Sheffield
Hallam
University

Cooperative social enterprises: company rules, access to finance and management practice

RIDLEY-DUFF, R. <http://orcid.org/0000-0002-5560-6312>

Available from Sheffield Hallam University Research Archive (SHURA) at:

http://shura.shu.ac.uk/774/

This document is the author deposited version. You are advised to consult the publisher's version if you wish to cite from it.

Published version

RIDLEY-DUFF, R. (2009). Cooperative social enterprises: company rules, access to finance and management practice. Social Enterprise Journal, 5 (1), 50-68.

Copyright and re-use policy

See http://shura.shu.ac.uk/information.html

Sheffield Hallam University Research Archive
http://shura.shu.ac.uk

To cite this article:

Ridley-Duff, R. J. (2009) "Cooperative Social Enterprises: Company Rules, Access to Finance and Management Practice", *Social Enterprise Journal*, Spring 2009, forthcoming.

Cooperative Social Enterprises: Company Rules, Access to Finance and Management Practice

Dr Rory Ridley-Duff

Faculty of Organisation and Management

Sheffield Hallam University

Member of:

Centre for Individual and Organisation Development (CIOD),
Charity and Third Sector Unit

Centre for Voluntary Sector Research (CVSR)

E-mail: r.ridley-duff@shu.ac.uk

© Emerald Group Publishing Ltd, 2009

Abstract

Objectives: In light of the faster than expected take up of the Community Interest Company (CIC) in the UK, this paper revisits findings from a study undertaken in 2000 on the impact of asset-locks on the longevity, growth and management styles in co-operative social enterprises.

Prior Work: The co-operative and employee-ownership movements played a leading role in the establishment of Social Enterprise London and the Social Enterprise Coalition. The heritage of the UK co-operative movement, however, differs from its continental counterpart in placing a much stronger emphasis on common ownership that inhibits the transfer of capital and assets to private interests.

Approach: This paper is both conceptual and empirical. It examines different worker co-operative traditions and develops a meta-theory that explains underlying assumptions in different forms of co-operative social enterprise. Using empirical data from 5 common ownership co-operatives and 5 equity-based co-operatives, this exploratory study found differences in management style, access to finance and growth prospects both within and between the two groups.

Implications: Devolution of management responsibilities was more prevalent in co-operatives permitting both individual and collective ownership, as opposed to common ownership. Access to external finance was less problematic for organisations where individuals had made investments. Despite this, it was not established that organisations with *external* equity or loan finance grew quicker or faired better over the longer term.

Value: The value of the paper lies both in the development of a meta-theoretical framework for differentiating forms of worker co-operative, as well as empirical evidence on the impact of asset-locks in the management and development of social enterprises. The study suggests that the CLS version of the CIC, or abandonment of the CIC in favour of an appropriately structured CLS or IPS model, may be appropriate for social enterprises wishing to grow, but makes little difference in small service oriented social enterprises.

Key Words: Social Enterprise, CIC, Co-operatives, Equity, Asset Lock, Common Ownership

Introduction

The original motivation for this study was a debate in an established worker co-operative seeking to invest in product development. Its constitution prevented it from applying for loan-funding from a Government scheme even though the scheme included co-operatives as a target group. Fund managers would not loan monies to any organisation unless it was able to convert loan repayments into equity capital in cases of default. In 2008, during the delivery of third sector governance seminars at Sheffield Hallam University, a consultant claimed that 40 (of 2700) CICs had applied to *deregister* after experiencing problems with their asset lock. These comments prompted discussion of the original research and led the author to read more widely on alternative ownership models for social enterprise. As a result, this paper updates previously published work (Ridley-Duff, 2002) by re-analysing findings and conducting further secondary research.

The next section presents an updated literature on co-operative models of ownership, and includes a meta-theoretical framework for understanding different forms of staff controlled co-operative social enterprises. A methodology section outlines the approach used to combine findings from the original study with more recent research. This is followed by a section presenting results from both the original study and further desk research. Discussion and conclusions provide insights into the likely success of the CIC as a choice for social enterprise development.

Forms of Co-operative Social Enterprise

Social enterprises adopting a co-operative, mutual or co-ownership approach change the relationship between owners, consumers and workers. This involves restructuring the organisation to erode the distinction between employer and employee, with the goal of eliminating wage-labour as the dominant mode of working life (ICA, 2005). Alternatively, the relationship between retailer and consumer is restructured so that consumers and/or producers have control over the enterprise and supply chain (Woodin, 2007).

These practices can be motivated by ideological, empirical or pragmatic considerations. Ideological motivations are premised on a moral commitment to fairness at work, often underpinned by empirical studies that theorise how ownership combined with effective participation improves the double-bottom line (Ellerman, 1990; Whyte and Whyte, 1991; Bradley and Taylor, 1992; Oakeshott, 2000; Conyon and Freeman, 2001; Jensen, 2006; Erdal, 2008). Pragmatic motivations, on the other hand, involve the use of co-operative laws to obtain legal and social advantages (Paton, 1989). For example, Howarth's (2007) study of co-operatives in Argentina found that choices were influenced by the rapid communication of legal rights within established social networks. A co-operative's ability to apply to a local court for permission to use idle company equipment for up to two years (to facilitate the transfer of assets from bankrupt companies) spurred trade unionists to recommend the co-operative form when members were threatened by a business closure.

In the last decade, model company rules have become available that allow social enterprises to separate voting rights and equity, or adopt structures reflecting a range of interests (Spear, 2001; Brown, 2006). In the UK, the founders of Democratic Business Ltd fuelled the debate about the role of equity with a series of publications between 1996 and 2000 (Major, 1996, 1998; Major and Boby, 2000). Their enthusiasm coincided with the publication of *The Ownership Solution* (Gates, 1998) which Brown (2006) has interpreted for the social enterprise movement. In ideological terms, this gave a new impetus for pluralist thinking on ownership, governance and management control, igniting fresh debates on the merits of stakeholder involvement (Sternberg, 1998; Vinten, 2005) and the form this should take in social enterprises (Borzaga & Defourny, 2001; Ridley-Duff, 2007).

Historically, perceptions of co-operatives have been negatively influenced by prominent figures on both wings of the political divide. Marx (1984: 440) commented, "they naturally reproduce in their actual organisation all the shortcomings of the prevailing [capitalist] system" and this encouraged left-wing parties to argue that political activity should concentrate on the working class. Sidney and Beatrice Webb (1914, 1921) also adopted the view that co-ops would always suffer from worker-indiscipline and poor management. Rothschild and Allen Whitt (1986) not unreasonably criticise the Webbs for failing to support their claims with empirical evidence, and when Cornforth et al. (1988) examined the failure and survival rates of British co-ops between 1978-1986, they found relatively good performance compared to the private sector (compare Paton, 1989; Holmstrom, 1993).

Spear (1999) charts how the deregulation of public services led to a thaw in trade union hostility toward co-operatives and employee-buyouts. In some cases, they acted more like their continental and South American counter-parts by playing a lead role in their creation (Patton, 1989; Howarth, 2007). Deregulation, unfortunately, also provided opportunities for careerists and private speculators. Cook et al. (2002) tracks the legislative changes that allowed “carpetbaggers” to cash in on building society demutualisation as well as the subsequent period in the 1990s when career-oriented executives benefited from promoting the sale of demutualised societies to private banks.

The UK Context

It is appropriate to ask ‘why has development in the UK differed significantly from the rest of the EU?’ Between 1970 and 1990, the most influential organisation promoting and servicing worker co-ops was the Industrial Common Ownership Movement (ICOM)[1]. Established in 1971, model rules were produced in 1976. Over ten years, this triggered the creation of 1176 co-ops employing 6,900 people - an average of six staff per co-op (Cornforth et al, 1988). In contrast, ten years after the constitution of the Spanish Mondragon co-ops was regularised (around 1960), 48 co-ops were created employing 8,570 people (averaging 179 staff). When it is considered that the Mondragon region is just *half the size of Wales*, the gap in achievement is apparent (Oakeshott, 1990). One common explanation is that members’ capital investments finance the co-operatives, while a share of surpluses and welfare benefits accrue to individual members. Unlike co-operatives in the UK which favour community over individual ownership, the Mondragon system builds in explicit benefits and substantial profit-sharing arrangements that provide for the long-term welfare needs of members, their families and the wider community (see Oakeshott, 1990; Whyte and Whyte, 1991; Turnbull, 1995; Lezamiz, 2003).

In the UK, although there is no specific company law covering co-ops, ownership structures have usually been based on Industrial and Provident Society model rules (IPS). After serving a probationary period, worker-members pay £1 for a share. When they leave, they give up their share. Not only is external share-ownership prohibited, each member’s share cannot accrue in value, and the member cannot gain financially from the sale of business assets. ICOM had a virtual monopoly on registering UK co-ops as *common ownerships* until the late 1980s. In 1988, the Employee Share Ownership Centre (ESOC) was established. By 2000, the ESOC (2000) claimed that 2,000 companies had created employee ownership share plans (ESOPs), including 80% of the top 1500 quoted companies. These involve over 3 million employees, but they rarely give employees more than a 20% stake. However, several authors have found that the mechanism of the ESOP - an employee benefit trust (EBT) that uses the assets of the company to fund share purchases for employees - has been used to create a significant number of *majority* employee-owned businesses that now contribute more to GDP than the charity/voluntary or agricultural sector (Spear, 1999; Major and Boby, 2000; Knell, 2008).

Major (1996, 1998) researched the various problems faced by co-ops and ESOPs in the USA and contended that most suffer from 'equity degeneration' – a situation where one or more stakeholder is unable to realise the full-value of their past efforts, risk-taking, investments and decisions. Expanding a theme propounded by Ellerman (1990), he argued that ownership and control were not inextricably linked and that rules with two types of share – Voting Shares and Value Added Shares – could effectively separate ownership rights from voting rights. This approach, however, has proved less popular than one promoted by the Baxi Partnership and Employee Ownership Association (EOA) (see Erdal, 2008: Chapter 17). Based on US-style leveraged employee-buyouts (Rodrick, 2005) with Mondragon-type democratic controls, private sector companies and common-ownership co-operatives are converted to majority employee-owned companies. The system uses a profitable track record and growing asset base to secure loans that establish an employee-benefit trust which can acquire the business (compare Spear, 1999). Initially, at least 50% (+1) of shares are held in the EBT with subsequent annual surpluses distributed through an ESOP to individual share accounts. Providing 50% (+1) remain in trust and there is an embedded mechanism issuing new shares to employee accounts, a *profitable* company cannot be acquired by outside investors against the wishes of the trustees (employees).

This combination of collective and individual ownership has attracted both Sunderland Home Care Associates (SHCA) and Eaga Ltd (see www.employeeownership.co.uk). In 1998, SCHA converted from a £1 per member common ownership model to a combined EBT / ESOP model. In 2006, its steady growth and business performance in social care led to recognition when they won 'top social enterprise' at the UK's 2006 Enterprising Solutions Awards (EOA, 2008). Since 2004, they have replicated the model in three other regions and added a further £3.2m to the group's turnover (Higgins, 2007).

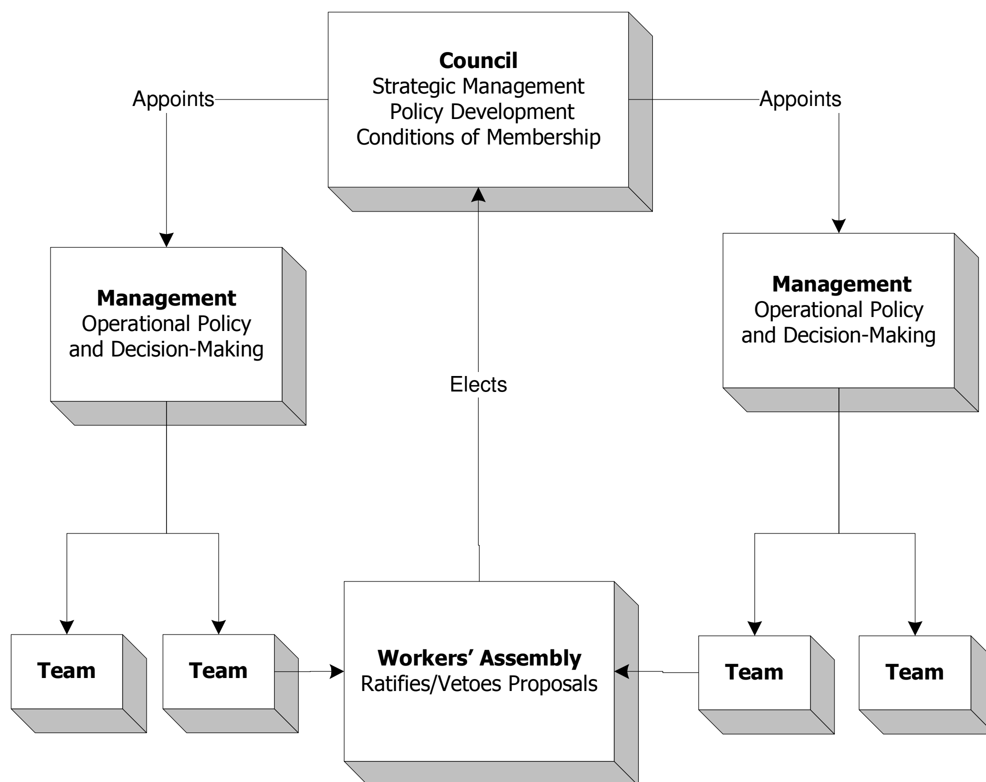
The various cooperative forms of social enterprise, therefore, can be summarised as shown in Figure 1.

Figure 1 – Typology of Worker Co-operatives and Employee-Owned Businesses

	Common Ownership Workers do not share in the assets of the company	**Individual / Collective Ownership** Workers and stakeholder groups share the assets of the company
Non-Equity	Common ownerships. Limited profit distribution in equal proportions. Reserves and assets belong to the organisation, not members.	Mondragon style co-ops that provide for internal capital accounts that are revalued as fixed assets vary in value. A proportion of profit accrues to capital accounts (owned by individual members), and interest is paid on the full balance each year. Reserves and assets belong to members collectively.
Equity	Common ownerships that allow equity that does not rise/fall in line with market values. Limited profit distribution according to equity holdings. Reserves and assets belong to the organisation, not members.	EBTs / ESOPs in the UK/US and elsewhere or Labour Companies (Sociedad Anonima Laboral) in Spain that support majority employee-ownership. Equity rises and falls in line with market values with dividends allocated shareholders. Share values reflect the market worth of the company. Reserves and assets belong to members collectively.

Does this imply a link between ownership and management structure, and what impact does this have on development? All worker co-ops have an assembly of workers that (in theory, but not always in practice) retains supreme decision-making power (Anon, 2007). The frequency this body meets varies with size. In the small co-ops, all workers can meet weekly: large co-ops may convene only once a year. Regardless of whether co-ops are commonly or individually owned, they frequently develop what Oakeshott (1990:155) has called 'the classic co-operative control structure'. This is shown diagrammatically in Figure 2.

Figure 2 - Representative Management

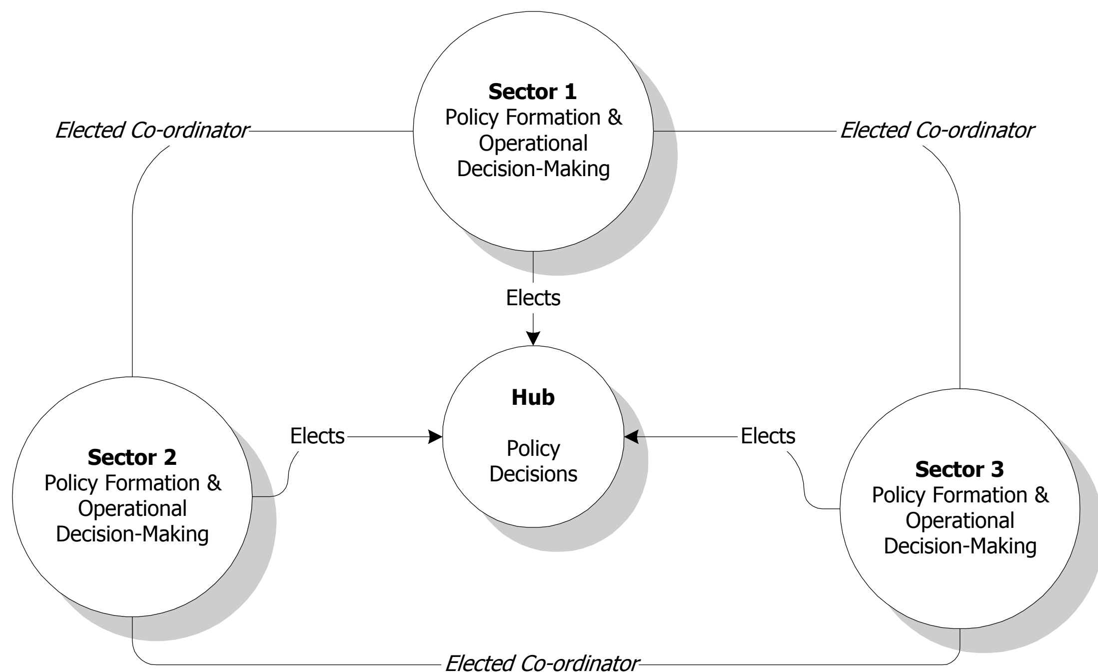


Suma, in Halifax (England), resisted the tendency towards an elected policy-*making* body. In the early 1980s, it started experimenting with collective forms that devolved decision-making powers to smaller autonomous groups (ICOM, 1989). Initially, they divided the General Meeting into two groups - personnel and finance – a system that evolved into a 'doughnut' model with autonomous groups free to organise day-to-day activities including recruitment, scheduling and business development. By 1988, Suma had grown to more than 40 so the General Meeting was abandoned in favour of 3 'sectors', each with representatives elected to a central co-ordinating body nicknamed the 'hub' (Cornforth, 1995). In the early 1990s, each sector met weekly to discuss issues facing the business and then took views to hub meetings for decision. Co-ordination was achieved through a business plan, departmental budgeting, and an elected position of 'sector co-ordinator'.

The significance of Suma's structure is that policy formation and operational management was devolved (close to product and service delivery), while policy decisions were conceded to an elected body (see Figure 3). As a whole, the structure maintained the participative character of collectives, rather than the predominantly top-down representative models outlined by Oakeshott (1990). This might seem like an isolated diversion but for the fact that the doughnut model coincided with Suma's growth. By 1993 the structure supported over 60 staff, and by 2000 over 90 (Warburton, 2000). By 2004, however, some elements of the

‘classic’ model had been re-adopted. Elected “sector co-ordinators” had been replaced by appointed “functional co-ordinators”. These were described by the hub chair as part-time managers accountable through regular member surveys appraising their performance. The balance of their time was allocated to non-managerial warehouse duties to keep them connected to practical business issues. General Meetings were also reintroduced, this time enforced by new rules requiring attendance (Cannell, 2004).

Figure 3 – Suma Doughnut Structure



Certainly, it appears that there is a stronger dependency between company rules and access to finance than company rules and management practices. Considering the variety of management styles in use, it is reasonable to suggest that growth and viability does not depend on conventional business practices, providing solutions encourage high levels of participation and formally delegated decision-making powers (compare Paton, 2003). Fieldwork, therefore, was designed to explore whether the link between company rules and access to finance is a more significant factor in the growth of co-operative social enterprises than management structure.

Research Methodology

This exploratory study was conducted using telephone interviews. In 2000, twenty organisations were selected by working alphabetically through a directory of co-ops and employee-owned businesses (provided by Major, 2000). All came from London and Home Counties (total population 84) to ensure a balanced sample of non-equity and equity co-ops from a single geographical location. Even so, as it was not possible to select all organisations from a single industry, each was screened to ensure income was derived from “professional services”. This screened out manufacturing organisations to limit variability.

With the exception of the researcher’s own company, the size of each was not known beforehand. An attempt was made to obtain data on turnover and expenditure from public records but this was not always available. Obtaining financial data in test interviews proved impractical and unreliable so the questionnaire was amended to obtain a verbal assessment of turnover and staff changes in the last 5 years.

Semi-structured telephone interviews (up to 40 minutes long) were used to collect both quantitative and qualitative data from a final sample of 11 companies, with one answering the questionnaire by e-mail. It was subsequently found that two organisations were non-profit making: these have been excluded from the results to leave a final sample comprising ten service-based "more than profit" co-operative social enterprises from a single region. There were an equal number of non-equity co-ops (prevented by their rules from issuing "ordinary shares") and equity co-ops (offering shares that carry voting rights and dividend entitlements).

The interview focussed on decisions involving significant expenditure. Each organisation was asked to explain how proposals were put forward, the forum(s) in which they were discussed, and which person or body had final decision-making authority. A range of qualitative data was collected about trading conditions, special constraints and any triggers for expansion and contraction. To examine long-term outcomes, four companies (two equity-based, two non-equity) were selected for a follow up investigation in 2008 using public (secondary) sources. In all cases, multiple sources were used to check claims including: web-articles; Companies House records; news reports; company web-sites and annual reports. To honour the original commitment to confidentiality, company names and sources have been withheld.

Results

In 2000, five cases (A – E) were constituted with common ownership rules as Companies Limited by Guarantee (CLG). These issue £1 shares to members upon completion of a probationary period. Members give up the share upon leaving. The share does not accrue in value or entitle the member to the company's profits or assets (upon liquidation). Profits can be distributed in the form of bonuses. The other five cases (F – J) were constituted as Companies Limited by Share (CLS). Two used model ICOM rules that allowed shareholding, either through an employee trust or direct investment. While entitling the shareholder to a proportion of profits, shares did not confer ownership rights or accrue in value. The other three businesses used internally devised rules to issue tradable shares. In these three cases, the formal board included members of staff elected by the workforce: participative management practices (staff teams) were in operation in all co-ops. Shares in these companies could rise and fall in value. A summary of the sample is given in Figure 4.

Figure 4 – Characteristics of Selected Companies

Company	Formed	Size	Constitution	Comments
A	1998	7	ICOM, with equity shares	New organisation formed with a core group providing advice/consultancy to women's organisations.
B	1998	8*	Employee-owned business	Created to provide ICT services. Formed as a spin off (acquired staff from branch of a US company).
C	1988	10	ICOM, with equity shares	[Information on services no longer unavailable]. Formed with 20 staff, grew to 36, then slowly shed staff.
D	1986	50*	Employee-owned business	Created to provide ICT / communication services to public and third sector organisations. Grew rapidly after changing to a CLS.
E	1995	105*	Employee-owned business	Company acquired by approximately 30 staff (spin off) providing creative design services to all sectors. Owned by employee benefit and profit-sharing trusts.

F	1994	3	ICOM, £1 shares	Formed with small group of staff to provide design services. Now 3 core staff with additional work contracted to freelancers.
G	1983	9	ICOM, £1 shares	Formed by group of consultants to provide management advice. Do not wish to grow "too much".
H	1979	10	ICOM, £1 shares	Formed by 8 staff wanting 'freedom from supervision' by providing computer services to public and third sector organisations.
I	1980	15	ICOM, £1 shares	Co-operative formed to provide management and agency services for performing arts professionals.
J	1986	16	ICOM, £1 shares	Formed to provide training and film editing services. Also attempted to create CLS 'sister companies'.

Companies A-E are 'equity' co-operatives (* indicates variable yield equity); companies F-J are common ownership 'non-equity' co-operatives. The following results were published with the original study (see Ridley-Duff, 2002).

Table 1 – Breakdown by Size and Management

Company	**Size**	**Managers?**	**Additional Board Meetings?**	**Comments**
A	7	Yes	Yes	Have a General Manager. Board is elected by staff.
B	8*	Yes	Yes	Structure/Staff inherited, have an MD.
C	10	No	Yes	No managers, but do have professional directors.
D	50*	Yes	Yes	General Meeting abandoned after growth, Board of Directors created, with managers and teams.
E	105*	Yes	Yes	Directors appointed by staff teams. Board meets to approve accounts before AGM. Elected staff welfare organisation.
F	3	No	No	3 core staff, work regularly contracted to 4 freelance staff. Additional freelancers in busy periods.
G	9	Yes	No	Work Allocator, Personnel Manager and Finance Manager appointed at AGM by consensus.
H	10	No	Yes	Management functions distributed amongst directors. Members become directors after 2 years
I	15	No	No	Paid staff obtained work for professional members, who then pay commissions to the co-operative.
J	16	Yes	Yes	Managers appointed by Board. Board became self-selecting after growth.

All 'equity' co-operatives had formally elected boards that discharged functions outside member meetings (in two cases, this was only to satisfy formal requirements of company law). In three of the 'non-equity' co-operatives, no separate directors meeting took place. Another noteworthy difference was a flexible approach by non-equity co-operatives to the payment of fees to members. In three cases, operations oscillated between a quasi-wages system and the payment of professional fees. Co-op I always paid fees to members, while co-op H used a similar system in its early years. In contrast, all 'employee-owned' organisations operated a payroll for 'employees'. One interesting variation of this is case B where staff worked the first two months without pay to 'earn their equity'.

Table 2 – Breakdown by Size and Authority to Make Expenditure

Each organisation was asked whether individuals were authorised to make expenditure to determine how much decision-making authority is delegated.

Company	Size	Can Individuals Authorise Expenditure?
A	7	Yes – up to £500
B	8*	Within Approved Budgets
C	10	Within Approved Budgets
D	50*	In Transition to Departmental Budgeting
E	105*	Within Approved Budgets
F	3	Minor Items Only
G	9	Minor Items Only
H	10	Minor Items Only. Cheques need one director's signature up to £500, but group approval required before making purchases
I	15	No
J	16	Within Approved Budgets – variable individual limits

There is more evidence of delegation of authority amongst the equity co-ops (A – E).

Table 3 in the original study (Ridley-Duff, 2002:77) calculated the average age of equity-based co-operatives to be 7 years compared to 14 years for common ownerships. The average size was 36 in equity co-ops compared to 11 for common ownerships.

Table 4 – Where are proposals made and discussed?

The research then asked where proposals for staff recruitment and equipment purchases were initiated and discussed.

Company	Size	Source of Proposals	Comments
A	7	Management	Consensus sought, General Manager keen not to be seen as 'manager'.
B	8*	Staff Team	MD keen on participative management style and consensus.
C	10	Directors	
D	50*	General Meeting/Management	Managers no longer answerable to General Meeting, just the board (which contains staff representatives).
E	105*	Staff/Management Team	Mostly team-based, Directors consulted.
F	3	General Meeting	
G	9	General Meeting	
H	10	General Meeting	
I	15	General Meeting	
J	16	Management or Board	… meetings held with staff every 2 weeks to 'ensure participative management style'.

It is noteworthy that two equity co-ops (B and E) allowed staff teams to take the lead role in the creation and development of proposals. These cases indicate a different approach to organisation compared to other co-ops in the sample.

Table 5 – Where are proposals finalised and approved?

Company	Size	Final Decisions	Comments on Decision Making
A	7	Management	General Manager plays down his 'manager' role.
B	8*	Management	Consensus always used (never vote); MD must approve.
C	10	Board	Board takes decisions. Always vote.
D	50*	General Meeting/Management	In transition to a 'conventional management structure' due to conversion and rapid growth.
E	105*	Management	Consensus in team always used (never vote), but relevant Director must approve decision.
F	3	General Meeting	Consensus amongst 3 core staff.
G	9	General Meeting	Consensus, occasional voting.
H	10	General Meeting	Consensus, occasional voting.
I	15	General Meeting	[No information].
J	16	Management or Board	Consensus sought, final decision by board.

Tables 6 and 7 (Combined) – How is business expansion (staff recruitment) and equipment typically financed?

Discussions then focussed on financing expenditure (Ridley-Duff, 2002: 77-78).

Company Type	Finance Raised Using...	Staff / Expansion	Equipment	Comments
Equity	Cash Reserves/Profit	1	3	(Only 4 responded to staff/expansion).
	Loan Finance	1	1	
	Equity	2	1	Initial equipment purchases only
Non-Equity	Cash Reserves/Profit	4	4	
	Loan Finance	1	1	

Finally, tables 8 and 9 in the original study (Ridley-Duff, 2002: 80-81) show verbal assessments of changes in turnover and staff numbers: these had risen faster in equity coops than common ownerships over the previous 5 years. These assessments were checked against background information to see if 'objective' data supported the claims.

Table 10 – Employment Growth

Type	Employment (Whole Sample)	Years Traded (Whole Sample)	Staff Growth (per annum)
Equity	180	35	5.1
Non-Equity	53	77	0.6

Discussions yielded some rich qualitative data. One non-equity co-op (G) was happy with (even proud of) their size and structure and always used cash reserves/profits for expenditure. In the follow up study, company G had grown from 9 to 12 staff: its website confirmed that it remains employee owned and controlled. Two others (F and H) had periods where members limited growth aspirations, recognising that growth would bring changes that few members wanted. One (F) preferred to handle busy periods by contracting freelance staff, rather than recruiting more members.

Three co-ops (originally 'non-equity') working with new technology experienced problems obtaining investment funding (cases D, H and J). The first (D) converted to a company limited by shares (CLS). The second (J) created 'private' sister companies that could receive investment. The third (H) was actively discussing changes to its rules in 2000 to issue equity. By 2008, co-ops D and H had following through plans with variable results. In D, the conversion struggled after a few years: public sources and company documents confirm that

there was dissatisfaction with the way private shareholders progressively undermined workplace democracy. In 2001, additional investment from the Baxi Partnership was acquired to strengthen employee-ownership but this did not stop an entire department leaving in 2002 to create a new co-operative (D1). Companies House records, however, show that by 2006 it was dormant, and that in September 2008 D1 requested voluntary liquidation. Five other members organised a transfer into a *consumer* co-operative (D2). This business traded strongly and reacquired assets taken over by D in 2003. It grew year on year until 2007 when its annual report shows 41 staff and a turnover of £7m. Dividend payments to members are made each year, with matching amounts paid to a 'social economy development fund'. In contrast, Companies House records show that company D was dissolved in 2006.

This case (D) illustrates that a worker co-operative can lose control to a private trading company then can reacquire it in the form of a consumer-cooperative (D2) through social action. Clearly, from the timing of events, this was not an entirely hostile endeavour. Company D's website shows a degree of consent in the transfer of assets to companies D1 and D2. Nevertheless, this is a far cry from what was envisaged in 2000. It represents a case that lends support to the argument that democratic 'degeneration' (Michels, 1961) can be reversed by democratic 'renewal' (Cornforth, 1995).

Non-equity co-ops (cases F and H) had been unable to obtain loans or overdrafts without personal guarantees. Equity co-ops (C, and the spin-off enterprise from H) found it much easier to obtain bank loans at low rates of interest after members made personal investments. However, there was one notable exception: co-op (E) had rules that prevented the issue of *external* equity and did not require up-front investment from members (having used an EBT / ESOP to acquire control). The bank was unhappy and made a loan application conditional on giving personal guarantees. It made clear that it disapproved of plans to issue equity to all staff, and formally advised distributing shares only to managers (the same advice was given to H1 during its spin-off). Co-op E decided *against* the bank loan and, within 5 years, traded its way out of debt, tripling staff numbers (to 105) and increasing profits ten-fold. Its longer-term fortunes, however, were more variable. Press reports indicate a problem that triggered the departure of 5 senior staff in 2002. Staff numbers quickly halved (to 50) and the founder also departed. Nevertheless, co-op E stabilised: press reports claim it had 55 staff in 2008, and the company's website claims staff still have equal shares. The governing body comprises a 5-person 'council' including two non-management staff elected by the workforce.

In extreme cases, members of non-equity co-ops felt trapped by their rules and expended considerable energy trying to work around them. Co-op J, for example, created a private limited company to prevent losing a customer that wished to invest in J's development. Later, this created new problems when auditors sought to prevent the transfer of assets (resulting in a rental arrangement for equipment). In another case (H), the non-equity co-operative created a second employee-owned business (H1) that had both internal and external shareholders while retaining a system of one-member one-vote on policy decisions. Although company (H1) later ceased trading, the original worker cooperative (H) survived and still trades. In 2007, however, the founder (approaching retirement) wrote to former members to announce plans to wind it up.

In contrast to these mixed experiences, the MD of one equity co-operative (B) recounted experiences working in the US. Equity was available to all staff but paid no dividend. Re-investment was as high as possible with the aim of building the company (and its share value). In 7 years, shares increased from $10 to $135, and the business had a $5 billion turnover. For reasons that were not explained, the company was sold off (and run down) so

he chose to sell his shares and invest £50,000 in a new UK-based employee-owned co-operative. Within two years it had eight staff and a turnover above £2 million.

The stronger employment performance of the equity co-ops that did not have common ownership rules should be noted here. The table below was included in the original study to show the employee-owned co-ops in a category of their own.

Table 11 – Employment Growth

Type	Sub-Type	Employment (Whole Sample)	Years Traded (Whole Sample)	Growth (Staff/ annum)	Average Size
Equity	Employee-Owned Business	163	21	7.8	54
	Common Ownership	17	14	1.2	9
Non-Equity	Common Ownership	53	77	0.6	11

This performance needs to be contextualized, however, with a cautionary note about drawing conclusions from such a small sample. Two of the employee-owned businesses inherited a favourable business environment, taking over existing customer-bases. In subsequent years, their performance was more variable so their growth potential is overstated (even if still relatively strong).

Discussion

How reliable is the data? We need to take into account several factors. Firstly, all the interviewees were senior staff and some were founder members. Their aspirations and values - typically to run businesses democratically - may have projected a more idealised picture of their workplace than would have been the case if, for example, new staff had been interviewed (see Ridley-Duff, 2005). Secondly, a major limitation is that only one person from each organisation was interviewed. However, the researcher found all the interviewees offered comments freely and never got the impression that relevant information was being withheld or distorted. Given the subject of the research, it was necessary to talk in the first instance to staff that had an understanding of the company's constitution, structure, decision-making process and financial performance. With regard to sample size, increasing it would have introduced more variables into the study (different locations, business types[2]), which would have reduced the ability to examine the impact of company rules specifically.

There is one immediate question regarding the 'outlier' cases (case D with 50 staff, and Case E with 105). Should these be excluded? Given their history, the answer is definitely 'no'. In case D, the organisation struggled to grow beyond 15-20 staff when using ICOM / CLG rules. To move beyond this size, and secure investment, a corporate structure was created using an EBT, a new trading company and a private sector partner. The switch to tradable equity, therefore, was considered a necessary step to re-capitalise the business. In case E, the original spin off company had only 30 staff (smaller than at least one of the ICOM companies, which grew to 36 staff before shrinking back to 10). In this case, the growth was attributed to the company design based on an EBT and profit-sharing trust which provided a powerful incentive for increased productivity and profitability. Without this, individuals could not acquire individual shareholdings in the new company and provide for their long-term future security. Their size, therefore, is attributable – at least in part – to the company rules selected, not just the management style adopted.

Nevertheless, the following analysis should be approached with caution: results are suggestive, not conclusive.

Rules and Management Structure

Tables 2, 4 and 5 gave clues to the different approaches taken to management. Table 2 shows that all equity co-ops delegate authority to make expenditure, and most use annual budgeting as an aid to authorising as well as controlling expenditure. In contrast only one (the largest) non-equity co-operative used a similar approach, with the rest requiring group approval for almost all expenditure.

Tables 4 and 5 summarised the main attributes of proposal making and decision-making. Two of the fastest growing businesses (both employee-owned businesses) typically initiated proposals at the lowest level – the staff-team - and only required approval of one other person (a director or senior manager). All the equity co-ops based on common ownership rules had a formal management body (a General Council / Meeting) that needed to reach its own consensus. While this could be a function of size, even the smallest equity co-ops used a formally recognised manager while common ownerships twice their size did not.

Is there a link between these approaches and business development? The data suggests there is, but it is difficult to draw a direct relationship between the two. Some common ownerships (cases G and H) had a cautious approach to growth, but this did not hold across the sample. It is worth recalling Suma's management structure here. Its defining characteristic (for a period in the 1990s) was devolved proposal-making and operational responsibility with final approval sought from (an elected) management. What we can say with certainty is that there is a qualitative difference between the approach to decision-making in the businesses that have grown larger (including Suma). The focus is on experienced staff nurturing good proposals (and screening out bad ones) usually initiated at team level. As Suma is itself based on common ownership rules (ICOM, 1987, Appendix 1), it cannot be said that common ownership *necessarily* results in a top-heavy management system. The higher incidence of centralised proposal- and decision-making in the common ownerships, however, does suggest that the rules encourage this.

Given the objective of participation and democratic decision-making in most (if not all) of these businesses, these findings question whether General Meetings actually produce the levels of participation and self-governance that is desired. The evidence, supported in the literature on mentoring and coaching, indicates that devolved decision-making driven by individuals in staff-teams, guided by experienced leaders, is a more effective way to secure active participation in organisation development (Clutterbuck & Megginson, 2005).

Rules and Access to Finance

It was suggested earlier that the link between company rules, access to finance and growth may be a strong one. Table 10 shows that equity-based co-ops took on an average of 5 staff a year, nearly 10 times the rate of non-equity co-ops. After follow up research, it is clear the difference is overstated but still substantial. Other evidence is now available. Firstly, the cases of Sunderland Care Home Associates and Eaga Ltd (www.employeeownership.co.uk) provide further evidence of rapid growth after a switch away from common ownership to an EBT/ESOP model. Further evidence comes from a study of 300 companies by Conyon and Freeman (2001) that was not available in 2000. This study found a 20% productively improvement in private sector organisations that combined employee-ownership **and** participative management, compared to ownership or participation alone. Lastly, there is the evidence presented to the All Party Parliamentary Group for Employee Ownership indicating a broadening of employee-ownership sector. None of the sample chose the reverse route (changing from a CLS to a CLG) for any reason, although case (D) split off from a CLS to form a *consumer* co-operative based on the IPS model revised in 2002. In only two cases (F and G) was a CLG considered desirable as a long-term organisational form. In the other

three cases, the CLG was considered an obstacle to growth whether desired (as in case H) or the result of market pressures (as in case J).

However, it is by no means clear that *external equity* is either necessary or advantageous. While there are examples of companies in the sample growing rapidly as a result of converting or creating companies to receive external investment, the most remarkable growth is in an EBT/ESOP that issued only internal equity. This mirrors the case of SHCA, and lends support to Cornforth et al. (1988) who found that building the strength of internal revenue streams can be more effective than seeking external investment. However, tables 6 and 7 suggest that, while companies of both types prefer to use cash reserves and profits to fund equipment expenditure, equity is useful to fund expansion if legal mechanisms ensure that the social structure of the company can be protected. With the follow up research, it is clear that external funding brings significant risks. However, where this is organised through establishment of an EBT / ESOP rather than an external shareholding, the signs are that it provides a more stable transition to employee-ownership.

Can we generalise from these conclusions? The answer is a heavily qualified "Yes". The sample, while including some variability and being fairly small, was sufficiently well controlled to suggest further directions for research. We can, with some certainty, say that company rules do not directly influence management structure, but do encourage certain structures (particularly in the start up years). In saying this, it should be remembered that one non-equity co-op ignored its rules on voting rights, introduced a self-selecting board and fairly rigid top-down management (case J). Other companies that provided for voting according to share-allocation never voted on anything (cases A, B and E), adopting a consensus approach in all decision-making. Management style and structure is a matter of choice, whether the rules seek to influence them or not.

Finance is a different matter. The possibilities open to a business are intrinsically linked to both the company's own rules and the legal environment in which they operate. The evidence suggests that restrictions on the issue of equity have the potential to harm organisational development. This being the case, the choice of a CIC registered as a CLG is unlikely to be the optimum choice for social enterprises that wish to grow. While the evidence was inconclusive about whether external equity is necessary, the study suggests that equity in any form can help businesses develop faster because it encourages a creative attitude towards efficiencies as well as new options for collaborations and partnerships.

If growth is not desired, or the organisation delivers services that do not require large investments in technology, there is little need to structure the organisation so that it can issue equity. In this case, a CIC can be an appropriate form, although an IPS or Charitable Incorporated Organisation may also be appropriate. Small-scale service organisations with low investment needs can be well served by common ownership forms (and can still, if not a charity, introduce profit-sharing arrangements). It may even foster an egalitarian culture conducive to effective small team working. In this study, such organisations were able to meet investment needs from their own revenue streams (cases F and G).

Conclusions

The conclusions of this study suggest a course of action for staff controlled (worker) co-operatives. In addition, while the findings were not derived from voluntary organisations, charities or consumer co-operatives, the research indicates that staff participation combined with profit-sharing could provide benefits to a wider range of multi-stakeholder social enterprises. A worker co-operative with growth ambitions is better served by structuring itself as an employee-owned enterprise with rules that combine majority collective and minority

individual equity ownership, rather than a common ownership co-operative based on either an IPS or CLG model. It helps if equity is allowed to vary in line with the fortunes of the company. While there is evidence that external equity is not necessary for rapid growth, it can play an important role in weathering a downturn in trade, assisting business development and expansion. It can also be a tool for cementing joint ventures with suppliers and customers.

One question that remains is whether a combined EBT/ESOP can sustain democratic organisation comparable to a common ownership co-operative. The evidence from this study is encouraging, with combined systems of collective and individual ownership ensuring overall control is not lost to outside interests. One-member, one-vote principles (at least at the level of the staff meeting) were in evidence and motivation levels may even be enhanced. Elected worker-directors were evident (and encouraged) in all the organisations that were equity based, but not in all common ownerships (see case J). Nevertheless, external financial pressures did trigger the break up of one organisation attempting change (case D) and another attempt failed to achieve sustainability after problems negotiating with a venture capital fund (case H1). Furthermore, it should not be forgotten that long-standing examples (such as John Lewis and Arup) use 100% collective ownership successfully, and that the consumer co-operative based on an IPS continues to develop and invest without the problems reported in this paper.

Asset locks, in most but not all cases, came to be regarded as a problem. Frequently, this understanding only developed in the wake of internal/external pressures for growth. This being the case, the CIC form – even in its CLS guise – may not be the optimum choice for staff-controlled social enterprises because it denies capital growth to the parties that create value. Both forms of CIC are designed to be *re*distributive, not distributive, and this weakens the case for it where staff are responding to their own disadvantages or low pay. The CIC – like the pre-1997 IPS model deployed in ICOM worker co-operatives – may come to be seen as exploitative by shifting surpluses into indivisible capital reserves without adequately compensating entrepreneurial labour or making financial capital amenable to effective democratic control. Viable alternatives like the Spanish coops (Whyte and Whyte, 1991; Holmstrom, 1993), trade-union led ESOPs (Spear, 1999) or investor-led ESOPs (Erdal, 2008) merit active consideration.

The consumer co-operative model discovered in follow up research was unexpected, and offers a clear attraction. The surplus sharing arrangements reported in annual accounts stated that approximately 15% of profits were shared amongst employees, with dividends paid to members (i.e. the co-operative's customers) and an equal amount deposited in a social economy investment fund. This multi-stakeholder model is worthy of continued scrutiny as it offers a model for *generating* capital that can be invested in the social economy, whilst also attractive to workers and beneficiaries. Moreover, it appears to be an excellent model for competing with (or reforming) utility companies.

With regard to further research, there are three recommendations. Firstly, follow up studies with a larger sample, and which interview a wider range of staff, would be able to confirm whether the decision-making processes described here represent a reasonable reflection of practice elsewhere. Secondly, there appears to be a link between team-based decisions supported by experienced staff in a coaching (rather than managing) role and higher levels of staff participation and enterprise growth. This is worth a separate study, particularly in the light of a substantive literature outlining the arguments for team-based structures with supportive 'democratic' managers (Johnson, 2006). Social enterprises, because they are relatively free from external financial interests, may prove the place where these management practices find the most fertile ground.

Lastly, it is apparent that common ownership and employee ownership are fundamentally different – although they can be combined effectively to achieve a partial asset lock and strong performance through surplus sharing mechanisms. Each give rise to different internal dynamics so a further comparative study, on a larger scale, would be able to account in more detail for differences in social and economic performance.

Acknowledgements

I would like thank all the participants in this research who generously gave their time, as well as the reviewers to the Social Enterprise Journal for helpful feedback and comments.

Dr Rory Ridley-Duff is Senior Lecturer in Human Resource Management and Organisation Behaviour at Sheffield Hallam University. His professional background was gained as a director of worker co-operatives designing and delivering enterprise-level software system to Third Sector organisations. Following his book *Silent Revolution: Creating and Managing Social Enterprises* he won a Hallam PhD Studentship to study workplace democracy and governance in employee-owned organisations. This resulted in ground-breaking theory on gendering processes that affect enterprise governance and HRM processes. He has written a number of articles on social enterprise, including contributions to *Corporate Governance: An International Review* and the *International Journal of Entrepreneurial Behaviour and Research*.

---

[1] ICOM merged with Co-operatives UK in 2001.

[2] Companies outside the London area, or in retail or manufacturing would have been drawn into the sample.

References

Anon (2007) *Proceedings Report: Corporate Governance and Co-operatives,* Peer Review Workshop, London, 8th February.

Borzaga, C. & Defourny, J. (eds), *The Emergence of Social Enterprise,* London: Routledge.

Bradley, K. & Taylor, S. (1992) *Business Performance in the Retail Sector,* London: Clarendon.

Brown, J. (2006) "Designing Equity Finance for Social Enterprises", *Social Enterprise Journal* 2(1): 73-81.

Clutterbuck, D., Megginson, D (2005) *Making coaching work: Creating a coaching culture*, London, CIPD

Conyon, M. and Freeman, R. (2001) *Shared Modes of Compensation and Firm Performance: UK Evidence,* National Bureau of Economic Research, Working Paper No. 8448.

Cannell, B. (2004), personal communication, field visit 20th January 2004. Claims are supported by a transcript of an audio journal entry made on the day of the visit.

Cook, J., Deakin, S. & Hughes, A. (2002) "Mutuality and Corporate Governance: The Evolution of Building Societies Following Deregulation", *Journal of Corporate Law Studies,* July, 2(1): 110-138.

Cornforth, C. (1995), "Patterns of Cooperative Management", *Economic and Industrial Democracy*, 16: 504-509.

Cornforth, C. J., Thomas, A., Spear, R. G., Lewis, J. M. (1988) *Developing Successful Worker Co-ops*, London: Sage Publications.

EOA (2008) *Case Studies: Sunderland Home Case Associates,* http://www.employeeownership.co.uk/case-studies.htm, 27 September 2008.

Ellerman, D. (1990), *The Democratic Worker-Owned Firm – a New Model for the East and the West*, Boston, MA: Unwin Hyman.

Erdal, D. (2008) *Local Heroes: How Loch Fyne Oysters Embraced Employee Ownership and Business Success,* London: Viking.

Employee Share Ownership Centre (2000), *About ESOPs in the United Kingdom*, www.mhcc.co.uk/esop/esop/abesops.htm, accessed June 2000.

Gates, J. (1998) *The Ownership Solution,* London: Penguin.

Higgins, G. (2007) "Enterprising Solutions in Health & Social Care", *Good Company,* Issue 2, Summer 2007, pp. 6-7.

Howarth, M. (2007) *Worker Co-operatives and the phenomenon of empreas recuperada in Argentina: an analysis of their potential for replication*, Manchester: Cooperative College.

Holmstrom, M. (1993), *The Growth of the New Social Economy in Catalonia*, Berg Publishers.

ICA (2005) *World Declaration on Worker Cooperatives,* Approved by the ICA General Assembly in Cartagena, Columbia, 23rd September 2005. www.cooperatives-uk.coop/live/images/cme_resources/Public/governance/Worker%20co-op%20governance/**ICA**.pdf, accessed 27 September 2008.

ICOM (1987), *No Single Model: Participation and Organisational Democracy in Larger Co-ops*, Leeds: ICOM.

ICOM (1989), *Managing Change or Changing Management: Suma Case Study*, Leeds: ICOM.

Jensen, A. (2006) *Insolvency, Employee Rights and Employee Buyouts: A Strategy for Restructuring,* Alnmouth: Common Cause Foundation (Parliamentary Report).

Johnson, P. (2006) "Whence Democracy? A review and critique of the conceptual dimensions and implications of the Business Case for Organizational Democracy", *Organization*, 13(2): 245-274.

Lezamiz, M. (2003), personal communication, 6th March. Mikel Lezamiz provided his bank account record at the Caja Laborale (the Mondragon Bank) to a group of visiting academics and practitioners during a field visit. This supported his claim that most members at Mondragon accrue in excess of £100k in profit shares after working for 20 years. This is sufficient (at 2003 prices) to pay off any remaining mortgage and make a substantial provision for retirement.

Knell, J. (2008) *Share Value: How Employee Ownership is Changing the Face of Business,* London: All Party Parliamentary Group on Employee Ownership.

Major, G. (1996), "Solving the Under-Investment and Degeneration Problems of Worker's Co-ops", *Annals of Public and Co-operative Economics*, 67: 545-601.

Major, G. (1998), "The Need for NOVARS (Non-voting Value Added Sharing Renewable Shares)", *Journal of Co-operative Studies*, 31(2): 57-72.

Major, G. and Boby, G. (2000), *Equity Devaluation, the Rarity of Democratic Firms, and "Profit Shares"*, www.democraticbusiness.co.uk/vanekps.html, accessed June 2000.

Major, G. (2000), *Survey of UK Worker Co-ops and Majority Employee-Owned Firms*, www.democraticbusiness.co.uk/survey.htm, accessed June 2000.

Marx, K. (1984), *Capital III*, London: Lawrence & Wishart.

Michels, R. (1961) *Political Parties: a sociological study of the oligarchical tendencies of modern democracy*, New York: Free Press.

Morrison, R. (1991) *We Build The Road As We Travel,* Gabriola: New Society Publishers.

Oakeshott, R. (1990), *The Case for Workers Co-ops* (2nd Edition), Basingstoke: Macmillan.

Oakeshott, R. (2002) *Jobs and Fairness: The Logic and Experience of Employee Ownership*, Norwich: Michael Russell.

Paton, R. (1989) *Reluctant Entrepreneurs,* Open University Press

Paton, R. (2003) *Managing and Measuring Social Enterprises,* London: Sage Publications.

Ridley-Duff, R. J. (2002) *Silent Revolution: Creating and Managing Social Enterprises,* Barnsley: First Contact Software Ltd. http://www.scribd.com/doc/2885922

Ridley-Duff, R. J. (2005) *Communitarian Perspectives on Corporate Governance,* PhD Thesis, Sheffield Hallam University, http://www.scribd.com/doc/3271344

Ridley-Duff, R. J. (2007) “Communitarian Perspectives on Social Enterprise”, *Corporate Governance: An International Review,* 15(2): 382-392.

Rodrick, S. S. (2005) *Leveraged ESOPs and Employee Buyouts (Fifth Edition),* Oakland, CA: The National Center for Employee Ownership.

Rothschild, J. & Allen-Whitt, J. (1986), *The Co-operative Workplace*, Cambridge: Cambridge University Press.

Spear, R. (1999) “Employee-Owned UK Bus Companies”, *Economic and Industrial Democracy,* 20: 253-268.

Spear, R. (2001) "United Kingdom: A Wide Range of Social Enterprises", in Borzaga, C. and Defourny, J. (eds), *The Emergence of Social Enterprise,* London: Routledge, pp. 252-269.

Sternberg, E. (1998) “The Defects of Stakeholder Theory”, *Corporate Governance: An International Review*, 5(1): 3-10.

Turnbull, S. (1995) “Innovations in Corporate Governance: The Mondragon Experience”, *Corporate Governance: An International Review*, 3(3): 167-180.

Turnbull, S. (2001) “The Science of Corporate Governance”, *Corporate Governance,* 10(4): 261-277.

Vinten, G. (2001) “Shareholder versus Stakeholder – is there a governance dilemma?”, *Corporate Governance: An International Review*, 9(1): 36-47.

Warburton, J. (2000), “Change Management”, presentation to Leap Conference, Feb 2000, Leeds University.

Webb, S & Webb, B (1914) *The Cooperative Movement,* publisher unknown.

Webb, S. & Webb. B. (1921) *The Consumer’s Cooperative Movement,* publisher unknown.

Woodin, T. (2007) *A Good Way to Do Business: Support Social Enterprises in Greater Manchester,* Manchester: The Cooperative College.

Whyte, W. F., Whyte, K. K. (1991) *Making Mondragon*, New York: ILR Press/Itchaca.