering UK co-ops until the late 1980s. In 1988, the Employee Share Ownership Centre (ESOC) was established to promote ESOPs. The ESOC (2000)

claims that 2,000 companies have now created all-employee share schemes, including 80% of the top 1500 quoted companies. These involve over 3 million employees, but they are rarely given more than a 20% stake in their firms. However, Major (2000) found that the mechanism of the ESOP - an employee trust that uses the assets of the company to borrow money to buy shares on behalf of its employees - has been used to create at least 22 *majority* employee-owned businesses employing 51,250 people[2].

Major (1996, 1998, 2000) also researched the various problems faced by different forms of co-ops (including the ESOPs in America) and contends that all existing co-operative forms suffer from 'equity degeneration' – a situation where workers are unable to realise the full-value of their past efforts, risk-taking, investments and decisions. Expanding a theme propounded by Ellerman (1990), he argues that ownership and control are *not* inextricably linked. In fact, they are best separated. Democratic Business Ltd, created to promote the new idea, offers model rules with two types of share – Voting Shares and Value Added Shares - which separate ownership rights from voting rights without compromising workplace democracy. Value Added Shares (unlike those in common ownership co-ops) are 'real equity' that confer ownership rights, rise and fall in value, and are tradable on both primary and secondary markets.

Continental Europe

Co-ops elsewhere use a variety of rules. In the Mondragon region of Spain, workers make an investment in their business through a *capital account*. Profits and interest accrue to workers' accounts each year, and when they leave or retire the proceeds are re-paid to them. The Mondragon co-ops also restrict membership to the organisation's employees and make no provision for external shareholding. However, they differ from common ownerships in two respects. A worker's capital account can accrue in value through the distribution of profits and also when a company's assets are revalued. Also, a substantial investment is required, usually the equivalent of several months wages. The Mondragon co-ops, therefore, are based on a form of *individual ownership*.

Spanish law also allows the formation of SALs (Sociedad Anónima Laboral, or Labour Company). SALs are like ordinary limited liability companies except that there are special provisions regarding share ownership and control. Shares must be held by at least 85% of permanent employees and no individual or company can own more than 25% of the shares. Constitutionally, there is provision for voting in proportion to share holding although in practice one-person one-vote is typical. SALs extend ownership in important ways. Firstly, shares have value in a market and can be traded. Secondly, 49% of shares can be sold to external investors.

In France, co-operative law allows membership and voting rights to non-workers. However, there are provisions that protect employees, and limit the influence of external shareholders. At least 66% of the organisation's Board of Administration must be workers, and workers cannot receive a smaller percentage of profits than shareholders. The striking difference with UK and Spanish co-ops is that non-workers are allowed a formal role in management and decision-making structures.

Italy, which employs more people in its co-operative sector than the rest of Western Europe put together has developed its common ownership co-ops the most. Five political parties support the largest and most influential federation - the Lega Nazionale delle Co-operative e Mutue (the Lega). Italian co-ops, like many in the UK, only require workers to pay a nominal fee for a share that cannot accrue in value. The same restrictions on workers benefiting from the sale of business assets also applies. However, unlike UK co-ops, long-standing legislation guarantees statutory financial benefits and support.

We can summarise the different business forms in the table below.

	Common Ownership Workers do not share in the assets of the company	**Individual Ownership** Workers share in the assets of the company
Non-Equity	UK ICOM co-ops, Italian Lega co-ops and equivalents in the US and Spain	Mondragon co-ops and similar models in the US and UK that provide for internal capital accounts
Equity	UK ICOM co-ops that allow equity that does not rise/fall in line with market values	US and UK ESOPs, SALs and Democratic Businesses that issue equity that rise and fall in line with market values

Accessing Finance

Cornforth (1988) argues that common ownership is the main obstacle to co-ops obtaining finance.

"…common ownerships are excluded from most sources of venture capital, which is an increasingly important means of financing the expanding small firm, because they are unable to issue equity." (p. 213)

He concludes that, as a result, common ownerships are often over dependant on loan finance, and that repayments act as a constraint on development. He reports that the same conclusions were reached by PA Management (1985) who argue that co-ops would benefit from amendments so that they can offer equity to investors.

Cornforth also finds evidence that being forced to rely on internal financial reserves can benefit co-ops. He reviews Vanek (1970) who argued that restrictions on sources of capital would result in under-investment, under-production and overpayment of workers. Cornforth's study of UK printing and whole food co-ops found that those that performed best, in relation to other small businesses, had done so because they used internal reserves instead of external finance. Indeed, he identifies that under-capitalised co-ops often progress to financial stability by converting 'sweat equity' into financial surpluses. They then have a cheaper source of finance than competitor businesses.

However, Cornforth finds a second serious constraint on investment. Common ownerships do not represent a good investment for their own members because they cannot benefit from capital growth. As a result, few co-operative members (or external investors) are prepared to invest their savings.

As we have seen, employee-owned businesses in the UK and continental co-ops, employ more people than their common ownership counterparts, and are usually significantly larger. What they have in common is a way of obtaining finance. In Mondragon, the Caja Laboral Popular (CLP) – a co-operative bank – provides finance. With strong community support, it provides advice, financial services and finance for the whole group. The Mondragon co-ops also obtain significant monies from their own members, who must make an investment upon becoming a member. As these investments cannot be withdrawn until workers leave or retire, they represent a significant source of long-term finance (albeit debt finance, rather than equity).

Elsewhere continental co-ops use individual equity. In France, the historical development of co-ops from the building and artisans' co-ops of the late 19th century has resulted in legislation allowing both workers and non-workers to be shareholders. Being able to offer equity solves constraints experienced by common ownerships; they can attract investment from both external shareholders and their own workers. A similar flexibility is found in the SALs of Spain. There, at least 85% the workforce must own shares and these can be freely traded subject to limits on individual holdings. Access to capital is improved as well as relations with businesspeople (Holmström 1993, p 117-118).

The common ownerships of Italy and Spain, however, have been able to obtain finance from another source: the government. In Catalonia, workers are able to invest in 'rescue' co-ops through state loans at low rates of interest or using advances on unemployment pay. Likewise, statutory support for Italy's co-operative sector has resulted in three key benefits; a ten-year exemption from stamp duty; access to cheap government loans; and tax-free interest on capital that workers invest in their own businesses.

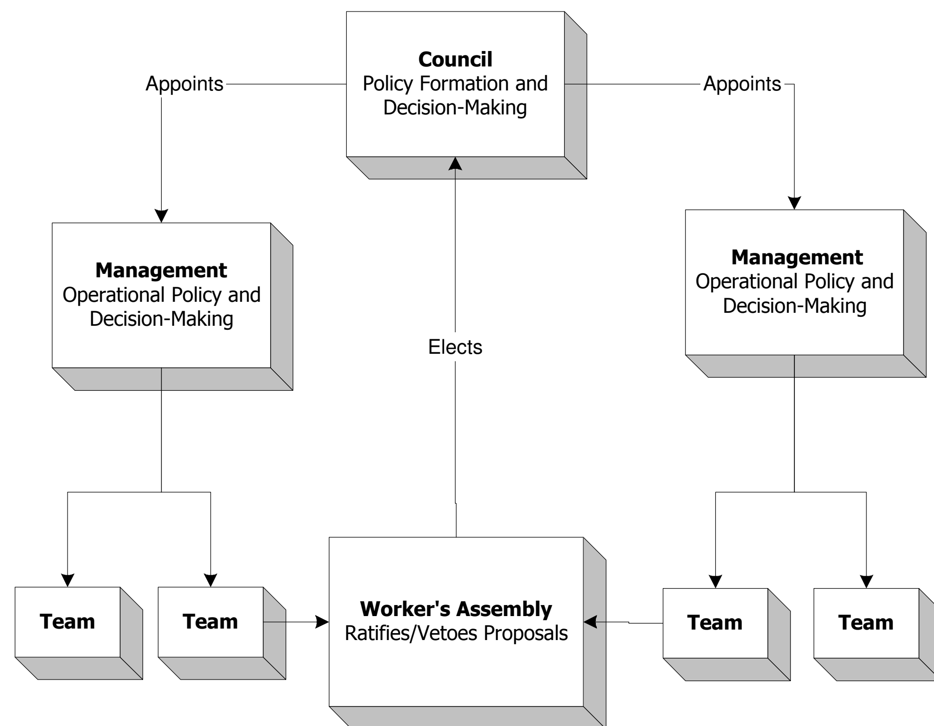
Clearly, the UK common ownerships suffer a disadvantage when it comes to investment. On the one hand, they do not have

generous government support; on the other, their restrictive rules prohibit variable yield equity, which take away incentives for anyone to invest. On the face of it, many UK co-ops have, in the main, adopted forms that are least suited to the economic environment in which they operate.

Management Structures

Is there a link between ownership and structure, and what impact does this have on development? All co-ops have one feature in common – an assembly of all workers that (in theory at least) has supreme decision-making power. The frequency with which this body can meet varies with the size of the co-operative. In the small co-ops, all workers can meet on a weekly basis. In the large co-ops they may only meet once a year. Regardless of whether co-ops are commonly or individually owned, as they grow they frequently employ what Oakshott called 'the classic co-operative control structure' (p. 155). This is shown diagrammatically below:

Diagram 1- Representative Management



Berry and Roberts (1984) suggest that the election of a council should start when a co-operative grows beyond fifteen staff, and that the appointment of executive management becomes necessary when membership grows beyond 50 workers. When ICOM undertook the ICOM Pilot Program (1987, p 65, 69), it became apparent that while this model certainly exists, there is frequently dual-control whereby collective management structures for policy formation and business planning coexist

alongside line management structures for day-to-day operational matters.

Cornforth (1988, p 69) studied sixteen co-ops and found considerable variation even in small co-ops. Three co-ops with less than 10 members employed a co-ordinator or manager. In contrast, some of the largest (and most successful) co-ops, instead of adopting the 'classic' model, adopted complex collective structures.

Cornforth, Holmström, and Rothchild and Allen Whitt all draw attention to the fact that organisation structure is strongly influenced by the circumstances in which each co-operative is formed. In the case of 'New Wave' co-ops, collective forms of management are usually preferred. However, in the case of 'rescue' and 'endowed' co-ops formed by converting a conventional business, it is often the case that existing managers and structures survive alongside the establishment of a workers' assembly.

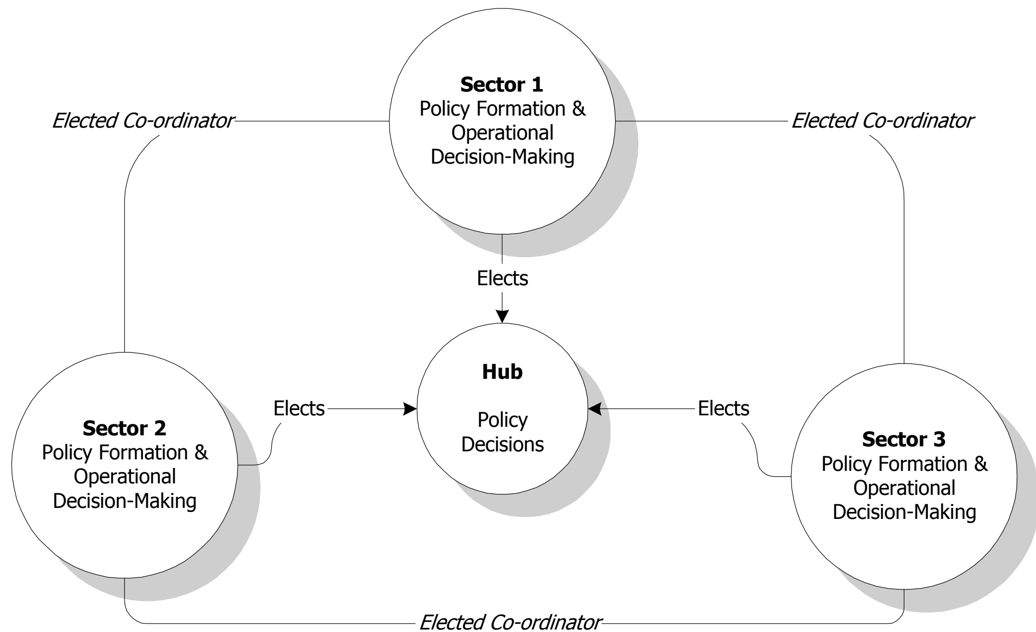
Alternative Structures for Growth

Suma, in Halifax, resisted the tendency towards an elected policy-*making* body. In the early 1980s, it started experimenting with alternative collective forms that devolved decision-making powers away from a General Meeting to smaller autonomous groups (ICOM, 1989). Initially, they divided the General Meeting into two groups - personnel and finance. This was later succeeded by a doughnut model, in which autonomous groups were given freedom to organise their day-to-day activities including recruitment, scheduling and business development.

By 1988, Suma had evolved the doughnut model further. As the number of staff had grown (to more than 40), the General Meeting was considered impractical. Suma divided into 3 sectors, and each sector elected representatives to a central co-ordinating body nicknamed the 'hub' (Cornforth C, 1995). Each sector meets weekly to discuss issues facing the business, and their views are taken to the hub meetings for decision. Co-ordination is achieved through a business plan, departmental budgeting, and an elected position of sector co-ordinator, with responsibility to co-ordinate within and between sectors.

The significance of Suma's structure is that policy *formation* and operational management remains devolved (close to product and service delivery), while policy *decisions* are conceded to an elected body. As a whole, the structure maintains the participative character of collectives, rather than the predominantly top-down representative models discussed earlier.

Diagram 2 – Suma Doughnut Structure



This might seem like an isolated diversion but for the fact that the doughnut model has helped Suma's growth and commercial success. By 1993 the structure supported over 60 staff and by 2000 over 90 (Warburton, personal communication). The doughnut model was included in ICOM management training seminars in the late 1980s and early 1990s, and has been adopted by other UK co-ops keen to preserve participative management structures[3].

Towards a thesis

Certainly, it appears that there is a much stronger dependency between company rules and finance than company rules and management structure. We have seen that in the UK, while there have been fewer success stories than on the continent, the successes that have been achieved have depended less on adherence to a particular management structure than on establishing a stable financial base. Considering Suma's continued growth it seems reasonable to conclude that business expansion and commercial success does not depend on adopting conventional business management styles and structures, providing there are high levels of participation combined with formally delegated decision-making powers.

There is considerable variation in management styles and structures within UK social enterprises even within companies that use the same model rules. ICOM companies can use collective, representative, or line management structures (including combinations of these) without necessarily affecting their commercial development. The main conclusion we can draw about the relationship between ownership and structure is that where common ownership gives rise to collective forms of

management, these are subject to their own span-of-control limits. Group effectiveness diminishes as the number of members rises above 6 members and simple collective management needs to give way to new structures in which the role of consensus changes, and decision-making power is formally delegated to an elected team or manager.

Our fieldwork, therefore, will test the thesis that the link between company rules and access to finance is a more significant factor in the growth of social enterprise than management structure.

Research Methodology

Twenty organisations were selected from the directory of co-ops and employee-owned businesses published by Democratic Business Ltd. The businesses were all selected from the London and Home Counties without regard for size. With the exception of the researcher’s own company, the size of each was not known beforehand. London was selected because it was the only area that contained sufficient numbers to obtain a balanced sample of non-equity and equity co-ops of a single business type.

Even in the London area, it was not possible to select all organisations from a single industry, so each company was screened to check that they derived their income from the sales of value-added or professional services (management services, consultancy, computer services etc.) to limit the variability of the sample as far as possible. An attempt was made to obtain data on turnover and expenditure from publicly available records. However, because many were small, this information was not always available. Obtaining financial data in test interviews proved impractical and unreliable. It was felt that inaccurate or incomplete data would be less useful than a subjective assessment of turnover and staff changes obtained during the interview. The questionnaire was amended accordingly.

Semi-structured telephone interviews were used. Face-to-face interviews were considered, but it was felt that the additional time this would take would limit the sample size further and make it more difficult to obtain a sample large enough to make effective comparisons. Structured questionnaires were also considered, and indeed tested in a trial, but these did not reveal any details about the decision-making *process*, and reduced the researcher’s ability to understand the attitudes of the interviewees towards their own working practices.

A final sample of 11 companies agreed to be interviewed by telephone, and one answered the questionnaire by e-mail. In most cases, a 1-page e-mail document explaining the research was sent to the interviewee prior to the telephone interview.

During interview, it was found that two organisations were non-profit making, and these have been excluded from quantitative analysis. This leaves a final sample of ten service-based profit-making businesses from the London area, with an equal

number of non-equity co-ops (prevented by their rules from issuing shares) and equity co-ops (allowed to offer shares).

Each telephone interview lasted between 15 and 40 minutes. The interview gathered background information: when the business was established; how many staff were currently employed; and how the company was constituted. The main body of the interview focussed on decisions involving significant expenditure. Each organisation was asked to explain how proposals were put forward, the forum(s) in which they were discussed, and which person or body had final decision-making authority. We discussed how each expenditure was financed, and the extent to which this was typical of previous practice.

Each interview was rich in qualitative data, particularly about the trading conditions, special constraints and the causes of expansion. Therefore, the results that follow include qualitative comments and a separate section for qualitative feedback.

Results

Five businesses were constituted under common ownership model rules as Companies Limited by Guarantee. These issue a £1 share to members upon completion of a probationary period. Members give up the share upon leaving. The share does not accrue in value, and does not entitle the member to the company's profits or assets (upon liquidation). Profits are sometimes distributed through bonuses.

The other five businesses were constituted as Companies Limited by Share. Two were under model common ownership rules that allow shareholding, either through an employee trust, or direct investment. While entitling the shareholder to a proportion of profits, shares still do not confer ownership rights or accrue in value. The other three businesses used internally devised rules to issue tradable shares. Shares in these companies are revalued periodically and can rise and fall in value.

In order to help evaluate the impact of size on the various results obtained, some tables have been presented in size order so that differences between non-equity and equity businesses become more apparent.

Note – enterprises that allow the revaluation of shares owned by individuals are marked with an asterisk.

Quantitative Data

Below are the results obtained from the interview questions.

Table 1 – Breakdown by Size and Management

Type	Size	Managers?	Board?	Comments
Equity	7	Yes	Yes	Have a General Manager. Board is elected by staff
	8*	Yes	Yes	Structure/Staff inherited from previous company. Have a Managing Director.
	10	No	Yes	No managers, but do have professional directors
	50*	Yes	Yes	Previously run by General Meeting, but growth required creation of a Board, with management and teams.
	105*	Yes	Yes	Directors appointed by Staff Teams. Board only meets to approve accounts before AGM. Have an elected Staff Welfare organisation.
Non-Equity	3	No	No	3 core staff, but work regularly contracted to a further 4 freelance staff. Additional freelance staff are contracted in busy periods.
	9	Yes	No	Work Allocator, Personnel Manager and Finance Manager appointed by consensus each year.
	10	No	Yes	Management functions distributed amongst directors. Members become directors after 2 years
	15	No	No	
	16	Yes	Yes	Managers appointed by Board. Board is self-selecting

Table 2 – Breakdown by Size and Authority to Make Expenditure

Each organisation was asked whether individuals were authorised to make expenditure to determine how much decision-making authority is delegated.

Type	Size	Can Individuals Authorise Expenditure?
Equity	7	Yes – up to £500
	8*	Within Approved Budgets
	10	Within Approved Budgets
	50*	In Transition to Departmental Budgeting
	105*	Within Approved Budgets
Non-Equity	3	Minor Items Only
	9	Minor Items Only
	10	Minor Items Only. Cheques need one director's signature up to £500, but group approval required before making purchases
	15	No
	16	Within Approved Budgets – variable individual limits

Table 3 – Staff Numbers, Average Age and Size

Background information on the age of the business, and number of current staff was asked to validate subjective data about growth.

Type	Average Age	Average Size (Staff)
Equity	7	36
Non-Equity	15	11

Table 4 – Where are proposals made and discussed?

We then discussed where proposals for staff recruitment and equipment purchases were typically initiated and discussed. As the process changed little for different categories of expenditure, only one table is presented.

Type	Size	Source of Proposals	Comments
Equity	7	Management	Consensus sought, General Manager keen not to be seen as 'manager'.
	8*	Staff Team	MD keen on participative management style and consensus
	10	Management	
	50*	General Meeting/Management	Managers not answerable to General Meeting any more, just the board (which contains staff representatives)
	105*	Staff/Management Team	Mostly team-based, with Directors being consulted
Non-Equity	3	General Meeting	
	9	General Meeting	
	10	General Meeting	
	15	General Meeting	
	16	Management or Board	…but meetings held with staff every 2 weeks to ensure participative management style

It is noteworthy that two equity co-ops allowing their shares to be revalued periodically have adopted fundamentally different approaches to organisation, with Staff Teams taking the lead role in the creation and development of proposals.

Table 5 – Where are proposals finalised and approved?

Type	Size	Final Decisions	Comments on Decision Making
Equity	7	Management	General Manager says he plays down his 'manager' role as far as possible
	8*	Management	Consensus always used (never vote), but MD must approve
	10	Management	Board takes decisions. Always vote.
	50*	General Meeting/Management	In transition from General Meeting authority to more conventional management structure due to conversion and rapid growth
	105*	Management	Consensus always used (never vote), but relevant Director must approve decision.
Non-Equity	3	General Meeting	Consensus amongst 3 core staff
	9	General Meeting	Normally consensus, occasional voting
	10	General Meeting	Normally consensus, occasional voting
	15	General Meeting	
	16	Management or Board	Consensus always sought, but final decision rests with board

Table 6 – How is business expansion (staff recruitment) typically financed?

Having discussed the decision-making process, we then reviewed how major expenditures were financed.

Type	Finance Raised Using...	Number	Comments
Equity	Cash Reserves/Profit	1	Only 4 responded to this question.
	Loan Finance	1	Fifth business had not taken on staff in the last 5 years
	Equity	2	
Non-Equity	Cash Reserves/Profit	4	
	Loan Finance	1	

Table 7 – How is new equipment typically financed?

Type	Finance Raised Using…	Number	Comments
Equity	Cash Reserves/Profit	3	
	Loan Finance	1	
	Equity	1	Initial equipment purchases only
Non-Equity	Cash Reserves/Profit	4	
	Loan Finance	1	

Table 8 – Changes in turnover in last 5 years?

Finally, each organisation was asked to assess changes in turnover and staff numbers over the last 5 years.

Type	Change	Number	Comments
Equity	Up a Lot	4	Including all businesses with revalued shares
	Up a Bit	0	
	Steady	0	
	Down	1	
Non-Equity	Up a Lot	2	
	Up a Bit	0	
	Steady	2	
	Down	1	

Table 9 – Changes in staff numbers in last 5 years?

Type	Change	Number	Comments
Equity	Up a Lot	3	Including all businesses with revalued shares
	Up a Bit	1	
	Steady	0	
	Down	1	
Non-Equity	Up a Lot	2	
	Up a Bit	0	
	Steady	2	
	Down	1	

Table 10 – Employment Growth

The above (subjective) assessments were tested against the background information obtained at the start of the interview to validate consistency.

Type	Employment (Whole Sample)	Years Traded (Whole Sample)	Growth in Staff Numbers (per annum)
Equity	180	35	5.1
Non-Equity	53	77	0.6

Qualitative Data

The introductory discussions about the workings of each business yielded some rich qualitative data about the problems and growth potential of each type of business. A minority of non-equity co-ops were happy with (even proud of) their size and structure, and always used cash reserves/profits for expenditure. Some had limited aspirations regarding growth, recognising that growth would bring changes that few members wanted. One non-equity co-op preferred to handle busy periods by contracting freelance staff, rather than employing permanent staff.

However, it was noticeable that the three co-ops working in areas of new technology (all founded as non-equity co-ops) experienced problems obtaining finance for investment. The first converted to a company limited by share to overcome its problems, the second created sister companies that could receive investment, and the third is planning to change its rules to issue equity.

Several non-equity co-ops were unable to obtain loans or overdrafts without personal guarantees. Equity co-ops (particularly those where members themselves had made investments) found it much easier to obtain bank loans at low rates of interest, or fund start-up and expansion costs from equity. However, there was one notable exception: one equity co-op had rules that prevented the issue of external equity. Additionally, they did not require up-front investment from new staff, and planned to distribute equity equally each year. The bank was unhappy and made a loan conditional on personal guarantees, nor did they approve of issuing equity to all staff, advising them to distribute it only to managers. The enterprise decided against a bank loan, and traded its way out of debt. Five years later, its turnover had tripled, staff numbers had tripled (to 105) and profits had increased ten-fold.

Staff in two of the non-equity co-ops felt they were not being adequately compensated for past successes and sacrifices. This was combined with feelings that new workers benefited disproportionately from the sacrifices of existing and ex-workers. In one case, workers who had foregone training to enable others to receive it saw the beneficiaries quickly leave and obtain higher wages. In the most extreme cases, directors felt trapped by their rules and expended considerable energy finding ways to work around them. In one case a (successful) non-equity co-op created a private limited company to prevent losing a customer when the customer wished to invest in their business.

In contrast to the mixed experiences reported by non-equity co-ops, the MD of one equity co-operative recounted his experience working in a previous US employee-owned business. Equity was available to all staff, but paid no dividend, so that re-investment was as high as possible. The aim was to build the company (and its share value). In 7 years, shares increased from $10 to $135, and the business had a $5 billion turnover.

When it was sold off (and run down), he was able to invest £50,000 to help establish a UK employee-owned business that took on staff from the old company. Within two years it has a turnover in excess of £2 million and employs 8 staff.

The better economic performance of the equity co-ops that do not have common ownership rules should be noted here. The table below puts the employee-owned co-ops in a category of their own.

Table 11 – Employment Growth

Type	Sub-Type	Employment (Whole Sample)	Years Traded (Whole Sample)	Growth (Staff/ annum)	Average Size
Equity	Employee-Owned Business	163	21	7.8	54
	Common Ownership	17	14	1.2	9
Non-Equity	Common Ownership	53	77	0.6	11

We need to put their performance into context, and add a cautionary note about drawing conclusions from such a small sample. Two of the employee-owned businesses (as we shall call them from now on) inherited a favourable business environment, taking over existing customer-bases from businesses that were already established. Both had experienced people at top management levels, with previous business and management experience. The third business is in a high-growth industry, currently attracting large levels of investment.

In the next section, we will consider the extent to which these results support or contradict our original thesis.

Analysis

How reliable is the data? We need to take into account several factors. Firstly, all the interviewees were senior staff and some were founder members. Their aspirations and values - typically to run businesses democratically - may have projected a more idealised picture of their workplace than would have been the case if, for example, new staff had been interviewed.

Secondly, only one person from each organisation was interviewed. The image of the organisation projected to the researcher is necessarily intermingled with that person's aspirations and feelings about their company. Again, new staff may have given a very different impression. Lastly, the sample is

small which limits the extent to which general conclusions can be drawn.

However, the researcher found all the interviewees open and free in their comments, and never got the impression that relevant information was being withheld or distorted. Given the subject of the research, it was necessary to talk to staff that had an understanding of the company's constitution, structure, decision-making process and financial performance. With regard to sample size, increasing it would have introduced more variables into the study (different locations, business types[4]), which would have reduced our ability to examine the impact of company rules specifically.

We must never ignore the size of the sample. While it is as well controlled as possible (given the few number of co-operative enterprises trading in the UK), it is still too small to draw wide-ranging conclusions. We should regard the results as suggestive, rather than conclusive.

Rules and Management Structure

Tables 2, 4 and 5 give us clues to the different approaches taken to management. Table 2 shows that all equity co-ops delegate authority to make expenditure, and most use annual budgeting as an aid to authorising as well as controlling expenditure. In contrast only one (the largest) non-equity co-operative uses a similar approach, while the rest require group approval for almost all expenditure.

Tables 4 and 5 summarise the main attributes of proposal making and decision-making. Two of the fastest growing businesses (both employee-owned businesses) typically initiate proposals at the lowest level – the staff-team - and only require approval of one other person (a director or senior manager). All the equity co-ops based on common ownership rules have a formal management body (a General Council) that needs to reach its own consensus. Most non-equity co-ops require consensus at a General Meeting.

Is there a link between these approaches and business development? The data suggests there is, but it is difficult to draw a direct relationship between the two. However, it is worth recalling Suma's management structure here. Its defining characteristic was also that proposal-making and operational responsibility was devolved, with final approval sought from (an elected) management.

What we can say with certainty is that there is a qualitative difference between the approaches to decision-making in the faster growing businesses (including Suma) than the others in the sample. The focus is on senior staff nurturing good proposals (and screening out bad ones) *usually initiated at team level*. As Suma is itself based on common ownership rules (ICOM, 1987, Appendix 1), it cannot be said that they always result in a top-

down management. The higher incidence of centralised proposal making and decision-making in the sample perhaps suggests that common ownership rules encourage this.

Given the objective of participation and democratic decision-making in most (if not all) of these businesses, these findings raise the question of whether General Meetings actually produce the levels of participation and self-governance that is desired. The evidence, supported in the literature, suggests that devolved consensus decision-making between a staff-team and an experienced manager creates a more participative environment.

It is worth recalling the research on group working in the previous chapter. We learned that a loose group structure, which recognises the abilities of its best individual to solve problems, is likely to lead to better decision-making and more creativity. We also learned of serious weaknesses in collective decision-making. Our observations in this chapter are consistent with the theory that an environment which allow individuals to work in a loose coalition will produce better results than one where they are subject to formal group control.

Group proposals and group efforts appear to benefit if an experienced individual can help with evaluation and screen out poor ideas early on. When we also consider team members preference for democratic leaders over laissez-faire and autocratic leaders (see page 57), we can begin to form our ideas about the overall design of the organisation. We can envisage that organisations made up of small teams coached (and accountable to) effective managers will produce the optimum in both staff satisfaction and performance.

Rules and Access to Finance

We suggested earlier that the link between company rules, access to finance and growth may be a strong one. Table 10 shows that the equity-based co-ops took on an average of 5 staff a year, nearly 10 times the rate of non-equity co-ops. When combined with qualitative data about the investment problems in non-equity co-ops (and their various solutions) the study confirms that this link is strong.

However, it is less clear that *external* finance is necessary for fast growth. There are examples of companies growing rapidly as a result of converting or creating companies to receive external investment, but the most remarkable growth is in an employee-owned business with only internal equity, which also declined a bank loan. This supports Cornforth's findings that building a business from internal reserves can be better than seeking external investment. However, tables 6 and 7 suggest that while companies of both types prefer to use cash reserves and profits to fund equipment expenditure, external equity is useful in setting up a company and taking on more staff.

The striking difference in Table 11 between the equity co-ops (that do not revalue equity) and the employee-owned businesses

(that do) is hard to explain simply in terms of one having a more favourable business environment than the other. Clearly management skills and structure combined with previous experience make a difference, but the link between these and business rules are not direct or immediately apparent. Nor are they mutually dependant. On the other hand, the links between business rules and access to finance are clearly observable, and can be seen to directly influence the rate and nature of business development.

Can we generalise from our conclusions? The answer is a heavily qualified "Yes". The sample, while including some variability and being fairly small, was sufficiently well controlled and representative enough to suggest some generally applicable conclusions. We can, with some certainty, say that company rules do not directly influence management structure, but do *encourage* certain structures. In saying this, but we should keep in our thoughts the exceptions that show how easily these can be changed. One non-equity co-op ignored its rules on voting rights, introduced a self-selecting board and fairly rigid top-down management. Other companies that provided for voting according to share-allocation never voted on anything, and used consensus in all decision-making. <u>Management style and structure is a matter of choice, whether the rules seek to influence them or not</u>.

Finance is a different matter. The possibilities open to a business are intrinsically linked to the rules and law. The evidence suggests that restrictions on the issue of equity have the potential to harm business development. While the data was inconclusive about whether *external* equity is necessary, it firmly suggests that equity in any form helps businesses develop faster, and that variable yield equity, which allows employees to benefit from the growth of the business, encourages faster growth.

Is the link between company rules and finance more important than between company rules and management? On this evidence the answer is equivocal. Certainly the rules influence finance more than the management, but this is not the same as saying that access to finance is *more important* than management. On this question, we cannot really provide an answer, only that both finance and management contribute significantly to commercial success.

Recommendations

The main conclusions of this study suggest a clear course of action. A social enterprise is best served by establishing itself as an employee-owned business with rules that allow staff to acquire equity. It helps if that equity is allowed to vary in value with the fortunes of the company. While there is evidence suggesting that external equity is not necessary for rapid growth, it can play an important role in weathering a downturn in trade,

make business development easier and help fund expansion. It is also a tool for cementing joint ventures with suppliers and customers.

With regard to further research, there are three recommendations. Firstly, a follow up study with a larger sample, which interviews less senior staff would confirm whether the decision-making processes described here are a reasonable reflection of general practice. Secondly, there appears to be a consistent link between team-based decisions approved by senior staff, higher levels of participation and faster growth. This is worth a separate study, particularly in the light of modern management theories suggesting that team-based structures with supportive 'democratic' managers are more efficient than traditional top-down management. If our measure of democracy is the giving of a voice combined with accountability, there are serious questions to ask about the effectiveness of General Meetings in allowing effective participation.

Lastly, it is apparent that Common-Ownership and Employee-Ownership are fundamentally different and give rise to different internal dynamics and growth potential. A further study would be useful to understand these dynamics in more detail, and reveal why employee-owned businesses outperform common ownership businesses by such a wide margin.

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[1] Against a backdrop of growing civil rights and women's movements

[2] 40,000 of these are employed by the John Lewis Partnership

[3] Including ContactSoft Ltd

[4] Companies outside the London area, or in retail or manufacturing would have been drawn into the sample.

Chapter 7 - Designing Organisations

Overview

The Job Description

I trod, where fools alone may tread,
To speak what's better left unsaid,
The day I asked my boss his view
On what I was supposed to do;
For, after two years in the task,
I thought it only right to ask,
In case I'd got it badly wrong,
Ad-hoc'ing as I went along.

He raised his desultory eyes,
And made no effort to disguise
That, what had caused my sudden whim,
Had equally occurred to him;
And thus did we embark upon
Our classic corporate contretemps,
To separate the fact from fiction,
Bedevilling my job description.

For first he asked me to construe
A list of things I really do;
While he – he promised – would prepare
A note of what he thought they were;
And, with the two, we'd take as well
The expert view from Personnel,
And thus eliminate the doubt
On what my job was all about.

But when the boss and I conflated
The tasks we'd separately stated,
The evidence became abundant
That one of us must be redundant;
For what I stated I was doing
He claimed himself to be pursuing,
While my role, on his definition,
Was way outside my recognition.

He called in Personnel to give,
A somewhat more definitive
Reply, but they, by way of answer,
Produced some vague extravaganza,
Depicting in a web of charts,
Descriptive and prescriptive parts,

Of tasks, the boss and I agree,
Can't possibly refer to me.

So, hanging limply as I am,
In limbo on the diagram,
Suspended by a dotted line
From functions that I thought were mine,
I feel it's maybe for the best
I made my innocent request;
I hopefully await their view
On which job of the three I do!

Bertie Ramsbottom, *The Bottom Line: A Book of Business Ballads*

Fundamentals

Why is organisation design important? In our review of group working we found that any group that is to function effectively has a large number of issues to address (see page 52). Many of these are resolved (or made worse) by decisions taken about formal organisation structure.

John Child (1984) summarises the essential questions that organisation designers need to consider[1]:

- How should tasks and responsibilities be allocated to individuals?
- How specialised should job specifications be?
- What formal reporting relationships are required between individuals/teams?
- How many levels of hierarchy are necessary?
- What span of control is desirable for each manager/team?

Task Allocation/Job Specification

In planning a new organisation, we need to consider exactly what work the organisation will do and then construct jobs that will best contribute to achieving it. In constructing jobs, we should satisfy ourselves that we have answered the following questions.

- What tasks need to be done?
- How will tasks be taught?
- How should tasks be organised into jobs and who should decide this?
- How much discretion to should be delegated to the individual?
- Who should have authority, and what responsibilities accompany authority?
- What factors influence the desirability of 'tight' and 'loose' job specifications

In order to avoid the comedy described in the business ballad at the start of this chapter, it is worth writing job descriptions as part of the business planning process. You can review them whenever you organise recruitment or as a practical aid to conducting staff appraisals.

At First Contact Software Ltd all members of staff have a one-page job description that briefly describes their role, followed by a list of required and desirable skills (and experience). The required skills are the minimum required to do the job effectively. The desired skills are those that would enable the person to command a top market salary for their job in a similar organisation.

The job descriptions do not list duties. In my view there is only one duty: to develop the skills set out in your job description and use them as fully as possible to benefit your company, your team and yourself. The task of the manager, in consultation with team members, is to deploy the available skills within the team in the most effective and efficient way possible. Individual duties will vary frequently - particularly when staff join or leave the team - so rigid lists of duties for each individual have the potential to undermine the flexibility within the team that the norming process (see page 52) will resolve naturally.

Using Job Descriptions Effectively

Job descriptions are of practical use. During recruitment they can be used to help design interviews to assess required skills. When assessing pay awards, each desirable skill should be taken into account and increase a member's market salary. When undertaking staff appraisals, job descriptions set the framework within which personal qualities can be properly assessed. For example, you would expect better presentation skills from your Chief Executive than from your bookkeeper.

In our review of motivation we considered Herzberg's view that the recognition of achievement is the single biggest contributor to satisfaction and motivation. A job description that sets out required *and* desired skills provides the employer with many opportunities to recognise each member's achievements. It also plays a crucial part in mapping out the career path that will enable a member to attain the best possible salary for their job and achieve status and recognition for their contribution.

Specialisation

How specialised should each job be? We reviewed the impact of job rotation on motivation in Chapter 3 and found that over the longer term, staff dislike job rotation. Research suggested that specialisation increases productivity, but only for a short period of time. Therefore, we need a middle ground that avoids excessive rotation, but that also avoids excessive specialisation in order to retain commitment from the employee and ensure they can continue to enjoy their work while still being productive.

Job Enrichment

I was once asked to write a report to recommend whether the introduction of word processors into an organisation should be accompanied by a return to the 'typing pool'. While evaluating options, I called the British Standards Institute to find out their views. The typing pool, in their view, was anathema to good job design because it failed to provide a rich work experience that allowed staff be part of a recognisable organisational task. In short, it is an example of excessive specialisation that will not improve productivity (for the company) or satisfaction (for the employee).

This supports the conclusions of Hackman and Oldman (Chapter 3), who defined the following characteristics of a job that would maximise the scope for staff motivation and satisfaction. A job should:

- be meaningful
- be perceived as part of an identifiable task
- be recognised by an employee as significant
- allow a degree of autonomy
- include a variety of mechanisms to provide the employee with feedback

Of the above, the amount of autonomy and feedback were particularly influential on the motivating potential of the job. When we design jobs that are able to provide a rich work experience, we are engaged in *job enrichment* - a technique that broadens the job experience to improve work motivation, satisfaction and performance.

Reporting Relationships

Formal reporting is intended to provide staff and managers with information that enables them to understand how the business is performing. Many organisations maintain organisation charts (a hierarchical diagram to show how staff report to each other). Associated with this is a parallel mentally where line managers define the information they require staff to collate for them.

In my career as a business analyst I have frequently had to comment on and design systems that satisfy an organisation's stated requirement. A significant amount of time is usually taken at design to persuade clients to refrain from over-collection of data. Despite this, large quantities of data are frequently collected never to be used again in any report or to support any decision.

I believe that the wasteful collection of data stems from the traditional view of the organisation. A good business system designer will work initially with system users to identify the processes they perform and the outputs they require to perform them. There will be outputs required for day-to-day administration; there will also be outputs that will reveal whether a process is working and which provide data to evaluate an aspect of organisation performance.

These outputs define the end result of a process (what data is actually used to fulfil or complete a business process). By working backwards from the outputs, the input requirements can be determined, and the input screens designed to fit in with the way the process is undertaken.

Instead of working backwards from the required result, many organisations about to purchase an information system engage in

a kind of orgy. Groups of staff get together to define all the data they believe they will ever need to collect. They employ a 'just in case' mentality, defining their data collection requirements *just in case* they might need it at some point in the future.

What these experiences reveal is that most organisations do not know what data they need to collect in order to run themselves or what to measure to test the effectiveness of their management systems.

Process-Based Views of the Organisation

The recent revisions to International Quality Management Standards (ISO 9001:2000) both challenge and add to the traditional view of organisation structure. They promote a process-based view of the organisation. One key benefit is that the organisation can better ask *what should be measured* in order to know if a particular business process works. Any measurement that does not add to your understanding of whether a process works can be discarded, saving time and effort without reducing understanding.

For example, First Contact Software Ltd has identified a process it calls 'Winning New Business'. When we considered what to measure to establish whether it worked, we found that only two measures were required:

- The number of sales enquiries
- The value of orders

At ContactSoft Ltd, before we learned how to take a process-based view, we prepared reports for the AGM on the number of enquiries, the number of sales leads, the number of product demonstrations, the number of quotations, the number of sales proposals, the number of new clients, income reports etc.

If our marketing is improving, enquiry numbers will increase.

If our selling technique is improving, order values will increase (so long as enquiry numbers do not drop)

Order Values/Number of Enquiries should increase over time (all other things being equal).

Only these two measures are actually necessary to tell us that we are doing things right. Everything else is over-collection and results in over-reporting that does not increase our knowledge.

The traditional view is still helpful to us in the task of deciding what jobs are needed and who is responsible for staff mentoring, appraisal and development. The process-based view is much better at deciding what we need to report and to whom.

Below are two views of a fictitious computer company Leading Edge Ltd from different perspectives. We can then take

these into account when we consider the impact they may have on job and team design.

Diagram 1 – Leading Edge Ltd - Organisation Tree

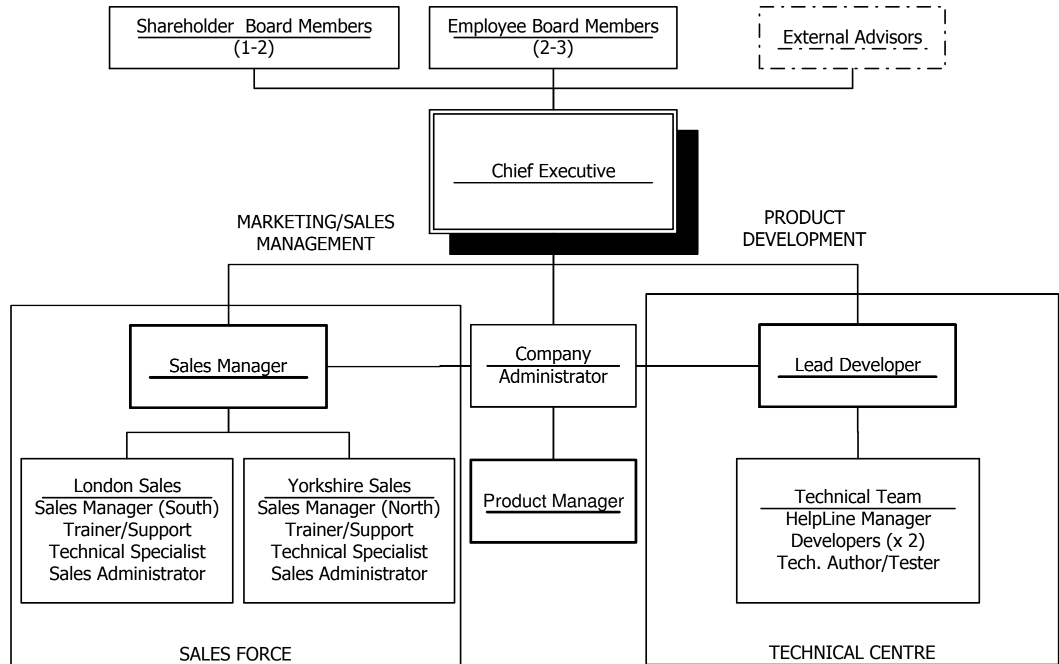
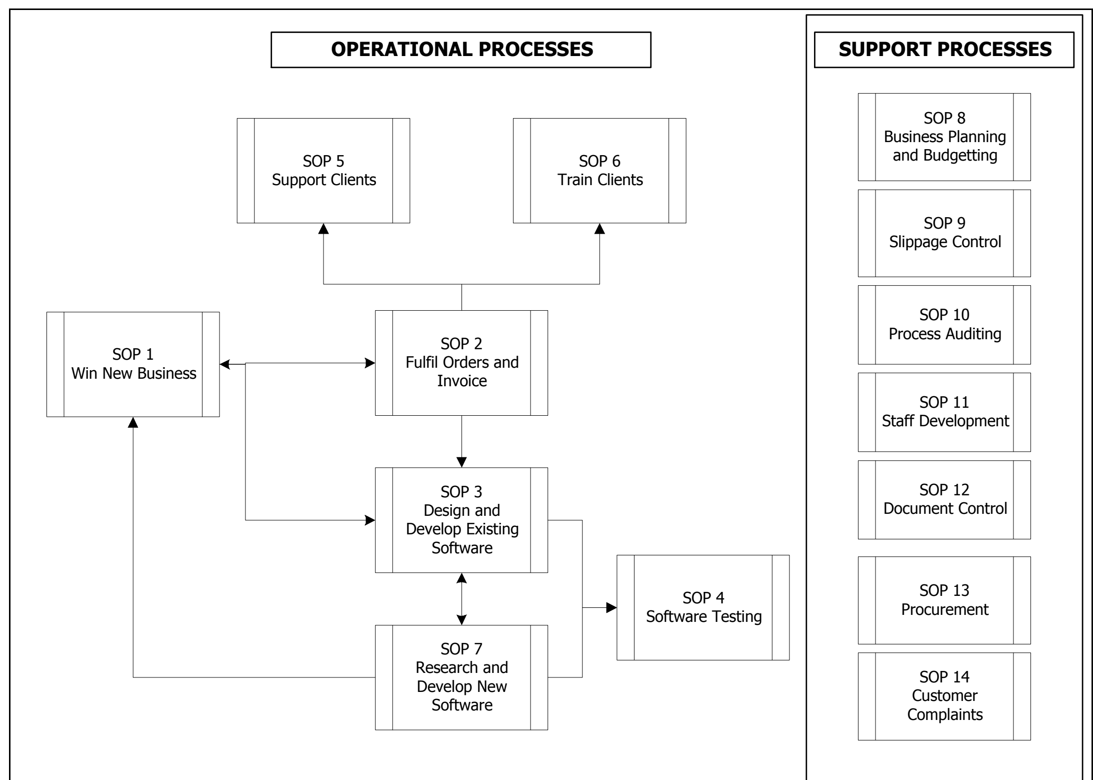


Diagram 2 – Leading Edge Ltd in Process View



Within an ISO management system, we must define who is responsible for each process, and which staff are involved. We must also define what is measured to establish if a process is improving or getting worse. If we do this well, we can minimise the number of things that we need to collect in order to effectively monitor the performance of the organisation. Minimising this will maximise the amount of time actually spent trying to achieve the organisation's goals.

Spans of Control and Self-Managing Teams

How many people can a manager (or team) effectively manage? Research suggests that there is no single answer to this question as it depends on two factors:

- Technological environment
- Variability in the production process

Where variability in the production process is considerable, and the technological environment more complex, the number of staff that can be effectively managed by one person may be as low as three. Where there is standardisation in production, and technology is established and reliable, the number may rise dramatically.

Tom Peters argues for "teams as the building blocks of modern organisations" and that a manager could effectively manage over 100 staff organised into self-managing teams. Experience from the co-operative sector suggests this is not possible without problems of structurelessness arising (see page 43) and will also create problems with accountability.

My own experience, albeit in a highly technical and variable 'production' environment, suggests that workgroups bigger than six have the potential to fragment and become less effective with each new member.

ContactSoft was a self-managed enterprise (there were no formal managers). Several times in the 1990s the organisation grew to about 9 – 10 staff, only to shrink back again to 6 or 7. Each time it shrank, the organisation became more profitable (even though the conventional wisdom is that the increased overheads per person should have made the company *less* profitable). Each time it grew it became *less* profitable and later shrank again.

The only way to account for this is that without formal management structures, self-management becomes increasingly ineffective when there are more than 6 people in the team. If we are to believe Peters, then it follows that a manager can effectively service over 15 self-managing teams – a tall order in my view unless there are factors of technical simplicity and standardised production that make this possible.

We should also consider evidence from the last chapter. In ten years, 1176 'New Wave' co-ops were created in the UK employing 6,900 people - an average of just six staff per co-op. The same pattern was true in the US where 30,000 jobs were created in about 5,000 'New Wave' co-ops – again just six staff

each. Clearly, there is a natural process within self-managing groups – with no formal management structure – that inclines them to grow and stabilise at about six members.

When we build our social enterprise, we need to bear in mind that the benefits of autonomy are eroded once a team grows beyond six. Our optimum model, therefore, should combine teams of up to six people working with skilled managers. This will maximise scope for autonomy - a highly significant factor in motivation – without compromising efficiency.

Degeneration in Democratic Organisations

Meister (1974, 1984) established a theory of degeneration, which has been applied to democratic enterprises[2].

Stage 1 - High commitment and idealism

Stage 2 – Appointment of administrators/coordinators

Stage 3 – Loss of idealism, adoption of market values

Stage 4 – Control by members given up to managers

Certainly, we can observe this process repeatedly in many organisations that started out with claims to be democratic. However, the strength of the degeneration thesis falls if idealism is not lost when market values are adopted. Indeed, to suggest that market values are not democratic is itself a questionable assumption.

The theory also falls if the introduction of managers – on balance - increases individual participation, influence and accountability. These three measures are surely the ones we should use to judge any claim to be democratic.

ContactSoft's transition to First Contact Software Ltd appears to support the degeneration thesis and yet I would argue on two key fronts:

- Its ideals have changed rather than been lost
- Its members can influence organisation policy, operational practice and staff development more than they were able to through collective management structures.

How can a degenerated co-operative claim to increase members influence over the organisation? If we recall our learning of group theory, we observed how difficult it was a member to voice their own opinion if the whole group is present. Asking people to vote publicly in General Meetings (particularly if this is by a show of hands) will *decrease* democracy, not increase it.

By giving individuals specific ways to contribute to operational practice (through an ISO management system) and granting individuals the right to appraise their managers and peers (as in a 360° appraisal system), you can actually *increase* their ability to

participate and influence their working environment. This environment can be combined with voting rights over business objectives and policy to maximise participation in all its forms.

Market values are not incompatible with democracy. As we discussed in Chapter 1, markets have a broadly positive role to play in keeping both people and companies accountable. Is Meister's idealism one in which the right to a voice is more important than personal accountability? If it is, then he confuses anarchy with democracy.

Cornforth (1995)[3] wrote a paper arguing that there is an alternative to degeneration without repudiating the degeneration thesis. To see whether there is a case to answer, let us consider how First Contact Software Ltd measures up against the Six International Co-operative Principles:

<u>Open Membership</u> - no discrimination in who can become a member.

Employees of First Contact Software Ltd are members as soon as they join and are eligible to stand for directorship. Investors are also members and can standard for directorship.

<u>One Person, One Vote</u>
Employees of First Contact Software Ltd acquire 1 voting share in each of the first five years. Employees who have been employed for 5 or more years vote on an equal basis. The weighting of voting shares allows existing members to protect established policy during rapid expansion of the business, and allows new members to earn equality through commitment to the enterprise.

<u>Limited Return on Capital</u> - invested money receives fixed interest – profits must not go to capital.

Loans – the mainstay of many social enterprises - guarantee that money goes to capital even when profits are <u>not</u> made. Research confirms that business performance is better and employee incomes higher when some profit goes to capital.

First Contact Software Ltd divides the surplus equally between employees and shareholders. Employees can limit the return on capital by increasing their risk (by putting more of their salary into a bonus scheme) that will allow them to keep more of the surpluses they create.

<u>Members Benefit in Proportion</u> to their participation in the co-op – i.e. fair wages, bonuses.

First Contact Software members receive fair wages and have an appeal procedure if they believe their wages are below market rates. However, managers can use the same appeal procedure if they believe a member is overpaid. Shareholders can ask for the re-valuation of any member's salary (including managers and directors).

All members participate in a bonus scheme and receive benefits in proportion to the risks they take.

Educational and Societal Objectives - genuine commitment to members' personal development, and improvement of society.

First Contact Software Ltd is totally committed to developing its staff and fulfilling both educational and social objectives (such as providing increased employment and promoting community values). We recognise, however, that profits are necessary in order to fulfil these commitments. We are an Equal Opportunity Employer.

Co-operation between Co-operatives - break down competitive market relations with other co-operatives.

Most UK co-operatives cannot co-operate with each other effectively because the best mechanism for co-operation (equity) cannot be issued (see Chapter 6). Market relations keep businesses accountable and benefit the consumer. First Contact Software Ltd issues fully tradable shares and will use them proactively to build a network of democratic employee-owned businesses that will swap equity to create mutual dependence. This use of the market will lead to more co-operation, not less. The issue of tradable shares does not compromise the policy-making rights of employees.

I leave judgement to the reader.

Conclusions

Good organisation design starts with an understanding of the processes involved in running a business. Once these are understood, you can begin to define the tasks involved in each process and how they can be organised into jobs. Even when an organisation grows, the process-based view will not change unless the product range or production process changes substantially.

By starting with a process-based view, it becomes clear what measurements you need to take to establish whether each process is working or failing, and which people should take responsibility for monitoring and improving them. Information should be provided to the team, not just its manager, so that all members can contribute to improving each process.

The knowledge gained can be fed into the writing of job descriptions and also the requirements for information systems needed to support and develop the business. A third key benefit is that the training requirements of staff are clear from the outset and effective induction is made easier.

Traditional organisation charts are still useful to represent how people will be organised into work teams. They show who takes management responsibility for staff development and appraisal within each team and help establish a social structure more quickly, particularly for new employees.

Process-based management systems help us to create jobs that provide a richer, more meaningful working experience, which will enhance motivation, productivity and satisfaction. We should avoid rotating jobs too often, or making them so specialised that people cannot connect their own job to the wider tasks of the organisation.

Having considered many issues, let us now bring them together in a discussion of building the enterprise.

1 Child J (1984) Organisation: A Guide to Problems and Practice, 2nd: Harper & Row London

2 Cornforth et al (1988) The degeneration thesis. Developing Successful Worker Co-operatives.

3 Cornforth C (1995), Patterns of Cooperative Management, Economic and Industrial Democracy, Vol 16, p 504-509.

Chapter 8 - Building a Business

Overview

In this final chapter we look at how we can create a democratic firm that is participative and thriving in every sense. The sources for this final chapter include material from all previous chapters, but also two new ones. Firstly, there is the theoretical basis for a new type of democratic enterprise reviewed in "The Democratic Firm" by David Ellerman (1991). Ellerman's work was one of four cited by Guy Major as a major influence on the debate about ownership in co-operatives during the 1990s. The concrete expression of some of Ellerman's ideas is captured in the model rules used by First Contact Software Ltd[1]. The lasting importance of Ellerman's book to us is what it has to say about ownership and control.

The second key text is "Making it Big in Software" Peter McHugh (1999). This is a text from the European Software Foundation specifically looking at successful UK software companies and the conditions that brought about their success. It is more a management handbook than an academic text. However, its importance to us is its extensive discussion of business development and the pre-requisites for the growth of technology businesses. It considers the question of why some companies grow while others do not. After overcoming initial hurdles, it then discusses the establishment of a sales channel and creating a 'winning business model'.

Ownership and Control

In Chapter 6 we discussed the various forms of co-operative enterprise. We remarked how a new form of Labour company fuelled successful growth of the co-operative sector in Spain where 85% of workers must own shares, and 49% of shares can be sold to external investors. Indeed the 51%/49% split in share ownership is one of the long-standing measures in many countries of whether a co-operative is worker controlled (and therefore a *real* co-operative).

However, there is a precedent for allowing more than 50% of shares to be held externally in French co-ops. This is complemented by provisions to ensure that management remains under worker control, and that over 50% of profits are distributed to members.

The need for a 51%/49% split in shares is based on the assumption that to retain control a link must be made with *ownership,* yet this is clearly not the case in France. Ellerman discusses the rationale for this link and argues that it is a tenet of capitalist ideology (expressed through company rules) because of the owners' concern about their ability to control the company. However, the link is a choice, and is not inevitable. It is easy to establish the separateness of control and ownership with a few simple tests.

Companies that own a lot of assets can lease them to other companies. The fact that they own the assets of another company does not entitle them to a share of the profit that the other company makes through use of the asset, or to manage its operation.

Equally, companies often own very few assets, but nevertheless thrive and have a complete legal entitlement to retain all residual profits and manage themselves. This is not to say that the owners of the assets are without influence. Clearly the less a company owns, the more vulnerable they are to external influence. However, Ellerman establishes that a company's claim to its own profit is based on the direction of the hiring agreement. Whichever company hires (or creates) the asset becomes entitled to the profit generated by it – ownership is immaterial. Once you conclude that ownership and control are indeed separate and independent, you can freely explore the role of each in the construction of a new type of company.

Many old-style co-operatives *and* conventional private businesses cling to the assumption that ownership and control must go together. However, it is a matter of record that any business that clings to control at the expense of investment will compromise its ambitions if it wishes to grow and achieve financial stability. Social enterprises need their own resolution to counter the problems created by this mindset. Their approach needs to uphold the benefits of democratic control and accountability while successfully attracting investors (both internal and external) by sharing surpluses.

The Employment Contract

Ellerman attacks the *employment contract*. He asserts that it is through the employment contract that capital hires labour and alienates it from its share of surplus and its moral right to control the enterprise.

"The employment contract is essentially a scaled-down version of the Hobbes' anti-democratic pact of subjugation wherein people give up and alienate the right to govern themselves to a sovereign (the employer is *not* the representative or delegate of the employees)" (p. 32)

He argues for a new model in which there is a fundamental change in a worker's relationship to his firm; s/he becomes a member-owner rather than an employee. In this state, s/he has

to share both the good (profit-sharing) and bad (liability-sharing) aspects of ownership.

Democratic Business Ltd has picked up and given a legal form to Ellerman's ideas. UK companies can now use their model rules as the basis of their constitution. Their model rules share the same implicit assumption that an 'employee' mentality is best replaced with a 'member-owner' mentality. There is an explicit intention to create a culture in which member-owners are rewarded in the manner of an owner as well as a worker.

Like all owners, member-owners increase their employment security – and the viability of their enterprise - by accepting that their income will vary with the success of the business. The rules also encourage members to increase their income through profit-sharing and dividend payments rather than raising fixed wages. These can all be seen as attempts to cultivate owner rather than worker attitudes.

In the early days of a successful business, owners often take limited wages to build the value of the company, and later derive increased wealth from the value they have created. This is as true of social enterprises as conventional ones (hence the concept of 'sweat equity') but what differs is that restrictive rules often lead social enterprises to increase incomes by driving up wages rather than distributing equity[2]. Consequently, co-ops become vulnerable when trading conditions change, and staff have less incentive to resolve underlying business problems because their losses are usually minimal if they leave for alternative employment.

A person with an equity stake in their business will still be concerned about the success of the business if they leave. As a result, leaving the business (for another job) is a less attractive option, as the benefits of leaving have to be weighed against the possible loss of equity. Equity is therefore not just a reward mechanism, but also an ingredient in the company structure that encourages active participation to solve business problems.

Arguments for this new approach started with research by PA Management and Chris Cornforth in the 1980s, were continued by many (including Ellerman) in the early 1990s, and have reached fruition with Democratic Business Ltd. The realisation of the ideal can be found in the constitution of First Contact Software Ltd.

The vision of the future is of businesses controlled by their employees, owned by a coalition of interests (workers, family, friends, and private or public investors), with all stakeholders gradually receiving increased income through profit-sharing and dividends.

Entrepreneurial Behaviour

A key aspect of this change has to be to convince more people that an entrepreneurial attitude achieves more success

(commercially and socially) than a traditional worker mindset. There is much research on risk-aversion amongst co-operative workers, but it remains true that they show many signs of entrepreneurial behaviour, particularly in difficult trading conditions. They often accept temporary lower or deferred wages to overcome cashflow or profitability problems, providing they will be the beneficiaries when trade improves. They also wrestle with investment decisions and may forego wage increases to reinvest surpluses in their own businesses.

What is the unique contribution that entrepreneurs bring to a company? The dictionary definition of a person who gains rewards by accepting risks does not capture the whole picture. Entrepreneurship is more than making risky investments; it is also the capacity to create a productive organisation to promote a product or service.

Ellerman characterises the role of the entrepreneur as follows:

> "In a democratic firm, there is no assumption that everyone's work is of equal value to the enterprise. Entrepreneurial work is the most creative and often the most important form of work in an enterprise. Without it, the enterprise would not have been organized." (p 32)

We can add that in the technology industry, where conditions and 'tools' change rapidly, entrepreneurial behaviour is a pre-requisite for survival long after the initial organisation has been established. He continues:

> The entrepreneur's product is often intangible, a form of intellectual property or an organisation structure" (p33)

We should be clear that entrepreneurship is a type of work, not a financial contribution. The link commonly made between the two is simply that the financial contribution is often the only way the entrepreneur can employ themselves to test an idea. Of course, they typically do this to derive a financial benefit and this has led 'capitalism' to claim entrepreneurship as its own. However, Ellerman says that the relationship between the entrepreneur and capitalist…

> "…is not an entirely happy marriage. Entrepreneurship is a form of labor, not a form of capital. Within the employment system, the conflict is most acute when entrepreneurs negotiate with venture capitalists for control of the enterprise." (p 32).

It is often the case that, after negotiations, the entrepreneur ends up as an employee again, or worse still, unemployed. Will this relationship be different in a democratic firm? Firstly, entrepreneur(s) cannot be alienated from their product, as their entitlement to control it is not compromised by yielding ownership. However, this brings a new challenge – how to recognise their contribution without turning everyone else into a rented resource. Ellerman suggests that royalty payments, patents and copyrights can all be used to capture entrepreneurs' contribution.

My own view is that shares are a better compensation than patents (which are costly to a business) or royalty payments (which will create a significant amount of administration and raise costs). Like patents and royalties, they continue to provide a benefit after the entrepreneur leaves and impose no additional overhead on the business.

Summary

We can summarise the characteristics of the new-style democratic company we want to create as follows:

- controlled by its employees
- owned by its shareholders (employees and investors)
- committed to replacing the employer/employee relationship with 'member-ownership'
- committed to increasing members wealth through sharing surpluses equitably
- self-aware of the different qualities and roles that individuals contribute to the creation and development of a successful company

The next part of the jigsaw is to build an awareness of what influences the success of a company. Once we have an understanding of this, we can turn our attention to harnessing the strengths of a new-style democratic business towards a particular purpose.

Building a New Company

In this section we look at the factors involved in creating a successful technology company.

Framework for Successful Growth

Peter McHugh, in his book "Making it Big in Software" (1999) starts by considering the factors that are required for steady growth, and then identifies a series of success factors. He initially focuses on why some companies smoothly move through product Version 1.0 into early growth and then high growth, while others become stuck in a stage of their development.

He identifies a *pre-requisites filter*, which if not satisfied results in a company dropping into a *steady state*. This is where a company has established its viability and may grow incrementally, but tends to oscillate between set boundaries. Its survival, while not easy, is not really in question. However, the conditions are not present for steady growth. When we consider the pre-requisites filter, it is easy to see why so many companies remain small for a long time, while others grow very quickly.

Pre-requisites Filter

- **Ambitions** to grow the business
- A strong **product** offering

- An **effective management** team
- Access to sufficient **funding** to support growth

To progress to early growth all four of the above must be satisfied. However, the story does not end here. Companies that achieve early growth will also fall into a steady state if they do not have:

- A winning **Business Model**
- A clear **Export Strategy**

These are the *accelerator factors* that McHugh identifies. Deficiencies in these prevent the company maximising access to customers. However, if they are satisfied, a company typically moves into an *exponential growth* phase (30% or more per annum), which becomes self-sustaining and is almost impossible to stop except by changes in the product's market.

Success Criteria

McHugh identifies three qualities of an *all weather ship* - a company that is able to ride the ups and downs of business life and achieve the pre-requisites for early and high growth. The all weather ship requires:

- A Customer-Centric Product
- Balanced Management
- Equity Finance

A *customer-centric product* meets a precise market need, delivers something unique, and is continually enhanced to meet new customer requirements. The best products meet a <u>global</u> market need.

The product needs to be driven by a *balanced management team* in which changing requirements are identified and matched to available resources and new recruits, thereby maintaining management stability.

These need to be combined with *equity finance* to provide sufficient cash to fund product development, build up internal resources, create a sales/distribution channel and marketing model that maximises access to customers. In particular, McHugh draws attention to the need for business founders to have a mindset that is comfortable yielding part ownership of the company to attract investment. Initially this will come from private investors, then most likely venture capital, and ultimately from a stock market flotation.

Case Study – From ContactSoft to First Contact Software

ContactSoft embarked on all three journeys but it took First Contact Software Ltd to finish them. ContactSoft undertook a major product review in 1999, which established the basis for a more customer-centric product. ContactSoft was unable (unwilling?) to find ways of financing the necessary product development and marketing to turn around its own fortunes.

First Contact Software Ltd (partly through its new structure) was able to access additional finance and is now engaged in fulfilling ContactSoft's original goals. Account management and a user group provide two further formal mechanisms to give and receive customer feedback.

Achieving balanced management was less straightforward. Although the appearance of new management was established in late 2000 at ContactSoft Ltd, there was a clash of cultures that eventually resulted in the division of the enterprise. Staff who wished to establish new working arrangements joined First Contact Software Ltd, while those that resisted them stayed in ContactSoft Ltd or left.

Obtaining finance in a start-up venture is never easy and this continues to occupy a significant amount of management time. Establishing the new company constitution and attracting small private investors has been relatively straightforward, but convincing institutional investors is taking time. Most support has comes from within the enterprise, a bank, and family and friends. Small private investors may yet be the most influential factor in obtaining the initial finance for marketing and expansion of the sales operation.

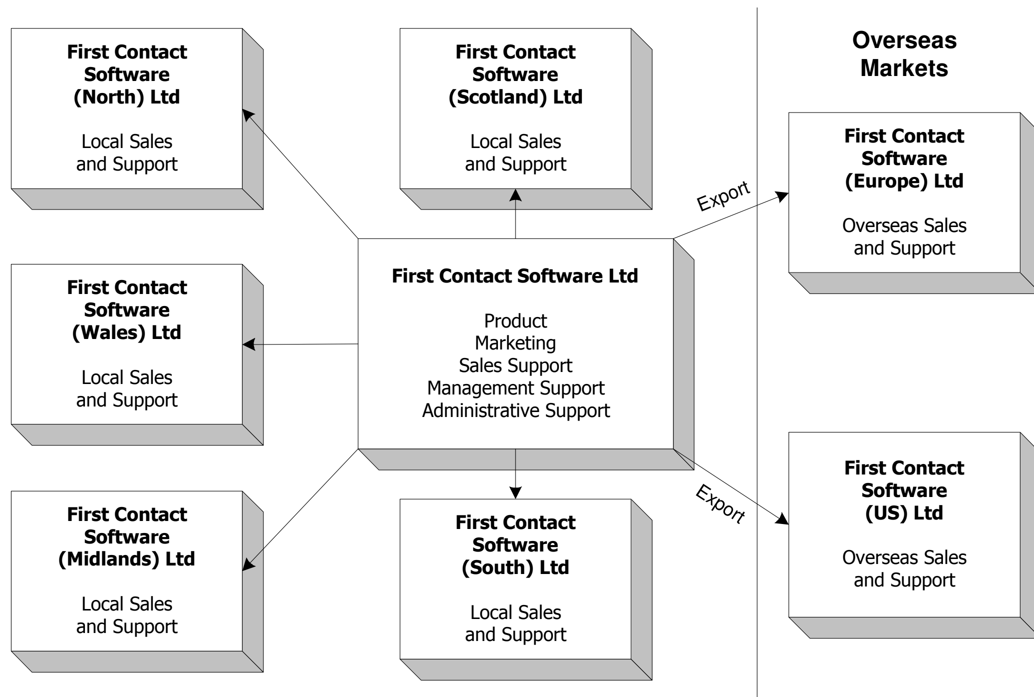
While it is premature to consider an export strategy, it is not too early to design products for an international market. It is also not too early to consider how to create a 'winning business model'. The model can be tested in the UK and once success is achieved we can learn how to replicate it.

In our case, the starting point for a 'winning business model' is the establishment of successful sales teams made up of professional sales and support staff. Once this is done, we need to focus on how to replicate it successfully and rapidly in different locations. Our winning business model is to create profitable self-managing sales teams and then offer them the opportunity to establish themselves as a separate business.

Our choice of company rules is crucial. Their importance to us is not just what they can do for us now, but what they will allow us to do when we want to create a network of companies to sell into different markets in different locations.

On the next page is a provisional view of our future development. Not only can these companies all use tradable Value Added Shares to co-operate and bind together their mutual interests, in the longer term it should be possible to establish a plc as a holding company to finance expansion.

Diagram 1 – Expansion Model for First Contact Software Ltd



The achievement of this vision rests on the ability to create sales teams that can deliver products cost-effectively. These could be branches. However, using a franchise approach (popular amongst business advisors, banks and growing companies) the chances of success may significantly increase. Franchises have a far higher success rate when compared to other methods of expansion because they offer a number of advantages.

- Risks are fewer for local entrepreneurs wanting to establish their own businesses because they do not have to invent a product and company structure
- Overheads for the parent company are lower because local entrepreneurs bear a substantial part of the start-up costs
- Franchises run as separate businesses and have a measure of local autonomy
- The organisational model binds the success of the franchise to the success of the parent company, encouraging two-way support and co-operation

If each of the above satellite organisations were a Democratic Business then all of the characteristics of the franchise model would be present, but without the legal form. The parent company can replicate the sales operation in different locations and give autonomy to local staff. However, it would have part-ownership of the operation (in return for product, marketing and admin services) that will bring revenues back.

It would also have a voice in the running of their operation (through their General Meeting and Board of Directors). An *exchange* of equity between the parent and child company would bind the success of the two companies together; each would have a voice and information rights and a stake in each other's success. The arrangement also benefits all members of the group by spreading financial risk amongst all the companies.

However, there are two importance differences when comparing this model to franchises; firstly, the model preserves and promotes a democratic form of enterprise at the local level; secondly, the parent company receives a return on its investment through Value Added Sharing rather than a management fee based on turnover.

In the last part of this chapter, we turn our attention to the sales team – the part of our enterprise that we must replicate successfully if our business model is to succeed. In doing this, we need to revisit what we have learnt from the earlier chapters in this book.

Building a Successful Sales Team

In Chapter 7, we looked at the components of organisation structure. The key point, in the context of this discussion, is what we have been able to learn about the span of control limits of teams. A number of texts (combined with our own experience) suggest that teams become less efficient when they grow larger than 6 people. What is more, the more complex the team's task, the smaller the team needs to be to maintain cohesion and effectively do its job.

Secondly, our chapter on motivation revealed a need to provide career paths for people so that they can meet personal objectives within an organisation setting. Career paths can be met either by providing a 'specialist' route, or a 'management' route. Both can have their own reward packages to recognise achievement and competence.

In Chapters 4 and 5, we considered leadership, and how this impacts on the work of a team. We recognised that team working has both benefits and problems, and that leaders emerge whether formally appointed or not. The larger the team, the more individual initiative is stifled, often to the detriment of the team's objective. We need a new model that better supports individual initiative and recognises individual expertise within a team setting.

In Chapter 6, we observed a model where consensus decision-making between individuals and an experienced manager can play a positive role alongside group decision-making. This enables individuals who are intimidated within the group setting to make their proposals directly to a manager. It also allows individuals to act on initiatives more quickly where discussion with the whole group is not warranted. The manager can use

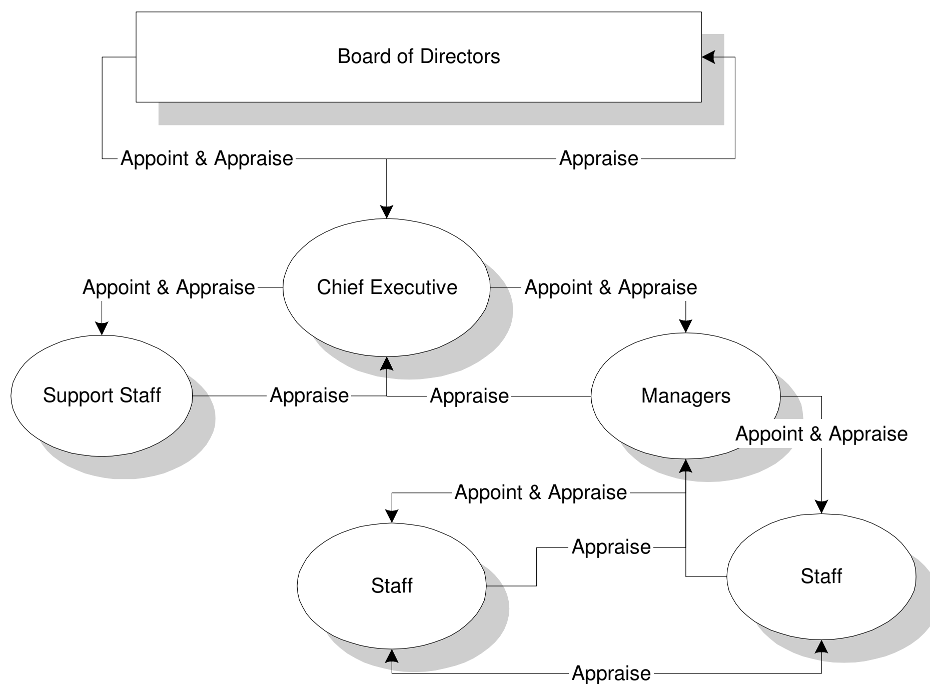
their discretion as to whether the proposals need whole group acceptance, or can be enacted immediately.

Accountability is a complex issue. Simply electing managers does not guarantee accountability and there is a strong case for people with extensive business and management experience (i.e. directors) to appoint management posts. How do you ensure that managers appointed by a board of directors remain accountable to *all* stakeholders?

The answer is to promote accountability between members and managers by weaving it into the fabric of the organisation. One method we have considered (Chapter 7) is ISO management systems, which take a process-based view of organisation. They give a voice to participants in the process but also make them accountable to it.

Another way is through the power to appoint and appraise, especially where promotion and pay prospects depend in part on the outcomes of appraisals. A system whereby each party in a direct relationship becomes responsible for a member's appraisal would enhance accountability. This approach has become known as a 360° appraisal system – taken to its extreme it would involve feedback from customers. Under this model, a team member plays a role in appraising their manager as well as vice versa.

Diagram 2 – Achieving Accountability in a Social Enterprise



The model holds good until someone receives an appraisal indicating unsatisfactory performance. At this point, our founding staff members have agreed that it becomes a management issue. Managers only then conduct that member's appraisals until performance is again satisfactory[3].

From Theory to Practice

At First Contact Software Ltd, software delivery is a complex operation, never twice the same, and varying according to the unique requirements of each client. Each sale brings together the skills of a salesperson, technical specialist, and a training/support specialist. In some cases, a software developer is also required to customise a product to cope with a specific need. This does not always imply four people are needed as some may have skills in several areas. However, we can say with some certainty that there are three skills that, when combined effectively, increase the chances of a sale:

- interpersonal skills combined with knowledge of the sales process
- implementation skills (matching needs to resources)
- detailed knowledge of how a product solves administration and business problems

Long-term success rests on the ability to demonstrate this combination of abilities to a client through the company's marketing strategy and sales process. This should increase their confidence in the company and its products. It is not possible to expect that one person can effectively communicate this combination of skills so we need to assess what collaboration will achieve our aim.

There is a good case to partner a salesperson with a technical specialist to provide mutually beneficial support. A 'good' salesperson will learn more quickly supported by a specialist and also have access to expertise that it is not practical for them to learn. Likewise a 'good' specialist needs a 'good' salesperson to deliver a steady stream of work and provide opportunities and challenges that widen their experience and skill set.

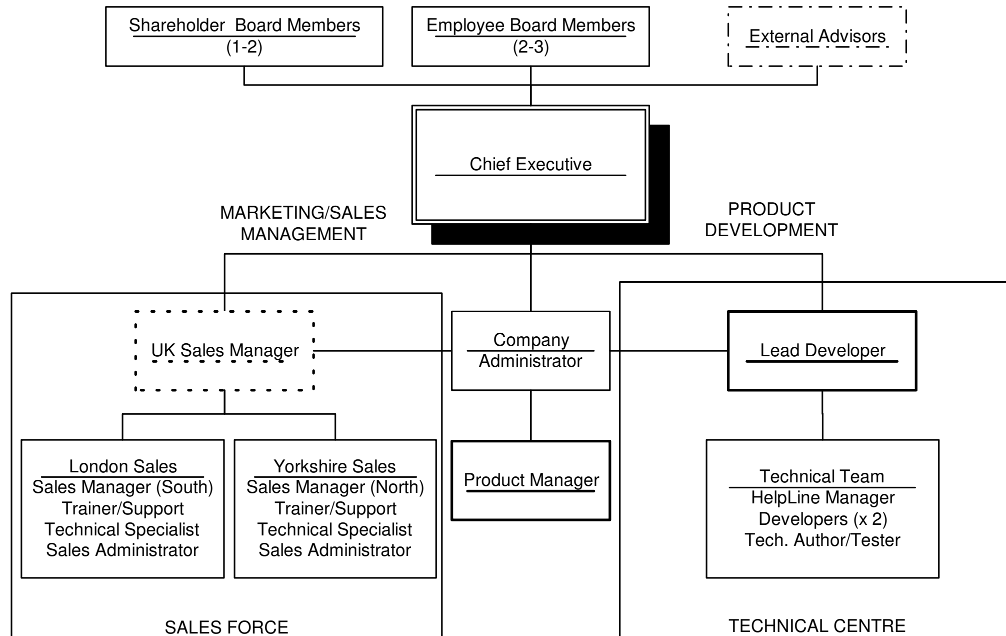
This model was used by IBM to successfully establish its business in the 1970s/80s. A salesperson was accompanied by an 'engineer' in pre-sales activities to answer technical questions/concerns. The pre-sales engineer was not always a hands-on person, but remained focussed on giving answers to technical questions required to gain trust and achieve a sale. After a sale, a 'real' engineer delivers the system.

A good salesperson with adequate technical sales and administrative support is capable of providing work for a fairly large team of support/training staff. Support, training and development specialists can be assigned to projects on a case-by-case basis. While this might create accountability difficulties, these would only need to be managed internally, and should be

no more difficult than working directly for several clients at the same time.

The considerations above invite the structure we reviewed in Chapter 7 (see below).

Diagram 3 – Leading Edge Ltd



It would be wrong to see this as a hierarchy. The owner of the process for "Winning New Business" and "Order Fulfilment" is the Sales Manager. When we consider our commitment to management as a service we can view this as a sales-focussed business model. At the centre you have a series of small sales operations (4 to 8 people) supported from two sides.

Firstly, managers set budgets, provide knowledge of each sector and guidance on organisational policy and working practices. They also arrange access to resources, and lead the recruitment and development of new staff. Secondly, the sales operations are supported by technical specialists who on the one hand provide technical expertise to the sales process to gain the confidence of the client and help cost proposals. On the other hand, they take responsibility for delivering systems effectively, competently and cost-effectively.

The salesperson (with their specialist team) also provides a service to people less close to the sales process. Sales increase the resources managers have to support the teams' activities. Similarly sales increase opportunities for technical staff to increase their skills and develop their careers. There is a clear benefit to all parties if co-operation is achieved across the organisation.

The guiding principle is that a manager should not need to interact in a group setting with more than 6 people. If a team grows beyond 6, it should trigger the recruitment of a new salesperson and the formation of a new sales team. If we do not do this, we may fail to preserve the optimum environment for autonony within teams, which contributes to high motivation and satisfaction.

And Finally...

Building any enterprise requires meticulous and careful planning if the aspirations of the company include growth and steady development. You cannot spend too long planning your business or building a support network of advisors and investors unless you have only a brief window of opportunity in a particular market.

The rocks on which a successful enterprise is founded comprise:

- A Flexible Constitution (Articles of Association)
- A Sound Understanding of Organisation Behaviour
- A Good Product Offering
- A Good Capital Structure

If the product offering is at least as good as most in the market, the business should enjoy some success.

If the product offering is one of the best in the market, the business should thrive and grow.

On top of these foundations, we must build teams of people who can work together productively. We can achieve this if we attend to the needs of people in the company and ensure there are opportunities for development and personal achievement. To help us, we can build a process-based view of the organisation to expose its information and reporting requirements. From this view, we can better establish what tasks need to be performed and how these can be assembled into jobs that people will enjoy doing.

The heart of any organisation is always its people. We must use our knowledge of motivation, leadership and group process to provide appropriate opportunities and support structures that realise their (and our own) potential. The constitution and management systems of a company should enhance each individual's capacity to contribute while holding them to account if they do not.

Participation and accountability – these are the foundation of democracy. In a democratic business they are also the foundation of commercial success and the way to effect profound social change. The silent revolution will take at least a generation, maybe two. Its fortune depends upon the ideas in this book taking root in the minds of able people who are willing

to risk their old way of life to establish new businesses that will eventually deliver wealth and opportunity. I hope this book finds you.

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[1] Based on model rules available from Democratic Business Ltd.

[2] As has happened at ContactSoft in the period 1996-2000.

[3] The argument put to the company was that once a member's performance becomes unsatisfactory there is a possibility it could end in an industrial tribunal should the member later lose their job due to continued poor performance. In these circumstances, the manager may be held to account and it was felt inappropriate that other staff (peers) should be put in a position where they are party to the decision to terminate a member of staff's employment.

Appendix A – Company Rules

Guide to First Contact Software Ltd Rules

This document is for potential employees and investors of First Contact Software Ltd. They explain important aspects of the company's rules in plain English so that they can be understood more easily. The rules are based on model rules available from Democratic Business Ltd.

Memorandum and Articles Of Association

1. The Memorandum is a document that defines the name of the company and its initial shareholders. It is sent to Companies House and can be inspected by any member of the public to establish the names and addresses of our founder members and directors. It also defines how many shares each founder member received/purchased when the company was established, and the total number of authorised shares. Initially we have 10,000 Voting Shares and 4,999,900 Value Added Shares

2. The Articles define how the company is constituted, who governs it, and the rights of company members. These are also sent to Companies House and can be inspected by any member of the public. Potential investors often examine rules carefully because they determine the rights that they will get when they make an investment, and how the company is governed. The rules are important to employees and existing investors too, because they control the terms under which others can take a stake in the enterprise and the influence they gain by doing so.

3. Articles 1 and 2 define the scope of Table A (part of the Companies Act) and terms that are used throughout the rules.

CAPITAL – Articles 3 to 9

4. These articles define the shares we can issue and the rights associated with them. We have two types of share:

   a) Voting Shares can only be held by employees. Holders gain the right to attend, speak, propose and *vote* on resolutions at the company's General Meetings. Employees receive one voting share when they join the company, and one additional share for each completed year of employment up to a maximum of 5. They can elect (and remove) up to three directors. The way in which shares are issued ensures that influence over company policy and key appointments are – to some degree - proportional to the commitment and experience of employees. Company policies (i.e. business objectives, business values and policy) are controlled by Voting Shareholders.

   b) Value Added Shares (VASs) can be held by anyone (including employees). Holders gain the right to attend, speak and propose General Meeting resolutions. Value Added Shareholders can also elect (and remove) up to two directors and a non-executive Chairperson. The Chairperson has a casting vote at Board and General Meetings. The issue of these shares ensure that influence over key appointments is proportional to the financial risk assumed by each investor. Half the company's Surplus is distributed in proportion to the number of VASs held by each member. The company is owned by its Value Added Shareholders.

The directors (minimum 2, maximum 5) elected by each set of shareholders are legally responsible for the impact and implementation of company policy. They control the appointment of the Chief Executive Officer (see below).

5. Employees must purchase a Minimum Capital Stake (i.e. they must agree to buy a part of the company when they join it). The stake required is 15% of initial annual salary, but this can be purchased over 3 years. The stake entitles the member to a share of the profits and assets of the company.

6. Employees can earn free VASs by increasing the value of the company. 40% of the increase in the company's value each year is distributed to employees as free VASs in proportion to the amount of salary each employee contributes to a Bonus Pool (see below). If no value is added, no VASs are issued.

GOVERNANCE – Articles 10 to 23

7. These articles define how the company is run and the decision-making rights of shareholders, directors and the Chief Executive Officer. In our company, there is a distinction between:

   Shareholders: who own the company

   Directors: who are legally responsible for the impact of company policies, and who evaluate and make recommendations on business objectives and their implementation

   Executive Officers: who decide how best to organise the company to achieve policy and business objectives.

8. Shareholders and the company's board of directors do not manage the company's employees – this is delegated to a Chief Executive Officer (CEO).

9. The CEO is responsible for the organisation and management of the company and fulfilling the company's policy and business objectives. The CEO can only be removed by the board of directors, not shareholders. However, as directors can be removed by shareholders, shareholders do have indirect influence over the appointment (and removal) of the CEO.

10. So long as the company does not 'under perform', employees continue to control business objectives and policy because external investors cannot vote at General Meetings, or out-vote the directors elected by employees.

11. If the company 'under performs' (repeatedly makes losses or loses value), then employees lose their right to control business objectives and policy. These rights are assumed by Value Added Shareholders in proportion to their financial risk (shareholding). After the business has been profitable for two consecutive years, voting rights are restored to employees.

EXPENSES, BENEFITS AND PAY – Articles 24 to 38

12. Directors and employees will be paid reasonable expenses. A schedule of acceptable expenses must be agreed with all shareholders, not just between employees.

13. Employees will be paid a market-related salary and the rules define the mechanisms by which disputes over market salaries will be resolved. Initially an employee's market salary is paid as Basic Wages and Shares. Shares are issued as part of pay until an employee has purchased their Minimum Capital Stake. An employee must invest at least 5% of their salary until they have purchased their stake. New staff (those in their first 12 months) cannot receive more than 95% of their salary as Basic Wages unless they make an up-front investment in the company.

14. After the first 12 months, each employee must commit a further 10% of their salary to a Bonus Pool. The amount committed to the Bonus Pool (expressed as a proportion of the whole Bonus Pool) determines each employee's entitlement to a share of bonuses.

15. Each employee has discretion over how much of their market salary they risk in the Bonus Pool (subject to the 10% minimum). While it is easy for an employee to commit more salary to the Bonus Pool, it is not as easy to reduce it. To reduce their commitment, an employee must either swap their risk with other employees (i.e. get other employees to increase their risk so that they might reduce their own), or get all shareholders to consent to a reduction in their risk.

16. Employees' income is made up from Basic Wages, Bonuses and Dividends. Basic wages are paid as before, but cannot exceed 85% of an employee's market salary if they have not yet purchased their Minimum Capital Stake, or 90% if they have.

17. Half the company's (projected) Surplus is advanced back to employees in the form of bonuses which are added to Basic Wages. 80% is advanced back on a monthly basis. The other 20% is paid as a lump sum at the end of each year. Bonuses may be adjusted up or down by the Directors or CEO if the company's projected Surplus changes during the year. At year end, when the accounts are audited, final adjustments to bonuses will be made if necessary.

18. All shareholders (including employees) receive dividend payments if the company is in profit. Dividends are proportional to shareholding (VASs held).

19. If the company increases in value, employees receive a proportion of the increase as additional free shares (VASs).

Glossary of Terms

Sweat Equity

A term used to describe cash reserves in a co-operative enterprise that have been built up by deliberately underpaying staff or by deferring payment of full wages.

Social Enterprise

A name given to enterprises that actively seek to involve and benefit all stakeholders and serve their communities.

Surplus

income over and above planned expenditure

Equity Devaluation

a situation where those who have invested their time, energy and money in an enterprise are not fully compensated for their past efforts and decisions.

Conventional Business

a business in which some or all employees are denied the opportunity to buy shares.

Market

a place where people exchange their products, time, skills and money for mutual benefit.

Employee Ownership

a form of ownership in which all employees of the enterprise are permitted to own shares and benefit from the sale of business assets.

Common Ownership

a form of ownership that requires the assets of an organisation to be returned to the community if the organisation is dissolved.

Shares

a mechanism used by companies to represent ownership and entitlement to a company's assets and surplus.

Assets

the property, bank balances, shares, intellectual property, reputation and customer base of a business.

Debtor

anyone that owes an organisation money.

Creditor

anyone that is owed money by an organisation.

First Rule

that an organisation must be able to pay off its debts at any time (i.e. that its assets are greater than its liabilities).

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