



### THE MONDRAGON COOPERATIVE MOVEMENT

#### History of the Mondragon Cooperatives

In 1941, a young Basque priest, Father Jose Maria Arizmendi, came to Mondragon, a small working-class town in the Basque province of Guipuzcoa in Northern Spain. He began his teaching work in the apprentice school of the Union Cerrajera, the industrial company which dominated the town of Mondragon. This school, however, was not large enough to provide adequate training to the local youth. Failing to enlarge the school, Father Arizmendi gathered the support of the townspeople and opened a technical training school in 1943 with twenty students.

The first class graduated in 1947, and Father Arizmendi arranged for eleven of them to continue their technical education at the Zaragoza School of Engineering. By 1948, the school had been successful enough to establish the League of Education and Culture (Liga de Educacion y Cultura). It was a cooperative association of the townspeople, teachers, parents, and students which gave official status to the school that eventually became the Escuela Profesional Politecnica, the Polytechnical School.

In 1952, the eleven had completed their engineering education in Zaragoza and had moved into jobs in conventional companies. There they tried to put into practice not only their technical skills, but the teachings of Father Arizmendi based on Catholic Social Doctrine. Their efforts to dignify the role of labor and to democratize the workplace met with little success. In 1954, five of the eleven decided to form a new company to implement "the primacy of labor among factors of production." To obtain the necessary manufacturing license, they purchased the license of a small bankrupt company in Vitoria. After a fund-raising drive amongst relatives and Mondragon townspeople, they constructed a factory and commenced operations producing a small stove in Mondragon in 1956 with 24 workers. The new company was called ULGOR, an acronym formed from the initial letters of their names.

ULGOR rapidly diversified and grew so it had 143 workers by the end of 1958. In the period between 1956 and 1959, the entrepreneurial

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This case was prepared as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. It is an excerpt from "The Socialization of Entrepreneurship," by David P. Ellerman, staff economist at the Industrial Cooperative Association, Inc. and Assistant Professor of Management at Boston College.

drive of the founders of ULGOR led them to found or to assist in the formation of several other cooperatives. These included a machine-tool factory, Arrasate (which is the Basque name of Mondragon), an iron-smelting operation, Funcor, a consumer cooperative store in Mondragon which eventually expanded to become Eroski, and the segments of ULGOR, which were eventually spun off as a foundry, Ederlan, and a producer of domestic appliance components, Copreci.

#### The Founding of the Caja Laboral Popular

The rapid growth in the Mondragon cooperatives had, by 1959, outstripped the credit sources available to them. Father Arizmendi had a solution; start a bank as a credit cooperative. One of the founders of ULGOR records their initial reaction.

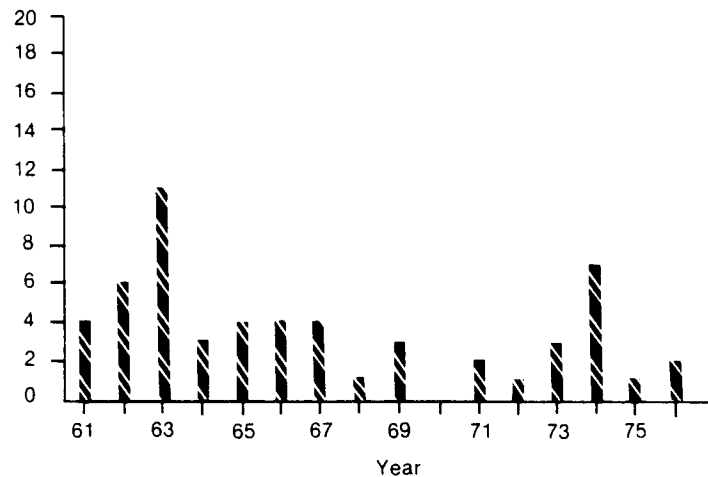
We told him, yesterday we were craftsmen, foremen, and engineers. Today we are trying to learn how to be managers and executives. Tomorrow you want us to become bankers. That is impossible.

But Father Arizmendi had done the necessary research and he was, in the end, persuasive. The bank, the Caja Laboral Popular Bank (Bank of the People's Labor) began operations in 1959 in Mondragon. Two of the ULGOR founders, Jose Maria Ormaechea and Alfonso Gorronogoita, emerged as the leaders of the Caja Laboral Popular (CLP), Ormaechea as the chief executive, the director, and Gorronogoita as the president. They had held those offices to the present day (1982).

One of the major innovations of the Mondragon Cooperative Movement is the Empresarial Division of the Caja Laboral Popular. In the period between the founding of ULGOR and the founding of the CLP, Ormaechea and his colleagues had exhibited extraordinary entrepreneurial ability in the formation of the cooperatives ULGOR, Arrasate, Funcor, and the operations which eventually became Ederlan, Copreci, and Eroski. When the bank was formed, Ormaechea generalized and institutionalized this entrepreneurial experience in the Empresarial Division of the CLP.

The lending power of the Banking Division of the CLP and the entrepreneurial drive of the Empresarial Division led to an unparalleled burst in cooperative economic development in the following years. In the first decade and a half of the CLP, the record of new industrial cooperatives started per year is indicated in the following graph.

### Industrial Co-op Start-Ups Per Year



The lack of new co-ops in 1970 was due to ULGOR's addition of 900 new members in the previous year. The co-op development experts of the CLP were busy consolidating that growth.

### The Mondragon Cooperatives Today

This growth has resulted in over 85 industrial cooperatives in the Mondragon Movement at the present time (1982) with around 20,000 worker-members. The present five-year plan of the CLP calls for the Empresarial Division to launch about five new industrial cooperatives per year, including cooperatives targeted for the Basque region of France. The industrial cooperatives are the heart of the Mondragon Movement, but other cooperatives have also been developed. In addition to over 85 industrial cooperatives, there are

- o 6 agricultural cooperatives,
- o 2 service cooperatives,
- o 43 cooperative schools using the Basque language,
- o 14 housing cooperatives; and,
- o 1 large consumer/worker cooperative, Eroski, with over forty stores.

In addition, there are the second-tier or superstructural cooperatives with both cooperative and individual-worker members. These include:

- o Caja Laboral Popular with 120 branch offices,
- o Ikerlan, a technological research institute,
- o League of Education and Culture (which now includes not only the polytechnical college, but a business school and a professional college); and,
- o Lagun-Aro, a social security and medical cooperative.

The Caja Laboral Popular is the center of the system which links all the cooperatives to the CLP and to each other by the Contract of Association.

### Father Arizmendi and Catholic Social Doctrine

From the formation of the technical training school in 1943 to his death in 1976, Father Arizmendi was the inspiration and guide for the Mondragon cooperatives--even though he never held any official position with the cooperatives. He remained a parish priest all his life. The polytechnical school has now been named Instituto Politecnico Jose Maria Arizmendiarrieta. The center of the Mondragon complex, a hillside which overlooks the school and which contains the Caja Laboral Popular, Ikerlan, and Lagun-Arc, has also been named after him. His bust appears in the lobby of the CLP and on the grounds of the polytechnical college. His writings are being edited and published, and his quotations are sprinkled throughout the publications of the Mondragon group.

Father Arizmendi's work and writings are explicitly based on Catholic Social Doctrine. Indeed, they are a striking anticipation of Pope John Paul II's recent encyclical, Laborem Exercens. Catholic Social Doctrine is a broad canvas, but the specific themes picked out and emphasized in Laborem Exercens were also the themes which guided Father Arizmendi's work. There is the "priority of labor over capital," the emphasis on the dignity of work, and the need for worker solidarity. A quarter of a century after Father Arizmendi's vision was put into practice with the founding of ULGOR, John Paul II called for socializing the means of work so that,

. . . on the basis of his work, each person is fully entitled to consider himself a part-owner of the great work-bench at which he is working with every one else.

John Paul II goes on to describe a "way towards that goal" which could be taken as a general description of the Mondragon industrial cooperatives and the associated complex of economic, technical, social, and educational cooperative institutions.

A way towards that goal could be found by associating labor with the ownership of capital, as far as possible, and by producing a wide range of intermediate bodies with economic, social, and cultural purposes; they would be bodies enjoying real autonomy with regard to the public powers, pursuing their specific aims in honest collaboration with each other and in subordination to the demands of the common good, and they would be living communities both in form and in substance, in the sense that the members of each body would be looked upon and treated as persons and encouraged to take an active part in the life of the body.

## The Industrial Cooperatives

### The Growth of ULGOR, ULARCO, and Other Industrial Co-ops

Worker cooperatives have been traditionally stereotyped as small ("dwarfish"), labor-intensive, underfinanced, and poorly managed. The Mondragon industrial cooperatives do not conform to these negative stereotypes. The Mondragon co-ops are sizable, capital-intensive, well-financed, and well-managed. There are a number of factors which contribute to the capital intensity of the cooperatives. Mondragon has an old industrial and metalworking tradition. But a critical factor seems to have been the technical engineering emphasis in Father Arizmendi's teaching. His school had a technical orientation from the beginning, and after the cooperatives got started, he strongly pushed them to stay abreast of modern technology. The five founders of ULGOR were trained as engineers; e.g., Ormaechea, now the director of the CLP, was originally trained as an industrial chemist. The aggressive technological posture of the Mondragon cooperatives has been maintained down to the present day and is currently spearheaded by the Ikerlan research institute (e.g., the first industrial robots developed in Spain were developed at Mondragon).

After ULGOR began operations in 1956, its entrepreneurial founders moved quickly to diversify and vertically integrate the operations. A line of electrical products was licensed from Germany, a foundry was added, and an Italian license was obtained for the manufacture of butane cookers and heaters. A capitalist foundry was converted to a cooperative that later became Ederlan ("Good Work"). The tool manufacturing cooperative, Arrasate, was established in Mondragon. Another cooperative, Funcor, making foundry products, was established in Elorrio. A consumer cooperative store, San Jose, was set up in Mondragon (which was later to be integrated into Eroski).

The Caja Laboral Popular was founded in 1959 by the cooperatives ULGOR, Arrasate, Funcor, and San Jose. With sound financing, ULGOR continued to expand and added product lines in water heaters and institutional and domestic stoves and ovens. Arrasate moved into production of large, industrial presses, shears, and cutters. A new cooperative, Copreci, was hived off from ULGOR to produce electronic components for both ULGOR and the external market. The foundry and casting operations from within ULGOR were integrated into Ederlan.

In 1965, ULGOR, Arrasate, Ederlan, and Copreci took the new step of forming the first cooperative federation or group, ULARCO. A cooperative group, such as ULARCO, is an attempt to reap some of the advantages of both large-scale and small-scale operations. The federation allows small or medium-sized co-ops to have common sales and marketing arrangements, common planning of product development and market strategies, and risk-sharing by a degree of income pooling and job pooling between the cooperatives within the group. The best upper limit per cooperative is considered to be around 400 or 500 members.

ULGOR continued to grow in spite of hiving off two more cooperatives within the ULARCO group, Fagor Electrotecnica (1966) and Fagor Industrial (1973). Fagor Electrotecnica itself further illustrated this

principle of growth by cellular division by spinning off a cooperative, Aurki (1981), which produces numerical control systems for machine tools. ULGOR now has around 3,000 members, and ULARCO as a whole has over 6,000 members. ULGOR is the leading Spanish producer of consumer durables such as refrigerators, stoves, washing machines, and dishwashers, under the brand name of "Fagor." ULARCO has also excelled in technology transfer deals (19 so far), such as the construction of turnkey factories, in countries around the Mediterranean, in Eastern Europe, and in Latin America.

ULGOR and its group ULARCO have always been the flagships of the Mondragon Movement. However, cooperative development outside of the ULARCO group continued unabated after the formation of the Caja Laboral Popular. Ten groupings, mostly on an area basis, have now been formed with the group sizes (aside from ULARCO) ranging from around 400 to 1,000 members per group.

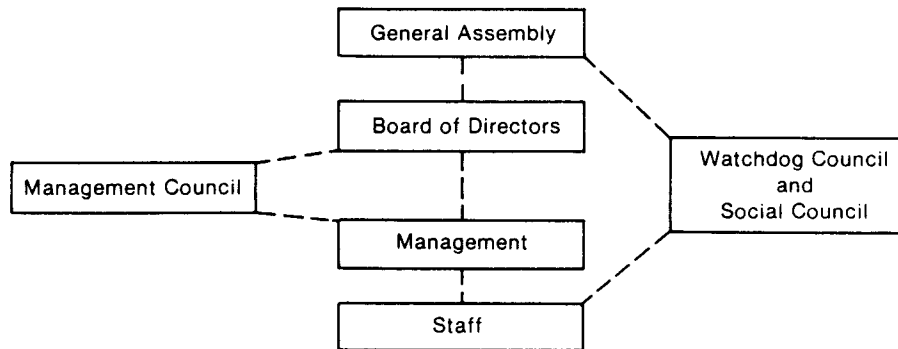
In Mondragon's growth from one to over 85 industrial cooperatives in a 25-year period, there have been no failures (although a failure amongst the agricultural/food cooperatives will be considered below). In the current recession, Spain has been hard hit and the Mondragon cooperatives have lost some sales, but there have been no large-scale layoffs. New admissions have been reduced or halted, some workers have been sent back to school to be upgraded in technical skills, work hours have been changed, and some workers have been shifted around within the groups. When layoffs have been necessary, the workers have continued to receive 80% of their pay.

#### The Governance System of the Industrial Cooperatives

In a worker cooperative, the membership rights (voting rights and rights to share in the proceeds) are attached to the functional role of working in the firm. Each worker qualifies for membership "on the basis of his work"; membership is not a property right which may be bought or sold. Hence, in a Mondragon worker cooperative, the principle is that all and only the workers in the firm are the members. The only exception is that, under unusual circumstances, up to 5% of the workforce may be individuals with special skills contracted from the outside. Rights come together with responsibilities, and one of the responsibilities of membership is the membership fee. At present, the fee is around \$5,000, with about 25% down and the remainder being paid by payroll deductions over a two-year period. On average, the entry fee covers about 10% of the costs of creating the job.

The ultimate authority in the cooperative is the General Assembly of members (Asamblea General). It meets at least once a year and periodically elects, on a one-member/one-vote basis, the board of directors (Junta Rectora). The terms are for four years; every two years, half of the directors are elected. The board of directors appoints the chief executive officer, the president, and the different department heads. Governing powers not delegated to the president or reserved for the General Assembly will devolve to the board.

Basic Organizational Chart for a Mondragon Cooperative



There are three other councils in the basic Mondragon governance structure, the Management Council (Consejo de Direccion), the Watchdog Council (Consejo de Vigilancia), and Social Council (Consejo Social). The Management Council is an advisory body which serves as an interface between the board and management. It consists of the president and the department heads, and it meets at least once a month to coordinate management plans.

The Watchdog Council consists of three members directly elected by the General Assembly with four-year terms. Their function is to obtain, monitor, and verify financial information and any other information requested by the General Assembly. In the Caja Laboral Popular, they have an internal auditing role, but in the other cooperatives, their role is more general. In large U.S. corporations with internal auditors, there is little independence of management, since the internal auditors are appointed by management and are answerable to management or the board. In the Mondragon cooperatives, the direct election of the members of the Watchdog Council by the General Assembly helps to provide a measure of independence.

The Social Council is directly elected, but not at the General Assembly meetings. Sections of 10 to 20 workers elect a representative for a three-year term. Workers meet once a week with their representative and all the Social Council representatives meet at least once every three months. The Social Council has advisory powers over a wide range of personnel affairs and its decisions are binding on safety, pay scale, and social welfare issues.

A sensitive issue in any workplace is the determination of the pay rates. The contours of the pay system are guided by principles of external solidarity and internal solidarity. In a worker cooperative, there are no wages per se, since the workers are the members, not the employees, of the cooperative. The net value accruing to the workers is the value of their product minus the nonlabor costs. Some of that value is paid out during the year (the closest analogy to "wages"), some is paid out at the year's end (bonuses), and some is retained in the cooperative. Since the net amount is not known until the end of the fiscal year, the amount paid out during the year is an advance or an anticipation (anticipos) of the workers' income.

The principle of external solidarity means that the anticipos (advances) for the lower pay rates will be geared only slightly above the wages of comparable work in the capitalist firms in the vicinity. According to the Spanish custom, the annual pay is given in 14 monthly installments, one extra month's pay in the summer (to finance an August vacation) with the other at Christmas time.

The principle of internal solidarity means that the top to bottom pay ratio in a cooperative will not exceed 3 to 1. Under certain circumstances, there can be special bonuses up to 50% of pay so such a bonus added onto an index 3 job would give an effective ratio of 4.5 to 1. In any case, the comparable chief executives in capitalist firms may receive two or more times as much as their cooperative counterparts. The noneconomic benefits of the cooperative movement have been appreciated mostly by the executives who have developed inside the movement. The pay ratios have made it difficult to recruit experienced executives from outside the movement. A 5 to 1 ratio is being presently discussed.

Individual pay rates are determined by the labor index attached to the various jobs, from the bottom to the top. Each job is evaluated on the basis of many characteristics such as necessary training and experience, decision-making responsibility, social relational skills, physical and mental demands, and special hardship factors (danger, noise, etc.). On the basis of these characteristics, each job is assigned a labor index on a 1 to 3 scale. The labor indices are published in a single manual that covers all blue- and white-collar workers from operatives to executives. The Social Council oversees the whole complex process of determining the labor indices.

The role of the Social Council has grown following a (nonsymbolic) strike at ULGOR. By 1974, ULGOR had grown quite rapidly to 3,250 members (e.g., 900 new members in 1969 alone). Channels of communication were not well-established and there was some worker disaffection. A particular dispute arose over a revaluation of job pay rates which downgraded certain tasks. It was made clear that the revaluation would not affect the labor indices of current members and would only be applied to new entrants. In any case, some dissidents went outside of the established channels for dissent and called a strike. The strike lasted for eight days and involved 414 of the 3,250 members. The board responded by dismissing the 17 strike leaders and by adopting disciplinary measures against the other 397 strikers. The strikers challenged this decision at an Extraordinary General Assembly meeting. After much heated discussion, the General Assembly ratified the board's decision by a 60 percent majority vote. The reason was not that the dissidents disagreed with management, but that they ignored the democratically agreed-upon procedures for expressing dissent such as through the Social Council.

The Social Council and the Watchdog Council form a legitimate oppositional structure, an independent organizational basis for the members to monitor, question, and dissent from managerial activities and policies. The functions of the Social Council closely resemble many of the functions of a trade union in a capitalist enterprise. Free trade unions were outlawed under Franco's fascist government. After Franco's death in 1975,



the subsequent liberalization fostered a burst in the development of trade unions and political parties.

There have been discussions between the cooperative group and trade unions to see if an appropriate form of affiliation could be worked out. Many unions have been formed, and as is often the case in Europe, most unions are affiliated with political parties. In addition to normal trade union functions, the unions try to recruit the workers for the associated political party. With so many unions and parties (about six in the Basque country alone), it is considered inappropriate and unwise for the Mondragon cooperatives to exclusively associate with one union and one political party. It is also considered inappropriate to have different unions and parties vying against one another within the Mondragon complex. Hence, under present circumstances, the cooperative-union relationship has not gotten beyond the discussion stage.

#### The Mondragon Legal Structure For the Industrial Cooperatives

At the beginning of the BBC documentary film The Mondragon Experiment, the narrator comments that the roads into Mondragon were bad. This could be taken as being symbolic of Mondragon's (voluntary or involuntary) isolation from the traditional cooperative movement. Traditional cooperatives in Europe and America contain a number of "standard flaws" which can be understood and corrected, but which, for various reasons, are usually reproduced. The autonomous development of the Mondragon cooperatives helped them to think through intelligent and creative answers to the problems of cooperative structure--instead of just copying the mistakes of the past.

The Mondragon Cooperative Movement as a whole is so unprecedented, that we cannot pretend to exhaustively list its unique contributions. Four major social inventions are of particular note:

1. the system of internal capital accounts, which gives the members a recoupable claim on their retained earnings, and which partitions that claim off from their membership rights,
2. the Caja Laboral Popular as a credit cooperative with the members being worker cooperatives and other cooperatives (not individual depositors),
3. the inclusion of the workers in a special category of membership in the nonworker cooperatives such as the agricultural, consumer, and second-tier cooperatives, and the resulting principle of staff self-management in those cooperatives; and,
4. the socialization of entrepreneurship embodied in the Empresarial Division of the Caja Laboral Popular.

In this section, we consider the first of these innovations, the internal capital accounts. The second and third innovations are discussed later in Part I, and the Empresarial Division is considered in Part II.

In a conventional corporation, the bundle of ownership rights consists essentially of the following three rights:

- o the voting rights,
- o the rights to the net income; and,
- o the rights to the net worth or equity of the corporation.

The first two rights, the voting and the net income rights, will be called the "membership rights" and the remaining rights to the net worth will be called the "capital rights."

A worker cooperative could be theoretically defined as a firm where the membership rights are personal rights attached to the functional role of working in the firm. Then the firm is an industrial democracy in analogy with a political democracy where the voting and other citizenship rights are personal rights attached to the functional role of residing in the community. The assignment of the membership rights to labor follows from the primacy of labor among the factors of production. The primacy of labor implies that labor shall not have the role of a hired factor; labor shall hire capital. Workers should always be the members of the firm, not the employees of the firm, and the net return (after a payment for the other factors) should be a return to labor.

The net labor income is the revenue minus the nonlabor costs, which, in conventional terms, equals the wages plus the profits. Part will be distributed during the fiscal year as anticipated labor income (anticipos), and the amount of labor income left at the year's end can either be distributed or retained in the firm to increase its capitalization. In either case, the labor income represents the value of the fruits of the workers' labor and it should belong to them regardless of whether it is distributed or retained in the firm.

It is the treatment of the retained labor income which has always caused problems in traditional worker cooperatives. There are two diametrically opposed flawed treatments: (a) the nonprofit treatment of forcing the workers to forfeit any recoupable claim on the retained income; i.e., to forfeit the capital rights, and (b) the capitalist treatment of combining the capital rights with the membership rights. Traditional worker cooperatives or self-managed firms tend to make one mistake or the other.

Many worker co-ops or self-managed firms, such as the Common Ownership firms in England and the self-managed enterprises in Yugoslavia, are structured like an American nonprofit corporation in the sense that there is no recoupable claim on the net worth of the firm. This eliminates any incentive to finance capital investment by retained earnings as opposed to borrowing, and it introduces numerous other distortions which have been analyzed in the economic literature. The principal flaw, however, is that there is no reason (misplaced idealism or Marxist ideology aside) to deny

workers the value of the fruits of their labor if that value is reinvested in the firm.

The opposite flaw is to attach the capital rights to the membership rights so that in order for an entering worker to qualify for the membership rights, the worker has to additionally purchase the capital rights due a retiring member. The noncooperative corporations which are employee-owned either directly or indirectly through an Employee Stock Ownership Plan (ESOP) have this type of capitalist structure. The traditional worker cooperatives in the United States such as the plywood cooperatives have a hybrid co-op/capitalist structure. To become a co-op member, a worker has to buy a share where the value of the share represents the capital value accumulated by a retiring member. In the better plywood co-ops, a share can be priced in the \$60,000 to \$80,000 range. In theoretical terms, this structure violates the principle that a worker is supposed to qualify for membership "on the basis of his work" and should not have to "buy" the membership rights. In practical terms, many workers cannot afford to purchase the shares, so they are hired as nonmember workers. Over a period of time, these firms become more and more conventional, with a small number of owners and a large number of hired workers. Eventually, the remaining owners may have to sell the whole company to a capitalist firm in order to recoup their accumulated capital.

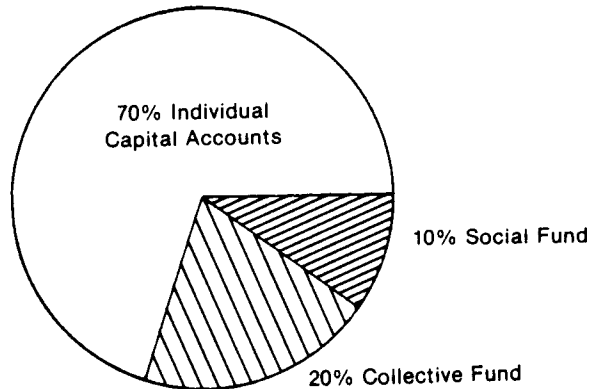
The Mondragon cooperatives solved this problem of having the membership rights attached to work without forcing the workers to forfeit their capital rights. To understand the solution, suppose that all net earnings were distributed to the members, deposited in a savings bank, and then loaned back to the cooperative. Then the members could recoup their claim on that capital value through their savings account, and yet the cooperative could self-finance its own capital investment (indirectly through the external savings bank). That arrangement is impractical, but recoupable, self-financed investment can be obtained by the alternative arrangement of moving the savings accounts directly into the firm itself. That is the solution worked out by the Mondragon cooperatives.

Each member has an internal capital account representing the capital value eventually due back to the member (usually upon retirement). The account is quite separate from the membership rights. Workers, depending on their seniority and pay rate, might have quite differing amounts in their accounts and yet they have the same membership rights; e.g., equal voting rights. An entering worker does not have to individually finance the payout to a retiring worker; the cooperative pays off the accounts of retiring members.

In addition to the individual capital accounts of the members, there is a collective account that is unindividuated. The sum of the balances in the individual accounts and the collective account is the net book value or net worth of the cooperative. There are several reasons for the collective account. One practical reason for the Mondragon cooperatives is that Spanish cooperative law requires that at least 10% of the net earnings be reserved for a social and educational fund. The Mondragon cooperatives expend these funds on such matters as Basque community schools, local community projects, and unemployment benefits. At

least an additional 20% of the net surplus is allocated to the collective account, and, unlike the 10% social dividend, this amount stays in the firm. The remainder, up to 70% of the net surplus, is allocated amongst the individual capital accounts.

#### Allocation of Retained Surplus



This collective account allocation can be rationalized on the basis of uncertainty. In the long run, there are unavoidable costs attached to uncertainty. In an uncertain world, a cooperative could not always try to pay back 100% of the retained earnings to the members. The collective account allocation can be seen as a form of self-insurance, a cost incurred to reduce the uncertainty of the payback. By only promising to pay back 70% or 50% of the retained earnings (rather than 100%), the cooperative can substantially increase the likelihood of keeping its promise.

When a new member pays in the membership fee, not more than 25% and typically 15% is committed to the collective account with the remainder being credited to the member's capital account. The individual capital accounts accrue interest at the rate of 6%, and that interest is usually paid out. Periodically, the effect of inflation is taken into account by revaluing the assets of the cooperative according to CLP-computed price indices. The capital accounts are then adjusted accordingly to maintain the balance of the balance sheet. Hence, the 6% interest rate is more like a real interest rate than a nominal interest rate (real rate + inflation rate = nominal rate).

The capital account interest is subtracted out of the net surplus computed at the end of each fiscal year. At least 30% of the net surplus is credited to the collective account (with 10% slated for social purposes). The remainder is credited to the individual capital accounts in proportion to the sum of each member's anticipated labor income and the interest payment on the member's account. There seems to be no theoretical

reason for the inclusion of the interest payment in the determination of that proportion. If the proportion was based solely on the member's anticipated labor income (anticipos), then each member's capital income (interest plus any inflation adjustment) would be fixed and independent of the firm's surplus for the year. That is what one would expect on the basis of the precept that labor is hiring capital so capital could get a fixed return with labor bearing the residual. By including the interest payment in the determination of each member's proportion, the members with the larger capital accounts are getting a larger proportion. Hence, the interest inclusion amounts to a form of "reverse profit-sharing," i.e., surplus sharing with capital.

The allocation of the retained surplus between the individual and collective accounts also holds when that surplus is negative, i.e., when there are net losses. Then not more than 30% can be debited to the collective account with the remainder being debited from the individual accounts. These formulas are further complicated when a cooperative is a member of a federation or group such as ULARCO. Then as a risk-sharing device, a percentage of the positive or negative surpluses is shared amongst the cooperatives in the federation.

When a worker leaves a cooperative, then the individual's membership rights are terminated since the membership was based on work. All or most of the person's individual capital account is paid out under financial arrangements which may vary from case to case. The percentage of the account paid out will depend on the circumstances of termination. If the person has reached normal retirement, or is leaving for circumstances beyond their control, then the full amount is paid out. If, however, the worker is leaving to work for a competitor or for similar reasons, then at the board's decision, up to 30% of the individual's account is forfeited and credited to the collective account.

There is no theoretical reason why the payout on the capital accounts must be postponed to termination or retirement. That allows for maximal capital accumulation during the first generation of co-op members. However, it also puts a premium on leaving the cooperative which the Mondragon co-ops have tried to counteract with the preretirement penalty. A more important problem is that it makes size and timing of the capital payout dependent on the demographic configuration of the work force. The Mondragon cooperatives have yet to retire a generation of members, and, indeed, they will be facing a large demographic bunching of retirees in two or three decades.

An alternative to the retirement payout plan is a fixed, multiyear rollover plan; pay out each surplus allocation to an individual's account after a fixed number of years (say, five or seven years) if the entry has not been debited by that time. This revolving of the internal accounts will tend to equalize the accounts (and risk-sharing) so there will not be large differentials in the account balances between the older and younger members. It also smooths the payout process by making it more independent of the demographic composition of the work force. All members would have to have less anticipated labor income paid out (to finance the account rollovers), but that is counteracted by the "second income" of

account payouts for the workers who have been members for longer than the five- or seven-year "waiting period." The main pinch is for the new members who have less anticipated labor income paid out, but no account payouts as yet. In any case, the choice between the termination payout plan and the fixed rollover plan is a pragmatic financial decision.

### The Other Mondragon Cooperatives

#### The Consumer/Worker Cooperative

A consumer cooperative store in Mondragon, San Jose, was one of the four cooperatives founding the Caja Laboral Popular (the other three being the worker cooperatives ULGOR, Arrasate, and Funcor). In 1969, the San Jose store and eight other consumer cooperative stores in the province of Guipuzcoa (which contains Mondragon) were consolidated in the new cooperative, Eroski. Today, Eroski has grown to over 45 stores throughout the Basque country with over 70,000 consumer-members and over 800 worker-members.

The cooperative movements in England and Scandinavia are dominated by the consumer cooperatives. The members of the cooperatives are the consumer patrons. The net proceeds are partially allocated to the consumer members in proportion to the patronage, their purchases through the stores. The workers in the consumer cooperatives have a normal, employer-employee relationship with the company. The workers can, of course, be members of the cooperatives as consumers. The governing role of the consumer-members is typically minimal, and the cooperatives are usually run by hired professional managers.

The customary consumer co-op ideology takes an instrumental view of labor and the firm as a whole. Instead of being employed for private profit, the labor and other resources will be employed for the social good (i.e., consumers). When the sellers want a higher price, that is private greed; when the buyers want a lower price, that is the social good.

The Mondragon cooperators did not copy the traditional consumer cooperative structure used elsewhere. The Mondragon cooperatives, all of them, are founded on the principle of the primacy of labor. The primacy of labor implies that labor shall not be treated as a hired factor, i.e., the denial of the employer-employee relationship. In all the co-ops, the workers form a special category of membership endowed with substantial overall governing power in addition to the principle of staff self-management. There is no patronage dividend for the consumer-members; instead, the prices, selection, and facilities are quite competitive, and the worker-members share in the net proceeds as in the worker cooperatives. The "consumer cooperative" Eroski would be more aptly characterized as a hybrid consumer/worker cooperative.

#### The Agricultural/Food Cooperatives

The strongest segment of the U.S. cooperative movement consists of the agricultural or farmer cooperatives. The farmer cooperatives and

worker cooperatives are sometimes both classified as "producer cooperatives," but the two types of cooperatives are quite different in structure. The farmer cooperatives are usually marketing cooperatives. In a supply co-op, supplies such as fertilizer, seed, gasoline, and electrical power, are bulk purchased or produced by the farmer co-op and then sold at a discount to the farmers. In a selling co-op, farmers and agribusiness corporations as independent producers sell their output to the agricultural co-op, which may then process the food (e.g., milk into butter and cheese) and sell it on the market. Some farmer co-ops have grown to enormous size and are not too different from large capitalist agribusiness corporations (except for the federal tax break for co-ops). Any workers in the production, processing, and distribution parts of a U.S. agricultural co-op are normal employees.

At present, there are six agricultural cooperatives in the Mondragon complex. Here again, the Mondragon cooperators did not copy the agricultural co-op structure used elsewhere, but worked out a new structure consistent with the primacy of labor. The farmers as independent producers and the workers in the processing plants and distribution networks are both members in different categories of membership; the farmers as "socios productores" and the workers as "socios transformadores." Hence, the Mondragon agricultural cooperatives are not traditional farmer cooperatives; they are hybrid farmer/worker cooperatives.

In the whole Mondragon Cooperative Movement, there has been one failed cooperative, and it was in the agricultural/food category. It was a fishing cooperative, Copesca, started in 1965 and finally wound up in 1973. It was a second-degree support cooperative consisting of 24 small fishing co-ops each with a fishing boat. In all the job-creating cooperatives in Spain, the Ministry of Labor will cover 20% of the job costs in the form of a low-interest, long-term loan. However, in the mid-1960s, the Spanish government wanted to particularly promote the fishing industry, and made generous loans available to finance fishing boats. Hence, this fishing co-op was the one project in which the government played a lead role in the financing. The government advanced 71% of the funds, the CLP 24%, and the fishermen advanced only the remaining 5% from their own funds.

The fishermen did not adapt well to participating in a cooperative business venture. Instead of retaining most of their net proceeds so they could eventually pay off their long-term debt, the fishermen increased their personal income and neglected the long term. In 1973, the CLP made an attempt to reconsolidate the boats in the worse financial shape. That would require another financial contribution from the fishermen--which was not forthcoming. Hence, in order to protect their depositors' money, the CLP initiated proceedings to wind up the fishing cooperative.

### The Housing Cooperative

Housing cooperatives were added to the Mondragon complex in the middle seventies. The financing of the construction or purchase of apartment buildings supplies a welcome outlet for the bulging funds of the CLP. After construction or purchase, the CLP can then make loans to

individual cooperators to finance their apartments. Today, there are 14 housing cooperatives associated with the Mondragon group, with over 1,200 apartments.

### The Educational Cooperatives

There are, at present, 43 cooperative Basque schools with about 31,000 students and with over 1,000 staff members. They offer bilingual (Basque and Spanish) instruction at the preschool, primary, and lower secondary levels. These co-ops are separate from the educational programs under the auspices of the League for Education and Culture. The membership of these co-ops is drawn from the staff, parents, and students, and they are financially supported in part from the social funds of the CLP and other Mondragon cooperatives.

### The Service Cooperatives

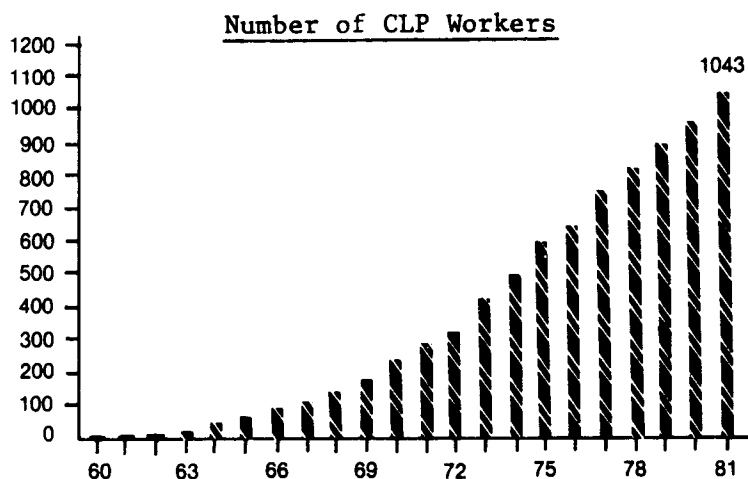
There are two cooperatives which are usually put into this category, Auzo-Lagun and Club Arkitze. Auzo-Lagun has around 450 members (mostly women). It is specifically designed to provide employment for people who, usually due to family commitments, want part-time and flexible time work arrangements. It specializes in the preparation of canteen meals, laundry, general cleaning, and subcontract work.

Club Arkitze is a cooperative sports and social club with a swimming pool and other recreational facilities. It has over 500 members, and is located in central Bilbao.

### The Superstructural Cooperatives

#### The Caja Laboral Popular

From the initial two offices in 1959, the Caja Laboral Popular (CLP) has shown remarkable growth. In the 23 intervening years, it has grown to be the 26th largest bank in Spain with 120 branches throughout the Basque region, over 1,000 workers, and around one-half million customers.





As a credit cooperative of the associated cooperatives, its primary loan activity must be with those cooperatives. However, it has become such an efficient mechanism for accumulating the savings of the Basque country that its lending powers are beginning to outstrip the funding needs of the associated cooperatives. Hence, the CLP has applied to the central Spanish government for permission to change its by-laws so that up to 15% of its loans can be to noncooperative firms in the Basque country.

The Caja Laboral Popular (CLP) is the group headquarters of the Mondragon Cooperative Movement. The Mondragon group is defined as the cooperatives which have signed the Contract of Association with the CLP. There are other cooperatives in the Basque region which are not associated with the CLP and which are not taken as part of the Mondragon Movement. The Contract of Association specifies the relationship between the associated co-op and the CLP such as the co-op capital contributions to the CLP, deposit of surpluses in the CLP, provision of reports to the CLP, and auditing of the co-op by the CLP. The contract also specifies the contours of the "Mondragon legal structure" for the associated cooperative such as the democratic governance principle, the limited return on capital, the attachment of the membership rights to work in the firm (i.e., members = workers), the membership fee, the individual internal accounts, the collective account (reserve fund and social fund), and the allocation of the positive and negative retained surpluses to the internal accounts.

In the United States and elsewhere, there are second-degree cooperatives, cooperatives of cooperatives. The members are not individuals but other co-ops, usually represented in proportion to their sales as in a second-degree marketing cooperative. The CLP and other support cooperatives are not second-degree co-ops in that standard sense. The principle of the primacy of labor entails that the workers in the CLP or other support co-ops must also be members in addition to the institutional or collective members. Hence, these co-ops are hybrids between first-degree worker co-ops and second-degree co-ops of co-ops. They are called second-tier cooperatives, or superstructural cooperatives. The CLP is also unlike the credit unions and cooperative or mutual banks in the United States, since the members are not depositors, but the associated cooperatives and the workers in the bank.

In its internal governance structure, the CLP has a General Assembly, a board of directors, a Social Council, a Watchdog Council (of three internal auditors, a Management Council, and several other committees. The General Assembly includes the CLP workers plus proportional representation from the associated cooperatives. The balance between the representation of the associated co-ops and the CLP workers on the board of directors is 2 to 1. Of the 12 directors, 8 are elected by the co-op representatives in the CLP General Assembly, and 4 are elected directly by the CLP workers. Half are elected biennially, i.e., 4 co-op and 2 CLP representatives every two years. The distribution of the 8 co-op representatives is usually 5 or 6 from the industrial co-ops, 1 from the consumer co-op, and 1 or 2 from the other superstructural cooperatives. The CLP also holds annual regional assemblies for the depositors. The management and the board of directors outline the CLP's activities during the year, and open a dialogue with the customers about their concerns.

Insofar as possible, the CLP has the same type of internal structure as the associated cooperatives. The CLP workers pay an entry or membership fee, and each has an individual capital account in the CLP. Instead of basing the surplus allocations to the individual accounts on the considerable surpluses of the CLP, they are based on the average level of surpluses in the associated cooperatives. The CLP also has a Social Council with a representative from every 20 workers, and, as usual, it oversees job evaluation, pay, and social welfare issues.

The departmental structure of the CLP has evolved over its history. The principal division has always been the banking division (Division Economica). In 1969, the nonbanking functions related to promoting and launching new co-ops and consulting with the associated co-ops were organized together in the Empresarial Division. There once was a Social Security Division, but in the early '70s, it was split off as a separate cooperative, Lagun-Aro.

Today, there are two principal divisions, the Banking Division and the Empresarial Division, plus a smaller General Services Division concerned with building maintenance and land acquisition for the CLP. The bulk of the CLP workers (around 900) are in the Banking Division. The Banking Division performs all the usual functions of a modern savings bank, computerized servicing of the depositors' accounts, managing the bank's portfolio of investments in short- and long-term securities, making new loan decisions, and monitoring the existent loans. The CLP computer center is in a modernistic building balanced on the hillside beside the CLP headquarters. It contains the Series 1100 Univac computer that is in contact with terminals in the 120 branch offices throughout the Basque country.

The Empresarial Division (in addition to the CLP structure) makes the CLP unique in the world of development banking. The entrepreneurial experience of the ULGOR founders (particularly the CLP director, Ormaechea) was institutionalized and socialized in the Empresarial Division (which will be considered in Part II). It has systematized the process of creating new firms so that, with the exception of the fishing cooperative, there have been no failures in the development of well over a hundred cooperatives. Just as the systematized innovation of the modern scientific research laboratory represented a major advance over the garage inventors, so the institutionalization of entrepreneurship in the Empresarial Division of the CLP represents a quantum leap over the isolated and unorganized small business entrepreneurs of the capitalist world.

### Ikerlan

On the hillside overlooking Mondragon, beneath the CLP headquarters, lies the technological research and development institute, Ikerlan. From the beginning of Father Arizmendi's technical training school, the Mondragon Cooperative Movement has emphasized the importance of staying abreast of modern technology. Today, Ikerlan is the symbol of that aggressive technological stance.

Up to the mid-70s, research and development was performed either in the cooperatives or in the polytechnical college. However, this proved inadequate to absorb the explosive developments in electronics and computer science of the '70s. In 1977, Ikerlan was hived off from the polytechnical college as an advanced applied research institute with over 60 research workers and in association with 32 "base" cooperatives and the super-structural cooperatives. It works in close collaboration with the polytechnical college. Engineering students can participate in Ikerlan in their final year. As in the other superstructural cooperatives, the Ikerlan workers elect a portion of its board of directors along with the associated cooperatives and the other support cooperatives. The workers elect four board members with the other eight members being elected by the industrial cooperatives associated with Ikerlan and by the superstructural co-ops.

Ikerlan is organized to perform research in the areas of electronics, mechanical engineering, thermodynamics (including solar energy), and computer science (or "informatics" as it is called in Europe). In addition to computing and other scientific facilities, it has a large machine shop so that models and working prototypes of new machinery or products can be constructed. Ikerlan has established contacts with over 20 other research institutes in Europe. It is part of Ikerlan's mission to keep abreast of new technological developments which may be relevant for new products or to apply in the production processes of the Mondragon cooperatives. For example, it is presently engaged in the study of microprocessor technology which can be applied both in new products (numerically controlled machinery and automatic control devices) and in automating aspects of production in the co-ops.

Ikerlan also practices the "Japanese" process of first copying a new development and then innovating. A good example is the development of robots in Ikerlan, the first such development in Spain. American Unimate robots were purchased to handle hot castings in the foundry, Ederlan. Ikerlan built its own first robot, Gizamat I, based on the Unimate design (which has no elbow in its arm). Then Ikerlan innovated by building a robot of its own design (with an elbow arm), Gizamat II. There are no plans at present to produce these robots as a commercial product. The purpose is to use the robots in production to replace people in certain hot and/or dangerous jobs, e.g., in the foundries. An auxiliary purpose is to stay abreast of the technology involved in robot construction which might find applications elsewhere in the Mondragon cooperatives.

Another new technology being currently explored by Ikerlan is computer-aided design, and computer-aided manufacture or CAD/CAM. This involves building an electronic model or blueprint of the desired entity using extensive computer graphics routines, and then producing the entity using computer-controlled manufacturing techniques. Ikerlan has used these techniques to design and produce printed circuits. The computer graphics or CAD methods have also been applied to produce architectural drawings.

Ikerlan was initially financed largely from the social funds generated by the Caja Laboral Popular. Its annual budget comes from self-financing, from the CLP, and from the associated industrial

cooperatives which request research projects. As the work of Ikerlan progresses, the technological knowledge is fed back to the cooperatives for product development, to the Empresarial Division of the CLP to suggest new co-ops, and to the polytechnical college to suggest new curricula for the future.

### The League for Education and Culture

Education has, from the beginning, played a crucial role in the Mondragon Cooperative Movement. Father Arizmendi often emphasized that "Knowledge is power; socializing knowledge implies the democratization of power." The principal organization coordinating the educational effort is the League for Education and Culture formed in 1948. At present, the league has four permanent staff members and is housed in the Ikerlan building. The league is itself a superstructural cooperative with a General Assembly and board of directors. Its General Assembly has representation from the educational cooperatives (e.g., the polytechnical college), associated industrial cooperatives, public authorities, co-op members and, of course, the staff.

The league monitors 18 educational centers: 4 preschool, 5 in primary and secondary education, 5 in professional and technical education, 2 in the permanent (adult) education department, and 2 in the new Center for Language Studies. In all, there are over 200 classrooms, over 8,000 students, and around 240 teachers and professors.

Father Arizmendi believed that social progress went hand-in-hand with technological progress; "Through mastering technology, it would be possible to develop and generate processes that would permit a more human and social development." The lineal descendant of Father Arizmendi's technical training school is the Instituto Politecnico Jose Maria Arizmendiarieta, the polytechnical college (which was previously the Escuela Profesional Politecnica).

The polytechnical college now offers to around 2,000 students courses up through professional engineering training with engineering degrees. It is itself a superstructural cooperative with a General Assembly and a board of directors. The representatives in the General Assembly come from three categories - teachers and staff, students and parents, and supporting institutions. The supporting institutions include not only the cooperatives, but some small capitalist enterprises which contribute financial support. The seats on the board are allocated in a manner approved by the General Assembly. The budget is covered by state subsidies, student tuition, and contributions from enterprises, particularly the social funds from the large cooperatives. There are two Social Councils, one for the teachers, and one for the students and parents.

In 1966, Father Arizmendi inaugurated another innovative educational project, a cooperative factory where students could work to finance their education and to learn first-hand about cooperative work. It is called Actividad Laboral Escolar Cooperativa or Alecoop. The participating students work in two five-hour shifts; when one shift works, the

other takes courses. Alecoop was not an immediate financial success. In 1970, its prospects were questioned, but the students rallied and helped turn it around. In 1970 it became an independent cooperative, instead of a department of the Escuela Profesional Politecnica. It has been profitable every year since 1971. Its financial success in producing teaching equipment for technical education has increased the number of positions upwards to around 800 students.

As a cooperative, Alecoop has its own General Assembly and board of directors drawn from three categories: students, staff, and supporting institutions. The students, as co-op workers, have entry fees and internal capital accounts. To allow for the demands of the payouts to graduating students, two-thirds of the net surplus is collectivized and only one-third is allocated to the individual accounts.

Another educational innovation of note is the student hostel Colegio Menor Viteri. It is also run as a cooperative, and it serves about 350 students. It often admits a large group of students from a single Basque town so that they will gain more experience in working together. Together with the hostel staff, they can organize seminars back in their towns to tell the people about the Mondragon cooperatives. Upon graduation, they may be able to return home to start a new cooperative.

#### Lagun-Aro

Since the Mondragon cooperators are not employees, they do not fall under the main Spanish social security system. Instead, they join the Association of the Self-Employed (Mutualidad de Autonomos). Since its benefits are rather inadequate the Mondragon cooperatives have established Lagun-Aro to provide substantial additional benefits. Lagun-Aro started as a division of the CLP, but in the early '70s it was established as a separate superstructural cooperative. In 1977, it moved into a separate building down the hillside from the CLP headquarters. As a superstructural cooperative, the associated cooperatives and the Lagun-Aro staff are represented in its General Assembly and on its board of directors. The staff members make a capital contribution as usual, and their internal account allocations are based on the average net surpluses in the associated base cooperatives.

At the end of 1981, there were 119 associated cooperatives, with 18,721 covered cooperators, and 47,768 covered beneficiaries. In addition to the pension benefits obtained from the Association of the Self-Employed, Lagun-Aro additionally provides sickness benefits, hospitalization, disablement compensation, and unemployment insurance (should that be needed). There are, however, no benefits for the first three days of any illness. Lagun-Aro also has programs for preventive medicine and industrial hygiene. When economic conditions force workers to be redeployed between jobs, this is usually done within the federations such as ULARCO. However, when 10% of the work force is involved, Lagun-Aro moves in to help. During the last year, 400 workers were redeployed with the help of Lagun-Aro.

The associated cooperatives are divided into 13 communities, the two largest being ULARCO and the community containing the CLP. Records are kept for each community concerning the receipts and payments on family and medical assistance and earnings compensations. If the receipts are in excess of the payments, 50% is refunded to the members. If there is a deficit, the community is charged for the difference. This encourages group solidarity and the responsible use of the benefits.

The pension benefits were originally rather generous. With 30 years service, the cooperator was entitled, at age 65, to receive 100% of the average pay over the previous 10 years. However, the rapid inflation of the '70s and the impending demographic bulge around the turn of the century forced a reconsideration. In 1976, the pension benefits were reduced to a system where after 10 years service, the cooperator would receive 36% of the last 10-year average. For each additional year, 1.2% is added so after 30 years service, 60% of the average pay over the last 10 years would be the pension. This pension is in addition to the payout of the cooperator's individual capital account and it is not subject to the same risk factors. The pension assets are invested elsewhere under tight government control, whereas the value represented by the individual capital accounts is invested in the cooperative itself.

#### The Empresarial Division of the Caja Laboral Popular

The entrepreneurial function involves more than the design and launching of new enterprises. Entrepreneurship is also involved in any major departure from "routine" management in an existing enterprise such as entering new markets, launching new products, major expansions, changeovers in equipment and technology, and in corporate reorganizations and turnarounds. The Empresarial Division institutionalizes entrepreneurship in the broad and rich sense which includes both launching of new cooperatives and major nonroutine changes in existing cooperatives. Its objectives must include this type of business assistance to the existing new cooperatives, because the Caja Laboral Popular is not only the financial center, but the group headquarters for the Mondragon Cooperative Movement.

Some writers translate "Empresarial Division" as "Entrepreneurial Division" which, however, might connote only the narrower launching function. Others have translated it as "Management Services Division" to emphasize the broader role. We have left "Empresarial Division," like "Caja Laboral Popular," as a uniquely proper name.

In the 1981 reorganization, the Empresarial Division was organized into six areas, each of which is divided into departments:

1. Studies Area (Estudios):

- o Research Department
- o Library and Documentation Center Department

2. Agricultural/Food Promotion Area (Promocion Agroalimentaria):
  - o Agricultural/Food Department
3. Industrial Promotion Area (Promocion Industrial):
  - o Products Department
  - o Promotion and Intervention Department
4. Consulting Area (Asesoramiento):
  - o Export Department
  - o Marketing Department
  - o Production Department
  - o Personnel Department
  - o Administrative-Financial Department
  - o Legal Department
5. Auditing and Information Area (Auditoria e Informacion):
  - o Auditing Department
  - o Information and Control Department
6. Urban Planning Area (Urbanismo y Edificaciones):
  - o Urban Planning Department
  - o Industrial Building Department; and
  - o Housing Department

The work of the Empresarial Division is directed by its Management Council (Consejo de Direccion) which includes the director of the entire division and the six directors of the areas. There are currently about 116 staff members in the Empresarial Division as a whole.

In the remaining sections of this case study, we will focus on the area concerned with the arch typical entrepreneurial function of launching new enterprises, the Industrial Promotion area. The description is based on interviews with the heads of the two departments in the area, the Products Department and the Promotion and Intervention Department.

The Empresarial Division is organized for the coordinated and unified delivery of technical-entrepreneurial services to the associated cooperatives and the CLP. It has the two broad objectives of increasing the reliability of the CLP loans to the associated cooperatives and to contribute to the development and consolidation of the cooperative movement in the Basque nation (Pais Vasco).

## Products Department<sup>1</sup>

The principal work of the Products Department is to explore market and product possibilities, and to write "prefeasibility studies" on certain promising markets and product ranges. These prefeasibility studies cover a product range (while a feasibility study for a prospective cooperative will focus on specific products), and contain initial cost data over a five-year period. The prefeasibility studies are carried almost to the same level of detail as the actual feasibility studies, but they cover various product options within a market area. The prefeasibility studies are gathered together in a "product bank" which can be used by the prospective manager of a new cooperative. The staff of the Products Department annually updates the information in the prefeasibility studies to keep them fairly current.

When a group of workers and a potential manager comes to the CLP with the intention of launching a new cooperative, the group will very often have their own product idea. The launching process involves the proposed manager working with the godfather (padrino), or, as some prefer to say, the advisor or counselor, to conduct a feasibility study for a period of 18 months to two years, called the "promotion period," before the cooperative is actually launched. The CLP will loan the money to the group to finance the manager's salary for this time period if the group can provide sufficient collateral. This could be provided by personal signatures of the group members (based on their personal assets) or the security could be provided by the assets or credit of co-signers. Often the group of workers will emerge from an existent cooperative or federation in which case that organization might be the sponsor.

If the loan to cover the manager's salary during the promotion period is arranged with the CLP and if the group seems to have the proper spirit, skills, and commitment, then the group is assigned a godfather and the feasibility investigation begins. If the group's initial product idea does not prove to be promising or if the group did not have specific product ideas, then they are allowed to choose a product or product range from the product bank of prefeasibility studies.

After initial investigations, the manager selects a specific product from the product range, and then focuses the feasibility study on that product. The prefeasibility study contains much of the initial spadework so the manager can develop a polished feasibility study in much less time than if the manager had to start from scratch. The manager must go over the relevant parts of the prefeasibility study by rechecking and thus updating all the market and cost information. By focusing and updating the relevant parts of the prefeasibility study, and by developing new information as required, the manager, with the assistance of the

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<sup>1</sup>This description of the work of the Products Department is based on an interview with Francisco Montero, the director of the department, and Jose Antonio Azpeitia, Industrial Development advisor in the department.



godfather, can usually have a final polished and completed feasibility study and business plan prepared by the end of the 18-month period. At that time, the CLP makes the decision whether or not to fund the cooperative.

The Products Department divides the markets faced by the cooperatives into three types:

- A. saturated or fairly saturated markets,
- B. uninteresting markets; and,
- C. potential new product markets.

Saturated or fairly saturated markets include machine tools, furniture, forging and foundry products, and home appliances. The cooperatives in the Mondragon Movement are divided into ten groups or federations on a geographical and/or product basis, the first and largest federation being the ULARCO group. The cooperatives producing these products for fairly saturated markets would already belong to an existing group. Many of the functions of the Empresarial Division of the CLP are decentralized to the group headquarters. In particular, the product/market research for these saturated product lines would be conducted in the group headquarters, not in the Products Department of the Empresarial Division of the CLP.

Uninteresting markets include ship building, truck production, and printing. For a variety of reasons, the CLP does not consider it appropriate to concentrate product research efforts on these markets.

Promising new products are the Products Department's primary concern. Products are grouped together into product lines which could yield several new firms. There may already be some cooperatives producing related products, but they might not be organized together as a group. By starting some new cooperatives producing related products, the basis can be created for the formation of a new grouping or federation. The specific technology used by the firms in a group may differ, but there is a commercial synergy obtained by joint marketing efforts.

For example, there is a product line of products relating to piping. There already are cooperatives producing centrifugal pumps, small ball valves made by forging, and other specialized valves. The Products Department is preparing a prefeasibility study on other products relating to piping such as butterfly valves, control valves, and other ball valves.

Other potential new product lines include:

1. materials transporters (e.g., conveyors and forklifts),
2. tooling (e.g., drills and reamers),
3. bath products (e.g., toilet paper holders, soap dishes, etc.),
4. electromedical and disposal equipment,
5. agricultural machinery (farm implements), and
6. public works machinery (e.g., smaller dumpers and excavators).

Promotion and Intervention Department<sup>2</sup>

Sr. Hidalgo, the head of the Promotion and Intervention Department, pointed out that one had to be a little crazy ("poco loco") to try to launch new cooperatives under the present economic circumstances. In addition to preserving and stabilizing the jobs of the current cooperative members, the formal objective in the CLP five-year plan is to launch five new cooperatives per year.

The Basque nation is divided up into regions, and the existent cooperatives are grouped according to their region. Then the cooperative initiatives can be classified into the following three categories:

1. initiatives from within a regional group of cooperatives.
2. initiatives from a region, but outside the regional group; and,
3. conversions: owner-inspired, or worker-inspired.

In the case of new cooperatives, a group of workers usually comes to the CLP. They select a promoter/manager who will work with the Caja's backing. They have an idea for a product, but the Empresarial Division may have doubts about:

- A. the product idea; or
- B. the promoter who:
  1. may be technically competent, but morally not a good leader (e.g., have dictatorial tendencies), or
  2. may be a good leader and a balanced individual, but not technically competent to carry out the project.

The promoter/manager must almost be a super manager; like an orchestra conductor, he must be able to wave the baton calmly and confidently, and then occasionally run over, grab, and play a fallen instrument, and then run back to continue conducting--all without the audience noticing, because otherwise, people might lose confidence in him.

If the group seems to have the right spirit, a good promoter/manager, and a plausible product idea, then the CLP will draw up a contract with the group. With adequate security, the CLP will make a deferred-interest loan to the group to finance the manager's salary during the promotion period, roughly the period of 18 months to two years from the time when the group signs the contract with the Caja to the cooperative's first invoice. There are several ways to secure the loan. Usually the group will emerge from the existent cooperative, and that cooperative will

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<sup>2</sup>This description of the work of the Promotion and Intervention Department is based largely on an interview with Rafael Hidalgo Seguro, director of the department. Sr. Hidalgo has a delightful flair for concrete and colorful expressions--which we will try to preserve in the description.

guarantee the loan. If the group is coming from outside an existing cooperative, the group must provide their own security. The CLP might accept the guarantee or collateral of a third party such as a well-to-do relative. Otherwise, the members of the group must personally sign, using their own assets as collateral.

The group registers as a cooperative society under Spanish law so that an entity will exist to receive the promotion loan and to pay the manager's salary during the promotion/launching period. The manager is assigned a godfather, a secretary, and an office in the CLP. The godfather will oversee the promotion and launching of the cooperative, and will continue in that oversight role until a little after the breakeven point, until "he can sleep at night."

The group will often have their own product idea, but that is not always a good idea. They must be able to fall out of love with "their product"--there are usually more flaws than appear on the surface. The godfather and manager perform an initial screening of the product using quite conventional criteria: market trends, sales per worker, capital per worker, and so forth. If the group's idea does not hold up, the group goes to the product bank of prefeasibility studies prepared by the Products Department of the Industrial Promotion Area. Often the group ends up using a prefeasibility study.

The promoter/manager applies a "bastard file" (a fairly coarse rasp) to the prefeasibility study to take off the rough edges and to try to single out a specific product from the product line (prefeasibility studies cover product lines). The manager must recheck and update all the relevant data, and search out any necessary new data. The manager will thus hone, polish, and finally put a finish on the study with a fine cloth. That is the process of turning the prefeasibility study into a feasibility study for a specific product. The final study must be in such detail that a third party could read it, and have all relevant questions answered. The promotion period, the period of time used by the promoter/manager to develop the feasibility study, used to be about two years. The use of the prefeasibility studies has helped to shorten the time from two years to 18 months.

The promoter/manager has access to the array of technical expertise in the Empresarial Division in the preparation of the feasibility study. In addition to the prefeasibility study and the seasoned advice of the godfather, the promoter/manager can call on the other departments. For details about the marketing part of the study, the promoter can consult the Marketing Department. To explore export opportunities, there is the Export Department. To plan out the production process, there is the Production Department, and to design an appropriate factory for the manufacturing process, there is the Industrial Building Department. For information about the personnel system and member payment arrangements, there is the Personnel Department. The Legal Department would handle the incorporation procedure, obtaining the necessary licenses and patents, and drafting the necessary contracts. The Auditing Department and the Information and Control Department will help to set up the accounting and management

control systems so that the progress of the cooperative can be monitored by the manager and by the CLP. And so forth.

When the feasibility study is complete, that is the moment of truth. The Operations Committee of the Banking Division of the CLP must make the decision to back the cooperative or not. Given that the promotion effort has reached this stage, rarely is the decision negative, especially if the group used one of the CLP's prefeasibility studies.

The general operational philosophy is to "travel light," to be able to change direction and tack, if one runs into difficulties.

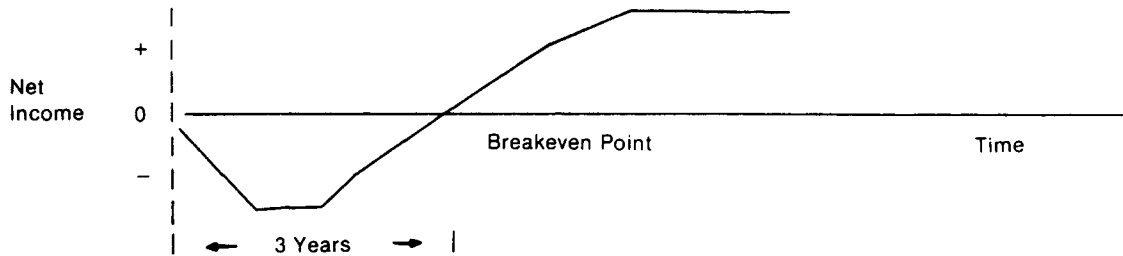
For example:

Some of these points are illustrated by a recent faucet factory which should create 45 jobs within five years. In five years, the projected annual sales are 260 million pesetas (ptas) in a total market of 10,000 million ptas, so they project a 2.6% market share. There are some major suppliers who hold 20% and 10% market shares. Their projected 2.6% share should be small enough so that it will not provoke any reaction from the existing suppliers.

The test marketing scheme used with this faucet factory illustrates how the CLP was able to substantially reduce its risks in this instance. The company was using a new faucet system patented by a multinational. A technology transfer and test marketing arrangement was worked out with a German firm which would manufacture the product, sell it to the cooperative which, in turn, would resell it at a budgeted loss of 15 million ptas for a year in the Spanish market. Most of the losses were for the one-time costs of setting up the distribution network. They had established 40-50 outlets for the faucets. After the test marketing, the feasibility study is to be revised as necessary, and then the CLP makes a final decision to fund the enterprise or not. Assuming a positive decision, the CLP finishes the loan, and the construction of the factory to manufacture the faucets will begin.

The test marketing scheme is an example of the "travel light" philosophy. Any bugs in the marketing plan could be discovered and corrected prior to the major capital commitment to build the factory. In the end, it is the market that gives and that takes away. The test marketing is a simulation of as much reality as possible to see how the enterprise would operate under fire.

There is usually a projected three-year period between the launching of the cooperative and the breakeven point when net income finally switches from negative to positive. This can be illustrated in the following graph.



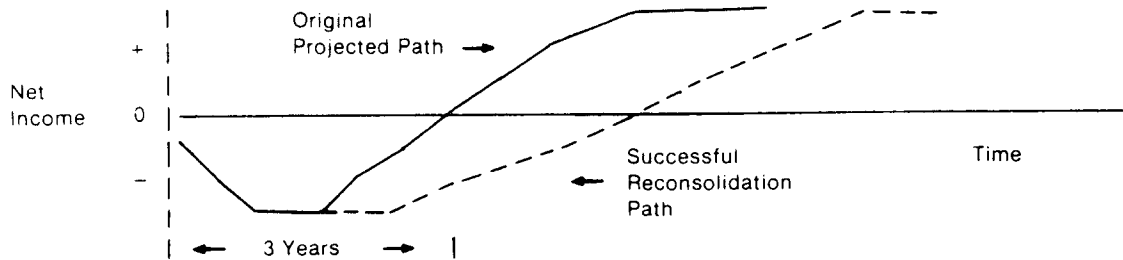
The start-up costs are divided into two parts:

- A. the promotion costs from the day the group comes to the CLP to the first invoice; and,
- B. the consolidation costs from the first invoice to the breakeven point.

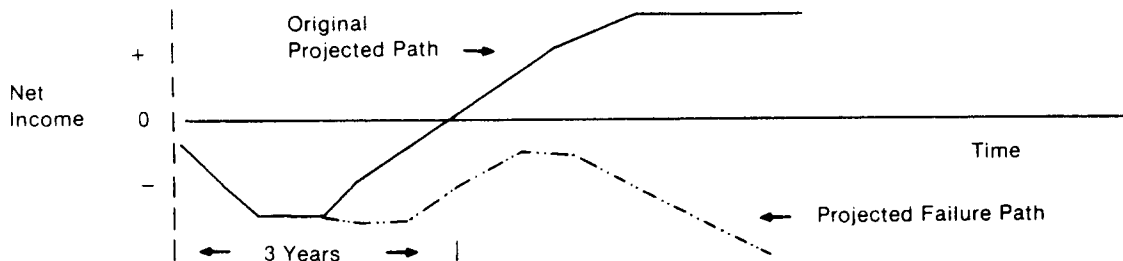
About 10% of the job creation costs are to be met by worker equity. The worker's membership equity has usually been around \$5,000 payable over two years, but current trends (giving rising job creation costs) are towards a \$10,000 membership fee payable over four years. About 15% of the total value of the cooperative's assets is usually supplied by the workers' equity and 20% from a low-interest loan from the Spanish Ministry of Labor to finance new job creation, with the remainder being financed by a loan from the CLP.

After a cooperative has been launched and consolidated (i.e., after breakeven), the net income is given the usual Mondragon treatment, e.g., about 70% of the retained net income is credited to the members' internal capital accounts. However, if this was the practice during the launching and consolidation period, then the negative net income would simply wipe out the founders' equity. The founders would unfairly bear the start-up costs, and any new members joining after the breakeven point would only share in the profits. In order to spread out the start-up costs, the CLP has developed a scheme to capitalize most of the start-up costs as an asset which is then depreciated over a period of years. Of the total start-up costs (promotion + consolidation costs), 30% is currently expensed and the remaining 70% is capitalized as an asset to be depreciated over a seven-year period.

There is always the possibility of erroneous predictions in the feasibility study--especially due to unforeseen external occurrences. The cooperative might not then obtain the projected breakeven point. The CLP must then reevaluate the situation to see if postponed interest or principal payments or a renewed capital injection and reconsolidation of the effort would eventually pull the cooperative through to a breakeven point.



It may be that the unforeseen events have so changed the situation, that the new projected point will just trail off downward without even pulling up to breakeven. In such cases of projected failure, the CLP has no choice but to wind up the enterprise.



In the cases where a reconsolidation looks promising, that will require new equity injections from the workers and a new loan from the bank. In all the cooperatives of the Mondragon group, there have been no failures--save one example of a fisherman's cooperative which was rather different from the industrial cooperatives typical of the Mondragon complex. The failure was also the one case where the government took the lead (71%) in the loan package. The CLP had a small portion (24%), and the workers had a minor financial commitment (5%). The loans had been used to purchase boats and partly for working capital. The fishermen had squandered their working capital, and the cooperative was soon in a distressed state. After some study, the CLP thought that a successful reconsolidation loan would be possible if the fishermen would make new capital injections and mend their ways. The fishermen refused, so to protect the depositors' money, the Caja said "See you in court" and initiated proceedings to wind up the company.

The godfathers are usually managers first, good managers who can then be groomed as godfathers. It is considered important that they come from the cooperative world so that they are already familiar with the problems of managing cooperative enterprises. The technological

orientation of the Mondragon cooperatives is evidenced by the fact that all the present eight godfathers have an engineering background.

Some of the godfathers work as interventionists in troubled cooperatives rather than with new launchings. There was one example in the past of a near-failure where the Empresarial Division intervened and completely changed the product line. The workers were sent home for a "furlough," while the old machines were torn out and the new machines installed for the new product line. The intervention and turnaround was successful.

In addition to start-ups and interventions, the department might work with potential conversions. The Mondragon complex of cooperatives is so well-known in the Basque region that no education work is needed to tell workers or owners of the cooperative option. Those coming to the Caja are usually the owners. In the case of owner-inspired conversions, their first thought is that the owner "must be in a bad way." If "the boss says he wants to get nearer God" by selling to the workers, the Caja looks closely at the ratios. In general, Sr. Hildago was skeptical about the possibilities for good conversions.

The Caja usually does a first-cut feasibility study, "smells a rat," and does not proceed. Is the firm a competitor of existing cooperatives? Is the market good? The CLP would not finance a conversion and still have the firm compete. The CLP would go to the cooperative in that area and ask about the firm. If the existing cooperative and the potential conversion are complementary, then the whole market position of the group might be strengthened by adding the new firm to the group.

Of all the Mondragon cooperatives, about five could be considered conversions. Many come, but few are chosen.

#### Advantages of Conversion:

1. It is an existing business.
2. The people are already trained in the business.
3. In these recessionary times, the assets can usually be acquired for very little, especially when "Florida beckons to the owner."

Disadvantages of Conversions: One of the principal difficulties is the staff question. Are the middle-level staff and the workers going to work together, going to become cooperators? "If concrete sets hard in 28 days, people are set in their ways in about 18 years." It is difficult to change people from salaried workers to managers. The personnel questions are the often main problem in a potential conversion situation. "If that is O.K., faith can work miracles."

In all of this work, Sr. Hidalgo pointed out that it is the cultural and social rewards which are important. "There are rules and contracts and the like, but ultimately you must work and live with each other."