Spanish Lessions

Employee-Owned Companies in Ohio on A Mass Scale?

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Dateline: December 2, 2008. National Bureau of Economic Research announces that US has been in recession since December 2007.

Another recession in Ohio? We are still in the last one! Between January 1, 2000, and November 30, 2007, Ohio lost 255,200 manufacturing jobs—25% of our manufacturing base. Over the same period, total Ohio employment dropped 154,700 or 2.8%. Since the "new" recession began on December 1, 2007 through October 2008, we've lost an additional 23,800 manufacturing jobs and 41,700 jobs over all.

The employee-owned sector is less likely to shed jobs. If we compare the performance of Ohio's Employee-owned Network companies for which we have employment data in 2000 and 2007 (24 manufacturing companies and 37 total companies), the manufacturing firms have shed 1% of their jobs—not 25%—and total employment has grown by 15%—not dropped 3%. If Ohio's manufacturing sector had matched Network companies, we'd have 230,000 more manufacturing jobs than we had in November 2007 (the 2008 data aren't available yet) and close to one million additional total jobs in the state. Now, Network companies aren't representative of the entire employee-owned sector: They are more participatory, more likely to communicate how the business is doing, and more likely to provide training. Moreover, the employee-owned sector as a whole is less likely to shed employment than their conventional competitors, far less likely to offshore or outsource, and more likely to reinvest in new plant, property and equipment in Ohio.

Yet despite these advantages, the employee-owned sector has grown only slowly over the last 15 years.

What can we do to encourage greater growth?

Should we start new employee-owned firms?

One of the big holes in American employee ownership is the absence of employee-owned start ups. ESOPs are far too expensive for start ups. Co-ops don't cost too much, but they are virtually unknown. What Small Business Development Center knows enough about them to suggest a co-op when you come in announcing "My buddy and I want to start a new business"?

Besides, they are hard to capitalize. They aren't designed to include outside capital from non-members.

We need new tools for creating new employee-owned businesses. The most promising ideas come from Spain. They were developed initially to deal with the massive economic dislocations that accompanied Spain's entry into the European Union in 1986. Since then they have been developed sequentially to meet the needs of the times and they have become a substantial source of new business and job creation.

In the Basque region alone, which has a population of 2.1 million, or roughly that of greater Cleveland, between 100 and 150 new employee-owned firms are established annually.

Over the last three decades, Spain has developed three new employee-ownership mechanisms for responding to economic dislocation that we should consider.

The first is a new form of corporation: the Sociedad Laboral (SL), or "Corporation of Labor." It is a form of corporation majority-owned by employees but based on stock ownership and able to include non-employee capital (unlike cooperatives). It's a simple, flexible, and cheap way for employees to buy troubled companies or to start new ones. Since 1997, when the Law on Labor Corporations changed, about two-thirds of new employee-owned companies have used this legal form.

The second is a way to capitalize new SLs and co-ops through lump-sum distributions of unemployment compensation and severance pay. This approach not only capitalizes new employee-owned businesses, it tends to preserve "social capital"—more on this below. Both make business success more likely.

The third is an intense support system that helps new start ups and provides economies of scale for small, employee-owned businesses.

Labor Corporations

The Spanish system of "Corporations of Labor" (Sociedades Laborales, SLs) offers a unique tool to recapitalize companies under employee ownership and to start new companies out of the wreckage of old ones. As a form of incorporation, it's also inexpensive. As a result, there are about 20,000 of these Labor Corporations in Spain today, employing about 130,000.

In October I visited with the general director of the Basque regional association of Sociedades Laborales, Josetxo Hernandez Duñabeitia, in Bilbao, Spain. Hernandez was one of the pioneers of this form of share-based employee ownership in his company in the 1970s, and has worked since 1982 with the Basque regional association of Corporations of Labor ASLE (Agrupación de Sociedades Laborales de Euskadi). Although the initial SLs were, says Hernandez, all industrial companies, today there are about 1000 SLs with a bit more than 13,000 employees in the three Basque provinces in all sectors of the economy.

The core of the Corporation of Labor is the following:

1) It is a form of incorporation in which workers in the company own more than 50% of the shares in the company;

2) No single person can own more than 1/3 of the stock in the company, with one exception: when a public organization takes partial ownership, it can hold up to 49%; and

3) No more than 25% of the hours worked by permanent employees of the company can be worked by non-owners in companies with fewer than 25 employee shareholders and no more than 15% of the hours can be worked by non-owner employees in companies with more than 25 employee owners.

The SLs are part of the "social economy," says Hernandez. They seek "balance between human and business development" and to create "an equilibrium between capital and labor."

SLs come in two varieties. The first is the regular Corporation of Labor (Sociedad Anonima Laboral) which originated as a way to buy companies threatened by shutdown or job loss. It dates in practice to worker buyouts in the late 1970s and was accorded separate legal status through 1986 legislation; it requires a minimum capitalization of 60,000 Euros (about $80,000 at the current exchange rate of €1 = roughly $1.35). The second is the Limited Liability Corporation of Labor, established in 1997, which requires a minimum capitalization of 3,000 Euros and is appropriate to new start-ups. So easy to establish are the SLs that roughly 3 out of 4 employee-owned start ups in the Basque region now take that legal form.

In Spain as a whole, there are 2600 of the former, employing 38,000, and 17,700 of the latter, employing 93,000. Average employment is low (less than 7 per firm), but total employment is a respectable 130,000.

While Sociedades Laborales have modest tax benefits (primarily for incorporation and transfer taxes), the basis of their success is that since 1985 employees can receive their unemployment compensation (24 months in Spain and between €24,000 and €30,000, depending on the number of children the unemployed worker has) in a lump sum to recapitalize the company or to start a new company.

Capitalizing new firms: Financial and social capital

There are two major problems in starting new businesses: (1) capitalizing the firm (financial capital), and (2) building a reliable group of employees who can work together successfully (social capital). "Social capital" is the relations of collaboration and trust between the employees that grew out of years of working together in an existing business. It's lost in plant shutdowns and takes years to rebuild. The failure to create it successfully is one of the major causes of new business failure in the US.

Beginning in the late 1970s, Spain began encouraging groups of employees who lost their jobs to shutdowns or layoffs to jointly start new employee-owned businesses, saving social capital for the new business, and converting worker financial rights into capital for new business start ups.

The initial mechanism for capitalizing new firms was lump-sum distribution of severance pay in shutdown or layoff situations. Spain had a general system of severance pay for valid dismissals — today it is 20 days' wages for each year of service up to a maximum of 12 months' pay. Obviously, bankrupt businesses that are shutting are not going to pay severance to their workers, so the Ministry of Labor lent the employees their severance to help capitalize the new business. Today there's a national severance insurance fund which can provide severance pay when companies can't.

Beginning in 1985, the government also provided lump-sum distribution of unemployment compensation to employees in major permanent layoff/shutdown situations to help capitalize new employee-owned companies through co-ops or Labor Corporations. In order for the employee group to receive lump-sum distributions, they had to have a viable business plan to resuscitate their shut firm or to start a new employee-owned company. The plan has to be vetted by a reputable cooperative or SL development program and to pass the scrutiny of the unemployment compensation system. The unemployment compensation system continues to monitor the new employee-owned business for three years.

The funds are used to capitalize or recapitalize the business by providing working capital (including wages) in the start-up or restart phase. Obviously, this sys-

At work in a Sociedad Laboral: Felix Sarrionandia, one of the workers who took over Izar Cutting Tools in 1991, tends his machine 17 years later in the company's new plant. Izar is an ASLE member.

tem also reduces long-term unemployment by creating new businesses.

What's to keep us from trying a pilot program like this in Ohio?

Support system for employee-owned start-ups

One of the truly astonishing aspects of the Spanish system of employee ownership start-ups is the intense level of services provided by various employee-ownership business development centers. They are well staffed and provide services that go far beyond what our Small Business Development Centers provide.

And they have an extraordinary success rate: only about 1 in 5 cooperative business start-ups fail in the first five years, as contrasted with about 4 out of 5 conventionally owned business start-ups in the US. We visited 3 cooperative business assistance centers which all work just in the Basque region.

Saiolan, located at Mondragon University, is the Mon-

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Izar Cutting Tools

I visited one of the largest of the SLs, Izar Cutting Tools SAL, to see how the form works in practice. Located just outside of Bilbao in a brand new factory which opened in March 2008, Izar traces its origins to 1910. It began as a division of a family-owned automotive supplier, producing cutting tools for the parent company's use. Now it produces drill bits and milling machine tooling for CNC machining centers. .

Under the government of Francisco Franco (1939-1975), Spain sought to achieve complete economic self-sufficiency ("autarky") behind high tariff walls. It sought to be self-sufficient in everything: cars, trucks, etc. At its peak employment before the crisis, Herramientas de Amorebieta, as Izar was known in those days, had more than 1000 employees. As Spain prepared to enter the European Union in 1986, it was apparent that many things had to change. The local Basque government sought to achieve international competitiveness by marrying local companies to foreign "technological partners." By that time, the family had already sold Herramientas de Amorebieta, which was split into an automotive supply company and a cutting tool company. The latter was sold to an Italian investor based in France "who put in nothing but drained a great deal from the company," according to Izar General Manager Carlos Pujana.

This absentee investor was ousted after pressure from the workers, which included strikes, demonstrations, assemblies, and picketing his home in Paris. "He basically got the plant for nothing and we got it back from him for nothing" in a purchase in 1991, says Pujana.

At the time the employees took over the company, it had been subject to substantial disinvestment and needed to be recapitalized. That was financed from three sources:

The first was the payment of 24 months unemployment compensation in a lump sum to the employees to invest in the company. Wasn't this a risk? "Sure, but it was the only option to preserve our jobs," said board president Maria Feli Arrizabalaga, who is an inside sales person with 30 years seniority at Izar.

The second was the advance of severance pay from the national severance pay fund (which backstops insolvent companies for their severance obligations—20 days pay per year worked up to 12 months pay—as a loan to the company. That loan is currently a matter of dispute since the government has twice passed legislation forgiving loans from this fund made for the purpose of keeping firms open as Sociedades Laborales.

The third was a 20 percent pay cut and increase in working hours agreed to by employees. Subsequently the company required additional capitalization in 1997, and the employees put in additional funds.

Izar is governed by an elected administrative board (similar to a Board of Directors) of 7 members. The General Manager is not a member of the board. All of them are inside members (and unpaid), drawn from various areas of the company: inside sales, workshop manager, purchasing, machine operator, quality control, etc. They are elected by the employee owners. Additionally, there is a paid non-member secretary of the board, an outside lawyer. The presence of an outside lawyer in the board is legally mandated. "It's a balanced board that reflects the makeup of the company," says Pujana. The board meets monthly, and Pujana reports to it. The company is also unionized, and Pujana meets with the union on a monthly basis as well. Board officers are elected by the board, but the Izar pattern is to elect the top vote getters among the board members as President and Vice-President.

The company is owned by 130 of its 204 employees as a Sociedad Anonima Laboral (SAL). All permanent employees are owners, and none but employees are owners. Unlike other SALs, all permanent employees are expected to become members. By contractual agreement (which is not a SL legal requirement), employees who retire are required to sell their shares back to the company, and the company is required to buy them. Shares are valued at the price originally paid by the initial SAL members, adjusted for inflation. The current value of the original members' shares is €28,000 (ca. $38,000). New employees put in €14,000 for their ownership stakes. This can be paid through a wage checkoff over a period of up to 10 years, depending of the needs of each employee.

In general the company has reinvested 70% of profits back into the company (and it now has a brand new plant), far above the 10% compulsory reinvestment in the SL sector; and it has paid out 30% of profits to its employee owners in dividends. Today Izar is the largest producer of cutting tools in Spain and one of the top 5 in Europe. OAW