Cleveland Goes to Mondragon

In October 2008, the Cleveland Foundation sponsored a study trip to the Mondragon Cooperative Corporation (MCC) in Spain's Basque region to examine the utility of that model for the Evergreen Cooperatives in the Greater University Circle area in Cleveland. The Evergreen Cooperatives will be a group of cooperative businesses employing residents of the Greater University Circle neighborhood. The first cooperative planned is a laundry serving health care institutions in the neighborhood and beyond

The Mondragon cooperatives prove the viability of the co-op model on a large scale in a market economy. They began in 1956 with one cooperative with five employee-owners making paraffin stoves. Today, they are the 7th largest business group in Spain. They comprise an interconnected group of some 87 industrial cooperatives organized in 11 industrial groups with 71 subsidiaries in Spain and 69 plants abroad (largely in Europe and Latin America); a major grocery and retail cooperative which is the 2nd largest retail chain in Spain; and a financial group that includes a credit union/bank (the Caja Laboral with 19 billion euros in assets and 1.1 million members) and a mutual insurance company. The Mondragon Cooperative group includes numerous secondary co-ops established by the primary cooperatives to provide economies of scale. These include a dozen joint R&D centers to support the industrial cooperatives, a number of training cooperatives, consulting and accounting cooperatives, a consulting engineering company, a cooperative university with close to 4000 students (about half in engineering), and more. Together the Mondragon cooperatives employ over 100,000 and have sales of more than 15 billion euros (€1 = $1.35).

The co-ops are highly innovative. Mondragon's substantial R&D efforts absorb about 5% of the value-added in the industrial cooperatives. Twenty-eight percent of the industrial group's sales in 2008 were new products that weren't sold in 2004.

The Mondragon co-ops put money back into the cooperative sector. Co-ops can deduct their contributions to their industrial group's reserve funds (an average of 20%) and to the MCC funds for investment in new products, new co-ops, the MCC reserve fund and Mondragon University (14%) from what otherwise would be pre-tax profits. Co-ops' statutory income tax rates on the remainder are 10% (vs. 35% for conventional companies), provided the cooperative also contributes 10% of profits (after income tax is deducted) to a social welfare and education fund and earmarks a minimum of 20% of remaining profits for the indivisible reserve fund within the individual cooperative. The indivisible reserve would belong to the public sector, not to the members, if the co-op liquidated. In practice, Mondragon co-ops go well beyond the statutory minimums to put more money into education and individual co-op reserves.

Diagram 1 illustrates the way it works for the average industrial cooperative.

Diagram 1: Distribution of Co-op Profits

Gross profits (after other business costs)
– 20% average to group reserves (ranges from 15% to 40% as determined by the group)
– 10% to MCC investment co-op to invest in new products and co-ops (5% grants, 5% equity)
– 2% to MCC education fund (Mondragon University and R&D projects)
– 2% to MCC Solidarity Fund (to cover individual co-ops' losses)
= Taxable profits

Taxable profits
– 10% tax to government
= **Net profits** which are split;
10% to Social and Education Fund (each co-op decides how to distribute this money)
45% to indivisible reserves in the individual co-op (Statutory rate 20%)
45% to members' accounts in the individual co-op (paid out at retirement)

This is a very different tax regime than for American ESOPs, especially Sub-S 100% ESOPs, which are tax free and have no obligations to anyone, and certainly none to develop new employee-owned firms. The Spanish system gives a high level of tax relief but only in return for employee-owned firms putting significant sums back into the community and into cooperative development, and the Mondragon cooperatives do more than is required by law. Over time, it also leads to a high level of permanent capitalization in the employee-owned sector, relative to the American ESOP structure in which 100% of value is distributed to employee owners. This system of distributing profits obviously strengthens the coops as a group and increases the long-term viability of the individual employee-owned company.

Unlike American employee-owned companies, the Mondragon co-ops support each other in hard times. Each of the 11 industrial cooperative groups pools a portion of its profits to cover potential losses in member co-ops within the group. Typically this covers about half of losses. The Mondragon Cooperative Corporation backs this up with a pool of 2% of total group profits that picks up 1/3 of an individual co-op's remaining losses. Only the remainder — about 1/3 of the original loss — is debited against the individual co-op's capital (and member accounts). This doesn't continue indefinitely but supports a money-losing firm for 2-3 years to get it past a cyclical downturn or a restructuring. Add that to the fact that the individual co-ops put 45% of profits back into indivisible reserves every year, and you begin to understand why the whole system is so resilient in bad times, despite the small size of the individual industrial co-ops.

Members make substantial investments. To join one of the industrial co-ops, prospective members serve a probationary period of up to three years and then pay a €14,000 membership fee, or roughly $18,000, typically over the next three to seven years. (Even in Eroski, the retail chain that has a lot of people working part-time, membership costs a still-substantial €9,000.) The membership fee helps to capitalize the co-op. In years when the co-op makes money, members receive 7½% interest on their membership fees. They receive 45% of the after-tax and after-social-contribution profits, and that is divided among their accounts on the basis of labor input into the cooperative. Their internal accounts also pay 7½% interest in years when the co-op makes money. At retirement, the member gets the membership fee and the value of his/her internal account paid out over 4 years.

In addition to interest on capital contributions, the member has a guarantee of employment throughout the Mondragon co-ops. If your co-op is reducing employment, you have a right to employment in another co-op which is hiring. Co-ops receiving members from other co-ops don't have to lay off probationary employees (no bumping rights), but they do have to hire members from downsizing co-ops rather than hire new probationary members. As a result, the co-ops are proud to say that they have never laid off a member in 52 years, though what the future will bring, no one can say.

The co-ops are democratically run. General managers are responsible to the general assembly of co-op members and to the governing council of the general assembly in between general assembly meetings. The Mondragon Co-operative Corporation (MCC) itself is, in effect, a reverse holding company in which the individual cooperatives "own" the corporation, and the MCC's general assembly and governing council is made of representatives from the component cooperatives.

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The co-ops promote economic equality in the society generally. Manual workers in the Mondragon co-ops earn 10% more than they would outside the co-operative sector, supervisors earn the same, and managers earn 40% less. Not surprisingly, 98% of managers are promoted from inside the co-ops. That requires a major leadership development program, provided by Otalora, the Mondragon training cooperative.

Management salaries are capped in relation to the minimum salary of co-op members: 92% of the cooperatives cap top manager pay at 4½ times the minimum salary; larger industrial co-ops cap top managerial pay at 6 times the minimum salary; and FAGOR, the largest industrial cooperative, with 4,000 employees, pays its general manager 7½ times the minimum salary. The Caja Laboral pays its general manager 8 times the minimum salary. And the Mondragon Cooperative Corporation pays its CEO 9 times the

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The Cleveland Foundation study trip group at Mondragon University at the memorial to Fr. Jose Maria Arizmendiarrieta. From left to right, Lillian Kuri, Cleveland Foundation; Margaret Hewitt, University Hospitals; Andrew Watterson, City of Cleveland; Christina Ayers, Cleveland Clinic; Bob Eckardt, Cleveland Foundation; Ted Howard, Democracy Collaborative and Cleveland Foundation; Steve Kiel, Hudson Consulting Group; Mary Ann Stropkay, ShoreBank; Jim Anderson, OEOC; Margaret Carney, Case Western Reserve University; Margaret Bau, US Department of Agriculture; and Mikel Lezamiz, Mondragon Cooperative Corporation.

minimum salary. Contrast that with the American Fortune 500 CEO compensation of 410 times the average wage.

European Union statistics say that the Basque region has the most equal distribution of income of any region in Europe, and Basque regional government surveys show that the highest level of equality in the Basque region is in the Gipuzkoa province where Mondragon is located and, within Gipuzkoa, in the Mondragon valley itself. Here are some of the things that impressed the study group:

[T]he most important message was that the Mondragon Co-operative Corporation only works with businesses that they feel are viable and will make a profit. While they do social good, they are not promoting a subsidy program. Their companies are in business to make money and keep people working while adding to the GDP of the economy.

– Margaret Hewitt, University Hospitals

I was struck by the overall unity of the efforts--how the various pieces of financing, governance, worker recruitment, review of whether to accept employees into the co-op, the level of cost for co-op shares, etc – all fit together. This meant to me it was hard to pick up any single piece and move it to US without thinking through how the other pieces fit with it.

– Bob Eckardt, Cleveland Foundation

Visiting Mondragon – meeting the people, seeing the businesses, experiencing the culture – was a real eye opener. For most of us, our only connection to a cooperative is an occasional visit to the local food coop. In Mondragon we walked the floor of an appliance manufacturer producing 800,000 washing machines a year; we saw a multi-billion dollar bank; we met with a professor at Mondragon University. All organized as democratically run, worker cooperatives that are efficient and effectively run businesses. Of course, none of this happened overnight. It all began in the early 1950s with three workers; today Mondragon has grown into a network of 120 plus cooperative companies with more than 100,000 worker-owners. For those of us interested in adapting this model to the realities of Cleveland, Ohio, this study visit to Mondragon provided new insights into critical strategic issues such as moving to scale, financing, governance, nurturing a network of local enterprises, and fostering a culture in which cooperative ownership and management are valued. Funding permitting, I'd urge that we organize additional study visits for other leaders of Cleveland.

– Ted Howard, The Democracy Collaborative

The study team has been an inspiration. Everyone is committed to learn and has been open and diverse in discussion of cooperatives in general and Evergreen in particular. I especially can relate to the need to create the bank early in the Mondragon experience. We have a similar issue with the Evergreen Fund. The Mondragon experience reinforces the need for thorough planning as company start ups are vetted and launched over time. It was gratifying to note the need for profits in order to sustain the enterprise. Also, the commitment to customer service as the priority goal above all other strategies.

– Jim Anderson, OEOC and CEO, Evergreen Cooperative Laundry

As a co-op developer, making the pilgrimage to Mondragon was like I had died and gone to co-op heaven. Mondragon and the Basque area put serious resources into co-op development, and the region is rewarded with an 85% success rate of new business start-ups. Mondragon co-op organizers are quite savvy about keeping abreast of market trends, utilizing cutting edge technology, nurturing competent management, incubating the business idea, and securing ample self financing. What a refreshing alternative to expecting a solitary entrepreneur to shoulder the entire burden of starting a new business – and then lamenting the high failure rate.

– Margaret Bau, US Department of Agriculture Rural Development

We are not angels and this is not paradise.

– Mikel Lezamiz, Otalora, Mondragon training cooperative

The Mondragon Cooperatives have been described at considerable length previously in Owners at Work, most notably in Karen Thomas, "Lessons of Mondragon's Employee Owned Network," OaW, Summer 2000, pp. 5-9, and John Logue, "From Mondragon to Ohio: Building Employee Ownership," OaW, Summer 2001, pp. 16-17. You can read those articles in our website library at http://dept.kent.edu/oeoc/publicationsresearch/Spring2000/EnvisioningEmployeeOwnership.htm (2nd article) and at http://dept.kent.edu/oeoc/publicationsresearch/summer01.pdf respectively. Thanks to Mikel Lezamiz for his assistance in getting the facts right in this article. OAW

A recreation of the study of Father José María Arizmendiarrieta, the driving force behind the Mondragon cooperative system.