



Taylor & Francis
Taylor & Francis Group

ENTREPRENEURSHIP IN THE MONDRAGON COOPERATIVES

Author(s): David P. Ellerman

Source: *Review of Social Economy*, Vol. 42, No. 3, Community Dimensions of Economic Enterprise (DECEMBER, 1984), pp. 272-294

Published by: [Taylor & Francis, Ltd.](#)

Stable URL: <http://www.jstor.org/stable/29769232>

Accessed: 28/06/2014 17:07

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at <http://www.jstor.org/page/info/about/policies/terms.jsp>

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.



Taylor & Francis, Ltd. is collaborating with JSTOR to digitize, preserve and extend access to *Review of Social Economy*.

<http://www.jstor.org>

ENTREPRENEURSHIP IN THE MONDRAGON COOPERATIVES*

By DAVID P. ELLERMAN

Industrial Cooperative Association and Boston College

SECTION A: INTRODUCTION

A.1. Overview of the Mondragon Cooperative Movement

Today there are over 85 industrial cooperatives in the Mondragon Cooperative Movement with around 20,000 worker-members. The industrial cooperatives are the core of the Mondragon group, but other cooperative forms have also been developed. There are:

- 85 industrial cooperatives,
- 5 agricultural cooperatives,
- 2 service cooperatives,
- 43 cooperative schools using the Basque language,
- 14 housing cooperatives, and
- 1 large consumer/worker cooperative with over forty stores.

There are also the second tier or super-structural cooperatives with both cooperative and individual-worker members such as:

- Caja Laboral Popular (CLP), with the Banking Division of 141 branch offices and the Empresarial Division,
- Ikerlan, a technological research institute,
- League of Education and Culture (which includes not only a Poly-technical College but a business school and a professional college), and
- Lagun-Aro, a social security and medical cooperative.

All these cooperatives of the Mondragon Cooperative Movement (located throughout the Basque region of northern Spain — with a few now being started in the Basque part of France) are associated by a Contract of Association with the Caja Laboral Popular as the center or hub of the cooperative group. [For more description, see Part I of Ellerman, 1982.]

A.2. Social Inventions of the Mondragon Cooperatives

William Foote Whyte, who has written about the Mondragon system of cooperatives, [Gutierrez-Johnson and Whyte 1977] has emphasized the concept of a “social invention.” [Whyte, 1982] The process of invention and innovation should not be confined to technology and engineer-

*0034-6764/84/1201-272/\$1.50/0.

This study is based, in part, on research and interviews in Mondragon in July 1982 and in January 1984. Both trips were funded by the German Marshall Fund of the United States.

ing. There are also social inventions, new social structures, and institutions created to meet individual and collective needs. There are at least four important social inventions embodied in the Mondragon Cooperative Movement:

1. The Mondragon legal structure based on the internal capital accounts.
2. The Caja Laboral Popular as a super-structural credit cooperative with a membership of cooperatives, largely worker cooperatives.
3. The direct, self-managing membership role of the staff members in all the non-industrial cooperatives such as the consumer, agricultural, educational, and superstructural cooperatives.
4. The institutionalization of entrepreneurship in the Empresarial Division of the Caja Laboral Popular.

All four social inventions have contributed to the unprecedented dynamism and perseverance of the Mondragon cooperatives. In this discussion of the Mondragon cooperatives we will focus on the socialization of entrepreneurship in the Empresarial Division of the CLP.

A.3. The Institutionalization of Entrepreneurship

To institutionalize entrepreneurship, the Empresarial Division has assembled a staff of 150 to provide expertise in the full range of technical and managerial services relevant to starting and running a business. The Empresarial Division of the CLP has, to our knowledge, no counterpart or parallel in any small business sector (not to mention cooperative sector) elsewhere. The closest type of organization which has a similar technical role, but quite a different social role, would be the corporate or group headquarters in a conglomerate or multi-national corporation. However, due to the ownership structure and thus the goals of the major, conventional, capitalist corporations, the massive technical and financial resources at their command have not been applied to further the social goals of net job creation and local economic development.

The task of net job creation has fallen to the small business sector. The bulk of what little new employment creation there has been in these difficult times has been in the small business sector. [See Birch in Friedman and Schweke (eds.) 1981.] There are a number of organizations, such as the Entrepreneurship Institute, Venture Founders, City Venture Corporations, and a number of university-associated Small Business Development Centers which work to assist individual entrepreneurs and small business. [See Zupnick and Katz 1980.] Yet, there have

heretofore been no institutions which have amassed and organized technical, managerial, and financial resources comparable to those of a major corporation, and then effectively applied those resources to the social goals of community and regional economic development with locally-based small and medium-sized businesses. [See Mackin 1983.] The Empresarial Division in particular, and the Caja Laboral Popular as a whole, are thus social inventions of substantial and far-reaching import.

Few topics evoke more sentimentalism in the business press than the topic of "entrepreneurship." Yet, an unromantic analysis of modern economic tendencies gives little reason to doubt Schumpeter's prediction of the eventual "obsolescence" of the heroic, individual entrepreneur. [Schumpeter 1950, Chap. XII] Schumpeter uses an analogy with the evolution and development of military combat, from the personalized combat of armored knights to the impersonal collective mayhem of mechanized armies. But a more promising analogy with the evolution of entrepreneurship is the closely allied development in the methods of scientific and technological innovation.

The analogue to the individual entrepreneur is the garage inventor or basement tinkerer, those splendid individuals who in times past have fueled the engines of technological development with a constant stream of inventions. Those times are largely gone. Technological innovation has become a medium-to-large-scale undertaking. Depending on the field, technological research now requires a certain critical mass of intellectual, financial, and organizational resources usually beyond the reach of the individual. In the mainstream of technological development the individual inventor has been replaced by the technological research laboratory or institute associated with industry or academia.

In America, the prototype of the industrial research laboratory was Thomas Edison's laboratory in Menlo Park, New Jersey which Henry Ford later reassembled as a museum in Greenfield Village in Dearborn, Michigan. Edison had made and sold a number of inventions before he established the Menlo Park laboratory. He used his prior experience as an inventor to design, organize, and staff the laboratory so that it would help systematize and institutionalize the process of technological innovation. Edison called his Menlo Park laboratory an "invention factory."

The Empresarial Division is a "factory factory." Together with the Caja Laboral Popular as a whole it is the *prototype of a new kind of economic development organization* which institutionalizes the function of the small business entrepreneur — just as Edison's Menlo Park

laboratory was the prototype of the modern industrial research laboratory which systematized the function of the individual inventor. Jose Maria Ormaechea and his co-founders of the first (1956) cooperative in the Mondragon group, ULGOR, were the Edisons who, in the founding and expansion of ULGOR, Arrasate, Funcor, and the operations which became Ederlan, Copreci, and Eroski used their entrepreneurial experience to design, organize, and staff the Empresarial Division of the CLP.

The Caja Laboral Popular is itself a cooperative and is ultimately responsible to all the associated cooperatives, and cooperatives are the only form of business organization promoted and launched by the Empresarial Division. Hence, entrepreneurship has not only been institutionalized in the Empresarial Division, it has been socialized. This is of great importance for progressives in America, Europe, and elsewhere. The industrial cooperative or self-managed form of business organization epitomized in Mondragon is the third way, the alternative to the capitalist and governmental-socialist forms of business ownership. The worker cooperative implements the structural framework for industrial democracy and economic justice in the workplace. [Ellerman 1983; Ellerman and Pitegoff 1983]

In spite of these attractions it is widely argued that entrepreneurship would be curtailed and stifled by the cooperative ownership of self-managed firms, and by the public ownership of state-socialist or nationalized firms. The argument is that entrepreneurship cannot in any sense be "socialized." While this entrepreneurship argument clearly has some validity in the case of government-run firms, the example of Mondragon is a clear-cut counter-example in the case of industrial cooperatives. Entrepreneurship has not only been successfully institutionalized and socialized in Mondragon, it has been dramatically improved. Even allowing for cultural and economic difference, the record of starting over a hundred firms (including some of the largest producers in Spain) in the last 25 years with only three failures must be seen as a quantum leap over the quality and type of entrepreneurship represented in America where 80 to 90 percent of all new small businesses fail within 5 years. [Zupnick and Katz 1980, 3]

SECTION B: HISTORY OF THE MONDRAGON COOPERATIVES

B.1. Father Arizmendi and the Technical Training School

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 teaching in the apprentice school of the Union Cerrajera, the industrial company which dominated the town of Mondragon. The 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 College.

B.2. The Founding of ULGOR

In 1952, the eleven had completed their engineering education in Zaragoza and had joined conventional companies. There they tried to put into practice not only their technical skills but the teachings of Father Arizmendi which were 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 labour among factors of production." [See Thomas and Logan 1982, p. 19.] 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 began operations, producing a small stove in Mondragon in 1956 with 24 workers. The new company was called ULGOR, an acronym formed from their names.

ULGOR rapidly diversified and grew employing 143 workers by the end of 1958. Between 1956 and 1959 the entrepreneurial 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; the segments of ULGOR which were eventually spun off as a foundry, Ederlan; and a producer of domestic appliance components, Copreci.

B.3. The Founding of the Caja Laboral Popular

The rapid growth of 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. [Quoted in Oakeshott 1978, p. 175.]

But Father Arizmendi had done the necessary research and he was, in the end, persuasive. The bank, the Caja Laboral Popular (Bank of the People's Labor), began operations in 1959 in Mondragon. Two of the ULGOR founders, Jose Maria Ormaechea and Alfonso Gorrongoita, emerged as the leaders of the Caja Laboral Popular (CLP), Ormaechea as the chief executive (the Director) and Gorrongoita as the President. They still hold those offices today.

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 in 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, several new industrial cooperatives were begun each year with the exception of 1970. 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. This growth has resulted in over 85 industrial cooperatives in the Mondragon Movement with around 20,000 worker-members.

B.4. 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 been renamed Instituto Politecnico Jose Maria Arizmendiarieta. The center of the Mondragon complex, a hillside which overlooks the school and which contains the Caja Laboral Popular, Ikerlan, and Lagun-Aro, 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 were explicitly based on Catholic Social Doctrine. Indeed, they are a striking anticipation of Pope John Paul II's recent encyclical, *Laborem Exercens*. [See Baum 1983.] 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," [*Laborem Exercens*, section 12] the emphasis on the dignity of work, [section 9] and the need for worker solidarity. [section 8] 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. [section 14]

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. [section 14]

The Mondragon cooperative complex is perhaps the best example in the world today of the type of social/economic system sketched in *Laborem Exercens*. [See Baum 1982 for more analysis of *Laborem Exercens*.]

SECTION C: THE EMPRESARIAL DIVISION OF THE CAJA LABORAL POPULAR

C.1. The Caja Laboral Popular

From the initial two offices in 1959 the *Caja Laboral Popular* (CLP) has shown remarkable growth. In the 25 intervening years it has grown to be the 25th largest bank in Spain with 141 branches throughout the Basque region, over 1000 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 for and received permission from the central Spanish government to change its bylaws so that up to 15 percent of its loans can be to non-cooperative 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 counted as part of the Mondragon Movement. [See Thomas and Logan 1982, pp. 40-41, fn. 14.] The Contract of Association [see Appendix B in Campbell, et. al. 1977] 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" [see Ellerman 1983 and Ellerman and Pitegoff 1983] 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 capital accounts, the collective account, and the allocation of the positive and negative retained surpluses to the internal accounts.

In the U.S. 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. But the CLP and other support cooperatives are not second-degree co-ops in that standard sense. The principle of the primacy of labor demands that the workers in the CLP or other

support co-ops must also be members as are the institutional or collective members. Hence, these co-ops are hybrids of first degree worker co-ops and second degree co-ops of co-ops. They are called second tier cooperatives or super-structural cooperatives. The CLP is also unlike the credit unions and cooperative or mutual savings banks in the U.S. since the members are not the depositors but the associated cooperatives and the workers in the bank.

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 non-banking 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 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 existing loans.

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. It has systematized the process of creating new firms so that with the exception of a fishing cooperative in 1973 and two small cooperatives at the end of 1983 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 investors, 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.

C.2. The Empresarial Division of the CLP

The entrepreneurial function involves more than the design and launching of new enterprises. Entrepreneurship is also involved in any major departures from "routine" management in an existing enterprise such as entering new markets, launching new products, major expan-

sions, changeovers in equipment and technology, and in corporate reorganizations and turnarounds. The Empresarial Division institutionalizes entrepreneurship in the broad and rich sense of launching new cooperatives and making major, non-routine changes in existing cooperatives. Its objectives must include this type of business assistance to both the existing and the new cooperatives because the Caja Laboral Popular is not only the financial center but the headquarters for the Mondragon Cooperative Group.

Some writers translate "Empresarial Division" as "Entrepreneurial Division" which might connote only the narrower launching function. Others have translated it as "Management Services Division" [Thomas and Logan 1982] to emphasize the broader role. We have left "Empresarial Division," like "Caja Laboral Popular," as a uniquely proper name.

The Empresarial Division is organized into seven areas, some of which are divided into departments:

1. Studies Area (Estudios):
 - Research Department,
 - Library and Documentation Center Department;
2. Agricultural/Food Promotion Area (Promocion Agroalimentaria):
 - Agricultural/Food Department;
3. Industrial Promotion Area (Promocion Industrial):
 - Products Department,
 - Promotion Department;
4. Intervention Area (Intervencion):
 - Intervention Department;
5. Consulting Area (Asesoramiento):
 - Export Department,
 - Marketing Department,
 - Production Department,
 - Personnel Department,
 - Administrative-Financial Department,
 - Legal Department;
6. Auditing and Information Area (Auditoria e Informacion):
 - Auditing Department,
 - Information and Control Department;
7. Urban Planning Area (Urbanismo y Edificaciones):
 - Urban Planning Department,
 - Industrial Building Department, and
 - 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 seven directors of the areas. There are currently about 150 staff members in the Empresarial Division as a whole.

My focus is on the areas concerned with the archtypical entrepreneurial functions of launching new enterprises (Industrial Promotion Area) and turning-around troubled enterprises (Intervention Area). The description is based on interviews with the head of the Industrial Promotion Area, with the department heads of the two departments in the area (the Products and the Promotion Departments), with the head of the Intervention Area, and with people working in these areas.

C.3. Industrial Promotion Area: Products Department

The principal work of the Products Department is to explore market and product possibilities, and to write "prefeasibility studies" on certain promising markets and products ranges. As used by the CLP, the phrase "prefeasibility study" does not refer to a preliminary first-cut feasibility study. The CLP prefeasibility studies are product/market studies. They cover a product range, while a feasibility study for a prospective cooperative will focus on specific products. They investigate the level of demand and prices available in output markets and the supply and costs in input markets. The prefeasibility studies are gathered together in a "product bank" which can be used by the prospective manager of a new cooperative. There are currently about 15 studies in the product bank. The staff of the Products Department periodically updates the information, but the prefeasibility studies may still be obsolete after three years.

When a group of workers and a potential manager come 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 (called the promotion period) for a period of 18 months to two years 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. If the group's initial product idea does not prove to be promising or if the group did not have specific product ideas, they are allowed to choose a product or product range from the product bank of prefeasibility studies.

The Products Department considers certain markets such as machine tools, furniture, forging and foundry products, and home appliances to be saturated. The cooperatives in the Mondragon Group are divided

into ten groups or federations on a geographical and/or product basis. The first and largest federation is 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.

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 the product line relating to piping. There already are cooperatives producing centrifugal pumps, small ball valves made by forging, and other specialized valves. The Products Department prepared a prefeasibility study on other products relating to piping (e.g., butterfly valves, control valves, and other ball valves) to facilitate the entry of other cooperatives into the field.

The product lines of recent and current prefeasibility studies include:

1. computers (software and peripherals),
2. robotics (industrial robots and numerically controlled machines),
3. materials transporters (e.g., forklifts and robotic stackers),
4. plastics (high precision with more stiffness and density),
5. wood construction (timber-framed, pre-fab kit houses), and
6. agricultural machinery (farm implements for small farms).

In addition, the European Space Agency has asked some of the Mondragon cooperatives to produce certain components for future European satellites.

C.4. Industrial Promotion Area: Promotion Department

The process of launching a new cooperative usually starts when a group of workers comes to the CLP. They select a promoter/manager who will work with the CLP's backing. If the group seems to have the right spirit, a good promoter/manager, and a plausible product idea, 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 (usually about 18 months). There are several ways to secure the loan. Usually, the group will emerge from an existent cooperative and that cooperative will guarantee the loan. If the group is coming from outside an existing cooperative, they 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 one and a half to two years after the startup.

The group will often have their own product idea. 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.

If a prefeasibility study is used, the promoter/manager works on the study to take off the rough edges and to try to single out a specific product from the product line. The manager must recheck and update all the relevant data, and search out any necessary new data. Eventually, a polished feasibility study for a specific enterprise producing a specific product emerges from the prefeasibility study. 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 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 handles the incorporation procedure, obtaining the necessary licenses and patents and drafting the necessary contracts. The Auditing Department and the Information and Control Department help to set up the accounting and management control systems so that the progress of the cooperative can be monitored by the manager and the CLP.

A CLP feasibility study consists of three volumes laid out in a specified manner. Volume I presents the information on the product, the markets for the product, and the markets for the supplies. Volume II presents the specific cooperative project, the economic, engineering, and organizational information about the enterprise. Volume III analyzes the economic feasibility of the chosen cooperative enterprise. Given the preparation time and these technical support services and other resources of the Empresarial Division, it is not surprising that the CLP feasibility studies are considerably more sophisticated and reliable than the supposedly better studies produced by American MBAs.

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, the decision is rarely negative, especially if the group used one of the CLP's prefeasibility studies.

The worker's membership equity has usually been around \$5,000 payable over 2 years, but current trends (given rising job creation costs) are towards a \$10,000 membership fee payable over 4 years. About 15 percent of the total value of the cooperative's assets is usually supplied by the workers' equity, 20 percent is a low-interest loan from the Spanish Ministry of Labor (used to finance new job creation), and the remainder is financed by a loan from the CLP.

After a cooperative has been launched and consolidated (after breakeven), the net income is given the usual Mondragon treatment, i.e., 50 to 70 percent 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 (including the manager's salary during the

promotion period), 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, 30 percent is currently expensed and the remaining 70 percent is capitalized as an asset to be depreciated over a seven year period.

Projections usually allow for about three years of losses after the startup before the cooperative reaches the breakeven point. The initial loan is typically scheduled to be paid back seven years after startup. There are usually no interest or principal amortization payments during the first two years. In years three and four, the interest (at the 8 percent level) and principal payments begin, and then the interest increases to 14-15 percent for the remainder of the loan.

There is always the possibility of erroneous predictions in the feasibility study — especially because of unforeseen external circumstances. The cooperative might not then obtain the projected breakeven point. The CLP must then re-evaluate 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. In cases of projected failure, the CLP has no choice but to wind-up the enterprise.

In the cases where a reconsolidation looks promising, new equity injections from the workers and a new loan from the bank will be required. The failed fishermen's cooperative (1973) was rather different from the industrial cooperatives of the Mondragon complex. The failure was the one case where the government took the lead (71 percent) in the loan package. The CLP had a small portion (24 percent) and the workers had a minor financial commitment (5 percent). The loans had been used to purchase boats and for working capital. The fishermen had squandered their working capital, and the cooperative was soon in a distressed state. After some study, the CLP decided 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 CLP initiated proceedings to wind-up the company.

The Empresarial Division of the CLP has sponsored about 24 new promotions in the last decade. Due to the severe recession in Spain during the early 80s, the pace of new launches slowed (2 in 1982 and 1 in 1983), while increased emphasis was placed on intervention in distressed cooperatives. In 1984, the promotional efforts are being revived so that four or five new cooperatives are expected in the medium-to-high

technology area.

C.5. Intervention Area

Prior to 1983, the Promotion Department of the Industrial Promotion Area was the "Promotion and Intervention Department." The godfathers worked not only with new launches but with distressed cooperatives which needed their experience and seasoned business judgment. The godfathers were typically good cooperative managers who were then groomed for the role of the "padrino." It was considered important that they come from the cooperative world so that they would be familiar with the problems of managing cooperative enterprises. The technological orientation of the Mondragon cooperatives was evidenced in that all the godfathers had an engineering background. [Oakeshott 1981, S11]

There was one example of a near-failure where the Promotion and Intervention Department intervened and completely changed the product line. The workers were sent home for a "furlough," while the old machines were torn out and new machines installed for the new product line. The intervention and turnaround was successful. There were other, less extreme interventions largely on an ad hoc basis.

By 1983, the impact of the general recession had forced the Empresarial Division to systematize the machinery of intervention. In the previous three years the CLP had had to write off a little over a million dollars in loans to cooperatives, and about 40 percent of its co-op loan portfolio was under an interest moratorium. One response was to split off the intervention function from the Industrial Promotion Area and to place it in the newly-created Intervention Area. The first head of the area was also head of the Auditing and Information Area which closely monitored the economic performance of the cooperatives. Godfathers could still work both on new launches and interventions.

In the newly systematized process of intervention there are three levels of intervention:

1. Low risk — a warning or alert level,
2. Medium risk — where the intervenor may be present one day a week, and
3. High risk — where every aspect is under review and the intervenor is effectively running the cooperative.

There are certain "alarm bells" monitored by the Auditing and Information Area which create the level 1 alert. There are certain "triggers" which induce a level 2 or level 3 intervention. For example, the cooper-

ative might approach the CLP to reschedule its loan payments, or the CLP auditors (at present, Arthur Andersen) might require the CLP to add a bad debt reserve for the cooperative. At level 2 the interest payments might be reduced (e.g., to 8 percent), and at level 3 the interest payments would be suspended.

Although associated with the CLP, each Mondragon cooperative is still an autonomous entity. As the major creditor the CLP will have a close working relationship with a distressed cooperative. When intervention is necessary, the preferred form is a Contract of Intervention. The contract spells out the roles, powers, and responsibilities of the manager, the board of directors, the intervenor, and the CLP. The previous ad hoc intervention process was subject to several abuses. The cooperative manager would try to put the intervenor in the position of making the case for financial relief to the Banking Division of the CLP, or the manager and board would not take the responsibility for making the case to the general assembly of members for reductions in advances ("wages") or increases in capital contributions. The contract of intervention is designed to place these responsibilities clearly on the shoulders of the management and board of directors.

In the process of intervention the managers are assumed to be "innocent until proven guilty." In principle, the intervention is viewed as an accident. It is essential to support and strengthen the manager and the management team. Each intervention has unique aspects, but there are usually changes in the product line, wage cuts and/or increases in the capital contribution, and increased motivation on the part of the managers, the board, and the members. In the case where management itself is the problem there will be changes. The intervenor will support the new management which emerges or will help to find new management.

In 1983, out of 34 interventions, two general managers, six other managers, and three chairs of boards were changed. Two of the distressed cooperatives were wound-down and closed at the end of 1983. One, Labeko, was an unsuccessful conversion of a private chocolate factory, and the other, Scoiner, manufactured machinery for veneering furniture. Otherwise, the interventions were successful. Indeed, the two closed co-ops were only the second and third closures in the history of the Mondragon cooperatives.

SECTION D: CONCLUDING REMARKS

In a modern, industrialized economy the individual entrepreneur

faces formidable obstacles in any attempt to start a business of any size and/or potential. Beyond the sector of shops, stores, and other service-oriented micro-businesses, entrepreneurship requires an array of technical and business skills, as well as old-fashioned business experience and seasoned judgment which are rarely available to individual entrepreneurs.

Between 80 and 90 percent of all small business startups in the United States fail within five years. [Zupnick and Katz 1980, p. 3] These statistics indicate that small business entrepreneurs are functioning as "cannon fodder" in a social, Darwinistic process that is far too costly for the meager return. To start ten firms in order for one or two to survive beyond five years is surely an excessively wasteful social mechanism for net job creation and economic development. There should be a better way.

The larger corporations and conglomerates can amass the technical and business skills, and the financial resources necessary to dramatically improve, if not reverse, the odds faced in new business startups or other job creation efforts. But the major corporations, by and large, choose not to use their resources for the purposes of job creation or local economic development. There are two major reasons:

1. there are other, less risky and non-entrepreneurial ways for the big corporations to enter new product markets, and
2. corporations are not structured to pursue such social goals as the economic development of a particular region or locality.

Large corporations use their power and resources to avoid risks, not to take them. Instead of directly launching new ventures, the major firms tend to enter new product markets by purchasing successful small businesses in the new area. The war of all against all among small businesses serves as a filter to select the "fittest" businesses that have pioneered a new market. The enormous waste of that selection mechanism is a cost borne by the would-be entrepreneurs, their families, the employees, and by society as a whole; it is not a cost directly borne by the large, risk-averse firms. The major firms can remain aloof from the struggle and then buy-up the winners (or survivors). Hence, large corporations find little reason to use their vast resources in a vigorously entrepreneurial fashion. And, in a recession, if the supply of buyable small businesses dwindles the big corporations can use their massive resources not to take over the entrepreneurial function, but to play the game of trying to take over each other.

Conventional corporations are also not structured to pursue goals

such as job creation or economic development in any specific locality. Their structure is capital-based, not labor-based. [See Ellerman 1983, 1984a, 1984b.] Their goal (in theory) is to maximize the present value of the equity capital invested in the corporation. That precludes and overrides any ultimate commitment to any specific people (such as the people presently working in the firm) or to any specific locality. A large firm might contribute to the economic development of a city, state, or region, but only for instrumental reasons, only as a means, not as an end. When capital is in command and market forces shift capital will tend to pursue its highest return wherever that might be.

That is a brief and over-simplified description of the present crisis of entrepreneurship. The people who want to be entrepreneurial do not have access to the requisite technical/economic resources, and the business institutions which do have the required resources are not structured to be entrepreneurial or socially accountable.

Against this background, the example of the Empresarial Division of the Caja Laboral Popular is particularly striking. The CLP shows how the needed technical expertise, business experience, and financial capital can be amassed, organized, and used in a new type of economic development institution which performs an entrepreneurial function in a small to medium-sized business sector. Unlike isolated entrepreneurs, the managers and workers assisted by the Empresarial Division can create new companies with a high success rate in a complex and competitive economic environment. And unlike the large conventional corporations, the Caja Laboral Popular is structured in a socially accountable manner to pursue cooperative economic development in the Basque country regardless of the shifting rates of return to capital. It is not a capital-based company, it is a labor-based, democratic, social institution.

Mondragon is a reality, but it is also a question. The success of the Caja Laboral Popular and the Mondragon Cooperative Group is not the question; the question is whether or not that success can be replicated elsewhere in the developed and developing world. In a different social context, what would replace Basque nationalism as the foundation of social solidarity — or is such a social bond necessary? To what extent is the Polytechnical Institute a necessary part of the system? Can the economic part of the system be replicated without the long leadtime necessary to create such an adjoining educational system? To what extent is it necessary for the firms to be cooperatives? Can entrepreneurship be institutionalized in a private development bank and used to

startup privately owned small businesses? Can a local, regional, or national government set up and operate a CLP-like development bank with an entrepreneurial division, or will the political environment of any government agency always prevent it from being entrepreneurial?

The study of Mondragon and the experience of the Industrial Cooperative Association in United States indicate some preliminary answers to several of these questions. Solidarity is indeed a crucial factor, especially given the lack of support for cooperative enterprises in a capitalist environment. Ethnic or national solidarity is not the only possibility however; solidarity might also be based on union or church affiliation, or simply on the commonality of the vision of a democratic workplace. As to the relative necessity of a Polytechnic-like educational institution in other settings, it is difficult to judge. In the technologically advanced counties there is not the same shortage of high-level technical training. Yet, there is little or no ethical or social education woven into the technical and scientific curricula which would emphasize "the priority of labor over capital."

There is reason to doubt that entrepreneurship can be successfully institutionalized in a private enterprise having a market relationship with potential privately owned startups. It is a straightforward market failure argument. Private ownership gets in the way of social association. It would interpose a market relationship between a private entrepreneurial development bank and the potential new firms. Yet the entrepreneurial function is too developmental, too fraught with risk, and too long-term to be viable as a financially self-supporting contractual market relationship. When the uncertainty and transaction costs are so high the market fails.

The experience of Mondragon indicates that the institutionalization of entrepreneurship should be internalized in a whole social complex that is self-supporting in its entirety. The Empresarial Division does not stand alone. It, together with the whole Caja Laboral Popular and the associated cooperatives form a self-sufficient social complex. It is self-supporting not only in the financial sense but in the development of human potential. The technical and managerial expertise built up in the cooperatives is fed back into the system (e.g., through the godfathers) to support the development of new enterprises. The cooperative form of economic enterprise encourages that type of social association, while conventional private ownership tends to atomize society and to reduce all social association to the level of market relationships.

Some skepticism seems in order concerning the entrepreneurial

potential of a governmental, CLP-like development bank with an entrepreneurial division. Government sponsorship is sometimes seen as a source of social accountability, but it could tend to make a development bank more responsive to the political and bureaucratic environment — with less entrepreneurial initiative to meet social needs. Government enterprise in the West, not to mention the East, does not hold out much hope of capturing the entrepreneurial function. The government can provide seed capital for an entrepreneurial development bank established in response to initiatives from below, but such a bank should be eventually spun-off as a democratic, social institution.

To be institutionalized, entrepreneurship should be socialized. We have reason to doubt that either a private enterprise or a governmental enterprise can do the job. The conventional public/private alternatives form a false dichotomy. The initial seed capital could come from either above (the government) or below (private savings). The point is that an entrepreneurial development bank should be organized in the realm of intermediate social institutions such as the Caja Laboral Popular and the other superstructural cooperatives of the Mondragon Group, which combine social accountability with autonomy from the government. To get beyond the poverty of the traditional public/private debate, there needs to be much more experimentation with what Pope John Paul II outlined in his encyclical, *Laborem Exercens*, as “a wide range of intermediate bodies with economic, social and cultural purposes.” [section 14]

That experimentation requires breaking the logjam of the bipolar worldview which sees the only choice as a variation on the two paradigms of private enterprise capitalism and government enterprise socialism. Mondragon shows that a cooperative third way is possible, not just as an idle speculation, but as a tangible reality. A cooperative system offers not only more democracy and more justice in the workplace; it can also offer more entrepreneurship.

REFERENCES

- Baum, Gregory. *The Priority of Labor*, New York, 1982.
- Birch, David. "Generating New Jobs: Are Government Incentives Effective?," in *Expanding the Opportunity to Produce: Revitalizing the American Economy through New Enterprise Development*, edited by R. Friedman and W. Schweke, pp. 10-16, Washington, 1981.
- Bradley, Keith and Alan Gelb. "Motivation and Control in the Mondragon Experiment," *British Journal of Industrial Relations*, Vol. XIX, July 1981, pp. 211-231.
- _____. "The Replication and Sustainability of the Mondragon Experiment," *British Journal of Industrial Relations*, Vol. XX, March 1982, pp. 20-23.
- Campbell, A., C. Keen, G. Norman, and R. Oakeshott. *Worker-Owners: The Mondragon Achievement*, London, 1977.
- Campbell, Alastair. *Mondragon 1980*, Leeds, England, 1980.
- Ellerman, David. *The Socialization of Entrepreneurship: The Empresarial Division of the Caja Laboral Popular*, Somerville MA, 1982.
- _____. "A Model Structure for Cooperatives: Worker Co-ops and Housing Co-ops," *Review of Social Economy*, Vol. XLI, No. 1, April 1983.
- _____. "Worker Cooperatives: The Question of Legal Structure," forthcoming in *Worker Cooperatives in America*, edited by H. Levin and R. Jackall, Berkeley, 1984.
- _____. "Theory of Legal Structure: Worker Cooperatives," *Journal of Economic Issues*, Vol. XVIII, No. 3, September 1984.
- _____. "The Mondragon Cooperative Movement," Harvard Business School, Case No. 1-384-270, Boston, 1984.
- Ellerman, David and Peter Pitegoff. "The Democratic Corporation: The New Worker Cooperative Statute in Massachusetts," *New York University Review of Law and Social Change*, Vol. XI, No. 3, 1982-1983.
- Friedman, R. and Schweke, W., eds. *Expanding the Opportunity to Produce: Revitalizing the American Economy through New Enterprise Development*, Washington, 1981.
- Gardner, David. "Co-operative experiment a success," *Financial Times*, June 10, 1982.
- Gutierrez-Johnson, A. and W. Foote Whyte. "The Mondragon System of Worker Production Cooperatives," *Industrial and Labor Relations Review*, Vol. 31, No. 1, October 1977.
- Jackobs, Steven. "Community, Industrial Democracy, and the Cooperatives of Mondragon," B.A. Thesis, Harvard University, 1979.
- John Paul II. *Laborem Exercens*, (Vatican translation), Boston, 1981.
- Mackin, Christopher. *Strategies for Local Ownership and Control*, Somerville MA, 1983.
- Oakeshott, Robert. *The Case for Workers' Co-ops*, London, 1978.
- _____. "European Co-operatives: Perspective from Spain," in *Prospects for Workers' Co-operatives in Europe*, Vol. II, pp. S1-S22, Bruxelles, 1981.
- _____. "Alternative Strategies for Developing Workers' Co-operatives," paper presented at the Coady Institute Consultation on Workers Co-operatives, Antigonish, Nova Scotia, 1982.
- Saive, Marie-Anne. "Mondragon: An Experiment With Co-operative Development in the Industrial Sector," *Annals of Public and Co-operative Economy*, Vol. 51, No. 3, July-Sept. 1980, pp. 223-255.
- Schumpeter, Joseph. *Capitalism, Socialism and Democracy*, New York, 1950.
- Thomas, Henk and Chris Logan. *Mondragon: An Economic Analysis*, London, 1982.
- Vanek, Jaroslav. *The Labor-Managed Economy*, Ithaca, 1977.
- Whyte, William Foote. "Social Inventions for Solving Human Problems," *American Sociological Review*, Vol. 47, Feb. 1982, pp. 1-13.

- Young, Michael, and Marianne Rigge. "Overview," in *Prospects for Workers' Cooperatives in Europe*, Vol. I, pp. 1-86. Bruxelles, 1981.
- Zupnick, J. and Katz, S. *Case Study Profiles: Project NEED IT*, Worthington OH, 1980.