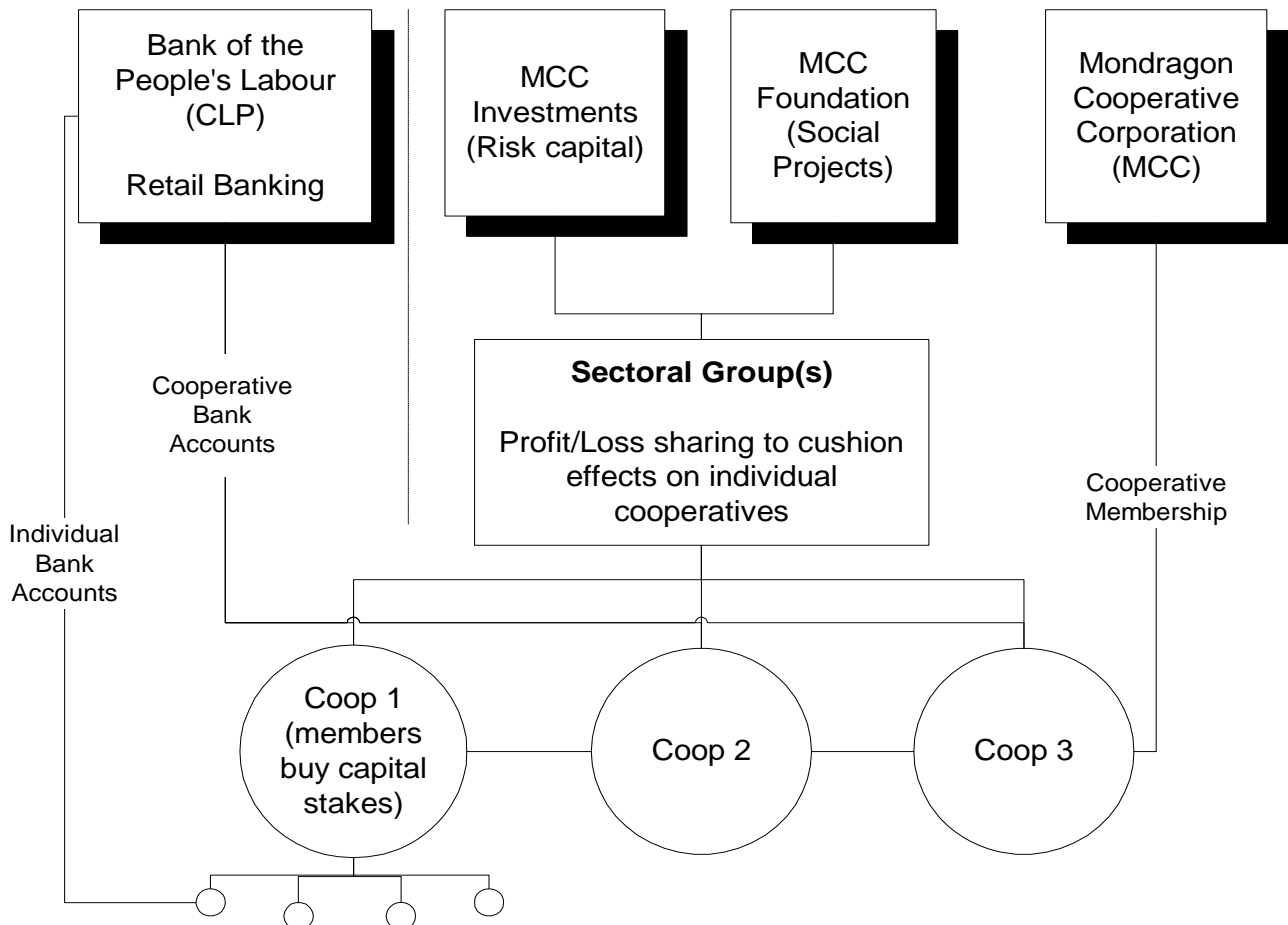


Case 11.4 – Social Investment at Mondragon

The following account is based on verbatim notes taken at a seminar about financial management arrangements and control structures in the Mondragon Cooperative Corporation. These were described to Rory Ridley-Duff and John Cullen from Sheffield Hallam University, Peter Beeby and Rick Norris from School Trends Ltd. The seminar took place on 5th March 2003 at Otalora (Mondragon Management Training School). Translation services were provided by Fred Freundlich, an academic based at Mondragon University. The diagram was developed after the field trip to interpret this and other material. It should be noted that *all* the organisations shown on the diagram below are cooperatives (based on one-person, one vote principles).



Explanatory Note:

1. Individual cooperative members buy capital stakes in their cooperatives (funded with the help of the CLP if necessary). The stake typically costs about 2 months' salary.
2. Cooperatives federate (i.e. create sectoral groups) and pay between 15 – 40% of their profits toward joint projects (marketing, branding, research). Up to 45% of profits (each year) are allocated to individual bank accounts (paid out upon retirement or upon leaving the cooperative group). The CLP allows these funds to be reinvested in the business.
3. The sectoral group calculates profits/losses to cushion the impact on individual cooperatives. A proportion of losses (maximum 40%) can be borne by group funds. The remainder must be borne by individual members (through deductions from their capital stakes).
4. MCC Investments receives 10% of profits from the sectoral group for 'high-risk' projects.
5. MCC Foundation receives 2% of sectoral group profits (in addition to 10% paid directly by individual cooperatives). About £20m a year is invested in educational and social projects.

Financial Controls at Mondragon

Based on journal notes from a field trip (5th/6th March 2003)

We were introduced to the idea that the co-ops work in groups, and that they pool profits. This is to help each other in adversity, and to uphold the principle of solidarity. So the principle of solidarity is more important than under capitalist arrangements (which is to let a company collapse).

They did re-structure themselves from geographical sectors into market-related sectors, and some functions were taken out of the bank and given to the sectoral groups so that they had more freedom in exercising them. So it was a way of decentralising. The profit pooling happens within sectoral groups, and they are staffed by representatives of the second-degree co-ops. The sorts of things that the sectoral groups can do are to share brand names, they can agree a whole set of integrated measures to support each other, and the amount of money that they contribute to group funds (between 15%-40%) is simply a reflection of the amount of integration that takes place. Some groups are quite loose, and do a lot of their own marketing and sales activities. But some are close knit and put more money in so more work can be done at the sectoral level. They contribute to the sectoral funds prior to implementing their own profit-sharing arrangements.

We then talked about the investment arms of the Mondragon Cooperative Corporation (MCC). It has two: MCC Investments and the MCC Foundation. MCC Investments is like a venture capital fund, a for-profit entity trying to make money. MCC Foundation is a not-for-profit organisation. It can provide finance for profit-related activities but is not itself a profit-making body - it tries to spend all of its money. Beyond financing feasibility studies it does social and educational work.

We were given an example of how sectoral finances work. He gave an example of trading results from 3 co-ops: two that were profitable, one that was not. They use labour costs to make an adjustment so that it is not based on raw trading results. In one example, there is a calculation that leads to a co-op making a £500,000 profit, then having it adjusted to £600,000 because it has a higher than average labour costs.

Equally, the co-ops that lose money can assign 40% of their losses into the group fund, but those that make a profit only put 20% of their profits in. The result of this is that a co-op that does badly does have to bear a bigger proportion of losses than the other companies have to commit profits. This is to some extent, to penalise the co-op – or find a fair balance (“always the balance” they kept saying) – but they adjust the profits across the group. The (sectoral) group’s profits are reported to the tax authorities because the total income across all co-ops is the same as the raw profit. The tax authorities based in the Basque region allow this flexibility.

Now this model is interesting because clearly the stronger co-ops help reduce the losses of the co-ops that are not doing so well. There is an issue of solidarity here – solidarity at the co-op level, but also at the individual level. By supporting or cushioning the losses of fellow co-operative enterprises they are, of course, reducing the amount of money that has to come out of individual capital accounts to cover the losses.

A lot of the time, they claimed, the flexibility that allows a co-op to share its losses with other co-ops is dependant on that co-op trying to address problems in their business. If they did nothing, they wouldn’t get this support. But providing they’ve tried hard to adjust their business, or to transfer staff out when they don’t need them, they can get lots of helps from the other members in the sector.

He mentioned that there is an informal norm aimed at preventing worker-members losing more than 30% of their own capital holding in any one year. If members have invested in their capital account



and they have performed badly, an internal informal arrangement means that they try – if at all possible – not to lose more than 30% of their account. [The lecturer] gave an example, if they only had one unit in their account, and they made losses, they would have to cover these losses from that last unit – they were accountable. He said it was important to understand that solidarity did not mean there is no pressure. In exercising solidarity, a lot of pressure gets applied to (loss-making) businesses to sort themselves out.

Pay Policy

There were other tools that helped to mediate pay policy. One he called an ‘independence index’. Basically, they understand what the internal wage bill should be because they track the wages rates agreed by unions in the local economy and these become the market rates – they know what should be paid. What the various policies do is provide information on a ratio of internal to external resources. A little bit hazy – quite complicated – but the upshot of it is that if a co-ops balance sheet is not healthy, wages *have* to be reduced. Also, there are limits about paying over the internal market rate and below the internal rate. He talked about a ratio of profits to payroll. So what it really meant was, if their trading results were good, yes, they can pay up to 9% more than average rate for the job, but that is dependent on doing very well. Similarly, wages could drop by 14% if trading results were not so good. He kept stressing the internal social pressure to perform well. The workforces encourage each other to maintain good performance through social pressure. Managers in poorly performing co-ops feel a lot of social pressure.

MCC Investments

We then talked about MCC Investments. The contributions that co-ops make give them the right to vote in the General Assembly of MCC Investments. Initially this is 756 euros/per person/per co-op. Quite a bill! We worked it out as if a company had 500 staff, this could amount to more than £50k. 100 staff is about £30,000. And they have to contribute 10% of their profits into the investment fund. The CLP (Bank of the People’s Labour) gives a donation, which is usually extremely generous. The CLP has large amounts of money and gives a substantial amount, in addition to 10% of its profits. The voting rights are linked to the headcount of each co-op.

MCC Foundation

The MCC Foundation. The CLP (Bank of the People’s Labour) gives 4% of its profits. The co-ops give about 2% of their profits. There can be non-foundation activities, such as business projects, feasibility studies, delegations abroad, export investigations and things like that. He mentioned FEPS, which is a co-operative (Basque) expression for the 10% of nett profits that go to non-profits, social organisations doing education and social work. I’m sure there is something there I’m missing, but I noted that this is 1000% more than the norm in the UK (where only 1% of corporate profits are donated to charity).

He talked through the activities of the Foundation and Investments. On the Foundation side, they did internationalisation studies, feasibility studies. They could use it for compensation of losses, but only up to 20% of those losses, so the Foundation again is something that cushions individual co-ops in less favourable times. He then talked about corporate projects, education projects and R&D projects, typically providing subsidies of up to £100k.

He called the investment side “serious financing”: new activities, overseas operations, helping with debt finance, and major corporate projects. For example, he gave an example of overseas development. General Motors said that if the MCC wanted to supply them, they had to create a plant in Brazil, so they did.

The investment arm is largely a debt financing system for the co-ops. He said it also protects the CLP because if the Bank of Spain came to do inspections it would not want to see the bank taking



highly risky investments so they transfer this money into MCC Investments to undertake more risky finance projects. Normally co-ops would go to the CLP first and they'd exhausted those facilities before they come to the MCC Investment Fund. It definitely helps co-ops get access to high risk capital.

Educational Activities

The educational activities – a lot of it goes into the university, some goes into training centres, and others goes to subsidise direct activities. He talked about an innovation park that had been created that the smaller co-ops can use: these have shared facilities in an innovation park. The larger co-ops are encouraged to have their own R&D facilities. I did wonder whether part of this was a little bit like the Learning Skills Council in the UK.

They did have a science & technical plan, with 15 points of action that he did not list. He did mention, for example, funding into biotechnology is one of the priority areas. About 10 million euros is spent annually. About 50% goes to business development activities, and about 50% to educational projects. In 2002, he estimated that it would have about 20 million euros in it. So if we think of something like Baxi which has got a total of £20m, in Mondragon we are talking about the MCC Investment arm having 20m euros a year. This is on top of the financing available from the CLP, on top of money available from Lagun Aro which is the Social Security arm. There are multiple sources of capital.

Investment Fund

He talked more about the Investment Fund. One part of it went into subsidy funds which was covering the highest risk activities. For example, the plant they build in Brazil they had to use part of this fund to cover to loss of values due to exchange rate changes. In the most extreme circumstances, money is set aside to write off debts. So there is a proportion of the money that provides a contingency fund. The investment activities – he stressed again their high risk nature – but he also said that the co-ops who have put money into the MCC get a return on that investment. So where there is a high risk investment in an overseas plant, then the co-ops get interest or a dividend. But the tendency is to try and spend everything – so they are trying to place all the money in projects. Lastly, he talked about the very favourable tax treatment of MCC Investments. Apparently the local government recognise what a valuable job MCC Investments is doing in creating jobs so it does not tax it too heavily. The argument was that it gets the tax revenue from the jobs that have been created, the employees and the profits of the co-ops.

Internationalisation

Finally, he turned to the internationalisation that they are engaged in. He talked about joint ventures. The biggest dilemma is how to integrate the overseas businesses into the overall model. The Congress taking place in May is looking at the intention of becoming an International Cooperative Corporation – actually specifying and having a strategy for internationalising their corporation. At the moment overseas there are profit-sharing arrangements. He said that once they've invested that they 'pedal hard' (as he put it) to promote the co-operative principles. He said that the values that tend to underpin overseas investments are: first, of all decent wages and conditions; second, community control. They had a 'realistic goal' to achieve worker-participation in equity, profits and decision-making where possible, and a long term goal of securing commitment to organising as co-operatives.

Postscript:

One stumbling block to Mondragon's aspirations (particularly in the UK) is that there are no cooperative laws. In other cases, the cooperative laws do not permit replication of the capital holdings at Mondragon. Integration of overseas operations into the group remains a challenge.

