THE ECONOMIC BASIS OF MEMBER-CONTROLLED ENTERPRISE – an introduction

Member-controlled enterprises (MCEs) need to be committed to a specific set of economics practices, forming a system which supports the achievement of their purpose. This economic system relies upon:

1. Self-sustainability
2. A purpose beyond profit
3. Finance that serves the purpose
4. Equivalence
5. Location is critical
6. Speculation has no role
7. Ethical practices are not optional
8. Economies of scale must balance with the requirements of member-control

WHAT DO WE MEAN BY 'ECONOMICS'?

Economics is the branch of knowledge concerned with the production, consumption and transfer of wealth. A distinction is drawn between 'microeconomics', which is concerned with the basic elements in the economy (including individual markets and agents such as consumers and businesses, buyers and sellers) and 'macroeconomics', which addresses issues affecting an entire economy, e.g. unemployment, inflation, economic growth, and monetary and fiscal policy.

1. Self-sustainability

The study of economics can help us understand how to manage our personal finances, run a viable enterprise and even maintain a balanced budget in the national economy. Here, however, our main concern is with successfully conducting a member-controlled enterprise. Although the economic precepts that underpin MCEs is based on different precepts (rules of conduct) than those that guide commercial businesses, MCEs cannot ignore the underlying discipline provided by the marketplace and confirmed by basic economic principles.

The study of economics also explains the distinctive framework within which MCEs must function. In particular, it confirms that MCEs, like any other form of business, must compete for the resources they need to carry out their purpose – and there is rarely any alternative to paying the market rate for the finance, labour, land and other assets needed. Therefore, it follows that MCEs must be able to use such resources at least as productively as any other form of enterprise; if not, they will simply be uncompetitive and unable to pay for these essential resources.

The objective when deploying resources within MCEs is achievement of the organization's purpose; therefore, the aim will be to optimize the use of the resources – 'doing more with less'. This replaces the objective of profit-maximization in commercial businesses.

What do we mean by a 'commercial' or 'investor-controlled' business?

A commercial business (including sole -traders, partnerships, and private and public companies) is conducted for the purpose of generating profits. An investor-controlled business is a commercial business run for the benefit of investors who own shares in it.

MCEs are guided by specific economic precepts **(rules)** that are the basis of co-operation and mutuality – and they differ significantly from those that guide commercial businesses. All of the differences arise because the purpose of a CME is different from that of a commercial business.

In the context of an enterprise, when we speak about the 'economics of co-operation' we are referring to the framework provided by a set of rules that must guide decision-making within MCEs. These rules are rooted in the purpose, practices and values of co-operation and mutuality.

2. The role of profit

In MCEs the purpose of the enterprise is not to generate profits, but to provide benefits secured by market intervention in the interests of the membership. This replaces the profit motive in commercial businesses. The use of the term 'profit' is, in reality, a misnomer in connection with MCEs, because any so-called 'profit' results from trading with the members, and it is not possible to make a profit from mutual trading – you cannot make a profit from yourself. The question of what constitutes a profit is confused by the taxation authorities, who choose to classify surpluses arising from mutual trading as 'profit' – quite simply because they wish to levy tax upon it.

Any surplus in MCEs is what remains after covering all operating costs, providing cover for any risks involved in conducting the enterprise, and generating the investment capital required to achieve the purpose of the CME. Any surplus may be distributed to members – not in relation to investment, but in accordance with the member's participation in generating the surplus. Surpluses may also be used in part to support the communities within which the CME operates.

***For example**: In a consumer co-operative this would be according to purchases, and in a worker co-operative according to the value of their labour input. This method replaces the distribution of profits in an investor-controlled company which is according to the number of shares held.*

3. The role of capital

In MCEs capital is the servant of the enterprise and not its master. It is the *means to an end* – achieving the purpose of the enterprise. Capital is fully entitled to a fair reward, but in a CME it should not directly participate in profits or any surplus. In an investor-controlled business the role of the investor is dominant; in MCEs this is replaced by member-control.

4. Equivalence must prevail

The prices set for goods or services provided are determined by the marketplace within which they operate. However, in all dealings with members the criterion of equivalence shall apply, with all members should be treated on an equal basis. This replaces the practice of profit maximization commonly operated in the individual transactions of commercial businesses. Such arrangements include offering secret 'deals' to some people, charging 'what ever the market will bear', and paying different rates for labour of the same value. Fairness and transparency must be the basis of trading within a CME.

5. Ethical provenance

Ethical standards must underlie all economic decision-making within a CME. Integrity, honest dealing and the absence of exploitation and sharp practice are the hallmarks of member-controlled enterprise – after all, if you cannot trust yourselves, then who can you trust?

6. The importance of place

When there is a reliance upon internationally mobile finance, coupled with dependence upon enterprises driven by profit-maximization, speculation and short-term share-price values, all too often, this combination of factors results in unemployment and the withdrawal of services from areas with lower profit potential. Capital is itinerant, and because many investor-controlled businesses exhibit little or no attachment to any specific location, they often migrate to areas where the cost of labour is significantly lower. When other areas offer the prospect of a higher return, such companies will withdraw their investment in businesses providing services in less-profitable locations. Only enterprises committed to a location and a specific group of people can provide a more secure base for employment and service provision in marginal locations, such as many rural areas.

The world seems generally wedded to a belief in the overriding supremacy of the investor-controlled business model. However, disillusionment is now apparent in many quarters. This is especially apparent when globally-operating businesses are shown to have no interest in sustaining local communities and when the delivery of essential services proves insufficiently profitable to justify their continuation. The problem then becomes one of finding ways to replace services withdrawn by the state or the investor-owned businesses that have taken flight. Member-controlled enterprises can, in many situations, offer the only realistic alternative.

7. Speculation and wealth

Speculation (gambling) has no place in the economic process of MCEs, because such activities cannot benefit the majority of members. MCEs exist to serve the membership in its entirety, and an individual member's gain is inevitably another member's loss. Speculation routinely produces few winners and a majority of losers, and so is unacceptable as the basis of mutual trading. It is no part of the role of CME executives to speculate/gamble with the savings of members or their collectively owned assets.

The people who create and produce goods or deliver services rarely benefit from speculation – a form of wealth distribution that benefits only those with considerable existing wealth. The inevitable impact of compound interest ('money begets money') almost guarantees that the rich will get richer.

Although it is sometimes necessary to pursue approaches so as minimize risk through a variety of 'insurance strategies', these must stop well short of speculation.

8. A matter of scale

Member-controlled enterprises require a different approach to many economic decisions, and MCEs need to balance the advantages that may accrue from economies of scale with the need to operate in ways that will sustain effective human relationships.

What do we mean by 'economies of scale'?

Economies of scale result when an enterprise obtains cost advantages (savings) through expansion. They commonly arise in purchasing (bulk buying of goods or materials), management (increased specialization of managers), finance (obtaining lower-cost finance when borrowing and/or gaining access to a greater range of financial instruments), marketing (spreading the cost of advertising over a greater range of sales or output), and technology (spreading costs such as research and development). Conversely, diseconomies of scale may also arise, especially in organizational terms.

Many MCEs start small and grow organically into large and complex organizations, frequently outstripping the capacity of their elected leaders and managers and/or their capacity to finance expanding operations. Of necessity, the pressure to deliver economic benefits to members almost inevitably results in MCEs seeking economies of scale. These might be achieved through mergers between smaller MCEs or amalgamation with a larger enterprise. However, in the process many of the fundamental characteristics of member-controlled enterprise often become lost.

Organizations that were once small, local, and based upon a form of direct democracy find themselves needing transformation into much more highly developed enterprises. To achieve this metamorphosis successfully requires both committed leaders of the highest caliber and the full involvement of the membership. The unintended outcomes of enlargement are often alienation of the membership and the loss of essential organizational purpose, which in turn commonly leads to demutualisation.

Successful transition to an organization that properly balances the need for economies of scale with the drawbacks of big organizations calls for creative approaches, probably involving well-managed, franchise-like operations and genuine federal systems.

9. Competition

MCEs need to compete with all other forms of enterprise for the resources needed to conduct their enterprise – land, labour (including those with management skills), finance, and all other requisite assets and services. This leaves little alternative to paying market rates for these commodities. In the short term, especially in the formation stage, MCEs can sometimes secure resources at less than the market rate (as when members provide voluntary labour or are willing to accept less than the market rate for the use of their savings). Occasionally MCEs may benefit from grants or gifts, but such assistance cannot be the basis for sustaining the enterprise in the longer term. The truth is that MCEs, of any form or type, cannot escape the fact that they must optimize the use of all resources.