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Journal Item

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Abstract: The article analyses governance difficulties at Fagor Electrodomésticos, for decades the world's largest industrial cooperative, and sheds light on how the cooperative model and governance might have contributed to the firm's bankruptcy. The case study examines how the cooperative model influenced the speed and quality of decision making. The roles of the main cooperative governing bodies (the General Assembly, Governing Council and Social Council) are evaluated and their limitations to effectively supervise and work with management to make difficult strategic decisions. Several governance improvement measures are proposed in order to help other large cooperatives combine democratic control and economically sound governance.

Keywords: Organisational failure; Cooperative degeneration; Cooperatives; Mondragon; governance

Introduction

For the conventional capitalist firms, the academic theoretical and empirical literature on the study of the governance bodies is prolific. For example, there are many well-known theoretical handbooks on this topic (e.g. Clarke, 2004; Solomon, 2007), together with widely referenced empirical works (e.g. Daily and Dalton, 1994; Heath and Norman, 2004).

Conversely, the governance of co-operatives, and in particular of worker cooperatives, is relatively under researched in the scholarly field, with a scarcity of both theoretical and empirical works. There are a set of works which have analyzed more or less tangentially this issue (e.g. Cornforth et al., 1988; Pencavel, 2013; Storey et al., 2014), but with few exceptions (e.g. Cornforth, 1995; Bakaikoa et al., 2004), these works either have not been focused on this topic as a key factor or have not adopted an empirical approach. Nevertheless, in recent years there has been a growing academic interest in the governance of cooperatives, and studies on the failure of large cooperatives, such as Canadian agricultural cooperatives (Fulton and Hueth, 2009; Fulton and Larson, 2009a, 2009b) and the near melt down of the UK Co-operative Group (Birchall, 2014a; Davis 2014; Myners 2014), have highlighted corporate governance difficulties as a key source for failure.

In recent years, the bankruptcy of Mondragon's flagship Fagor Electrodomésticos S. Coop.[1] (FED) has attracted scholarly attention (e.g. Alzola et. al. 2015; Errasti et al., 2017; Arando and Bengoa, 2018; Bretos et al., 2018; Basterretxea et al., 2019). Yet, these studies have focused predominantly on external factors, largely ignoring how those responsible for governance of the cooperative attempted to deal with these problems. While not denying the importance of external factors, this paper tries to increase our understanding of the potential challenges of the worker cooperative model, shedding light on how FED's cooperative model and governance contributed to the firm's bankruptcy. Special emphasis is placed on analysing how the cooperative model influenced the speed of decision making and the adoption of painful decisions. The paper also evaluates the role of the main cooperative governing bodies (the General Assembly, Governing Council and Social Council) and their limitations to make key strategic decisions and effectively supervise and work with management. Several governance improvement measures are proposed.

The article is structured as follows. The next section sets out the context of the case study and reviews the relevant literature. The third section discusses the research methods used. The fourth section summarizes the main findings of the study. The final section presents a discussion of the findings and the conclusions of the article.

Case study's context and literature review

In 2013 the world's biggest industrial worker owned cooperative, and Europe's fifth-largest maker of household appliances, FED, collapsed. The demise of FED gained international media attention not only in those countries where its factories where located (Spain, France, Poland, Morocco and China), but also in the world's leading economic journals. This media attention was due to FED's size and to its symbolic role as a model and launching platform for many other co-operatives that now make up the Mondragon Group. "This group comprises close to 264 firms, 98 of them co-operatives and has 81,837 employees and a total revenue of 11,936 million euro (Mondragon, 2019). The largest Mondragon cooperative is the retailer Eroski, with 30,903 employees in 2018, one third of them worker members. A large network of industrial firms producing goods in different sectors employed 38,772 people in 2018, 14,455 of them in non-cooperative subsidiaries. Mondragon's

[1] There are several Mondragon cooperatives that share the "Fagor" name and brand that are still trading successfully, such as Fagor Arrasate, Fagor Automation, Fagor Ederlan, Fagor Electrónica and Fagor Industrial. We use FED only to refer to Fagor Electrodomésticos S. Coop.

industrial and service firms gravitate around what Roche et al. (2018) define as “core elements”. This core is comprised of an Education network (Mondragon University and several vocational training and management training centres); 15 research centres; Lagun Aro, the Social Security entity, and Laboral Kutxa, the bank of the corporation. Mondragon differs from other corporations since power, authority and ownership is decentralized in a “federal” or “inverted pyramid” organisational structure. A consequence of this is that “any co-op that does not find that the Mondragon corporate offices are adding value to their operations may secede at any time” (Smith 2001, p. 28), as was the case with Irizar and Ampo in 2008. This “inverted pyramid” structure of autonomous cooperatives that cooperate voluntarily has also been argued by Mondragon managers to elude group responsibilities in the trials that followed the bankruptcy of FED.

During previous recessions Mondragon cooperatives had better relative performance compared to ordinary firms (Arando et al., 2015; Basterretxea and Albizu, 2010; Bradley and Gelb, 1987; Morris, 1992) and a low failure rate (Arando et al., 2015; Ellerman, 1984; Smith, 2001). Thus, the failure of FED came as a shock. Five years later, many post-closure lessons seem to have been learnt in the group, with evidence of its inner strength and resilience. It is worth mentioning, for example, the key role of Mondragon’s mechanisms of inter-cooperation which have helped to strongly mitigate the effects of the employment crisis generated by the collapse of FED (Arando et al., 2018).

Business failure literature and FED

Business failure literature presents two conflicting views on the cause of closure: the deterministic and voluntaristic perspectives (Mellahi and Wilkinson, 2004; Amankwah-Amoah, 2016). The deterministic perspective attributes business closure to environmental factors over which management has limited control. The voluntaristic perspective attributes business closure to factors arising from within the firm. Failure is caused by management decisions and lack of competency to reverse the decline caused by external factors (McGovern, 2007).

To a great extent, the deterministic perspective has guided many of the analyses of academics trying to explain FED’s demise (Alzola et al. 2015; Errasti et al. 2016; Arando and Bengoa, 2018). Those researchers, together with many voices in business-related media, resorted to defend the cooperative model based on a simple analogy: in the same way that many corporations went bankrupt with the economic crisis and the capitalist business model was not called into question; the bankruptcy of a cooperative, however emblematic, should not call into question the viability of the cooperative model. FED did not go bankrupt either because of its cooperative model or because of poor

management, but because of an exceptional fall in its main markets. In other words, due to purely external factors. Environmental factors most commonly mentioned are Spain's property bust and subsequent fall in the sale of appliances; new low-cost competition from China and Turkey and the entrance of aggressive Korean competitors in the mid-range market.

This complacent view contrasts with a critical analysis conducted internally by the Mondragon corporation (Ortega and Uriarte, 2015) more in line with the voluntaristic school. This internal analysis points towards many cooperative model and cooperative governance failures, mismanagement and internal communication problems. Similarly, the bankruptcy administrator, considers not only environmental factors as the cause of failure, but also internal ones such as "not following the same path as competitors by moving production to low cost countries, thus being unable to adapt prices to market needs, something that generated a reduction of sales and generated losses" or the "high debt leverage motivated mainly by the acquisition of the French firm Brandt and by the negative results of the main subsidiaries that asked for new investments" (Insolvency Administrator, 2014). Responsibility for these decisions lies with managers and governance bodies responsible of overseeing management. For example, buying Brandt through massive borrowing was proposed by managers, but then approved by 82% of members in the General Assembly. Not following the same rate of delocalization of production was also a decision conditioned by the governance bodies.

Literature on corporate governance in co-operatives

In this paper we define organisational governance as the 'systems and processes concerned with ensuring the overall direction, control and accountability of an organization' (Cornforth, 2004, 2012). At the organisational level the body with the main responsibility for ensuring governance functions are carried out is the organisation's board or governing body. However, it is important to remember that other actors may contribute to carrying out governance functions, such as shareholders or members at annual general meetings, board sub-committees and any advisory groups, and senior managers.

A variety of competing theories have been proposed to try to understand the role of boards in the private sector (Hung, 1998). The two most dominant theories are agency theory (Jensen and Meckling, 1976; Keasey et al, 1997), and stewardship theory (Muth and Donaldson, 1998). Agency

theory assumes that the owners of an enterprise (the principal) and those that manage it (the agent) will have different interests. Hence the owners or shareholders of any enterprise face a problem that managers are likely to act in their own interests rather than the shareholders. From this perspective the main function of the board is to oversee management, to ensure they act in the shareholders best interests. Consequently, board members should have the knowledge, skills and experience to monitor and, if necessary, control the behaviour of management. In contrast stewardship theory starts from opposite assumptions to agency theory. It assumes that managers want to do a good job and will act as effective stewards of an organisation's resources. Hence, the main function of the board is not to ensure managerial compliance with shareholders/members interests, but to support and work with management to improve organisational performance. From this perspective board members should have background and expertise to support top management and add value to the organisation's decision-making.

However, taken individually these different theoretical perspectives are rather one dimensional, only illuminating a particular aspect of the board's role. This has led to calls among corporate governance researchers for approaches that can help integrate the insights of these different perspectives (Hung, 1998: 108-9; Tricker, 2000: 295; Cornforth, 2004). One such approach is offered by Sundaramurthy and Lewis (2003) in a theoretical paper that draws on both agency and stewardship theories to suggest the role of the board is paradoxical, that boards must both control and support management. Their approach highlights important dysfunctions that can occur in the relationship between boards and management. They argue that organisations may experience a cycle of decline if boards put too much emphasis on either control or support roles. Too much stress on support can lead to groupthink where management ideas and strategies are not adequately scrutinised and challenged. This can lead to strategic persistence in good times and a cycle of organisational decline as performance deteriorates. Conversely, too much emphasis on control can lead to a separation of responsibilities between the board and management, and defensive attitudes where management feel unfairly criticised. If this persists increasing levels of distrust may reinforce defensive attitudes hampering communication and mutual learning, which can again lead to a cycle of organisational decline.

Tensions and challenges in co-operative governance

As well as the dysfunctions highlighted above co-operatives may face other tensions and challenges resulting from their particular form of governance. A key principle of co-operatives is that they should be governed democratically by their members based on the principle of one member one vote

(Cornforth, 2004; Novkovic, 2008). Importantly, any member can put himself or herself forward for election as a board member. Expertise may be desirable but is not a central requirement, as is suggested by other perspectives on governance discussed above. As a result, boards may lack the skills and experience to effectively oversee management and contribute to decision-making.

There are other important differences between co-operatives and public companies which are likely to make it more difficult for co-operative members to exert control over management (Spear, 2004), or support senior management and add value to their proposals. In agency theory it is assumed that the main interest of shareholders is to maximise profitability and that the market in corporate control, such as pressure from major shareholders or the threat of takeover, as well as board monitoring, will help to keep managers aligned to this goal. In co-operatives members, as owners, are the principles, but in co-operatives' shares are not traded in a market and members only have one vote irrespective of the number of shares they hold. Hence there are not the same pressures on managers to perform, such as pressure from major shareholders or the threat of takeover (O'Sullivan and Diacon, 2003).

In co-operatives the members collectively have overall control of the organisation. Small co-operatives often practice direct democracy with the general meeting of members taking important decisions, but as co-operatives grow this is usually not practical. A variety of studies suggest that participation rates of members tend to decline as co-operatives age and grow (Chaves et al, 2008; IFA, 2006; Spear, 2004; Lees and Volkers, 1996) and that general meetings are not an effective arena for members to influence decision-making, with deliberations usually limited to approving the annual accounts and reports (Mozas, 2004: Chaves et al, 2008).

This suggests that for larger co-operatives representative democracy in the form of an elected board is the most important means that members have of trying to either control managerial behaviour or improve management decisions, but at as noted above these boards may lack the expertise and skills to exercise effective influence (Chaves et al. 2008; IFA, 2006, Lees and Volkers, 1996). This problem is highlighted by Sivertsen (1996: 35) a senior manager in a Norwegian consumer co-operative:

> 'Co-ops tend to be management driven. Whereas board members in major private companies are elected within the business environment, board members in co-ops are elected among what we would call everyday people. Very often solid, earnest people with good judgement, but without the necessary background to make strategic decisions in the business world.'

More recently several studies of credit, consumer and agricultural co-operatives that have experienced crises or failure have pointed to weak governance by boards lacking the necessary skills and experience to adequately scrutinise management proposals (Fulton and Larson, 2009a and b; Birchall, 2014a; Myners, 2014).

In worker co-operatives differences in expertise may be less of a problem than other forms of co-operative as the members work in the co-operative. However, as worker co-operatives grow and employ professional managers it is likely that the gap in expertise between workers and management will grow. Batataille-Chedotel and Huntzinger (2004) in a study of French worker co-operatives suggest that once co-operatives grow to have more than 250 members boards do not have the competency to make strategic decisions. Previous studies on FED indicate that governance problems derived from co-operative members low business literacy and inability to understand financial information have been present in previous decades. Greenwood and González et al. (1989) found that FED co-operators felt that they were inundated with accounting data, business plans, technical and production information; information that co-operators were not able to understand. At the same time, many cooperative members also believed that key information was being kept from them. (Greenwood and González et al. 1989, 145-149). Similarly, Whyte and Whyte (1988, p. 227) wondered whether the members of FED were suffering from information overload and "given a larger and more complex volume of information than most are able to absorb". A decade later, Kasmir (1996) also found that many cooperative members of FED were frustrated and complained that they were unable to understand and make effective use of the information they received. "*All members of the cooperative are given a great deal of information, which they simply cannot get through. Social Council members who make the effort to synthesize the material, often find they need help interpreting information*" (Kasmir, 1996, 138).

The incorporation of independent members onto cooperatives' governing bodies has the potential to bring relevant expertise and different external perspectives to strengthen the organisations' decision making (Johanson and Østergren, 2010). A study of the governance of 60 large cooperatives in six different industries conducted by Birchall (2014b) found that around half of the 60 boards had appointed independent board members and he expected more cooperatives to follow. However, this was not the case at FED.

In addition, the boards of co-operatives may experience other problems besides a lack of skills. Low participation rates by members in elections may mean boards are not representative of the wider membership (Spear, 2004; Chaves et al, 2008). This problem can be exacerbated in worker co-

operatives if they employee non-worker members. Further challenges can arise when board members feel they are on the board to represent and defend the interests of particular groups of workers or members rather than work with management to further the best interests of the co-operative as a whole (Cornforth, 2004).

FED and its main governance bodies

Created in 1956 by five ex-students from a technical college in Mondragon to produce heating devices, FED soon expanded its production to other home appliances. Besides being economically successful, this worker cooperative helped in the creation of many new cooperatives in the 1960s and 1970s that nowadays are part of the Mondragon Group. After three decades of internal growth, in 1989 FED began a process of external acquisition with the takeover of Fabrelec-Edesa, a Spanish competitor in crisis with 790 employees. While employees of this firm were offered the possibility of becoming cooperative members, this option was not given to workers of foreign firms acquired afterwards (Errasti et al. 2016).

In 1994 FED opened a factory in Morocco. In 1996 it created a joint venture, Geyser-Gastech, with the German firm Vaillant. Then, in 1999 it bought 76% of the Polish white goods company Wrozamet (then FED-Mastercook), with 1,760 employees. In 2001 it created a joint venture in China (Shangai Minidomesticos Cookware Co Ltd) to produce pressure cookers. In 2005 it bought a kitchen furniture manufacturer, Grumal, with 400 employees. Finally, in 2005, FED made its biggest acquisition, Brandt Electroménager, the French leader in household appliances, with 4,700 employees.

This process of non-cooperative growth abroad converted FED into what Errasti et al. (2016) call a "coopitalist multinational" with 18 production plants in six countries, a workforce of 10,543 employees at the peak of its growth in 2006 and a complex structure as can be seen in Figure 1.

(Insert Figure 1 about here)

A quick glance at the structure highlights the complexity of decisions that rank and file members in the General Assembly and those serving in the Governing Council had to face. Besides its many production units in Spain and abroad, FED had nineteen subsidiary commercial firms in different countries; seven firms devoted to provide after sales and customer services; several firms to provide

internal services such as R&D and a portfolio of twelve different brands aimed at reaching different countries and market niches.

FED financed its internal and external growth strategies through borrowing, and when the financial crisis broke in 2008 and the market for home appliances in its main markets collapsed the company entered a sharp decline that finished with bankruptcy proceedings in November 2013, (Molina, 2012; Errasti et al, 2016).

The main governing bodies of the cooperative were the General Assembly of all members, and the elected Governing Council and Social Council. The General Assembly is the supreme body in the cooperative. Each cooperative member has one vote in the Assembly, regardless his/her position in the firm and regardless his/her investment. Formally it votes on the annual business plan, allocates profits, decides on mergers and acquisitions, votes on the admission of new members and the expulsion of any members, elects the Governing Council and monitors its performance (Kasmir, 1996, 36). In the case of FED, given its particular corporate culture, the General Assembly also decided on many other minor issues, as the results section shows.

The Governing Council in FED was made up of 12 members elected by the General Assembly for four years. The Governing Council appoints and oversees senior managers, prepares annual plans, determines job classifications, presents annual reports and accounts to the General Assembly and proposes the distribution of profits for the approval of the General Assembly (Kasmir, 1996: 36).

The Social Council, whose members are elected by the General Assembly, brings grievances to management on behalf of workers (such as concerning health and safety, job ratings, work pace, job assignments, recruitment and promotion criteria; pay policy, work schedules, relocations or pay policy). Besides, the Social Council communicates managerial decisions and conveys information downward (Kasmir, 1996: 37). Social Council members are elected from the different factories, departments or sections where they work. While other big Mondragon cooperatives have maintained a low number of members in their Social Councils (between 12 and 16), internal bylaws of FED established a minimum of 40 and a maximum of 60 members. Besides being large, as will be shown, the power of the Social Council at FED went far beyond its formal remit.

Methods

Due to the complex and interwoven characteristics of this study topic we adopted an exploratory qualitative methodology (e.g. Glesne, 2006). This aimed to contextualize and interpret the case following an abductive reasoning perspective, with an interactive engagement between empirical material and theory (Dew, 2007; Sinkovics and Alfoldi, 2012). The research drew on three main sources of information. First, public information available on the collapse of FED, such as journalistic reports, public corporate reports and information from the judicial process into the collapse of the company. Secondly, there was access to relevant internal reports from the cooperative and the corporation. Thirdly, a series of in-depth interviews were carried out with different stakeholders involved in the collapse of FED.

We conducted 30 interviews between October 2015 and December 2018, with a cross section of people involved with the cooperative in a variety of roles, that aimed to improve the reliability and richness of the information gathered (Miles et al., 2014) and cover the diverse interests at play (Glesne, 2006). A total of three interviewers, two of the co-authors of this article plus a research assistant, contributed to the data collection using a semi-structured script, which was further modified as the fieldwork progressed (Denzin and Lincoln, 2008). The script followed certain pre-determined general themes related to the case but allowed space for free-flowing discussions. Interviewees were identified using a combination of theoretical, purposive and snowball sampling (Patton, 2002). All in all, 15 senior executives (3 of them also representatives of the Governing Council and 2 of them also members of the Social Council for different periods of time); 6 rank and file worker owners, including 3 leading representatives of the Social Council for the last 25 years of the firm; a senior union official who defended non-owner employees during the bankruptcy process; 4 senior managers in the Mondragon central offices; and 4 senior Basque Government officials responsible for industrial policy. Most of the managers and rank and file employees interviewed worked for FED for at least 20 years. Similarly, the external stakeholders were also very closely linked to FED and Mondragon for long periods of time. It was decided to stop soliciting new interviews when few new contributions and insights were being obtained, giving rise to theoretical saturation (Miles et al., 2014).

In order to mitigate organisational silence (Morrison and Milliken, 2000) and potential social desirability bias (Nederhof, 1985), we asked interviewees for their personal insights, assuring them of anonymity. The interviews were carried out in Spanish and Basque — the later was used in order to attain closer proximity between the interviewer and interviewee, as suggested in Heras-Saizarbitoria *et al.,* (2013). The interviews varied in length from 90 to 170 minutes and were

recorded and transcribed verbatim. Before the fieldwork the interviewers discussed possible methodological distortions and biases related to interviewing people about a traumatic personal experience, for example using the interview to primarily 'tell his/her story' as a form of catharsis (Heras-Saizarbitoria, 2014), A distortion mentioned by Greenwood and González. (1989) in their study of FED. In general, with a few exceptions, the interviewers did not find that this was a significant problem.

Public information available on the collapse of FED was also analysed, including journalistic accounts, the different strategic plans of the company and discussion documents, and conclusions of the insolvency administrator. In addition, very extensive internal corporate data related to FED over extended periods of time were gathered. This included specific reports to address the crisis, internal working documents presented to various governing bodies and strategic plans and annual management plans for different periods.

The information from these three sources was triangulated and analyzed as suggested in the literature (e.g. Creswell 2003; Miles et al, 2014). Data was analyzed through constant comparison and interpretation (Silverman, 2006). As a result of the iterative process of interpretation, discussion and explanation (Glesne, 2006; Silverman, 2006) carried out by the three researchers, the following two main problems of governance at FED were evidenced: the delay and challenges in making difficult decisions; the lack of expertise of the governing bodies. These two issues are analyzed in depth in the following section of the article.

Results

While this paper focuses on governance issues, other relevant factors affecting FED's demise were raised in our interviews. Environmental factors, such as the burst of Spanish property bubble and the consequent drop in sales of household appliances, the increased bargaining power of big retailers, the growing market share of new entrants from Korea, China and Turkey with cheaper products and better quality-price ratios, or the increased competitive rivalry of big players such as Bosch and Siemens. Those factors, in particular the burst of the property bubble, have been analysed in previous papers on FED's failure (Alzola et al. 2015; Errasti et al. 2016; Arando and Bengoa, 2018), but despite the gravity of these external factors, most interviewees highlighted that the roots of FED's problems were already present at least a decade before the 2008 crisis.

Even before the bursting of the property bubble, in those years of extraordinary growth, interviewees noted that FED was losing market share (from 24.7% of the Spanish market in 2000 to 18.4% in 2007), obtained very low profit margins, lost huge amounts of money in some of its business units and uncompetitive domestic plants (e.g. the unit producing fridges had lost money for many years and lost 14.5 million euro only in 2004). The firm also faced important quality problems before the crisis, which it found difficult to fix (e.g. after launching its Innova fridge in 2003, 30% of its units sold in the following three years were returned by its customers due to quality problems). Interviewees also highlighted long lasting human resource problems that became chronic, such as high absenteeism, nepotistic recruitment and selection practices and the low commitment of members (see Basterretxea et al., 2019).

Above all, interviewees blamed poor decisions about relevant investments made between the mid-1990s and 2007 as the main root of the firm's death. In this period FED invested heavily in renewing its Basque factories and buying the French competitor Brandt. As a consequence, in 2012 FED concentrated only 32% of its production in low labour cost regions, compared to 50% at Bosch, 55% at Whirpoool, 62% at Electrolux, 70% at LG and Samsung or 100% at Arcelik-Beko, Haier and Vestel. In addition, FED's investments in Spain, Poland and France were financed by borrowing, creating huge financial problems when demand began to fall. Behind those decisions (and also behind the decisions that were postponed or never made) interviewees highlighted the central role of the governing bodies.

Delay in making decisions

The interviewees pointed out that the characteristic cooperative consultative process entailed slow and often difficult decision-making, a slowness that became more pronounced as FED grew in size and complexity

> *"Very slow, everything was very slow. The cooperative model is already slow, because it requires democratic decision-making. To the extent that every type of decision has to go through different groups, different meetings, today you present it, next week you adjust it again, the following week you wait for an opinion from the Social Council, then another opinion, then it ends in a General Assembly..."*. (FED manager, GC and SC member)

What was seen as more problematic than the delay in decision-making was that some decisions were never made. Although the management and the worker members of FED were aware that some business units were running at a loss for more than a decade, the cooperative's governing bodies did not discuss the closure of unprofitable plants in Mondragon, since managers presumed the cooperative members would not vote in favour of closing the plants where they were working.

> *"Everybody talked about closing refrigerators, but they never actually considered closing it, because it provided almost 700 jobs that would be lost in Mondragon... They would have stopped being members of FED. That vote never came about, and if it had, it would never have succeeded."* (FED Manager. Member of the SC)

> *"The refrigerator business lost 11 million a year on its own. We should have made decisions such as closing it 10 years before; closing what was unprofitable, closing it definitively. But here, at the time when we should have closed them (10 years ago), we had 600 cooperative members just in the refrigerator plant. It's a bit difficult to make people understand that a business is dying and that it is best to just kill it.* (…) *The management was sure we had to go there, they knew what needed to be done, but things were very slow."* (FED Manager. Member of GC and SC)

Not only the executives interviewed, but also the members of the Social Council recognized their responsibility in not making difficult decisions.

> *"In the Social Council we knew that refrigerators was in a bad way for a very long time. Refrigerators was bringing us down significantly and Fagor Mueble was a total disaster. The Governing Council informed the Social Council that refrigerators was bringing us down. And in the social part, from the left, (we were) great defenders of the jobs above everything else. …We put pressure on the Governing Council and that is a despicable way to win, because we said: we are going to defend the jobs in the General Assembly and we knew that we would win that vote.... And there, in the social part we were all wrong. It's a huge part of our guilt."*. (Social Council Member)

Other hard decisions were also taken too slowly, in the eyes of the interviewees. The employment policy of FED and other Mondragon cooperatives in times of crisis is characterized by flexibility in work schedules, salaries and job duties, as well as the relocation of members from cooperatives in crisis to those in need of manpower. The Insolvency Administrator's report (2014) notes that these

measures to reduce costs to adapt to the market "were never placed at the forefront, but rather, they always dragged behind the negative events."

These problems were exacerbated by traumatic changes in the company's top management. In 2006, the CEO proposed the first measures for wage reductions and unpaid overtime, but these were not accepted by the General Assembly, who also dismissed the CEO. This dismissal and the subsequent mass resignation of the entire Governing Council generated a reverse dominance hierarchy in which hard decisions were slowed down in order to preserve social peace (Basterretxea et al. 2019). Thus, some interviewees believe 2006-2010 was a lost period:

> *"From 2005 to 2010 we lost precious time. I think it was a time when we should have done things differently. And I don't know if we would have managed to save the company, but at least we would have generated a different culture from the one we started from when we began the relocations, (a culture of opposition to relocations and adjustments)".* (FED Manager)

Governing bodies not qualified for the size and complexity of the business

General Assembly

The members of FED are eligible to take part in the co-operative's General Assembly on the principle of one member, one vote. Interviewees highlight that attendance at assemblies in the 1990s and 2000s was generally low and only increased when salaries or austerity measures to address the crisis were discussed. Low participation rates were considered by some interviewees as a worrying indicator of members' commitment, apathy, and lack of co-responsibility.

> *"People do not feel they are members, they do not assume that they are members, but they talk about democracy. No. Participatory democracy is also a matter of co-responsibility, and that co-responsibility is not felt. If it was not a salary issue, or a strong issue, people did not go to the General Assembly. So, where is the democratic participation and where is this question of co-responsibility? I don't accept it."* (Social Council Member)

FED's Corporate Governance Reports prior to 2007 do not show the participation rates of members in the General Assembly, but figures from 2007 and 2008 in table 1 offer numerical evidence of very low attendance rates. Some rank and file interviewees said that many members signed at the entrance

to the General Assembly but immediately left without attending the debates and voting. Those behaviours are in line with the findings of Arregi et al. (2018) in another Mondragon cooperative (ULMA Archiuitectural Solutions), who found that workers had a moderately negative opinion of adherence to cooperative ownership practices.

Table. 1. Evolution of participation of members in General Assemblies of FED

	15/5/2007	13/5/2008	4/11/2008	13/5/2009	25/11/2009	11/5/2010	10/5/2011	15/5/2012	27/11/2012
Working members voting in the General Assembly*	1,029	671	2,411	2,001	1,981	1,501	1,201	1,239	1,599
Cooperative working members**	3,082	2,718	2,718	2,474	2,474	2,325	2,219	2,067	2,067
Participation rate	33.4%	24.7%	88.7%	80.9%	80.1%	64.6%	54.1%	59.9%	77.4%

*Figures obtained from Corporate Governance Reports 2007-2012

**Figures obtained from Annual Reports 2007-2012

Participation increased significantly after the Extraordinary General Assembly of November 4th 2008, when members had to vote on whether to renounce their Christmas bonus. Given the parlous state of the company, participation rates in subsequent General Assemblies remained high as members were asked to vote additional wage cuts and other austerity measures.

Many of the austerity measures proposed by managers were voted down in the General Assemblies of FED's final 10 years or approved with very small majorities. In the 2006 Assembly the proposal to reduce the Christmas bonus by one quarter was rejected by members. Two years later, angry exchanges between workers and managers over salary cuts again took place in the General Assembly, and in 2008 the cut in the Christmas bonus was finally accepted by a small margin (1,262 votes in favour and 1,149 against).

The debates on these austerity measures, both in the General Assembly and in the previous preparatory meetings were considered by interviewees to be conflictual and painful, with continuous "boos, whistles and tantrums" when managers spoke, and applause when worker members criticized managers.

> *"The 2006 Assembly was a complete disaster. Constant booing, a disaster. A lot of anger. …. A huge brawl. The General Director resigned, he resigned in the next Governing Council. …. Then we had another Assembly, after the closure [of FED], in February, in the Amaia Theatre, in which an assistant got up to hit the president, and that was very hard."* (FED Manager and Member of the GC)

Besides conflict, interviewees highlighted that most members in the General Assembly didn't have the knowledge and skills needed to vote on many strategic decisions of a big multinational like FED. Although the cooperative did have representative bodies a culture had grown up where anything major also went to the General Assembly. Size was often stressed, and many interviewees consider that direct democracy in General Assemblies is not well suited to big multinational cooperatives, suggesting the need for representative democracy:

> *"A cooperative of the size we have had, where we have had more than 3,000 members, is ungovernable, it's a mistake. It is difficult for me to renounce the principle of one member one vote, but I'm more and more convinced. I will have to learn to delegate my vote to those qualified people who can be in a small assembly in which decisions can be made. And if after 4 years, those people have not convinced me, I will change them. …. That's my opinion after this."* (FED Manager and Member of GC and SC)

Some interviewees believe that the slow decision-making and a large part of the conflicts were due to the fact that many decisions in FED were made by the General Assembly, and they proposed that in larger cooperatives decisions should be concentrated in the Governing Council.

> "*In other big Mondragon cooperatives as Eroski the Governing Council is more likely to make decisions compared to the Governing Council of the Fagor Group. For example, the amount of our salaries or wages was decided at the assembly. Do you have to decide not to receive [your salary] at an assembly? (...) Now the Governing Council (of other nearby cooperatives) is given greater power for cases such as that of having to carry out harsh measures.*" (FED Manager and member of the General Council).

It is significant that even those people who had been on the Social Council for long periods and who in the past criticized the Governing Council when it made decisions without consulting the General Assembly, now advocate giving more power to the Governing Council:

> *"Can a company operate by taking everything to the assembly? It's not possible. Especially when you have to make economic decisions, present real management plans, people have to know the facts. I believe that some decisions should be left in the hands of the Governing Council."* (Social Council member).

Governing Council

In theory, any cooperative member can put himself or herself forward for election as a board member. In practice, as in most Mondragon cooperatives, half of the members were elected among the candidates proposed by the Governing Council itself, and the other half among candidates proposed by the Social Council. According to interviewees, the profile of candidates proposed by the Governing Council were mainly technicians and middle managers. The Social Council proposed both rank and file members and technicians and middle line managers with a 'fighter profile' against management. According to many interviewees, board members sponsored by the Social Council failed to understand their governance role and went to the board meetings wearing their Social Council hat, with a behaviour closer to that of a union representative than to that of a board member.

The greatest deficiency mentioned by all interviewees is that the electoral system produced a majority of board members that lacked relevant skills to carry out effective supervision of managers and make decisions. This was not only a problem of rank-and file cooperators on the Governing Council, but also of middle ranking technicians. Many of our interviewees served as members of the Governing Council, and they acknowledge that despite their university degrees and experience, they were ill prepared to fulfil their role. All interviewees, including some former members of FED's Governing Council, admit the inability of the majority of members to understand the complex business issues presented to them and therefore to question the quality, robustness or completeness of the information and the strategies that managers proposed.

> *"The training and knowledge of the members of the Governing Council were not sufficient to monitor the management team and make decisions... No, no.* (FED Manager and Member of GC and SC)

> *"Did the members of the Governing Council have the skills to make the decisions they were making, to control the managers? No. I don't think so. I don't think so.*" (FED Manager)

> *"Until 2010, perhaps four or five of the 12 members of the Governing Council had the knowledge to question the executive's approach and to make demands, but the rest was a type of member who was not managing these issues on a day-to-day basis and who were distanced from these issues. So they cannot make demands (on the management), or debate and say yes (to management's proposals). I think there has to be a debate in the Governing Council."* (FED Manager)

Besides their monitoring role, and in line with the assumptions of the stewardship theory (Muth and Donaldson, 1998), some managers thought that the Governing Council should help managers to improve strategy and add value to top decisions. Those managers felt that FED should have selected some independent board members based on their professional expertise, as most corporate governance regulations and codes propose. Spanish and Basque laws allow the appointment of up to three independent board members, but FED, as most Mondragon cooperatives, relied only in its worker members.

> *"I missed a much more professionalised Governing Council. I missed having even one (independent) member with voice but not vote, but who could guide management.* (FED Manager)

A similar electoral system – often with poorly prepared candidates- was used to choose the members of many other committees that made important decisions, such as the Appointments and Remuneration Committee, Health and Safety Committee, and Job Evaluation Committee.

Many interviewees highlight that given the inability of board members to monitor managers and address important strategic and economic issues, those issues were often squeezed off the board's agenda and unimportant issues were given priority. A similar difficulty to differentiate between the domains of the shop floor and higher levels of management occurred in many General Assemblies, where many important multi-million euro investment decisions were often made without much discussion and debate, while economically trivial and irrelevant issues could provoke lengthy and self-destructive debates. Both in the General Assembly and in the Governing Council, many members exerted social control over managers on unimportant and trivial matters that should have been discussed in other forums or not discussed at all.

> *"When a member of the Governing Council asked me about parking, or other minor issues, trivial stuff, or about things that should be discussed in the Social Council …, that tells me the level of the Governing Council."* (FED Manager)

> *"The Governing Council is less qualified than a board of directors in a large PLC to enter into a true control of management. And it exercises a type of social control and debates that are unprofessional and that take up more time than in a conventional private company. (...)And that same Governing Council may be ignoring more important decisions that are not evaluated and controlled."* (Senior Basque Government Official)

When members of the Governing Council didn't understand the information and the robustness of the strategies management proposed to them, they simply trusted and rubber-stamped management's proposals and plans without being really convinced, and without engaging in critical and sound dialogue. Afterwards, if management proposals turned out to fail and provoked poor economic results, the Governing Council would fire the manager.

> *"Do I have enough knowledge to discern if we should buy a company like Brandt? Whether it is a good strategy or not? What ability do I have to make such a decision? I am more involved in other operational issues of the company, so when I am elected to the Governing Council and the CEO sells me the internationalisation strategy and the convenience (of buying Brandt), I trust him, because this (system) is based on trust."* (Member of the GC).

> *"The qualification of the Governing Council is a problem in cooperatives that are starting to become large and starting to internationalise, like FED. There is always an approach by the Governing Council of "I'll let you do it, I don't understand it, but hey, if you (management) say so, let's go with it. However, if it doesn't go well, I'm going to ask for your head", and that's the only relationship at the end that the Governing Council has with the management team."* (Senior Basque Government Official)

In order to overcome the low business literacy of many members serving on its Governing Councils, Mondragon cooperatives have made important training efforts. In 2000 Otalora, Mondragon's Corporate Management and Cooperative Development Centre, began to offer a 100-hour course to candidates who wanted to become members of cooperatives' boards (Basterretxea and Albizu, 2010). In 2019 Otalora offers three different courses to members of Governing Councils, totalling 88 hours of training. In those courses, training on financial topics (such as analysis of financial statements and Management Annual Plans) occupies a tiny part of the programme and is not enough to close the skill gaps of many board members. Even if Otalora and FED provided additional training to members of the Governing Council, most interviewees consider it naive to think the skills gaps of many members could be closed by training programmes.

Some managers, mainly those with marketing responsibilities, stressed another corporate governance problem that has not been analyzed in previous research. Most members of FED were industrial workers and technicians in its Basque factories. Meanwhile, most people working in sales positions in different regional and international sales teams were employees without any ownership rights. Thus, the electoral system generated board members who were industrial workers and technicians

whose interests prevailed over the global interests of the firm and the interests of other key functional departments and stakeholders.

> "*A product manager responsible for marketing has to define brands and ranges based on what the market demands. That was not the case in FED. … you defined the range according to the market needs and then they told you: "Yes, yes, it's fine, but the San Andrés plant needs to be fed". From the commercial area we suggested to the Governing Council that if we wanted to continue in the market or make money in some businesses,… the manufacturing had to go to another country. They didn't even listen! No way!*" (FED Manager)

Given the complexity of the firm in its last years, rank and file workers suggested that not only members of the Governing Council, but also top managers lacked the skills to manage the company. They stressed that between 2006 and 2013 FED had four different CEOs and four presidents of the Governing Council. As Errasti et al. (2017) underline, this management turnover undermined effective leadership needed to face strategic challenges. Our interviewees also highlighted that those changes often involved changes of many management positions in functional areas, subsidiaries and factories. Those replacements took place so often in the last years of the company, that many interviewees felt newly appointed managers didn't have enough time to properly conduct their tasks before they were replaced.

When our interviews took place, most of the managers interviewed were relocated to other Mondragon cooperatives, so they could compare the governance problems of FED with those of other cooperatives. There was unanimity that board members of other Mondragon cooperatives also lack relevant skills to supervise their managers effectively, but that the problems are less severe in small cooperatives where board members have to face simpler decisions than in a big multinational cooperative like FED.

When asked how FED managed to overcome two economic crises (in the 1970s and in the 1980s) with the same governance structure, several answers were given. Bigger size and complexity of the firm in its last years are almost unanimously cited by interviewees as a key answer. The older interviewees also point to the existence in the 1970s and 1980s of other governance mechanisms used to supervise managers. Back then FED was part of the ULARCO regional group of cooperatives and the CEO of ULARCO could oversee managers of the cooperatives who were not doing a good job and if necessary propose their replacement. Whyte and Whyte (1988, 159-162) offer a detailed account of the measures taken in the crisis that FED faced in 1983. That year, the

president of ULARCO questioned the management of FED, called for changing three of the four men in top positions and all the plant managers. He proposed a new CEO and many structural changes to the governing council of FED. According to interviewees, Mondragon central offices and Fagor group didn't play a similar role in the final crisis of FED. In fact rhetorical questions asking "where was Mondragon?" were frequent, criticizing Mondragon for not supervising FED's managers and their decisions properly. The fact that the CEO and the CFO of Mondragon in the last years of FED had been promoted from FED, and so didn't have enough independence to supervise the actions and strategies of the firm was also stressed by many interviewees.

Older interviewees also highlight the supervisory role of the entrepreneurial division of Laboral Kutxa (the bank of Mondragon) in the crises of the 1970s and 1980s when it replaced many managers of cooperatives in crisis (see Cheney, 1999; Ellerman, 1984;: Morris, 1992; Whyte and Whyte, 1988). This entrepreneurial division of the bank disappeared in 1991 and the supervisory role of the corporate bank became secondary when Laboral Kutxa was forced by the Bank of Spain to diversify risks and reduce its credit exposure to Mondragon cooperatives. As a positive effect, the collapse of FED has not led to the fall of the corporate bank.

Social Council

While other Mondragon cooperatives opt for a clear differentiation between the functions of the Governing Council and the Social Council; the cooperatives of the Fagor group developed a distinctive culture that gave more weight to the Social Council. This led to greater confusion and duality between the social and the executive channels.

At FED it was common for many management decisions to go to the Social Council for consultation and approval. An example is the purchase of the Polish company Wrozamet in 1999:

> "*When the debate about the purchase of Wrozamet came up, the president said: "This decision is going to be made together by the Governing Council and the Social Council. And the president and other members of the Social Council are going to go to Poland and you will meet with the members of the Solidarity union and they will come here and meet with you and you will explain how this works and then we will have the technical and economic debate, to see what numbers come out and then the social debate. The Social Council's report was*

favourable on the purchase of Wrozamet, it was taken to the Assembly and 82% voted yes". (FED Manager and Member of the SC).

According to the interviewees, decisions that should be made by the Governing Council were actually taken by the Social Council that put pressure on the Governing Council even in decisions such as the dismissal of the CEO, generating a culture where rights prevailed over responsibilities

"*You have to go back to February 24, 2006 that is when they cut off the CEO's head. The decision to dismiss the CEO is (theoretically) the Governing Council's... and in the General Assembly the president of the Social Council,* [name and last name removed], *took the stand …, saying that they, the Social Council, were the ones who removed the CEO... It was unsustainable, who's steering this ship? ..... It didn't make sense... a place where the decisions are not made among the experts...*" (FED Manager)

Effectively giving decision-making power to the Social Council, reflected the management's priority for maintaining social peace. Some interviewees pointed out that some members of the Social Council had more influence than some CEOs:

"*With the purchase of Wrozamet, I remember perfectly well that* [name omitted] *was the head of the Social Council at that time. She was the real power. She was the one who ruled for about 25 years, she was a woman with a strong political and union position and with a very important team of that type around her. …The strength of the Social Council here in the Fagor Group is not remotely similar to that of the rest of the Mondragon group cooperatives. …. Here the Social Council had a lot of strength and the rights, social conquest, were much more important. There was always talk of rights.*" (FED Manager and Member of GC and SC)

"*The Social Council was so strong that it could make the executive and the Governing Council stop projects. The Social Council had a very big influence, very big. I don't know how to explain why the Social Council had so much power. I was totally amazed at times. Maybe it had so much power because of the people on the Social Council. Because of their personal leadership.*" (FED Manager)

As was the case with the control exercised by the General Assembly and the Governing Council, the type of control that the Social Council exercised over top management was often aspects of day-to-day operational management, issues that should have been solved in lower bodies of the company.

> "*In the end you get used to "I want to talk to the manager". The Social Council members went to the manager's office every day for matters that they could have discussed with their direct superiors. Why do you involve the manager? What does the manager know about whether to extend this person's contract or not? The manager does not understand because they are dealing with other things, strategy issues.*" (FED Manager)

As in the case of Governing Council members, Social Council members often lacked the skills to conduct some of their tasks. One of the functions of the Social Council in FED is to communicate managerial decisions and convey information downward. Kasmir (1996) found that Social Council members were often unable to interpret the information by themselves. According to our interviewees, this problem persisted until the end of the firm.

In addition, workers' representatives in FED's Social Council and Governing Council stressed that cooperatives should give them access to external independent advice, such as professional lawyers and management accountants, to assist rank and file workers that serve as board members. This demand is not new and Social Council members of FED interviewed by Kasmir (1996, 137) criticized the "lack of access to outside professionals impeded workers' ability to exercise their democratic rights to manage their firms".

Conclusion and Discussion

The research shows that it is too simplistic to blame the failure of FED simply on external factors. While recognizing the importance of the external challenges that contributed to the demise of FED, as previous research highlights (Alzola et al. 2015; Errasti et al. 2016; Arando and Bengoa, 2018), our paper shows that internal factors linked to the cooperative's governance system and culture influenced key failed strategic decisions and reduced the capability of the firm to reverse the decline caused by external factors.

The research shows that democratic governing bodies can slow down or indefinitely postpone painful decisions concerning the closure of factories and units that lose money but employ worker owners. Painful measures that could have saved part of the firm weren't taken or even proposed by management to the General Assembly, since managers knew in advance that the worker owners would vote them down.

This research also contributes to the literature by allowing a better understanding of how organisational factors, such as organisational size and internationalisation through the takeover of foreign subsidiaries pose challenges for the cooperative model of democratic governance. Participants in the study believed that the level of direct democracy at FED is ill-suited to large multinational cooperatives. The application of the one- member -one vote principle in massive General Assemblies, with thousands of cooperative members that have to vote on complex strategic decisions they do not fully understand, is questioned by most of the interviewees. Given that many other Mondragon cooperatives are economically successful and some of them are also growing with over 4,000 working members, this growth may also be the seed of future governance problems like those found in FED. In fact, some interviewees highlight that similar conflictual and unproductive General Assemblies and subsequent mass resignations of Governing Councils are also taking place in other large Mondragon cooperatives, and they suggest large cooperatives should limit the power of General Assemblies and move to a stronger form of representative democracy.

In a largely conceptual paper Sundaramurthy and Lewis (2003) draw on both agency theory and stewardship theory to highlight an important paradox that boards face, namely that they need to both control and support management. They argue that if boards focus too strongly on either of these roles at the expense of the other it can lead to organisational problems. They propose that if boards are too critical and unsupportive of managers they may get trapped into defensive spirals of behaviour, which lead to processes of organisational decline. The case of FED provides evidence to support this proposal. In this destructive spiral, FED's Governing Council, heavily influenced by the Social Council, was very critical of management proposals and fired the CEO in 2006; afterwards other managers resigned and one year later there was an "en masse" resignation of the entire Governing Council. This destructive spiral generated fear among subsequent managers that then tried to maintain social peace by keeping proposals that might be opposed by worker members off the agenda that lead to a 'reverse dominance hierarchy' (Basterretxea et al., 2019) and contributed to FED's demise. Nevertheless, some interviewees felt that a 'reverse dominance hierarchy' is part of the *raison d'etre* of the cooperative model itself. Thus, the challenge is how to make this dominance and the voice of the members in the Governing Council and General Assembly work more effectively to supervise and guide managers. Some interviewees highlighted the example of ULMA, that has grown through spin-offs and creating new cooperatives, each of a size that can make democratic governance easier. A recent paper (Bretos et al. 2019) also offers interesting examples

from Fagor Arrasate and Fagor Ederlan, that have achieved the involvement of members at all levels in the discussion and elaboration of strategic plans through several mini councils.

Our study also contributes to the scholarly literature when cooperative membership is restricted to certain groups. In the case of FED, membership was not offered to the foreign subsidiaries the co-operative took over. In addition, the one-member one-vote principle generated a General Assembly and Governing Council composed mainly of industrial workers and technicians from FED's Basque factories. As a result, the interests of other key functional departments, such as marketing, and foreign subsidiaries were either under-represented or not represented at all. Interviewees believed this led to the downsizing of uncompetitive domestic plants being postponed and to a progressive loss of competitiveness.

Another key lesson from the experience of FED relates to the competency of worker board members to understand and act on the information they are presented with in large complex cooperatives. Giving all the information is not the solution, if cooperative members can not understand it. Indeed, it can create apathy and the rubber stamping of management proposals, unless workers feel their direct interests are threatened, when it may lead to greater involvement and conflict. According to our informants, thinking that training for business literacy and efforts to improve communication in simpler formats can equip worker board members to address complex economic and strategic problems facing multinationals like FED is naive.

The failure of FED made many other Mondragon cooperatives think that this competency gap can not be filled by training alone. Thus, a growing number of voices are asking for the professionalization of Governing Councils. While the nomination of board members based on meritocracy limits some of the governance problems of cooperatives, it also generates Governing Councils that do not reflect the plurality of interests of the members from different backgrounds. Professionalising totally the Governing Councils, as informants have told us that some Mondragon cooperatives are doing, is likely to mean that expertise is acquired at the expense of representation of certain groups of workers.

A potential solution to this governance problem as suggested by some of managers interviewed is to include independent board members on the Governing Councils. The appointment of independent directors has been possible since the approval of the Basque Cooperatives Act in 1993. However, FED and most of the Mondragon cooperatives have not made use of this opportunity. One possible reason is that bringing in expert independent directors on to the board is costly, and Mondragon

cooperatives' practice of not paying the members of the Governing Council for their role makes it difficult to attract professionals who could play this role. Nevertheless, as the failure of FED highlights, having poor Governing Councils can be far more costly if the cooperative fails.

As a result of FED's failure, the Basque government is drafting a new cooperative law (Gobierno Vasco, 2018) that, among other things, proposes to professionalise the governing councils and encourage the use of independent members. The draft bill increases the maximum percentage of independent members from one quarter to one third of the governing council. In order to make this position attractive, the draft bill contemplates payment for independent board members, which is proportionate to the cooperative's importance, its current economic situation, and, above all, the skills and experience that the independent board members bring.

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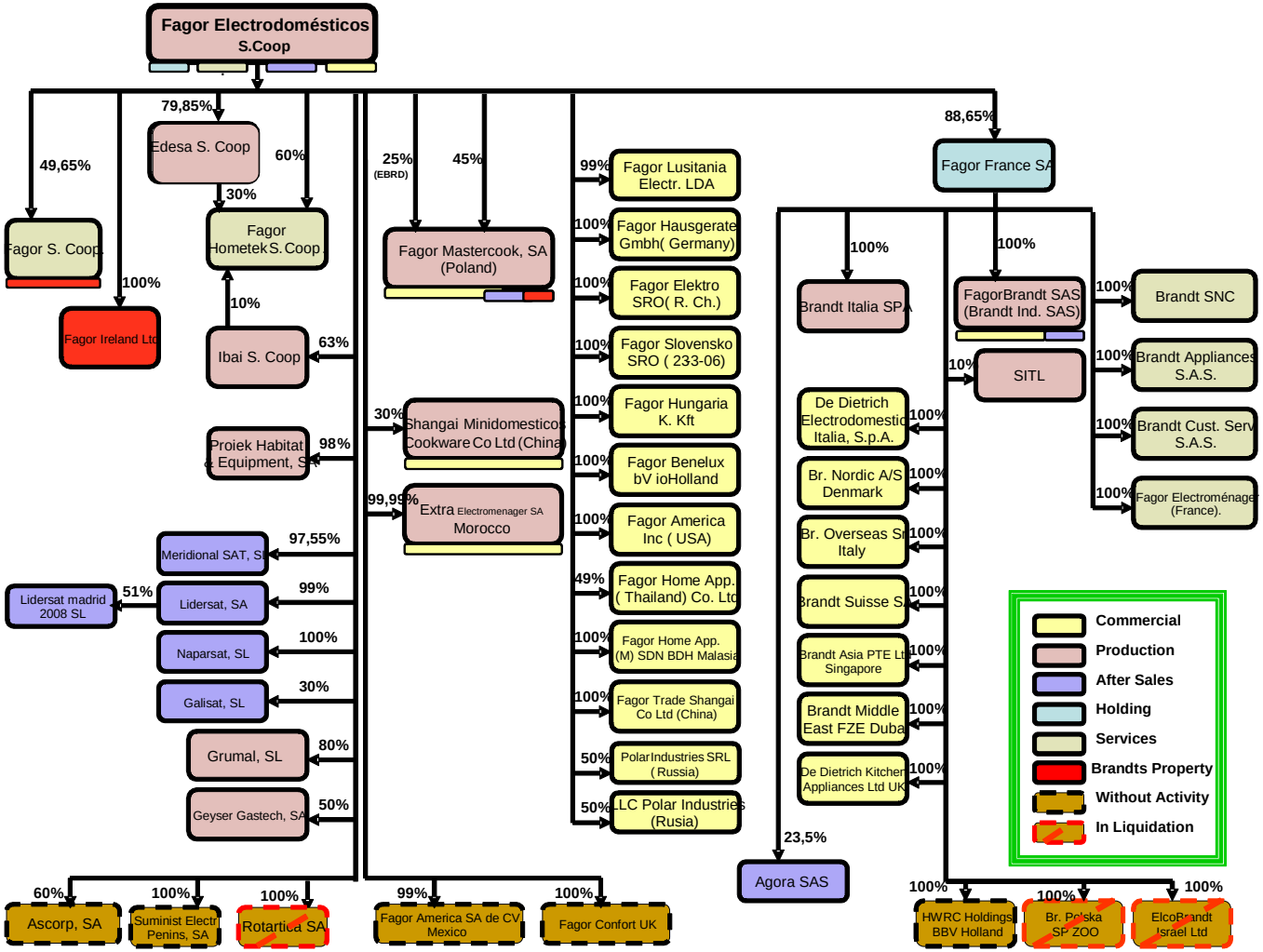
Figure 1. Firms belonging to the Fagor Electrodomésticos Group in 2012 Ownership%



Source: Internal documentation