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EMPLOYEE OWNERSHIP AS A FORM OF ECONOMIC DEMOCRACY

Abstract. *This paper provides a critique of the conventionally dominant model that has driven the world economy to the brink of collapse, a model that predicts failure for employee-owned and democratically structured firms. The paper contrasts these predictions with the success achieved by employee-owned companies structured democratically. Two case studies, the John Lewis Partnership in the UK and Mondragon in Spain show that democratically structured enterprises can succeed extremely well. Evidence is reported suggesting that people thrive with democratic ownership.*
Keywords: *Economic democracy, employee ownership, worker cooperatives, ownership, democracy, John Lewis, Mondragon*

Introduction

> *The democratic principle upon which this Nation was founded should not be restricted to the political processes but should be applied to the industrial operation.*
>
> *Albert Gallatin, 1795*

This paper explores the contradiction that exists between on the one hand the dominant economic model of the firm, which predicts failure for democratic, employee-owned firms, and the empirical evidence showing that such firms consistently perform outstandingly well in both economic and social terms. Two case studies illustrate and explain this success in depth.

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Traditional Economic Models Predict Failure for Democratic Employee-Owned Firms

The fascination of economists with the project of predicting human behaviour scientifically resulted in the development of mathematical models, from Walrasian marginal utility theory (Walras, 1874) through the Arrow-Debreu model of general equilibrium (Arrow and Debreu 1954) to the debacle of the current economic crisis, in which Alan Greenspan as Chairman of the Federal Reserve admitted that the model, which he described as an ideology, had proved flawed[1].

If that project of scientific prediction is to succeed it is necessary to make simplifying assumptions, including that of perfect competition. Other economists such as Joseph Stiglitz have pointed out that more realistic studies show that the neoclassical models are contradicted every moment by the real world (e.g. Shapiro and Stiglitz, 1984). But particularly with the end in 1989 of the Soviet challenge to the western market system, it seemed to the leaders of the Anglo-American world that the existing order of financially dominated global markets, backed up by neoclassical economic theory, was on course to move the world economy into endless steady growth.[2] Increasingly this confidence led to the acceptance of the appropriation of enormous wealth and power by a tiny proportion of the population, those who own and run the financial institutions and large corporations, with serious social consequences (Wilkinson and Pickett, 2009). It also led to the global destruction of wealth on an unimaginable scale, the effects of which leave nobody untouched (United States Senate, 2011).

And yet these pernicious theories persist. Economic theorists working in this dominant tradition have been strongly pessimistic about democratically structured businesses. They have predicted nothing but doom for democratic, employee-owned ventures (Ward, 1958; Furubotn, 1976; Jensen and Meckling, 1979; Hansmann, 1996; Boatright, 2004).

Jensen and Meckling, for example, (1979: 482) make much of the idea that workers will extract capital rather than invest it, because they will not want to invest beyond their personal time horizons. In practice, employee-owned firms invest consistently to grow and improve their companies (Erdal, 2011). By contrast, it is outside investors such as the Private Equity funds lauded by theorists such as Jensen that extract cash in the short term, often to the detriment of firms. The example of Debenhams is given below.

[1] *Testimony to Congress, the Committee on Oversight, 23 October 2008 http://www.youtube.com/watch?v=R5lZPWNFizQ accessed 14 Oct 2012.*

[2] *http://www.guardian.co.uk/politics/2008/sep/11/gordonbrown.economy.*

A further critique is made by traditionalists from the perspective of diversification theory: workers will have their savings tied up in the same firm as their employment, which is too much risk. The empirical work showing that in practice this is not the case is reviewed in chapter three of Kruse et al. (2010: 150ff). One can detect a touch of hypocrisy in the argument that to protect workers from risk they should be kept poor: they should not be given the potential wealth of ownership, even in a leveraged buyout financed by the firm, where they are not required to put any of their own resources at risk.

An argument that is made often in the literature is a variation on the theme that 'employee ownership is not an efficient mode of organisation' (e.g. Hansmann, 1996: 83; Furubotn, 1976: 122). No evidence is put forward for this belief, other than the repetition of faith in the market: if this were not so, then the market would have seen employee-owned firms proliferate. However, the empirical evidence has virtually never produced evidence that employee-owned firms have lower productivity than conventional firms. The key to understanding this conundrum lies in the asymmetries of power and interests explored by Ellerman and Erdal rather than in the models of traditional economists (Ellerman, 1992; Erdal, 2011). Greenspan was right to characterise the model as an ideology.

There was perhaps some excuse for these negative predictions until clear empirical evidence started to appear, mainly in the USA, in the 1980s that actually such companies tend to outperform their conventional counterparts, particularly in productivity – surely the holy grail for economists – and particularly where there was a genuinely participative approach to management – that is, where democracy was active. (e.g. Quarrey and Rosen, 1986; US General Accounting Office, 1987)

But the dominant paradigm is so strongly embedded that in fact what is now overwhelming evidence of the efficient and effective performance of democratic firms (e.g. Bradley and Estrin, 1988; Blasi and Kruse, 2000; Kruse et al., 2010) is still largely ignored in the mainstream. The traditional critiques continue to be referenced in the academic literature with no acknowledgement of the fact that their predictions have been shown to be false. The ripostes by the empirical researchers have been cast in surprisingly polite terms (e.g. Bonin, Jones and Putterman, 1993).

This paper looks in detail at two case studies of highly successful democratic businesses: the John Lewis Partnership in the UK, employee owned since 1929, and Mondragon Corporation, a network of some 120 worker-cooperatives in Spain, both of which continue to outperform their conventional competitors during the global recession, and in ways that I will demonstrate benefit their employee-owners at people as well as financially.

Early Impulses to Economic Democracy

Albert Gallatin's call to apply the principles of the American revolution to business, quoted at the head of this paper, did not find much echo. Even the political vigour of the newly independent US did not manage to extend 'the democratic principle' to 'the industrial operation', in spite of the fact that Gallatin remains the longest serving Treasury Secretary ever, serving under Presidents Jefferson and Madison. It is easy to forget that democracy in those early years was established only through an enormous political battle: there were strong disagreements over such fundamental issues as whether men should be allowed the vote only if they were white and owned property – which was the dominant view at first – and whether white women should also have the vote (see for example Wilentz, 2005). In 1802 New Jersey allowed white women (if they were married) to vote in two elections; unmarried women also voted in droves – a woman's marital status does not show in her face – and the experiment was quickly abandoned (Wilentz, 2005: 122). The alternative of allowing women to vote as well as men, and regardless of marital status, seems not to have gained much support among the all-male legislators. In the UK, with Parliament dominated by a corrupt and entrenched aristocracy, the struggle for anything resembling genuine male enfranchisement took much longer (Hammond and Hammond, 1911/2005: e.g. 14ff). Democracy has always been hard-won in the teeth of strong resistance from the currently-privileged elite. Gallatin's principled thinking became submerged in an acceptance that business was no place for democracy involving employees. Democracy was only for property owners, the shareholders – a position that still dominates corporate thinking today.

Political Democracy

In his monumental study of the contested rise of democracy in America Sean Wilentz describes the development of democracy as follows (2005: xix):

> *Democracy appears when some large number of previously excluded, ordinary persons... secure the power not simply to select their governors but to oversee the institutions of government, as officeholders and as citizens free to assemble and criticize those in office. Democracy is never a gift bestowed by benevolent, far-seeing rulers... It must always be fought for.*

De Tocqueville (1835) was impressed by the steps that at least white male Americans had taken towards achieving this ideal by the 1830s, although he was percipient on the role of wealth in the system (see also Gates, 2000).

Dahl, recognising degrees of democracy, placed particular emphasis on two aspects of democracy which have been found by developers of democracy in employee-owned corporations to be essential: the opportunity for citizens to understand, and an inclusive approach on equal terms (Dahl, 1989). Dahl characterises democratic government as resulting in polyarchy, rule by several people, elected officials, and emphasises also the need for regular elections.

The Nature of Conventional Corporate Ownership

In the UK in 1944, a time of great social solidarity, the distinguished Conservative Party ex-government-minister Lord Eustace Percy defined a problem with the law on corporations – a problem which is directly relevant to democracy; which underlies the manifest problems of 'corporate governance' (Haidar, 2009); and which is becoming more salient as democratic theory advances and fundamental human rights become more widely recognised.

> *Here is the most important challenge to political invention ever offered to the jurist or the statesman. The human association which in fact produces and distributes wealth, the association of workmen, managers, technicians and directors, is not an association recognised by the law. The association which the law does recognise – the association of shareholders, creditors and directors – is incapable of producing and distributing and is not expected to perform these functions. We have to give law to the real association and withdraw meaningless privilege from the imaginary one. (*Percy, 1944*)*

The defenders of conventional capitalism often claim to be defending private property. David Ellerman has pointed out that the rights embodied in the capitalist corporation are in fact not property rights at all, but the right of appropriation (Ellerman, 1992: 14 ff). In any corporation, the 'owner' is in fact appropriating the economic product of the business: 'In fact the business is carried out by everybody working there, but in law it is the enterprise of only the employer.' (Ellerman, 1992: 97). This appropriation takes place through the rights embodied in two complementary contracts: the 'ownership' contract (the rights given to holders of ordinary stock) and the employment contract, which removes the same rights from the 'real association' – the employees.

Within the association recognised by law, the corporate shareholders, democratic rights are well established, with for example the right of access to information and the protection of minorities being legally safeguarded.

But even today fundamental rights of the people who make the businesses succeed – the 'association of workmen, managers, technicians and directors' – are simply not recognised.

The rights set out in the employment contract generally provide some protection for the employee from the grossest abuses practised by business-owners in the past. But the contract gives the employee no positive democratic rights: no right to be informed about the business, no right to influence the key decisions made, and no right to participate in the wealth created by his or her efforts. Instead, these rights belong to the 'owner'. In other contexts, these 'ownership' rights are described differently: the person who has the right to all the information and to take all the key decisions for a body of people has in political terms the right to rule or govern; the holder of the right to appropriate the wealth of a body of people has in political terms the right to tax them.

The American Revolution erupted in large part in resistance to exactly those rights – to rule and to tax – because the American colonists, no matter how white or how propertied, had no right of representation (Reynolds, 2009: 59). With the development of democracy, acts of ruling and taxing are only legitimate if the people carrying out those functions are subject to election by all adults in the group. In the words of the second paragraph of the US Declaration of Independence, 'Governments are instituted among Men, deriving their just powers from the consent of the governed'.[3] These elections may be direct or through representatives who are themselves elected. In the conventional corporation the employees have no right to representation in that sense, and certainly no right to elect the managers, either directly or indirectly. The owner appoints the managers, rules the employees, and like a tax-collector gathers in any wealth that they create through their efforts.

These essentially political rights to rule and to tax are traded, bought and sold in the equity market. Thus it is that groups of private investors can buy control of a corporation and then manipulate it to extract the maximum amount of cash in the shortest time, at the expense of the people involved and to the detriment of the business. In 2003, for example, a group of financiers acquired the British retailer Debenhams; they used only £600 million of their own funds, borrowing another £1,100 million, which debt was then transferred to the company. They then extracted over £1 billion for themselves, leaving the company weakened and saddled with debt. In the process they reduced the amounts received by employees, and sacked many, replacing them with less expert people at lower pay.[4]

[3] *http://www.ushistory.org/declaration/document/index.htm accessed 12 Oct 2012.*

[4] *Debenhams: A Lesson in Private Equity. http://www.thisismoney.co.uk/money/markets/article-1609274/Debenhams-A-lesson-in-private-equity.html accessed 12 Oct 2012.*

This is the opposite of the behaviour that the theorists of conventional, undemocratic corporations predict (Coase, 1937; Alchian and Demsetz, 1972; Williamson, 1975; Jensen and Meckling, 1976). The prediction is that the capital markets will ensure – providing that the owners provide suitable incentives for their agents, the managers (Fama and Jensen, 1983) – that managers of companies will build them into strong businesses, serving useful functions. This goes all the way back to Adam Smith's 'invisible hand' description of how the pursuit of individual profit will lead people who own and run businesses to make the domestic economy strong, by providing useful products and services at reasonable prices. In today's context, that myth has been shown to be false. For example, economist Joe Stiglitz won the Nobel Prize for research in Information Economics the results of which he summarised in 2008 as, 'Whenever information was imperfect – that is, always – the reason that the invisible hand seemed invisible was that it was not there'.[5] In more expansive language he explained that

> *'The theories that I (and others) helped develop explained why unfettered markets often not only do not lead to social justice, but do not even produce efficient outcomes. Interestingly, there has been no intellectual challenge to the refutation of Adam Smith's invisible hand: individuals and firms, in the pursuit of their self-interest, are not necessarily, or in general, led as if by an invisible hand, to economic efficiency.'*[6]

But the idea that somehow 'the market' will produce socially useful results persists in its dominance of all debate, and allows the currently privileged to resist any ideas of democracy, and to encourage personal greed and rejection of morality – even the morality necessary to make markets viable (US Senate, 2011). The system supported by this ideology and its hugely powerful acolytes led to the collapse of the banking system and the enormous economic crisis that has blossomed since 2007. For example in 1998 Alan Greenspan, the longest-serving Chairman of the US Federal Bank, suppressed the efforts of Brooksley Born, the responsible official, to canvass formally the idea of regulating the derivatives market[7]. He did this in spite of her strong theoretical reasons for doing so – the market was opaque – and clear evidence that it was necessary – the failure in 1998 of LTCM a significant financial institution (Jacque, 2010). This market, still opaque and still protected from regulation by the most powerful financial officials in the land, triggered the banking collapse of 2007-8 (US Senate, 2011).

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[5] *Presentation to the Congreso Internacional CIRIEC, Seville, September 2008.*

[6] *Interview on http://www.beppegrillo.it/eng/2007/01/stiglitz.html, accessed 12 Oct 2012.*

[7] *Born, 13 Nov 1998, 'Regulatory Responses to Risks in the OTC Derivatives Market' Evidence to Congress on the LTMC collapse. www.cftc.gov/opa/speeches/opaborn-40.htm accessed 12 Oct 2012.*

The Development of Employee Ownership

Luckily, Gallatin was not alone, and over the centuries people have turned into reality their desire for democracy in their working lives. In modern times David Ellerman is pre-eminent among theorists (Ellerman, 1990). There is no space for a historical survey, but it is important to recognise that this has happened in all the major countries in various forms over the last few centuries (see Thompson, 1994; Oakeshott, 2000; Erdal, 2011). Analytically, we can separate the representative rights – the right to rule – and the financial rights – the right to tax. Sometimes the powers that be will share with the employees some of the financial rights, without transferring any real power; sometimes they will open decision-making to employee influence, without any notable sharing of the financial rights. But to a significant extent most developed countries now have a minority of businesses where the employees have real democratic rights: real power and real financial participation.

For example, a recent set of studies under the auspices of the National Bureau for Economic Research has established that in the USA 47% of all employees – over 50 million people – participate in what the authors call 'Shared Capitalism' (Kruse et al, 2010). In the majority of cases these participants in shared capitalism are far from having democratic rights in any strong sense, but the businesses are travelling in that direction, with often genuine systems of consultation and involvement in decisions, as well as participation in the wealth created. But a rapidly increasing minority have control of their companies through a system known as 'S-corp ESOPs', a system that gives substantial tax concessions to broad employee ownership, on the grounds that the growth of the employee-owned companies, and the eventual payment of the employee stakes from their pension funds, will ultimately lead to greater payment of tax.

In Spain, France and Italy the role of worker co-operatives, which are usually wholly democratic in their constitution, is significant. For example, approximately 30% of the GDP of the Emilia Romagna region in Italy is produced by worker cooperatives – this alone equates to about 2.65% of the GDP of Italy.[8] Worker coops are less concentrated in the other 19 Italian regions, but still significant in many. A pilot study in the 1990s gathered data pointing to wide social benefits of the socially constructive culture fostered by high concentrations of worker-cooperatives (Erdal 1999). Results included a range of positive social measures, ranging from a low gap between rich and poor; through a very positive attitude towards local

[8] *Derived from table in http://en.wikipedia.org/wiki/Economy_of_Italy#North-south_divide, date of access 01.07.2012 and Corcoran and Wilson, 2010: 6.*

authorities; a high participation rate in elections; a high rate of lifelong learning; lower rates of domestic violence; to lowered cardiovascular mortality across the whole population in the cities involved.[9]

In Spain, in addition to a long-established worker cooperative sector of some 10,000 cooperatives, which includes the globally renowned Mondragon network of 120 businesses and many social institutions, there is a fast-growing number of SALs (Sociedad Anonima Laboral), companies controlled at least 51% by the employees. By 2006 there were some 12,000 enterprises in this form, employing some 120,000 people (Jensen, 2009).

In France, in 2009 there were some 1,900 worker coops, employing around 40,000 people. Like the US and UK companies with employee-ownership, these worker-cooperatives excel in productivity (Fakhfakh et al., 2013).

In the UK, as in the US, the worker coop structure is relatively rare: the commonest form is the employee-owned company. The Employee Ownership Association has over one hundred member companies, ranging in size from the John Lewis Partnership, Britain's top-rated retailer, which employs some 80,000 people, down to numerous companies with less than 20 employees, many of them outstandingly successful. The total sales turnover of companies with employee-control or with substantial, broad-based employee ownership is estimated at between £25 billion and £30 billion.

The Evidence: Can employee-owners build successful businesses while maintaining 'the democratic principle on which this Nation was founded'?

This paper will now focus on two major organisations which have been particularly successful at combining genuinely democratic rights for employees with a high level of commercial success – a combination that is vital if this form of enterprise is to flourish. The first is Britain's John Lewis Partnership, the second Spain's Mondragon.

The John Lewis Partnership: Democracy in Britain's Foremost Retailer

The John Lewis Partnership was already a well established retail business when John Spedan Lewis in 1929 transferred its ownership into a trust for the employees. He had been planning this project since 1909, and since 1916 had experimented in one of London's major shops, Peter Jones, with some aspects of the system he devised. Now with the death of his father he

[9] *A large-scale replication by Monica Gago and Fred Freundlich of Mondragon University is set to be completed in 2013 in Gipuzcoa in the Basque region of Spain. Suggestive verification was provided by the actuaries of the John Lewis Partnership Pension Scheme, who showed that retirees from the John Lewis Partnership live longer than retirees from conventionally structured retailers (Alexander, personal communication).*

was free to put the plan into practice. There were five major legs to what he instituted: the ownership was to be 'neutralised' forever; the purpose of the company was to be the 'happiness of all its members' through 'worthwhile and satisfying employment in a successful business'; there was to be a culture of transparent openness; there would be a direct feedback from the shop floor to the board, outside the management structure; and the elected representatives from all the partners would be able to sack the otherwise-powerful executive chairman. Spedan Lewis's summary was that all the partners would participate in the rights of ownership: 'knowledge, power and profit' (Cox, 2010).

In commercial terms: the two arms of the partnership, the John Lewis department stores and the Waitrose food retailers, are annually rated by shoppers at the very top of their industries, which are highly competitive. And studies by economists from the prestigious London School of Economics and Political Sciences (LSE) using 20 years of data from all the major retailers established that the John Lewis Partnership had the highest marginal productivity of both labour and capital (Bradley and Estrin (1988); Bradley and Taylor, 1993). Through the global economic crisis since 2007 this employee-owned company has outperformed its competitors, with revenue growing consistently at a compound rate of 6.4% per annum, profits remaining broadly steady, and employment rising from under 45,000 (full time equivalents) to over 51,000. Actual numbers of people employed rose over the five years from 69,300 to 80,900,[10] during a period when most retailers were struggling.

And is the democracy real? Its constitution, which can be downloaded from http://www.johnlewispartnership.co.uk/about/our-constitution.html, ensures first of all that there is a good two-way flow of information. Many conventional corporations put great efforts into communicating with their employees; there are none that go to the lengths of JLP to ensure that managers not only communicate but also listen. Spedan Lewis agreed with Lord Acton's observation that 'power tends to corrupt, and absolute power corrupts absolutely' (Acton, 1887). He also observed that an effective way to keep the powerful from complete hubris is to expose them to a free press, and consequently he guaranteed in the constitution the publication of a magazine, the Gazette, now weekly, which publishes all letters, even anonymous ones. Each letter, or group of letters on the same subject, is answered by a director. As a communication device this has many benefits: rumours and discontents are surfaced publicly, not suppressed with the result that

[10] *John Lewis Partnership Annual Report 2012 http://www.johnlewispartnership.co.uk/content/dam/cws/pdfs/financials/annual%20reports/john_lewis_partnership_annual_report_and_accounts_2012.pdf accessed 12 Oct 2012.*

they fester; most people enjoy reading the often much mistaken criticisms that emerge; they then read the director's reply, which has the effect of ensuring that the great majority of people are constantly being educated about the business; trust is strongly reinforced, because it is obvious that nothing could long stay secret and the commitment to openness is patently real.

The second means of ensuring open two-way communication is the system known as Registrars. There is in each department store, and each group of supermarkets, one person whose role is to check on the managers, to identify when managers are not managing things in line with the principles of the constitution. These people stand outside the management hierarchy, reporting directly to a person on the board whose whole responsibility is to bring forward the results of this feedback system. Again, the purpose is to ensure that nothing can be hidden, that power cannot be abused by managers at any level. It might be expected to cause unhappiness and strife with the managers, but in practice it works well: the Registrars help the managers identify where there are problems and resolve them.

Finally, the communication system is based around elected forums, originally called 'Committees of Communication'. In each store, each department sends monthly one or two elected representatives to the forum, which is attended by the senior managers in the store. The representatives can raise any issue. Most are discussed and resolved locally, but they can be passed if necessary up to the next level of elected representation, and finally to the top one – the Partnership Council.

At this point communication merges into real power: the Partnership Council is the body which has the ultimate power to sack the chairman. The 67 elected representatives meet quarterly; at each meeting directors are interrogated publicly about everything for which they are responsible; any question may be asked; and the whole proceedings are published in the Gazette soon afterwards. (Spedan Lewis modelled this on Hansard, the publication that records verbatim all debates in the UK parliament.)

It is notable that this strong governance, with the board openly held accountable to the elected representatives of the people they manage, does not undermine the authority or responsibility of the managers to manage the business from day to day. There is still a conventional management structure, which has those responsibilities. The difference is that instead of reporting 'upwards' to outside owners, mainly financial institutions, they are accountable ultimately to the people they manage. This creates a very strong incentive for the senior managers to ensure that everyone understands what is going on and why specific decisions are made, and that managers consult in a genuine way with the groups of people who are affected by their decisions. The result is that the quality of the decisions improves, and the speed and effectiveness of implementation rise.

Interestingly, the local elections have been strengthened in recent years through a change in the election system: people no longer stand for election, they are chosen by their department colleagues in a ballot where everyone is eligible both to vote and to be elected. It is hard to get your name removed from the list of candidates – representing your colleagues if elected is seen as one of the responsibilities of ownership. This system is effective: those elected are the people genuinely trusted by their colleagues; they are given both a personal boost by being elected, and a real sense that their colleagues have a right to expect from them effective representation. This normally takes the form of ensuring excellent communication, but it also feeds into the system of power, ensuring that the chairman really is accountable to the people he manages. The democratic system is in good health.

One of the reasons why the John Lewis Partnership has managed to last for over 80 years in democratic employee ownership is that its ownership is collective, effectively neutralising the dangers of individual ownership. The securities – stock or shares – that embody conventional individual 'ownership' carry the rights to information, power and profit. These powers cover not just this generation, but all generations in the future. The value of shares is therefore both high and volatile – the right to extract wealth from the people employed is projected into the infinite future. If such securities are held directly by the employees the result is that there is a high financial incentive for each generation to sell the company rather than hand it on to the next generation. By selling it they receive the 'best guess' of the value over the future as well as the present, whereas if they hand it on, they will participate only in the current wealth created. This temptation is removed in John Lewis by the ownership being placed in a well-designed trust, which cannot be broken. The company is not for sale, so each generation works to make it successful and participates in its profits – a profit-sharing bonus is paid each year, the same percentage for each person, sometimes rising as high as three months' salary. They then pass the company on to the next generation, ideally stronger than ever.

Mondragon: the Global Flagship for Commercially Successful Democratic Business

The second example of successful democratically owned business is the network of 120 worker-cooperatives based in Spain known internationally as Mondragon.

Inspired by the local Catholic priest, Father Arizmendiarrieta, known as Arizmendi, the first worker cooperative was formed in 1956 by five blue-collar engineers with two key principles: that capital should serve people, and not the other way round, and that people should exhibit solidarity with each other. The men involved were not wealthy, but the business prospered, and in quick succession they spun out three more fast-growing complementary businesses as independent worker cooperatives. When in 1959 the banks, not having wealthy backers to hold responsible, refused to lend them any more money Father Arizmendi started a bank, making the original cooperative founders the directors. The bank then became the centre of a vigorous entrepreneurial process, mentoring and funding the formation and development of all 120 businesses.

In addition, the 120 businesses developed a considerable superstructure, including venture finance, research institutes, two universities and a social security system. Meanwhile, the businesses prospered. None of the start-ups has ever failed – a globally unsurpassed record. They include Irizar one of the world's leading coach manufacturers, whose operations are studied in Harvard Business School as a superbly effective system of engaging people; one of Europe's largest white-goods manufacturers, selling under the Fagor and Brandt brands; and one of Spain's largest retailers, Eroski, grown with the help of a truly innovative venture capital fund invented by Mondragon to support the growth without diluting the employee-ownership. From 1991 to 2011 the numbers employed grew from 25,500 to 83,500. The turnover of the industrial and retail groups in 2011 was over €14bn, and the bank, which has long been recognised as one of the most solvent in the world, had nearly €14bn under its administration.

Power in the Mondragon network does not lie in the superstructure, but in the individual worker cooperatives. Each is an independent business, under the control of its members. For example, Irizar the coach manufacturer is in 2012 outside the group, since its members decided to take a different approach from the group's in dealing with the recession; the hope on both sides is that it will rejoin in future.

The board in each cooperative consists of a number of people elected by all the members; the board's main role is to appoint and supervise monthly, and if necessary change, the chief executive. The chief executive then appoints the professional managers, and they run the business. Since the average size of the cooperatives is well under 1,000 people, the feedback systems are tight.

Again the key is that the person with the most day-to-day power is accountable to the elected representatives of the people he or she is managing. This creates the strongest possible incentive to keep them informed and to listen to their views.

The solidarity ethic is evident in many ways. It has allowed the creation of the superstructure and it also leads to groups of cooperatives with common interests sharing their profits (which moderates the danger when a business is losing money). In addition, with a view to ensuring that members will only lose their jobs as a very last resort, cooperatives which are doing well will provide employment for surplus members of cooperatives which are not.

The Mondragon constitution is better tailored to democracy than is the use of equity shares. We saw that the John Lewis Partnership had to neutralise their shares by parking them unassailably in a trust. In the case of Mondragon, there are no shares: no securities exist which could be sold. Instead, the rights of the members – rights which are combined into shares in the conventional model – are personal rights, which belong to each person not because they hold any security, but because of the role they carry out as members of the cooperative. The right to receive information, for example, is not because an individual holds a share: it is simply because he or she is a member of the cooperative. The same applies to the right to vote. These issues are clarified by Ellerman (1990).

This allows Mondragon to be less self-denying than the John Lewis Partnership when it comes to the distribution of the wealth created, while at the same time retaining more cash in the business. Each member has a personal capital account. Because of the history of starting each cooperative from scratch, capital contributed by members was essential: and each new member has to invest a substantial amount into the business. At the time of writing (2012) this sum stands at €14,000. When the business is profitable, some profit is retained as a general reserve and the balance is allocated to the capital accounts of the members. Note that in this way all the cash is retained in the business, which is helpful when they are growing their businesses from scratch. The only cash extracted is interest paid on the capital accounts. In this way they manage to give all their members a material interest in the capital retained, which is paid out when the member leaves.

The extent of the democratic control over this system is shown by the fact that a majority vote by the members of any one cooperative will mean that its membership of the network ceases, as in the case of Irizar. Once it is outside, the members could convert it to a conventional company and sell it. This has happened at least once: the power is real. But the genuinely democratically empowered members overwhelmingly choose to grow their businesses and pass them on.

There have been many studies of Mondragon. Oakeshott (1978; 2000); Whyte and Whyte (1988); and Erdal (2011) may be of interest. The Mondragon website http://www.mondragon-corporation.com/ is a useful source of data.

Conclusion

The examination of these two case studies shows that employee-owners can exercise genuine democratic control over their businesses, and at the same time make them very successful in commercial terms. When the rights to rule and to tax are taken from elite 'owners' and financial institutions and brought under democratic control, the employee-owners tend to make them prosper. There is also suggestive evidence that people who are democratically in control of their businesses thrive as human beings.

In the context of the economic crisis triggered by the ideology based on traditional economic models, these cases point to a way forward that is respectful of human rights and at the same time likely to see an increasingly productive economy, at the same time as reducing the gap between rich and poor. It is an attractive prospect.

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