Chapter Twelve

The Mondragon worker co-operatives and their lessons for Australia

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The Mondragon Co-operative Corporation in the Basque region of Spain offers a benchmark in industrial democracy. The Co-operative is a complex of industrial, retail, financial, civil engineering, service and support co-operatives. It is a strong and successful example of the uses of employee ownership to create jobs, drive regional economic development, facilitate entrepreneurship and empower workers to assume control of their workplaces and the wealth created by their labour. It demonstrates conclusively that it is feasible for labour to hire capital, rather than the reverse. It demonstrates how social and economic objectives both within firms and between them and the wider community can be harmonised with one another.

However, despite the overwhelming evidence of the success of Mondragon, co-operatives and other mutual societies are currently at a low ebb in Australia. This is in part due to the success of predatory demutualisers in plundering so many of their assets and converting them into proprietary limited companies. Apart from the National Party, political parties in Australia seem to have lost their institutional memory of co-operatives and governments are mostly unsympathetic to them. There is a widespread – albeit mistaken – impression that co-operatives are out dated and there is no place for them in a world dominated by free market economics and competition policy.

This chapter argues that rather than Australia attempting to re-invent the wheel in industrial democracy, our aim should be to identify what is current world best practice, and identify and apply in the light of our own needs and circumstances. The chapter argues that the Mondragon example demonstrates that co-operative and mutualist bodies are as capable as ever of enabling their members to provide themselves with necessities that would otherwise be unavailable or unaffordable. Introducing worker co-operatives along Mondragon lines into Australia might also result in co-operatives of other kinds regaining the high levels of public policy support and community participation to which their proven merits so plainly entitle them.

The co-operative form of doing business developed at Mondragon is a possible, profitable and socially responsible model of business organisation for Australia. The Mondragon experiment embodies two great cornerstones of the co-operative principle: employee ownership of the workplace and the role of the credit unions as engines of growth for the region. The latter provides cost-effective finance and advice to employee-owned businesses.

The philosophies that underpin the Mondragon model are 'evolved distributism' and the democratisation of the workplace. The development of democratic decentralisation has also encouraged co-operation amongst diverse forms of enterprise. This spirit of co-operation has contributed to the economic advantage and astonishing growth of the Mondragon region.

The success of Mondragon

From a standing start in 1956, the Mondragon co-operatives have grown into what is now the largest business group in the Basque region of Spain, the seventh largest business group in Spain and a major competitor in European and global marketplaces. What began 46 years ago as a handful of workers in a disused factory using hand tools and sheet metal to make oil-fired home heaters and cookers, has become a massive conglomerate of some 150 autonomous but intricately inter-related firms.

While the Basque region has unemployment even on official figures fluctuating between 15 and 20 per cent, the co-operatives have expanded their workforce over the last five years, from 34,397 to 60,000, and further increases are anticipated. Annual sales for the manufacturing co-operatives alone total more than $US3 billion and sales for the retail co-operatives are in excess of $US3.5 billion, with exports accounting for a stunning 49.4 per cent of all output.

The Mondragon Co-operative Corporation (MCC) is Spain's largest exporter of machine tools and largest manufacturer of white goods such as refrigerators, stoves, washing machines and dishwashers. It is also the third largest supplier of automotive components in Europe. Total quality management awards gained by the manufacturing co-operatives in 2000 included the European Foundation for Quality Management's European Quality Prize, and Gold and Silver Q prizes from the Basque Foundation for the Promotion of Quality (Mondragon Co-operative Corporation 2000).

Whole factories are designed and fabricated to order in Mondragon for buyers overseas. In addition, the MCC has some 22 overseas business subsidiaries, manufacturing, for example, semiconductors in Thailand, whitegoods components in Mexico, refrigerators in Morocco and luxury coach bodies in China. It is expected that the number of subsidiaries will double to around 55 by the end of 2002. [1]

MCC construction co-operatives have carried out major civil engineering and building projects at home and abroad, including the building of spectator stands and other key facilities for events such as the Barcelona Olympic Games. The steel structure for the new Guggenheim Museum in Bilbao — a building comparable in stature and complexity to the Sydney Opera House — was fabricated by a Mondragon co-operative.

The retail arm of the co-operatives, Eroski, is Spain's fastest-growing retail chain, with some 47 hypermarkets, 796 supermarkets, 569 self-service and franchise stores and a range of other specialist outlets. An Eroski subsidiary, Sofides, operates three hypermarkets and a chain of 19 supermarkets in France (Grupo Eroski 2000). The MCC's financial co-operatives, the Caja Laboral Popular credit union (CLP) and the Lagun-Aro social insurance co-operative, are among Spain's larger financial intermediaries.

Arizmendiarrieta and evolved distributism

The co-operatives were founded by a committed adherent of social Catholicism, Basque priest Don Jose Maria Arizmendiarrieta. The Basques had been on the losing side in the Spanish Civil War of 1936-38. In Arizmendiarrieta's words, 'We lost the Civil War, and became an occupied region' (Whyte and Whyte 1991, p. 242). The widespread destitution of the Basques in the aftermath of the defeat — now remembered as 'the hunger period' (Whyte and Whyte 1991, p. 26) — inspired Arizmendiarrieta to rebuild the local economy of Mondragon, and thereby the confidence, self-esteem and well-being of his parishioners.

His approach reflected a unique amalgam of ideas. Influenced as he was by the Catholic social teachings that Pope Leo XIII set out in 1891 in his social doctrine encyclical letter *Rerum Novarum*, he also drew freely on a rich and disparate range of traditions. The more obvious ones of these included Raiffeisenian credit unionism, guild socialism and Bellocian distributism. While Arizmendiarrieta never seems to have given his philosophy a specific name, it can best be understood as an 'evolved distributism'.[2]

Arizmendiarrieta's 'evolved distributism' stemmed from two basic principles. It was his strong belief that work and property – as opposed, for example, to consumption or saving – were so central to the lives of ordinary people that they could provide the foundations on which an enduring and just society could be built. He also believed strongly in the doctrine of subsidiarity –that a higher order of society should not assume, on behalf of a lower order, functions that the lower body is able to perform for itself. That was introduced by Leo XIII in *De Rerum Novarum* and elaborated by his successor, Pius XI, in the further encyclical *Quadragesimo Anno* in 1931, which reads:

> Just as it is wrong to withdraw from the individual and commit to the community at large what private enterprise and industry can accomplish, so, too, it is an injustice, a grave evil and a disturbance of right order for a larger and higher organization to arrogate to itself functions which can be performed efficiently by smaller and lower bodies (Pius XI 1931, p. 40).

In Arizmendiarrieta's view, the remedy in the economic sphere was plain. Labour should hire capital rather than capital labour, thereby enabling workers to assume ownership of their workplaces and become masters of their own destinies. Work afforded the individual not only a livelihood but also identity, self-esteem and capacity to fully participate in civil society. Accordingly, it was mandatory that, to the greatest possible extent, jobs should be available for all who need them, and unemployment should be eliminated or minimised.

Structure and governance of the co-operatives

Arizmendiarrieta's thinking shaped the structures and governance procedures within and between the new co-operatives. The basic building blocks of the MCC are its manufacturing, retail, service and construction co-operatives, otherwise known as primary co-operatives. Each primary co-operative is governed by a General Assembly. General Assembly meetings are held at least annually to receive reports and determine policy.

The Assembly in turn elects, by and from its number and, on a one-member-one-vote basis, a Governing Council consisting of three to twelve members. The Council steers the affairs of the co-operative between Assembly meetings. Governing Council members hold office for staggered four-year terms, with elections at two-year intervals.

There is also an Audit or Watchdog Committee to independently monitor the co-operative's financial performance and its compliance with its formally established policies and procedures. The Governing Council meets regularly, on a consultative basis, with a Management Council consisting of the Chief Executive Officer and senior executives. Independent of the Assembly and its offshoots, workplace groups within the co-operative elect Social Councils, which have a quasi-trade-union function, with responsibility for matters such as job evaluation and occupational health and safety.

Individual co-operatives are linked with one another in co-operative groups. Originally, the groups had a geographical basis. However, with the establishment of the MCC in 1991 – and the replacing of Mondragon Mark I by the current Mark II model – they have been re-constituted along functional lines. There is a Financial Group, a Distribution Group and an Industrial Group, with the Industrial Group in turn split into seven sub-groups. The aim is for the co-operatives within each group to engage in in-depth and continuous strategic planning, to identify and exploit economies of scale and business synergies, and to operate within an agreed overall strategic framework.

A further and final level of linkage is afforded by the peak bodies of the MCC: the MCC Congress, the General Council and the Standing Committee. The key role of the Congress is to set the overall policy and direction of the co-operatives. The General Council is responsible for drawing up and applying corporate strategies and co-ordinating the activities of the co-operatives and co-operative groups. The Standing Committee monitors the performance of the Committee and the groups, and sees that the decisions of the Congress are given effect.

Reasons for success

To what, then, can we attribute the effectiveness of these arrangements? Technical and scientific excellence apart, the key factors can be summarised as motivation on the part of members of co-operatives, solidarity and mutual support within and between co-operatives, and competitive advantage consequent on agency cost savings. Underpinning these factors most significantly is employee co-operation in the co-ownership of workplaces, plus the role of credit unions in supporting other co-operatives. This unique mix of labour and capital is plainly the reason for their success.

As to motivation, the success of the co-operatives stems from the fact that every permanent worker is an equal co-owner of his or her workplace, with an equal say in its affairs on a one-member-one-vote basis and an equal proportionate share in its profits or, on occasion, losses. Each worker has a direct personal stake-holding in his or her co-operative, through an individual capital account which is credited annually with the workers' share of the co-operative's profits, and enables them to maintain an on-going appraisal of the performance and its management and their fellow members. A related incentive is the possession of a secure job in a region characterised by high unemployment. In the words of recent president of the MCC, Javier Mongelos, 'The workers who own these co-operatives know their future depends on making profits' (Mongelos 1994).

Solidarity is a basic value of the co-operatives and is expressed in several ways. Solidarity within the co-operatives is exemplified by a flat compensation that is based on a determination by the Social Councils. A 1987 Participative Action Research (PAR) study of Mondragon's Fagor group of co-operatives, under the leadership of Cornell University anthropologist Davydd Greenwood, and the then Director of Human Resources at Fagor, Jose Luis Gonzalez, identified compensation rates within the co-operatives as being 'among the most egalitarian found in industry anywhere' (Greenwood and Gonzalez 1992, p.17).

Solidarity between co-operatives is evident in the inter-co-operative support funds that have been established to help co-operatives that encounter difficulties, thereby preserving jobs, and to make available special capital allocations for expanding existing businesses and creating new ones. Solidarity on the part of the co-operatives with the wider community is expressed through the 10 per cent of surpluses that they contribute to community projects, such as Basque language education. Furthermore, the co-operative sets rates for jobs at roughly the same levels as nearby conventional firms.

A further example of solidarity is the servicing of the primary co-operatives by a unique system of secondary support co-operatives. Arizmendiarrieta became aware at an early stage in the development of the co-operatives of the need for them to be self-sufficient to the greatest possible extent. The support co-operatives – along with the co-operative groups – were his answer. Capital is mainly sourced by the primary co-operatives from a support co-operative, the Caja Laboral Popular (CLP) credit union. Superannuation and other benefits are sourced from the Lagun-Aro social insurance co-operative, industrial research and development services from the Ikerlan and Ideko research and development co-operatives and technical skilling from the university of technology co-operative.

The Mondragon credit union, the CLP, has been much more than simply a source of capital for expanding current co-operatives or creating new ones. In the phase of rapid expansion which preceded the establishment of the MCC, what was then the Empresarial or Entrepreneurship Division of the CLP offered a uniquely comprehensive and effective service for incubating new co-operatives and ensuring their success. Groups seeking to establish co-operatives were initially assigned a mentor or 'godfather' to work with them in the preparation of their business plans and loan applications. Once loans were secured, the mentors remained with the co-operatives to assist them in setting up their businesses and enabling them to operate profitably.

As a condition of its loan, a new business was required to enter into a Contract of Association with the CLP which specified, among other things, its structure and processes. It was likewise a condition of the contract that specified performance and financial data should be reported to the CLP on a regular basis. Thanks to regular and comprehensive reporting, the CLP could count on receiving early warning of co-operatives experiencing difficulties, and thereby provide added specialist support through an Intervention Group within its Empresarial Division.

So effective was the Empresarial Division that only a handful of co-operatives have failed to become going concerns.[3] After the establishment of the MCC, the functions of the Empresarial Division have been hived off from the CLP, with some elements incorporated within the MCC and others forming new management consultancy and support co-operatives, such as Lankide Suztaketa I and Lankide Suztaketa II, and the fledgling new business incubator, Saiolan. As World Bank economist David Ellerman has written, 'Just as the systematised innovation of the modern scientific research laboratory represented a major advance over the garage laboratory, so the institutionalisation of entrepreneurship in the Empresarial Division of the CLP represented a quantum leap over the isolated and unorganised small business entrepreneurs of the capitalist world' (Ellerman 1982, p. 4).

As to agency savings, evolved distributism in the Mondragon mould owes its achievements largely to having overcome in part (and potentially in its entirety) what agency theorists call 'the basic agency dilemma'. Agency theory holds that the way individuals and institutions behave socially and politically can be explained in terms of a series of 'contracts'. Where one party (the 'principal') commissions a second party (the 'agent') to act on the first party's behalf, an agency relationship (a 'contract') is created. The substance of the contract (of the 'principal/agent relationship') is the agreement by the agent to comply with the wishes of the principal, who, in turn, agrees to provide the agent with a specified reward.

Agents are seen as falling into the two broad categories: profit-seekers, who undertake to deliver a product for a price; and employees, who are paid a wage in return for accepting instructions. In the case of the conventional profit-seeking, wage-paying firm, agency relationships of both types can be seen as co-existing within a layered structure of accountability:

> Production workers are accountable to managers, and are paid a wage in return for time on the job. Managers, in turn,

> are accountable to owners, and are paid a salary for directing and supervising production. Finally, the owners are accountable to customers, and collect a profit (the excess of revenue over costs) in exchange for organising the whole process (Donahue 1989, p. 43).

However, this still leaves a core problem (the 'basic agency dilemma') because individuals are, by nature, inclined to opportunism and the pursuit of their own self–interest. Divergences of interest, emerging inevitably between the principals and agents in an agency relationship, give rise to costs that defeat or detract from the purpose for which the relationship was created.

There is considerable scope for the expression of divergent interests, because principals and agents have only partial information about the real motives and interests of one another. Commonly mentioned examples of opportunistic behaviour on the part of agents include theft, collusion, misrepresentation and underperformance as reflected by absenteeism and low productivity. Principals in turn perpetrate comparable abuses by failing to deliver the letter or spirit of agreed rewards. 'The agency problem', in the view of the American scholar, John D Donahue, 'is the difficulty, in all but the simplest relationships, of ensuring that the principal is faithfully served, and the agent is fairly compensated' (Donahue 1989, p. 38). A major study of this issue concludes:

> The problem of inducing an 'agent' to behave as if he were maximising the 'principal's' welfare is quite general. It exists in all organisations and in all co-operative efforts – at every level of management in firms, in universities, in mutual companies, in co-operatives, in governmental authorities and bureaux, in unions, and in relationships normally classified as agency relationships such as are common in the performing arts and the market for real estate (Jensen and Mackling 1976, p 309).

The remedy for divergences between the interests of principals and agents that theorists commonly favour is to further strengthen and refine the contract between them.

Agency theory constantly tries to find better ways in which contracts can be negotiated, written and monitored, so that the likelihood of injury to the interests of either party by the other is reduced. Contractual devices for securing compliance by agents with the wishes of principals include closer monitoring by principals of the behaviour of agents; principals requiring from agents a bond or guarantee of compensation in the event of contracts being breached; and the use by principals of incentives and sanctions so that their interests and those of their agents become more closely aligned. Such mechanisms are necessarily costly, in some cases to the point where it makes greater sense for principals to perform the required functions for themselves or abandon them.

Agents in turn may have a negative response to the imposition of tighter contractual conditions that makes them ineffectual or self–defeating. In either case, confidence is dampened, investment discouraged and opportunities for growth and employment lost. More broadly, agency costs are detrimental to the well–being of regions and nations in their pursuit of competitive advantage. Given these difficulties and costs, questions arise as to whether there are ways other than tightening compliance mechanisms by which the issue of divergent principal and agent interests – of the basic agency dilemma – can be addressed.

The genius of Arizmendiarrieta lay in rethinking co–operation on the Rochdale model so as to incorporate principles and structures which reduce, and perhaps will ultimately eliminate, the basic agency dilemma, both within and between the Mondragon co–operatives. From the perspective of creating a more rational, that is fair and efficient, productive system, Mondragon is about primarily the evolution of systems within which all principals are agents and agents principals.

Needless to say, none of this implies that there are no differences of opinion within the co-operatives, or that issues are not hotly debated. As Greenwood and Gonzalez concluded from their research at Fagor: 'Fagor is an organization that carries out its operations through discussion and debate. ... The corporate culture does not resolve the issue or homogenise opinions: it tells the membership what it is important to debate about' (Greenwood and Gonzalez 1992, pp. 148, 153).

A key off-setting factor is the higher transaction costs which may be incurred by the co-operatives for the democratic, consultative and inclusive procedures whereby divergent viewpoints are brought into closer alignment with one another. The bottom line for their competitive advantage is the margin by which the reduction in their agency outlays exceeds the transaction costs of achieving it. Retaining and enlarging the agency advantage of the co-operatives is a key requirement – perhaps the most important single requirement – for their future well-being. Its significance cannot be overstated. What is needed is for all members of the co-operatives to feel as powerful and personal a sense of ownership of their workplaces as would sole-proprietor shopkeepers or small manufacturers.

What can Mondragon give to the world?

What lesson can countries like Australia and the United States of America learn from the Mondragon experience? Greenwood and Gonzalez concluded from their studies of the Fagor co-operatives that 'Perhaps the most important reason for understanding Mondragon is that the co-operatives may have found solutions to key economic and social problems of industrial production under contemporary conditions' (Greenwood and Gonzalez 1992, p. 44). In the first instance, Mondragon demonstrates the feasibility of worker ownership – of the workability of labour hiring capital rather then capital labour. Mondragon has not only grown from its standing start into a major conglomerate, but survived with flying colours the points of inter-generational succession where so many of its counterparts, and co-operatives and mutuals of other kinds, have been wound-up or become moribund.

Given Mondragon's example, it can never again be argued that worker ownership even of large-scale enterprises is impossible. At the least, the Mondragon experience should be regarded as a powerful source of encouragement for the establishment of employee share ownership plans (ESOPs). As the late Professor William Foote Whyte, co-author of the most comprehensive account of the co-operatives to date, *Making Mondragon: The Growth and Development of the Worker Co-operatives Complex*, has noted:

> ESOPs can be an important instrument for ensuring that workers retain ownership over the long run and for giving them the possibility of participating in decision-making. ESOPs do not guarantee that the workers will participate in decision-making, or even gain control of management, but

> it does keep such possibilities open (Whyte and Whyte 1991, p. 290).

One of the more recent of innumerable striking examples of ESOPs in the USA has been the $US810 million buyout of Appleton Papers by the firm's 2600 employees in November, 2001.

A report of the buyout states that 'The transaction ranks as one of the largest employee buyouts in history and marks the third paper industry buyout in three years, after the 45 per cent employee stake in Blue Ridge Paper and the 40 percent employee stake in Blue Heron Paper.' Mondragon highlights the need for legislation that properly encourages and facilitates the establishment of ESOPs, while providing safeguards against their being abused to confer disproportionate benefits on senior management.

Second, Mondragon demonstrates the uses of credit unions and other mutualist financial intermediaries as a means of bringing about local and regional economic development. It is unlikely that the Mondragon co-operatives would have grown to their present size or contributed on so spectacular a scale to job growth and the well-being of the local and regional economies, had it not been for the role of the CLP in mobilising the necessary capital. The CLP adopted at the outset the slogan 'save locally for investment in local enterprises, or pack up and leave'. Its approach was well-received. People flocked to save with CLP, enabling it to meet virtually in full the needs of the co-operatives, until it was required by the Bank of Spain in the early 1990s to place a higher proportion of its loans with other borrowers.

Even today, the CLP remains a key source of capital for the expansion of the co-operatives. In Whyte's view, Arizmendiarrieta's insistence that the co-operatives should be financed through debt rather then equity – through what was, in effect, the members lending money to their workplaces through their individual capital accounts and their credit union savings – must be ranked among the most significant of his many contributions to their success.

As the co-operatives have had no need to raise capital by issuing their members with shares, they are thereby less likely to attract the unwelcome attention of the predatory demutualisers that have plundered the assets of so many of Australia's mutual assurance societies and permanent building societies. Whyte wrote: 'Don Jose Maria made a number of other social inventions, but this initial one was most crucial.'[4]

There is no reason why Australian credit unions should not re-task themselves to shift their lending, either in part or wholly, from their present focus on personal and housing loans to bringing about economic growth for the local and regional communities of whose capital they are custodians. For example, the United Food and Commercial Workers (UFCW) credit union was the main source of equity financing for members of the union's Local 1357 in Philadelphia, in their buyout of two abandoned supermarkets, which were then re-opened as worker co-operatives (Whyte and Whyte 1991, p. 285).

Alternatively, new credit unions could be created for this purpose, perhaps under the CLP's original 'Savings or Suitcases' rubric. In either case, risk could be minimised by syndicating larger loans between numbers of credit unions. Such risk assessment skills as were unaffordable for local and regional credit unions on an in-house basis, could be provided collaboratively on their behalf by peak bodies such as, in the case of Australia, the Credit Union Services Corporation of Australia Limited (CUSCAL). Here again, the Mondragon experience should be an incentive for enacting legislation empowering credit unions to make loans for non-traditional purposes, without sacrificing their capacity to comply with stringent prudential requirements.

Third, the CLP demonstrates the capacity of credit unions and other mutualist financial intermediaries to transcend their origins as lenders and assume additional functions, such as business incubators. Just as the co-operatives are unlikely to have prospered, or perhaps even survived, in the absence of the credit union as a source of capital, so too they would not have done as well without the services of the Empresarial Division as an incubator – in David Ellerman's striking phrase, as a 'factories factory'.

To the extent that it might be difficult in Australia for purely local or regional credit unions to fund incubator services of the scale and sophistication of the Empresarial Division from their own resources, that function could also be assumed on their behalf by peak bodies, such again as CUSCAL. It may well be that the interests of nascent worker co-operatives would be better served by incubators based on credit unions and other mutualist financial intermediaries than by their state or municipal counterparts.

Fourth, the relationship between the Mondragon primary co-operatives and the CLP and its counterpart secondary support co-operatives, such as Ikerlan, demonstrates the strengths that accrue from measures formalising and reinforcing the inter-dependence of businesses and their sources of goods and services. The amounts credited annually to the capital accounts of members of the support co-operatives and of the primary co-operatives are tied to one another. Neither benefits without the other, and there is constant feedback to the effect that in order for either to succeed both must do so. Related inter-dependencies, reciprocities and mutual support are evident within the manufacturing, retail and financial sectoral groups.

None of this means that Mondragon is Utopia, or that the co-operatives do not still have some considerable way to go in fully implementing their values and principles. Still less is it to suggest that in order to benefit from the Mondragon model it must be adopted in its entirety. What Mondragon offers Australia is an impressive body of theory and practical experience on which we can draw selectively in remedying some of our most pressing problems and making the most of our opportunities. We would be foolish not to make the most of it.

Notes

1. For a useful account of the overseas subsidiaries and the issues they raise for the co-operatives, see Clamp (1999).
2. The most comprehensive account of Arizmendiarrieta's ideas in Azurmendi (1991) regrettably has not so far been made available in an English edition. For accounts in English, see, for example, Whyte & Whyte (1991), Macleod (1997) and Mathews (1999).
3. For example, Copesca was established in 1965 as secondary support co-operative in order to make fishing boats available to 24 fishing co-operatives. Copesca's capital structure was a departure from the usual Mondragon arrangements, in that 71 per cent of its funds were provided by the government in the name of job creation, as against 24 per cent from the Caja and only 5 per cent by the fishermen themselves. Rather than pay off the capital debt, the fishermen chose instead to increase their incomes. When further capital was required to keep the co-operative afloat, they refused to supply it, and the business closed down in 1973. Its eight-year history is an object lesson in the wisdom of Mondragon's insistence that adequate capital stakes should be held by both co-operatives and their members.
4. Letter to the author, 7 August 1999.

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