Democratic Ownership: Scale Through Leveraged Conversions

Preprint of a chapter forthcoming in the: *Routledge Handbook of Cooperative Economics & Management*

Authors: Tej Gonza (https://orcid.org/0000-0002-3136-3889), David Ellerman (orcid.org/0000-0002-5718-618X), and Kosta Marco Juri (orcid.org/0000-0001-7897-6271)

Abstract

A worker cooperative, if structured according to the principles of economic democracy (Ellerman 2021; Erdal 2012), is different from a conventional corporation in that the rights to profits and governance are defined as personal rights rather than a freely transferable property rights, and those personal rights are associated with the provision of labour in the firm. Worker cooperatives are a radically departure from capitalist firms in that they prevent the legal rights to be freely transferred on the market and concentrated in the hands of the few because they define these rights are personal rights of each worker in the firm. One of the problems that cooperatives face is that they do not have a standard gradual conversion mechanism but are generally established as new business startups or by an all-at-once conversion of a conventional company to a cooperative. Cooperatives are notoriously rare; however, contrary to the conventional explanation, research indicates that this is not due to inherent inefficiencies (Gonza 2016). One of the main challenges seems to be sluggish growth through starting-from-scratch creations on one hand, and legal, financial, and organizational complexities related to cooperative conversions on the other. We claim that the potential of scaling the cooperative sector is in the gradual cooperative conversion mechanism embodied in the concept of Cooperative ESOP (Ellerman, Gonza, and Berkopec 2022). We argue that the Cooperative ESOP can, with a help of strong supportive institutional environment, gradually create democratic ownership starting with existing capitalist firms without workers having to invest their own personal assets.

Keywords: democratic firms, worker cooperatives, Cooperative ESOP, property rights, personal rights, gradual conversions

JEL: P13; J54; G30; B55

Contents

Introduction

Democratic ownership in the sphere of economic production is often contrasted to capitalist ownership along the lines of transferability of legal rights, that is, profit and governance rights. If capitalist ownership implies full transferability of legal rights in production, democratic ownership anchors legal rights with the current generation of workers in the firm. A worker cooperative is generally considered the best practical proxy of a democratic firm (Ellerman, 2021; Erdal, 2012); however, worker cooperatives remain rare in contemporary economies, while the capitalist form of enterprise continues to dominate the markets despite the contrary predictions by intellectual giants like John Stuart Mill. Why did democratic ownership fail to achieve scale?

Worker cooperatives are, most commonly, established from scratch or by a full conversion of a capitalist firm. In this chapter, we argue that cooperatives faced challenges because they did not introduce a mechanism that would allow gradual conversion of a capitalist ownership into democratic ownership. We introduce an alternative proposal that can help to scale democratic ownership using the mechanism of leveraged gradual cooperative conversions. In the literature, the solution was described as the "Cooperative ESOP", since it is using the ESOP leveraged financing mechanism, which is attached to a cooperative vehicle (Ellerman et al., 2022 and Appendix). We argue that the mechanism of gradual and leveraged conversion, with the aid of institutional support, can help democratic ownership to grow in our economies and become mainstream.

Continued domination of capitalist ownership against democratic ownership

> *"The form of association, however, which if mankind continue to improve, must be expected in the end to predominate, is not that which can exist between a capitalist as chief, and work-people without a voice in the management, but the association of the labourers themselves on terms of equality, collectively owning the capital with which they carry on their operations, and working under managers elected and removable by themselves." (Mill, John Stuart. 1848. Principles of Political Economy, Book IV, Chapter VII)*

Labourers associated on terms of equality in the economic firm, democratically managing the business and owning the fruits of their labour, are not as common today as one would expect reading words by John Stuart Mill. Worker cooperatives, which best represent democratic values in economy, have been historically found in the regions that have provided strong and systemic institutional support; however, even in those regions, democratic ownership is limited to the margins of the economy, dominated by capitalist ownership. This section looks at the most common ways of worker cooperatives "coming about" and discusses issues that have prevented the cooperatives to be better represented in the population of economic firms (see Chapter 3, Mirabel, this Handbook).

Starting from scratch

The historical problem of scaling worker cooperatives through *starting-from-scratch* creation, has been particularly challenging due to several factors that are unique to the nature of the cooperative organizational form and the legal context that it inhabits. In economies based on capitalist ownership, it is typically economically sensible for an individual (or group of individuals) to establish a conventionally-owned firm when seeking to start a business, regardless of whether a worker cooperative could yield superior overall economic results. By doing so, the founder secures full ownership of the company, and consequently the exclusive rights to profits, decision-making, and capital appreciation, even as the workforce expands. On the contrary, establishing a worker cooperative would require sharing those rights with future members. Thus, in absence of a commitment to cooperative principles over pure financial gain, conventional ownership models will usually appear as the preferable option for individuals starting a new business. As Ben-Ner (1988, p. 290) argues, "a self-interested entrepreneur will not choose to establish a worker-owned firm and share entrepreneurial profits [and other ownership rights] with others, if the establishment of a capitalist firm is a viable alternative”. Moreover, if ownership rights are not tied to labor, the entrepreneur is able to extract entrepreneurial rents even if not employed in the company, meaning they can embark on multiple entrepreneurial ventures at the same time. In the startup community, the prevalence of conventional types of ownership is exacerbated by the fact that ‘exiting’ from the company, typically through acquisition by a dominant incumbent player, is often considered to be the ultimate goal for entrepreneurs (Moules, 2012; Pisoni and Onetti, 2018).

Besides the entrepreneur’s pursuit of self-interest, another key barrier to the development of starting-from-scratch worker cooperatives are the inefficiencies arising from the requirement to abide by democratic principles in the already delicate and difficult to navigate startup phase. In a worker cooperative, where democratic decision-making takes place, it is much more important to recruit people who are believed to share core values and possess the necessary organizational, leadership and entrepreneurial skills than it is in a conventional company. Especially in the startup phase, this process can be significantly more time-consuming, costly, and complicated than simply hiring people and instructing them, without involving any democratic process. Recognizing such potential challenges, which may arise when seeking to establish a cohort of like-minded and committed people, some may find the process of establishing a cooperative from scratch too risky.

Another key challenge is access to capital. Financial institutions and investors may be hesitant to fund unproven cooperative startups, instead preferring more conventional businesses with predictable structures (Dow, 2003 pp. 208-210; Dow, Chap. 2, this Handbook; Kerr, 2015). The rise of venture capital (VC) as a widespread source of finance for startups over the past two decades (Lemley and McCreary, 2018; Mygind and Poulsen, 2021) has arguably contributed to making conventional types of ownership the default choice for company founders.

With conventionally owned enterprises far outnumbering worker cooperatives, a monoculture of conventional ownership has permeated government, educational systems, financial institutions, consulting and professional services, and society as a whole (The Ownership Commission, 2012; Abell, 2014; Nuttall, 2012; ILO, 2023; Kruse, 2022). Specifically, this may manifest as a lack of information on the topic of worker ownership and of attention to worker cooperatives in schools and universities – including business schools –, a scarcity of consulting and professional services which understand the specific needs of cooperatives, and the presence of costly and overly bureaucratic processes for establishing a cooperative. These challenges hinder cooperatives in accessing financing, specialized training, and ongoing support, which may dissuade aspiring entrepreneurs from setting up a worker cooperative in the first place.

Conversions

The alternative path to the creation of democratic ownership is through cooperative conversion. While there are some examples of mechanisms for cooperative conversion in France (Les Scop, 2023; Fakhfakh et al., 2023), Italy (CFI, 2023; Lomuscio et al. 2023), and Spain (CECOP, 2013; Marcuello, 2023), they are often utilized_to save failing companies. These conversion mechanisms typically allow only for full (100%) cooperative conversions, something which greatly limits their potential for widespread adoption.

Access to capital presents a significant challenge for full cooperative conversions (see Chapter 21, Venanzi, this Handbook). Since the assets of a business are insufficient to serve as collateral for bank loans that could cover a complete buyout, cooperative conversions often depend on financial support from either the government or cooperative financial institutions. Italy, France, and Spain have thriving cooperative conversion infrastructures, mostly thanks to their strong cooperative movements and the respective cooperative ecosystems, which took centuries to develop.

When an operating company is transformed into a cooperative enterprise, this involves legal and organizational complexities that may deter potential cooperative members from participating. Understanding and navigating the legal, financial, and organizational aspects of converting to a cooperative can be a daunting task and may discourage full participation. (Vieta et al., 2017) Achieving a full conversion to a worker cooperative can also be challenging because of the resistance from existing owners, who may not be interested in the cooperative model or may fear potential financial losses. Furthermore, traditional businesses often have a hierarchical structure that can make it challenging to transition to a cooperative model, which emphasizes collective decision-making and shared ownership (See Chapter 10, Biggiero, this Handbook). The shift in organizational culture and power dynamics can be difficult for some businesses to embrace, leading to hesitancy in pursuing cooperative conversions (Orsi et al., 2023).

Different institutional measures are often called for to support the scaling of workers cooperatives (Cooperatives UK, 2023; Lawrence et al., 2018; ILO, 2014); however, little attention has been paid to the potential behind two words – *leverage* and *gradualism*.

Some conceptual clarity on democratic ownership

The economic firm is the factual institution of economic production, where labor is performed in combination with capital equipment, which helps to increase the output. The ontology of economic firm is the factual nature of economic production where labour is organized, coordinated, performed, and supported by capital equipment to increase productive capacity (Ellerman, 1990, 2021; Gonza, 2024; Robé, 2011, 2020). People who are actively engaged in production are firm members of the economic firm.[1] Production is the engagement of firm members in the creation of the labor product, which is expressed in value terms as the value added, the difference between the total revenue and the total non-labor costs used in production.

The legal structure underlying the economic firm as a factual organization provides a system of rules in production. To ensure consistency of expectations with the outcomes in production, the legal structure creates a system of rules that provides legal rights and legal roles to different stakeholders in production (Pistor, 2019; Swedberg, 2007). The legal structure of economic firm defines the authority and the rules of appropriation of the labor product (Coase, 1937). There are two sets of legal rights in production. Governance rights conventionally provide the right to vote on strategic governance questions on the shareholder assembly and give the right to delegate managerial authority. Economic rights can be divided into two categories: (i) the right to current profits (value added minus wages), whether they are paid out *or reinvested back into the company*, and (ii) the right to previously reinvested profits, that is, to the net asset value of the company.[2] The legal structure defines legal membership, that is, the recipients of the legal rights (Gonza 2024; Ellerman 2021).

---

[1] Conventionally, the employment relationship defines the boundaries of factual membership; however, with the more recent changes in labor organizations, especially related to labor-based platforms (LBPs) (Gonza & Ellerman, 2022), we should focus on alternative and more direct qualifications of factual membership.

[2] These rights are compromised in many worker cooperatives that do not have Mondragon-style individual capital accounts to record the reinvested portion of the profits so profits that are not paid out are ‘collectivized like in the case of Yugoslav self-managed firms, UK’s Employee Ownership Trusts, or many Italian and French worker cooperatives.

There are two central categories of a legal structure underlying the economic firm – a corporation and a cooperative (*ibid.*). In the corporation, the legal rights are assigned to a capital instrument that can easily be traded, sold, or otherwise transferred among physical and legal entities. In a corporation, legal rights are bequeathable. In the cooperative, the legal rights are attached to a functional role in the economic firm, which can either be the performance of labour (worker cooperatives), consumption (consumer cooperatives), provision of capital (credit cooperatives), or being a stakeholder (stakeholder cooperatives).

In conventional literature, the main objective of economic firm is defined as the maximization of shareholder value (Lazonick & O'Sullivan, 2000). An alternative part of economic and sociological literature may define other objectives of the economic firm, such us providing benefit to a broader set of stakeholders (Imperatori & Ruta, 2015; Leviten-Reid & Fairbairn, 2011; Novkovic, 2019). Based on two categories of legal structure above, we could provide a broader definition of the objective of the economic firm. The objective of the economic firm is to pursue the interests of its *legal members*, which may be shareholders, workers, or the members of the local community.

A democratic firm is an economic firm, whose legal structure attaches legal rights to factual membership in the firm (Dahl, 1985; Ellerman, 2015, 2021). Concretely, democratic firm assigns legal rights to the group of people responsible for the creation of the labor product (labor theory of property—not the labor theory of value) and governance rights to the group of people subjected to the managerial authority (democratic principles, the difference between affected and governed interest). The right to the added value in a democratic firm is assigned based on labour patronage, which should roughly reflect the labor contribution of a given member (Ellerman, 2015). The right to governance in a democratic firm is a democratic right, where each member in the firm has one vote regardless of their position in the firm (Dahl 1985).

> *"Here is the most urgent challenge to political invention ever offered to the jurist and the statesman. The human association which in fact produces and distributes wealth, the association of workmen, managers, technicians and directors, is not an association recognised by the law. The association which the law does recognise—the association of shareholders, creditors and directors—is incapable of production and is not expected by the law to perform these functions. We have to give law to the real association, and to withdraw meaningless privilege from the imaginary one." (Percy 1944, 38)*

In corporations and non-worker cooperatives (i.e., capitalist firms), the employment contract alienates legal rights from the workers. A democratic firm disassociates the imaginary and the real and attaches legal membership in the economic firm to the factual membership, that is, to the provision of labour in production process. Worker cooperatives are a type of cooperative that, in their ideal, attach legal membership to factual membership (see Chapter 6 on "worker cooperatives and other 'cooperatives'" in this Handbook). Only worker cooperatives are, in principle, democratic firms.

Democratic ownership is not limited to a sphere of the democratic firm. The ideals of the democratic firm are, in practice, very rare, since they require that 100% of legal rights are assigned to 100% of firm members.[3] But democratic ownership is a more flexible concept, since only a part of the legal rights in an economic firm can be structured in a democratic way. For example, a given economic firm may establish 30% democratic ownership structure, where 30% of conventional shares are "democratized" by being assigned to all the workers in an accessible way,[4] and by being democratically represented in governance of the firm. In that case, the other 70% of the shares could be traded on the market, held by a few individuals or founders, by the local community, or other stakeholders. We could call such a legal structure a hybrid cooperative.

Democratic ownership defined in such a way may lead to new ideas when thinking about scaling democratic ownership in the economy, since it allows a gradual conversion of a capitalist firm into a democratic firm – or, at least, a conversion into a part-democratic firm, where some part of economic and governance rights is (permanently) attached to firm membership.

Enabling scaling through leveraged and gradual conversions

In the US and, more recently in the UK, worker ownership has scaled quickly after the introduction of a special financial mechanism that leverages a worker-buyout on the future

[3] Even the »posterchild« of the economic democracy, Mondragon cooperatives, faces a certain degree of mismatch between assignment of legal rights among the firm members. While there are no legal members who are not workers of Mondragon cooperatives, not all workers are legal members of the cooperatives.

[4] We follow Gonza (2024, forthcoming) to define »accessible to all factual members«, where accessibility is defined based on positive and negative freedom of access to legal rights for all members. Negative freedom of access implies that there is no legal constraint for any worker or a group of workers in the firm, and positive freedom of access implies that there is an objective possibility for any worker to access the legal rights (most commonly, it is important that there are no financial constraints for becoming a legal member).

profitability of the operating company, building worker ownership without workers having to invest their own personal savings or pledge their personal assets or property. A worker buyout of the existing company (which should be a profitable company) is facilitated in this case through a special purpose vehicle, which holds shares in the names of the workers. The legal innovation behind those models can be restructured in a way that it helps to scale democratic ownership in the economy.

The Employee Stock Ownership Plan (ESOP) was introduced in the legislation in the United States of America in the 70s. Today, there are currently more than 6.500 existing ESOP businesses holding assets of over $1,6 trillion and employing roughly 10% of the country's private sector workforce. (NCEO, 2023) In the US in the past 25 years, there are 200 ESOP WBOs on average per year. Compared to the 223 worker cooperatives employing less than 2.500 workers and holding 128 million $ assets in the US (Abell, 2014), these numbers are staggering.

More recently, as of 2014, a similar mechanism was introduced in the UK, where the Employee Ownership Trust (EOT) has been extensively used by the business owners to provide an ownership succession tool or simply reward and motivate the employees by providing them legal rights in the business. In 2022, there were 332 transfers of businesses in EOT ownership, and by the beginning of 2023, there were a total of 1.418 worker-owned businesses across the UK (EOA, 2023a), and by October 2023 there were already more than 1.650 (EOA, 2023b)

There are a few possible reasons for such an explosion of employee ownership in the US and the UK; however, based on the literature discussing the difficulties of cooperative scaling due to capital problems and based on the empirical evidence from existing leveraged buyout mechanisms, we claim that the financing innovation behind the gradual leveraged buyouts enabled scaling by providing a solution to the capital access problem that limits growth and conversions of worker cooperatives (Pendleton, Robinson, and Nuttall 2023).

The interesting feature of the ESOP and the EOT models is that they in principle include *all* workers in "a share" of the legal rights.[5] Further on, the structure of the models anchors legal rights with the current generation of the workers, preventing transferability of legal rights,

[5] There are some exceptions. See (Rosen & Case, 2022)

making them *de facto* inalienable.[6] However, the main challenge of the models is that they are quite far from the democratic vision of ownership. While some selling owners may decide to create democratic ownership within the ESOPs and the EOTs they decide to set up, the legal default is a paternalistic structure where workers only receive pass-through voting rights on a limited set of decisions. The practice in the US and the UK tends to follow the minimal legal requirements on the issue of governance rights (Kroncke, 2017; Magowan, 2010; Russell et al., 2004). Furthermore, the UK's EOTs do not even provide full economic rights; the model creates a capital structure where workers received distributed profits as bonuses, but lose the claim over the retained portion of the profits, hence, providing only partial claim to the labor product to the workers (Pendleton et al., 2023).

The basic mechanism of the Coop-ESOP

The American or US ESOP provided a proven model for the gradual conversion of a conventional firm into an employee-owned firm. The models suffer from a few artifacts of its legislative history that are remedied in the model proposed here. The most important problem in the US ESOP is that the special purpose vehicle (SPV) holding the worker shares is a trust where the workers are only the beneficiaries of the trust, and the trustee has the final decision-making rights for the shares in the trust. This sort of trust is often used when a minor inherits wealth, and the wealth is put into a trust until the minor becomes of age. But the US ESOP trust is perpetual as if the employees were perpetual minors forever unable to make their own decisions.

Hence the first major change in the recommended model is to replace the trust with a special type of worker cooperative to serve as the SPV to hold the employee shares. As a cooperative, there is one person/one vote to elect the board of the cooperative to make the decisions for the percent of ownership of the underlying company in the Coop-ESOP. A cooperative, structured in a way to ensure democratic governance and to regulate the distribution of economic rights based on the labor contribution of the workers, could be used as a purchase vehicle of shares of the underlying company by using the power of leverage. For example, the cooperative could buy 50% of shares from the underlying "capitalist" firm for a certain price,

[6] This is only partly true. By legal design, an individual worker cannot – or is disincentivized to – sell or trade his or her shares held by the ESOP or EOT trust. It is possible, under certain conditions, to sell the stock held by the trust collectively. Sellouts are also one of the major reasons for stagnation in the number of ESOP plans in the US (Mygind et al., 2023; Rosen, 2023).

where either the seller agrees to a gradual financing (seller's credit), or where the cooperative obtains the loan, pays for the shares, and uses future profits to service the debt. The legal rights are so "anchored" in a special legal purpose cooperative and assigned to the cooperative members, providing them economic and democratic governance rights. If all workers of the underlying company are included as members in the cooperative, 50% of the legal rights are attached to firm membership, falling short of the democratic ideal, but nevertheless achieving partial democratic ownership. We follow Ellerman et al. (2022) and call this mechanism a "Cooperative ESOP".[7]

The second artifact of the US ESOP is that it was legislated as a special type of pension plan, so the employees only see any cash from their ownership when they are near or at retirement. Hence the second major change is that the Coop-ESOP model uses a share (or money) recycling or rollover model where oldest entries in the individual capital accounts (ICAs) are paid out in a continuous process. The repurchased shares or paid-off debts are recycled to the current employees so that new employees are automatically brought into ownership. This recycling or rolling-over of the individual capital accounts may start after the acquisition loan is paid off or earlier depending on the cash position of the underlying operating company.

The US ESOP and the European Coop-ESOP models are voluntary processes on the part of the previous owners who may be looking to a retirement that would preserve their legacy in the community or who simply want to create a "company of owners" rather than the usual company of just employees. The owner may want to start off with a low percentage of transferred ownership, say 20-30%, to see how everything goes for a few years before committing to sharing a larger percent of ownership.

The purchase of the owner's shares can be financed or leveraged by a loan from a financial institution to the ESOP underwritten by the company itself. In that case, the owner gets the cash immediately and then the loan is paid off over a period of time by contributions from the company to ESOP, not through any payments directly out of the employee's pockets or pay checks. The alternative to bank financing is seller's credit where the owner offers the credit and is only paid out over a period of time.

[7] To better understand the technical points behind the model, we suggest a reader to go through the article Ellerman et al. 2022.

If all goes well, then eventually the owner retires or otherwise transfers 100% of the shares to the ESOP. Then in the case of the Coop-ESOP, it can fold the operating company into the cooperative so the co-op becomes the operating company—or it could continue to operate with the operating company 100% owned by the worker cooperative.

Inside the Coop-ESOP

Each normal employee of the underling operating company should be a member of the cooperative. That fulfils the basic idea in a democratic firm that membership should be based on labor, not on the ownership of capital. There might be a small membership fee (e.g., 100 euros) but only for psychological reasons. Each member has an individual capital account (ICA) in the cooperative which is not "equity" but represents the amount ultimate owed to the member (as internal debt). That is, there are no votes attached to the size of a member's ICA (it is always one-member/one-vote). There are two ways to denominate the balance in a member's ICA: 1) as an amount of money (as in the Mondragon cooperative ICAs), or 2) as a certain number of shares as in the US ESOPs.

The balance in a member's ICA (after the initial "membership fee") comes from the ESOP contributions of the underlying company to the ESOP. That amount of money is to be accredited between the collective account and the ICAs. It is suggested that the collective account always receives credit for a fixed percent, say 20-30%, of the ESOP contribution. The remaining part of the ESOP contribution is accredited to the individual accounts according to some agreed-upon criterion representing their labor contribution in the company which is usually just their salary (or perhaps salary plus some measure of their time with the company), Thus, the credits to the accounts are a return to labor, not to capital. The ICAs should be conceptualized as debts to insiders as opposed to the usual debts to outsiders on the balance sheet. They do not represent "equity capital" since there is no equity capital in a worker cooperative; labor is the "equity" factor that qualifies one for membership in the cooperative.[8]

In spite of using language like "employee ownership," it is important not to let language dominate reality. The reality in a worker cooperative is that membership (often misdescribed

---

[8] There could also be a collective account that is not individuated to the members. The collective account would "collectivize" a part of the retained profits so that the value of those profits or the share appreciation is not individuated to ICAs. Mondragon cooperatives have a collective account, where most commonly around 30% of retained profits are collectivized as a kind of self-insurance policy that the values on ICAs will eventually be paid out. This is an effective device that may prevent the heavy liquidity requirements underlying the repurchase obligation, which often impose challenges for ESOP firms in the US.

as “ownership” for purpose of conventional communication) is a personal right based on people qualifying by working in the company, and is not a property right that can be sold or bequeathed to others. And since membership is based on satisfying the required functional role (working in the company), there is one member/one vote. There is no such thing as “having the qualifying role” ten times or a hundred times. And there is no such thing as selling the membership right since the “buyer” might not have the qualifying role, and if they had the qualifying role, they would not need to “buy” it.

This is the same as in the *democratic* political sphere where the qualifying role may be residence in a city or state or citizenship in a country. Those personal rights may not be bought or sold or bequeathed and are always one person/one vote. In a conventional company, there is no qualifying role so the membership rights become free-floating untethered property rights, “shares,” that can be bought and sold and held in multiple quantities. Each entry in a member’s ICA is dated (like additions in a person’s savings account). Initially, the cash in the ESOP contributions is then paid out on the bank loan or, in the seller’s credit arrangement, directly to the selling owner. If the ESOP contribution exceeds the required loan payments or is after the loan is paid off, then the cash is used to pay out the oldest entries in the member ICAs on a First-In/First-Out (FIFO) basis. That is the rollover or recycling plan that is an improvement in the Coop-ESOP compared to the US ESOP where the workers have to wait until near retirement to receive any payouts.

This rollover/recycling program has a number of other benefits other than “early cash” to the worker owners. In the US ESOP, the payouts are geared to the employee retiring or exiting the company. It is stochastic as to when people might choose to exit; indeed, there could be a “run on the ESOP” where a number of people retire at once since they are afraid the company might not be able to pay them out through the ESOP if they wait. With the rollover/recycle plan, nothing changes when a worker retires or exits except that there are no more credits to their accounts since those credits are based on labor contribution. Then as their account ages, it is paid out until it goes to zero in the rollover plan.

The second benefit of the rollover plan is that it tends to equalize the balances in the accounts since the oldest accounts are paid down and the newest accounts get their share of the credit. Hence the accounts of the oldest and longest serving employees do not just accumulate bigger balances which would increase their risk. As the older accounts are reduced and the younger accounts are increased, the “mortgage” for the capital assets of the company is slowly passed from the older generation to the younger generation of members in an automatic way independent of any stochastic or panic decisions.

Unfortunately, this sort of automatic repayment plan is not used in the US ESOPs so the liability to repurchase the shares in the ICAs just accumulates until the founding cohort of employees are retiring. Unless the company has carefully planned for those bunched repurchase liabilities, say with a sinking fund, then it seems that many ESOP companies are sold to meet those liabilities. Indeed, in the 30-40 years since ESOPs were set up, there are now slightly more ESOP sellouts than new ESOPs in the US—all due to an avoidable artifact of the US ESOP being legislated as a pension plan rather than a plan with continuous rolling over or recycling of the ICAs.[9]

Conclusion: Identifying the main source of scaling potential

Democratic ownership in the realm of economic production offers a great opportunity for social progress (Blasi & Kruse, 2019; Dudley & Rouen, 2021; Gonza, 2022; Yetim & Gur, 2023); however, despite its appeal, democratic ownership has struggled to gain significant traction in contemporary economies, where capitalist enterprises continue to dominate. There are known historical challenges related to the scalability of democratic ownership, but there are also possible solutions to problems limiting the economic alternative.

We argued that one of the main hurdles faced by cooperatives is their inability to offer a mechanism for the gradual conversion of capitalist ownership into democratic ownership. Rather than following the prevalent calls for establishment of worker cooperatives from scratch or through 100% conversions, the chapter introduces a concept termed "Cooperative ESOP". The suggested approach to expand democratic ownership involves a cooperative entity acting as a purchasing vehicle for shares of an existing company, by allowing gradual conversion and utilizing leverage to finance the acquisition of ownership rights in the name of firm members.

[9] Given the possibility of offers from cash-rich private equity funds or competitors, another mechanism to stop sellouts is to have a separate non-profit, e.g., “ABC Co. Preservation Association,” holding a “Golden Share” of stock, say 15% to 25% of ownership, that was silent on all normal corporate decisions but could veto any sellout of the employee-owned company.

One of the greatest potentials to apply these principles are in the ownership succession problem. Most of the US ESOPs and the UK EOTs have been established as a tool of addressing the succession challenge, but there is a great need elsewhere to find political solutions for a significant wealth transfer behind the succession planning. In EU alone, the small and medium-size business sector accounts for 99% of all businesses (European Commission 2023), employing two thirds of the private sector working population and contributing to more than half of the total value added generated by businesses in the EU. (European Parliament 2024) Approximately 450 000 firms with 2 million employees are being transferred each year across Europe, while EU institutions warn that almost a third of the businesses do not have a succession plan. (European Commission, 2006; European Union 2020) Supported by national regulatory frameworks and appropriate fiscal incentives, the cooperative ESOP can provide a tool for addressing the succession problem and scale democratic ownership into the mainstream.

Gradual leveraged buyouts implemented within a cooperative structure would address the issues related to capital access (since the conventional company undergoing conversion guarantees the loan) that hinder the growth of worker cooperatives in the population of economic firms, and while the strategy may not (immediately) achieve the purest form of democratic ownership within individual firms, it would help to scale democratic ownership in our economies.

Bibliography

Abell, H. 2014. *Worker cooperatives: Pathways to scale*. Takoma Park: The Democracy Collaborative. Available at: https://project-equity.org/wp-content/uploads/2023/06/Worker-Cooperatives-Pathways-to-Scale.pdf (Accessed: 13 October 2023)

Ben-Ner, A. 1988. The life cycle of worker-owned firms in market economies. *Journal of Economic Behaviour and Organization*. 10 (3), October.

Blasi, Joseph R., and Douglas L. Kruse. 2019. *Building the Assets of Low and Moderate Income Workers and Their Families: The Role of Employee-Ownership.* Rutgers University: Institute for the Study of Employee Ownership and Profit Sharing. https://smlr.rutgers.edu/sites/default/files/rutgerskelloggreport_april2019.pdf.

CECOP. 2013. *Business transfers to employees under the form of a co-operative in Europe*. Available at: https://base.socioeco.org/docs/bussiness_transfers_to_employees_under_the_form_of_a_cooperative_in_europe_cecop-3.pdf (Accessed: 18 October 2023)

CFI 2023. *CFI.* https://www.cfi.it/download/cfi_eng_01_2023.pdf (Accessed: 17 October 2023)

Coase, R. H. 1937. "The Nature of the Firm." *Economica* 4 (16): 386–405. https://doi.org/10.1111/j.1468-0335.1937.tb00002.x.

Co-operatives UK 2023. *Everybody's Business: A Call for Co-operative Growth*. Available at: https://www.uk.coop/sites/default/files/2023-09/Everybodys%20Business.pdf (Accessed: 2 November 2023)

Dahl, Robert A. 1985. *A Preface to Economic Democracy*. University of California Press.

Dow, G. K. 2003. *Governing the Firm: Worker's Control in Theory and Practice*. Cambridge: Cambridge University Press.

Dudley, Thomas, and Ethan Rouen. 2021. "Employee Ownership and Wealth Inequality: A Path to Reducing Wealth Concentration." *SSRN Scholarly Paper ID 3942536*. Rochester, NY: Social Science Research Network. https://doi.org/10.2139/ssrn.3942536.

Ellerman, David. 1990. *The Democratic Worker-Owned Firm*. London: Unwin-Hyman Academic. https://www.ellerman.org/the-democratic-worker-owned-firm/. (accessed March 22, 2024)

———. 2015. *The Democratic Worker-Owned Firm: A New Model for the East and West*. Reissue. London: Routledge Revivals.

———. 2021. *Neo-Abolitionism: Abolishing Human Rentals in Favor of Workplace Democracy*. Cham, Switzerland: SpringerNature. https://doi.org/10.1007/978-3-030-62676-1.

Ellerman, David, Tej Gonza, and Gregor Berkopec. 2022. "European Employee Stock Ownership Plan (ESOP): The Main Structural Features and Pilot Implementation in

Slovenia." *SN Business & Economics* 2 (12): 186. https://doi.org/10.1007/s43546-022-00363-7.

EOA (Employee Ownership Association) 2023a. *WREOC 2023 Employee Owned Sector Profile*. https://employeeownership.co.uk/wp-content/uploads/V5_2023-stats.pdf (accessed March 22, 2024).

EOA. 2023b. *EO Knowledge Programme*. https://employeeownership.co.uk/wp-content/uploads/EO-Knowledge-Programme-Report-2023.pdf (accessed March 22, 2024).

Erdal, David. 2012. "Employee Ownership as a Form of Economic Democracy." *Teorija in Praksa* 49 (6): 935–51.

European Commission. 2006. *Supporting SMEs: Commission tables initiative to facilitate transfer of businesses*. https://ec.europa.eu/commission/presscorner/detail/en/IP_06_307 (accessed March 22, 2024).

European Commission. 2023. *Definition of SMEs*. https://single-market-economy.ec.europa.eu/smes/sme-definition_en. (accessed March 22, 2024).

European Parliament 2024. *Small and Medium-sized Enterprises.* https://www.europarl.europa.eu/erpl-app-public/factsheets/pdf/en/FTU_2.4.2.pdf (accessed March 22, 2024).

European Union. 2020. *An SME Strategy for a Sustainable and Digital Europe*. https://digital-skills-jobs.europa.eu/en/actions/european-initiatives/sme-strategy-sustainable-and-digital-europe (accessed March 22, 2024).

Fakhfakh, Fathi, Nathalie Magne, Thibault Mirabel, and Virginie Pérotin. 2023. "Employee-Owned Firms in France." *Journal of Participation and Employee Ownership* 6 (2): 101–27. https://doi.org/10.1108/JPEO-10-2022-0025.

Gonza, Tej. 2022. "L'Esop, une piste pour l'économie sociale: Les perspectives d'un actionnariat social salarié dans l'UE- A new vision of a social enterprise: Standards and scaling social employee ownership in EU." Translated by Christophe Sente. *Territoires de l'économie sociale et solidaire*, December 7, 2022.

———. 2024. *The Effect of Structural Features on the Organizational Viability of Worker-Centred Firms.* PhD Thesis, Ljubljana, Slovenia: University of Ljubljana.

Gonza, Tej, and David P. Ellerman. 2022. "Turning Platform Workers into Owners: ESOP-Type Buyouts for the Labor-Based Platforms." *Teorija in Praksa : Revija Za Družbena Vprašanja* 59 (3): 665–81. https://doi.org/10.51936/tip.59.3.665–681.

ILO. 2014. *Job Preservation through Worker Cooperatives: An Overview of International Experiences and Strategies*. Geneva, Switzerland: ILO. Available at: https://www.ilo.org/wcmsp5/groups/public/---ed_dialogue/---actrav/documents/publication/wcms_312039.pdf (Accessed 29 October 2023)

ILO. 2023. *Rediscovering cooperatives: young people finding work the cooperative way. Cooperatives and the World of Work No.4*. Available at:

https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---coop/documents/publication/wcms_391216.pdf (Accessed: 13 October 2023)

Imperatori, Barbara, and Dino Cataldo Ruta. 2015. “Designing a Social Enterprise: Organization Configuration and Social Stakeholders’ Work Involvement.” *Social Enterprise Journal* 11 (3): 321–46. https://doi.org/10.1108/SEJ-08-2014-0034.

Kerr, Camille. 2015. *Investing In Worker Ownership: How Finance Institutions Can Create Deep Impact at Scale with Worker Cooperatives*. Democracy at Work Institute, https://institute.coop/resources/investing-worker-ownership (accessed March 22, 2024).

Kroncke, Jedidiah J. 2017. “ESOPs and the Limits of Fractionalized Ownership.” *The University of Chicago Legal Forum*. https://legal-forum.uchicago.edu/print-archive/esops-and-limits-fractionalized-ownership (accessed March 22, 2024)

Lawrence, M., Pendleton, A. and Mahmoud, S. 2018. Cooperatives Unleashed: Doubling the size of the UK’s Co-operative sector, *New Economics Foundation*. Available at: https://neweconomics.org/uploads/files/co-ops-unleashed.pdf (Accessed: 29 October 2023)

Lazonick, William, and Mary O’Sullivan. 2000. “Maximizing Shareholder Value: A New Ideology for Corporate Governance.” *Economy and Society* 29 (1): 13–35. https://doi.org/10.1080/030851400360541.

Lemley, M. A., McCreary, A., 2019. Exit strategy, *Stanford Law and Economics Olin Working Paper #542*. Available at: https://ssrn.com/abstract=3506919 (Accessed: 3 October 2023)

Les Scop (2023) *Chiffres Clés 2022*. Available at: https://www.les-scop.coop/chiffres-cles-2022 (Accessed: 17 October 2023)

Leviten-Reid, Catherine, and Brett Fairbairn. 2011. “Multi-Stakeholder Governance in Cooperative Organizations: Toward a New Framework for Research?” *Canadian Journal of Nonprofit and Social Economy Research* 2 (2). https://doi.org/10.22230/cjnser.2011v2n2a78.

Lomuscio, Marco, Ermanno Celeste Tortia, and Andrea Cori. 2023. “Worker Cooperatives in Italy: Legislation, Prevalence and Recent Trends.” *Journal of Participation and Employee Ownership* 6 (2): 128–48. https://doi.org/10.1108/JPEO-10-2022-0023.

Magowan, Stephen. 2010. “A New Old Idea for Incorporating Employees into the Governance of ESOP Companies.” *Journal of Employee Ownership Law & Finance*, Summer 2010, 22 (3): 11–41.

Marcuello, Carmen. 2023. “Employee Ownership in Spain: Worker Cooperatives And.” *Journal of Participation and Employee Ownership* 6 (2): 149–65. https://doi.org/10.1108/JPEO-10-2022-0022.

Mill, John Stuart. 1970. *Principles of Political Economy*. Harmondsworth: Penguin Books.

Moules, J. 2012. 'Head for the exit without stumbling on the way', *Financial Times*, July 6. Available at: https://www.ft.com/content/f12a1b2e-c079-11e1-9372-00144feabdc0 (Accessed: 26 October 2023)

Mygind, N., and T. Poulsen. 2021. “Employee Ownership: Pros and Cons - A Review.” *Journal of Participation and Employee Ownership* 4 (2): 136–73. https://doi.org/10.1108/JPEO-08-2021-0003.

Mygind, Niels, Joseph Blasi, and Douglas Kruse. 2023. “Guest Editorial: Introduction to Special Issue on Overcoming the Barriers for Employee Ownership Part 1.” *Journal of Participation and Employee Ownership* 6 (2): 97–100. https://doi.org/10.1108/JPEO-09-2023-032.

NCEO. 2023.. *Employee Ownership by the Numbers*. https://www.nceo.org/articles/employee-ownership-by-the-numbers. (accessed March 22, 2024)

Novkovic, Sonja. 2019. “Multi-Stakeholder Cooperatives as a Means for Jobs Creation and Social Transformation.” In *Cooperatives and the World of Work*. London: Routledge.

Nuttall, G. 2012. *Nuttall Review of Employee Ownership*. London, Department of. Business Innovation & Skills. Available at: https://assets.publishing.service.gov.uk/media/5a79ab1b40f0b63d72fc7918/12-933-sharing-success-nuttall-review-employee-ownership.pdf (Accessed: 27 October 2023)

Orsi, J., Lisa, W., and Jacob, S. (2023) *Legal Guide to Cooperative Conversions: A Business owners guide to cooperative conversion.* Available at: https://institute.coop/sites/default/files/resources/SELC%20et%20al%20-%20Legal%20Guide%20to%20Cooperative%20Conversions.pdf (Accessed 28 October 2023)

Ownership Commission 2012. *Plurality, Stewardship and Engagement*. Available at: https://www.mutuo.coop/wp-content/uploads/2012/03/Ownership-commission-2012.pdf (Accessed: 20 October 2023)

Pendleton, A., A. Robinson, and G. Nuttall. 2023. “Employee Ownership in the UK.” *Journal of Participation and Employee Ownership*, June. https://eprints.whiterose.ac.uk/200499/.

Percy, Eustace. 1944. *The Unknown State: 16th Riddell Memorial Lectures*. London: Oxford University Press.

Pisoni, A. and Onetti, A. 2018, "When startups exit: comparing strategies in Europe and the USA", *Journal of Business Strategy*, Vol. 39 No. 3, pp. 26-33. https://doi.org/10.1108/JBS-02-2017-0022.

Pistor, Katharina. 2019. *The Code of Capital: How the Law Creates Wealth and Inequality*. Princeton: Princeton University Press.

Robé, Jean-Philippe. 2011. “The Legal Structure of the Firm.” *Accounting, Economics, and Law* 1 (1). https://doi.org/10.2202/2152-2820.1001.

———. 2020. *Property, Power and Politics: Why We Need to Rethink the World Power System*. Bristol University Press. https://doi.org/10.46692/9781529213195.

Rosen, Corey. 2023. “Employee Ownership in the USA: Lessons to Consider in Creating More Inclusive Capitalism.” *Journal of Participation and Employee Ownership*. https://doi.org/10.1108/JPEO-11-2022-0029.

Rosen, Corey, and John Case. 2022. *Ownership: Reinventing Companies, Capitalism, and Who Owns What*. Oakland, CA: Berrett-Koehler Publishers.

Russell, John D., Mark Dirsmith, and Sajay Samuel. 2004. “Stained Steel: ESOPs, Meta-Power, and the Ironies of Corporate Democracy.” *Symbolic Interaction* 27 (3): 383–403. https://doi.org/10.1525/si.2004.27.3.383.

Swedberg, Richard. 2007. *Principles of Economic Sociology*. 1st edition. Princeton, N.J.: Princeton University Press.

Vieta, M., Depedri, S. and Carrano, A. 2017. 'The Italian Road to Recuperating Enterprises and The. Legge Marcora Framework'. *Euricse Research Report*, 15/17.

Yetim, Mehmet Ali, and Furkan Amil Gur. 2023. “Environmentally Conscious Decision-Making In Employee-Owned Ventures.” *Academy of Management Proceedings* 2023 (1): 13617. https://doi.org/10.5465/AMPROC.2023.13617abstract.