From Mondragón to Ohio: Building Employee Ownership

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*The Mondragón cooperatives in the Basque region of Spain have become the largest employee-owned business in the world, employing more than 50,000. **Owners at Work** described their impressive success in its Summer 2000 issue (on the web as "Envisioning Employee Ownership-Part 2* [http://dept.kent.edu/oeoc/pandr.htm]*). In April, 2001, John Logue, Alex Teodosio and Jackie Yates from the OEOC staff visited Mondragón in a group sponsored by the Cooperative Charitable Trust. What can Ohio employee-owned companies learn from Mondragón's unique style?*

When asked "why we can't develop something like the Mondragón cooperatives in Ohio?" in the past I always replied, "because we just don't have enough Basques."

A week in Mondragón taught me not to be so flip. The Mondragón cooperatives have their roots in Basque nationalism and in Catholic social and economic teaching, but their survival, growth, and prosperity in an increasingly globalized economy are the product of structural factors and capital consolidation that have nothing to do with nationality or religion.

Instead it has a lot to do with structural integration among cooperatives, particularly through the Mondragón Cooperative Corporation, and through its central financing institution, the Caja Laboral which, in effect, is a credit union for cooperatives.

There are about 115 cooperatives in and around the town of Mondragón. By and large they are small businesses, employing an average of 225; the outlier is a large retail grocery co-op which is jointly owned by its 25,000 employees and its customers. Unlike small employee-owned companies in the United States, however, the Basque co-ops have pooled their resources through the Mondragón Cooperative Corporation. This creates economies of scale and financial resources that enable them to support weaker co-ops or those caught in economic downturns and to compete aggressively in the new global economy.

Capital consolidation

The Mondragón co-ops have consolidated themselves in terms of capital to a far greater extent than American ESOP companies. This is true at two levels.

At the level of the individual co-op, each year the internal account system used by the cooperatives allocates a portion of the retained earnings—the "patronage dividend"—to the accounts of employees who worked in the co-op. The rest of the retained earnings goes into a collective account owned by all the employees. While the individual accounts are withdrawn at retirement, the collective account remains a part of the core financing of the cooperative. In effect, it is an asset bequeathed by each generation of employee owners to their successors.

Employees receive annual interest paid on their internal accounts. The interest payments currently are 6.5%. The larger the internal account the individual employee has, the greater the annual interest payment to the employee.

This system is fundamentally different than the American ESOP system which vests the entire value of the business in the hands of individual ESOP participants and pays them out in full for their shares when they retire or leave the company. First, the Mondragón system pays out only the individual employee's portion of retained earnings, which is not the full retained earnings of the business. Second, retained earnings reflect the book value for the company rather than market value. That generally understates the real value of the business based on its earnings power.

The consequence is that Mondragón co-ops are able to finance themselves internally to a significantly greater extent than American ESOP companies and have less call on their resources to repurchase accounts of retiring employees.

At the level of the Mondragón Cooperative Corporation, the cooperatives maintain policies which enable them to support each other when one is in difficult circumstances. The co-ops have their own financing institution, the Caja Laboral. This central Cooperative Bank provides financing for working capital and for new investments. It is owned by its depositors, which are primarily employee-owned enterprises and their employee owners. The Caja Laboral has become one of Spain's largest banks with over $7 billion in assets.

Having a cooperatively owned financial institution creates a separate sector for cooperative finance that makes capital available at commercial bank rates. It clearly lowers the overall capital costs for the cooperatives while providing all of them a security net in the form of a friendly lender.

Employment guarantee

One of the virtues of the financial consolidation of the co-ops is their ability to offer employment security.

From the average employee's point of view, the greatest advantage of being a member of one of the Mondragón cooperatives is the fact that membership confers a lifetime employment guarantee. Of course Mondragón worker owners can be terminated for cause or can choose to seek other employment. However, should your co-op fail for financial reasons, you are guaranteed employment in another Mondragón co-op.

This employment guarantee provides real security for individual employees. It doesn't prevent having to move to a new cooperative, but it does prevent members from ending up in long-term unemployment or having to seek a job flipping hamburgers. And employees can move to other co-ops for career advancement.

This employment guarantee would not be possible without the cooperation among the co-ops or without their collective commitment to flexibility and entrepreneurship.

Responding to globalization

The Mondragón co-ops grew up in the 1950s, 1960s and 1970s behind the high tariff walls which sheltered Spain's economy. Spanish entrance into the European Union—the European Common Market—was a rude awakening. After a crisis of confidence ten years ago and substantial institutional redesign, they found their niche in the broader European market only to have economic globalization strike in a new form: global competition in their core industries. This hit the co-ops in two ways.

First, the co-ops were subjected to increasing competition in what had been their protected home market. This was particularly true in the retail market, where small scale was the norm.

Mondragón's retail grocery chain found itself being overwhelmed by the internationalization of the Spanish grocery trade. The co-ops concluded that either they should get out of the grocery business entirely or they would need to expand massively to compete head on with foreign competition moving into their market. They chose the latter. Backed by the financial capacity of the Mondragón Cooperative Corporation, including the lending capacity of the Caja Laboral, the Eroski grocery co-op has developed explosively. It has added a chain of hyper markets which resemble Wal-Marts. The Eroski chain has become Spain's third largest grocery retailer, and it is the largest domestically owned. It employs some 25,000.

Second, to compete globally, Mondragón co-ops have begun an aggressive globalization strategy of their own. They have acquired or built from scratch twenty-six plants, largely in Spanish-speaking Latin America, and expect to double the number by 2004. Those plants sell into their host country markets and surrounding areas, generally buying some parts from the Spanish parent. They are not, however, displacing Spanish employee owners from their work. The Mondragón industrial cooperatives number among Spain's top ten exporters.

Delegation sponsored by the Cooperative Charitable Trust with HR Director Jesus Mari Labayan outside Fagor refrigerator plant in Mondragón.

The co-ops' globalization strategy has created some major disputes around the issue of whether and how to include foreign employees in the cooperative structure as owners. To date, foreign employees are just that: employees. However, inclusion of foreign employees in the cooperative structure is on the agenda.

Developing new employee-owned companies

The Mondragón Cooperative Corporation supports co-op development through a non-profit center to encourage product diversification and innovation in existing co-ops, product cooperation between co-ops, and establishment and incubation of new co-ops. Most new co-ops grow from current co-op members' ideas for new businesses or through business plans developed by students at Mondragón's University. The Caja Laboral provides the seed capital.

This approach has a number of advantages. First, it avoids concentration in any declining industry in crisis. Second, it develops synergies between existing and new co-ops. Third, it focuses new cooperatives on new and expanding lines of business.

There are high costs associated with business start-ups in Mondragón, just as elsewhere. But the technical assistance structure in Mondragón is clearly superior to what is available to most new businesses in other locations. Consequently the Mondragón survival rate is higher: 80% over the last 15 years.

What can we learn?

I went to Mondragón prepared to conclude that the Mondragón model was unique to the Basque country. If we didn't have any Basques, then we were out of luck.

I came back persuaded that the Mondragón model for capital accumulation creates companies that are more stable financially than our ESOP model. It also puts more back into the community. And the Mondragón co-ops are probably better prepared to compete in the new global economy.

Let's talk about capital first. The Mondragón model says that companies are created not just by current employees and cannot be owned fully just by current employees. They are created by previous generations of workers, and it is important for the current generation to be a good steward so that there will be jobs for the next generation. This is very different from the "just wait until we get a good merger offer—we'll be rich!" mentality that characterizes some American employee-owned companies.

Further, Caja Laboral—the co-op bank—provides financing for expansion and for new cooperatives. In harder times 10 years ago, its lending and its co-op solidarity helped struggling co-ops make it.

Second, the Mondragón co-ops put more back into the community than we expect ESOP companies to do. They get a special tax break—they pay 20% of profits in taxes rather than the usual corporate rate of 32%—provided they donate at least 10% of earnings to charitable educational, cultural, and other non-profit purposes; these help fund Mondragón's university and cooperative development. How many American ESOP companies—even Sub-S corporation ESOPs that don't pay any Federal income tax at all—put 10% of their profits back into the community for charitable and educational purposes?

Third, the economies of scale that the Mondragón cooperatives have achieved through their collaboration enable them to be highly competitive in the global economy despite the small scale of the individual cooperatives.

Visiting Mondragón encouraged me to envision an Ohio employee-owned sector with more cooperation among employee-owned firms, more involvement in the community, a common commitment to expanding employee ownership, a commitment by firms to incubate new employee-owned companies, and the creation of more joint institutions, including joint strategies for responding to economic globalization. **OAW**