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Teaching Case Study

Friesens Corporation

Supporting the Local Community through Employee Ownership

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Friesens Corporation: Supporting the Local Community through Employee Ownership

Teaching Case with Discussion Questions

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Abstract: This teaching case study explores the evolution of employee ownership at Friesens Corporation, one of Canada's leading book printers. Employee ownership has been a cornerstone of Friesens' ability to navigate economic downturns and systemic changes in the printing industry, while creating wealth for employees and retaining a strong commitment to the local community. Despite a lack of policy and taxation support for employee ownership in Canada, Friesens has managed to establish itself as one of a small group of Canadian companies that are wholly owned by employees. To get to this point, the company has iterated through several models of employee ownership, adapting and innovating as new challenges and opportunities emerged. Recent plans by the Canadian government to create a dedicated Employee Ownership Trust will go a long way to resolving outstanding challenges of maintaining Friesens' broad-based employee ownership structure.

Topics: Employee Ownership, Community Development, Employee Engagement, Public Policy

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This is a teaching case study. Additional versions of this case study may appear in print. This case was developed solely as a resource to stimulate classroom discussion. It is not intended to provide management advice on how to establish or operate an employee-owned organization, or to highlight effective or ineffective management decision-making. The authors are grateful to Friesens Corporation and all individuals who participated in interviews for their time and support. When requested, the authors may have disguised names or other identifying information to protect confidentiality. The authors would also like to acknowledge the generous support from Simon Pek's Social Capital Partners Fellowship from the Institute for the Study of Employee Ownership and Profit Sharing at Rutgers University, New Jersey.

Helping People Share Their Stories

Friesens is in the business of helping people share their stories with the world. Their products and services are all linked to storytelling and print. Most students in Canada and the US are familiar with one of their main products: school yearbooks. And if you bought one of the first five Harry Potter books in Canada, it likely came off a Friesens printing press, as did memoirs of Canadian and international celebrities like Rick Mercer, Michele Obama, and Bono.

Four divisions operate within the parent company: one focuses on trade books (coffee table books, art books, and memoirs); another on school yearbooks; a third on packaging, and a fourth helps individual authors self-publish. This business model has paid off: in 2022, despite the challenges of the pandemic and systemic changes in the printing industry resulting from digital publishing, Friesens surpassed $130M in annual revenue.

The story of Friesens is one of vision, perseverance, and adaptation. Central to this story and the company's success is a long-standing commitment to employee ownership by the founding family. Over several decades the family sold its holdings to employees, and Friesens became one of only a few medium sized companies in Canada entirely owned by employees. However, the journey has been marked by many twists and turns, including experimenting with several different ownership models to navigate the complexities of Canada's regulatory environment, and finding the right balance of risks and incentives for employee-owners.

Chad Friesen is the current CEO. He's not related to the founding family – Friesen is a common name in Manitoba, where the company is based – but he shares their values and their commitment to employee ownership. He joined the company in 1993 and assumed the CEO role in 2017.

The Friesen Family Legacy

Established in 1907, Friesens has long been an important part of the local community of Altona, Manitoba, where it is currently headquartered, where all its manufacturing is done, and where many employees live and raise their families. D.W. Friesen, an early entrepreneur in the community, started the company as a confectionary store, later adding a post office and several telephone franchises, and expanding into stationery. His sons joined the company in the 1920s, and, in the 1930s, their legacy in printing and publishing began with the purchase of their first printing press. The company has not looked back, surviving two World Wars, several economic recessions, and the digital revolution in publishing.

Undoubtedly, the entrepreneurial spirit embodied by D.W. Friesen has been a big factor in Friesens' longevity. But a commitment to employee ownership has also been fundamental to their success. All 600+ employees who work at Friesens enjoy the benefits of ownership. For example, in 2022, employee-owners received $5M in distributions. The average employee-owner received an ownership payment equal to nearly 20% of their base wages. And it is not just about rewarding the hard work of employees; Friesens also embraces an ownership culture where employees' contributions to decision-making and ground-up innovation are valued. As their website proclaims, "Acting as an owner is a fundamental value of the people who work at Friesens …. We're proud to be 100% employee-owned."

Why Employee Ownership? A Natural Extension of Community Values

When the company incorporated in the 1950s, two non-family employees purchased some shares and the journey towards 100% employee ownership was underway. By the 1980s, the three Friesen brothers foresaw that family-run businesses tend not to survive after a few generations and started exploring options to divest their holdings. For them, transitioning ownership to employees was the most viable means of ensuring the company would be successful in perpetuity. They had been active supporters of the cooperative movement in Manitoba in the 1930s and 40s, and employee ownership was a natural extension of their interest in democratic ownership of local enterprises.

Keeping the business in Altona was another important consideration. Selling to another company or to a private equity firm almost certainly meant that the business would move elsewhere, with significant implications for the many people in the surrounding community that worked for the company. CEO Friesen emphasizes the important debt that the company and the community owe to the values and commitment of the founding family:

> *"Employee ownership was a tremendous gift from the founding family to the future employees of the company and to the community. Quite frankly, we wouldn't have remained in Altona and we may not even exist today if not for the foresight of the Friesen family to introduce employee ownership."*

Unintended Consequences

With nearly 70 years of employee ownership, Friesens has iterated through several different models. In the 1950s and 60s, the model was direct share ownership by employees. In some cases, these shares were purchased by employees; in other cases, shares were granted to employees based on performance considerations. However, as more employees accumulated shares in the company, the Friesen brothers faced some unintended consequences. Because those early shares were directly owned by employees and transferable, the shares were often exchanged for goods and services in the local community. After a while, company equity was spread quite broadly among community members! While the Friesen family valued their connection with the community, they also wanted to incentivize employees to act as owners, which meant employees had to retain their ownership interests. So the company bought back all the non-employee-held shares and added a stipulation to the shareholder agreement that a Friesens shareholder had to be an employee.

Hybrid Employee Ownership--Financing a Buy-out with a Trust

In the 1980s, when family members decided to retire out of the business, the company was faced with a dilemma: employee-ownership seemed like the best way forward for the company and the community, but there was no way that employees could muster the capital to buy the family's holdings. The solution was to create an employee trust that could take out a loan to buy the family's shares and manage them on behalf of all employees. Employees would be the beneficiaries of the trust, which meant that they could enjoy the benefits of ownership (in the form of annual distributions and share appreciation) without having to purchase the shares individually.

> *"The family saw the writing on the wall, that multi-generational family businesses tend not to survive. First and foremost, they saw employee ownership as a chance to reward loyal employees. But they also saw it as an important transition for perpetuating the business. It was radical thinking at the time." –CEO Chad Friesen*

Since the trust has legal ownership of shares, it exercises voting rights on behalf of employees but must exercise these rights in the best interests of the employee beneficiaries. When employees pass probation with the company, they become eligible to receive the dividends that are paid from Friesens to the trust and then distributed to the employee beneficiaries. But employees never legally own the shares and, more importantly, never pay for share ownership. In some respects, then, an employee ownership trust is the best of all worlds. Employees receive the benefits of ownership at no cost, which levels the playing field since some employees may not have the resources to purchase shares. And because the trust is a perpetual owner, the company also benefits from a stable, long-term ownership structure.

Between the 1970s and 2010, there was a hybrid model of ownership at Friesens. Individual shareholders owned some of the shares and the trust owned some of the shares. But as larger shareholders retired, the trust needed to purchase more and more of the company shares. By the late 2000s the trust owned the majority of the company's shares.

Managing Risk with an Employee Ownership Trust

On September 15, 2008, the fourth largest investment bank in the US, Lehman Brothers, declared bankruptcy and triggered a stock market crash that wiped out trillions of dollars in market capitalization and precipitated what became known as the Great Recession. This shook the global economy to the core, deeply affecting both Wall Street and Main Street.

For Friesens, this global economic shock occurred at the same time as China was becoming a dominant force for outsourced printing, and the e-reader, Kindle, was launched. It was a perfect storm for a printing company. While the stock market rapidly recovered, and the global economy eventually got back on its feet, the years after the financial crisis were an anxious time for Friesens' employee-owners. Employees were concerned about the future of the business and what that future would mean for share values. The company was anxious about losing valuable employees due to these concerns.

Again, leadership at Friesens made a tough but ultimately prescient decision: the company would fund the trust to buy back all the remaining shares held by individual employees over the next six years. The company arranged nearly $40M in financing and guaranteed employees a set value for their shares. The purchase agreement was structured in a way that allowed the company to purchase a sixth of the shares per year over a 6-year period. By 2015, at the end of the buy-back period, the trust owned 100% of the outstanding shares in the company.

The path to employee ownership has been a long and winding road at Friesens. What the story shows is that there is not always one model of employee ownership that works in every situation. As the company moved from direct share ownership by individual employees to beneficial ownership through a trust, leaders at Friesens had to weigh the pros and cons of each approach, considering the local and global pressures they faced. Although the current employee ownership model is working extremely well for the company, there are still challenges it must navigate.

Going it Alone

In other jurisdictions like the U.S. and the U.K., generous tax breaks and favourable regulatory structures create positive incentives for founders to sell their shareholdings to employees. In Canada, there have been no tax incentives and, until recently, no dedicated employee ownership trust structure, which meant that Canadian companies had to figure out employee ownership on their own. Although one structure may not work for every situation, CEO Friesen argues that clear regulatory guidance and tax incentives would help immensely:

> *"We had zero tax and government support. A lot of what we've created has been in partnership with some really good lawyers. Our law firm developed the original ownership model and has been with us through all the iterations leading to today."*

One significant hurdle for Friesens has been the '21-year Rule,' which stipulates that any non-specified trust in Canada is deemed to have disposed of capital holdings at fair market value every 21 years. This meant that sizable capital gains taxes were payable by the trust at that time. Consequently, it has taken considerable legal maneuvering and administrative costs (for example, establishing multiple trusts) to avoid large one-time tax liabilities. Essentially, to avoid the 21-year rule, the company had to periodically buy back shares from the Trust and dissolve those shares. The trust then distributed the cash proceeds to employee beneficiaries as a dividend. However, even though the dissolved share value went to employee beneficiaries, this workaround diminished one of the primary motives for a trust-based model – to hold shares on behalf of all employees in perpetuity.

Thankfully, in early 2023, the Canadian government followed through on an earlier commitment to facilitate employee ownership in Canada by setting up a special purpose employee ownership trust that is exempt from the 21-year rule.[1] CEO Friesen is glad to see these changes, as they vindicate what Friesens had been doing for decades by removing an important barrier to employee ownership. He hopes the government will follow this first step with additional policies and incentives to make the transition to employee ownership easier for hundreds of other Canadian companies.

Despite the past challenges of setting up and operating an employee ownership trust in Canada, CEO Friesen is adamant that it has been the right model for the company. It makes ownership accessible for all employees because it does not require them to pay for shares. This inclusive attitude towards employee ownership helps create the ownership culture that underpins the company's success:

> *"When we use the term 'employee-owners,' we're being very deliberate. We know we're beneficiaries of the trust, but by referring to ourselves as owners, the intent of the trust is clear to everyone." –CEO Friesen*

Thinking Like Owners

Ownership culture is both a core value and a central management principle at Friesens. Employees are encouraged to think of themselves as owners.

> *"We wrap everything we do around employee ownership. When an employee thinks about company values, they think like owners: 'Safety matters at my company. Quality matters at my company.' We use employee ownership as a platform to embed company values and as a call to action. You enjoy getting ownership cheques and sharing the proceeds of the company. But every time product goes out the door that is subpar, or carelessness leads to a $20K mistake, that's money out of your pocket." –CEO Friesen*

As an example of this deep commitment to ownership thinking, Friesens employs some unique and innovative organizational practices. For example, the company often sends shop-floor employees on trips to preview acquisitions of major pieces of equipment and these operations experts become part of the decision-making process for the equipment acquisition. This embrace of ownership at all levels of the organization pays off. CEO Friesen estimates that the net margin at the company is approximately double the industry average:

> *"We are an employee-owned company, and we embrace a lot of values that are linked to this. We generate net margins that are double the rest of the market. There are many factors that contribute to this. But the fact that we consistently outperform the market is, frankly, tied to employee ownership. We have a licence to re-invest in our business more than any other ownership model."*

[1] Details of the new ownership trust and associated tax changes can be found at https://www.budget.canada.ca/2023/report-rapport/tm-mf-en.html#a3.

With external shareholders, companies are often driven to meet short-term performance metrics and distribute as much of the profit as possible to shareholders through dividends or stock buybacks. Unfortunately, this often jeopardizes long-term performance, resilience, and social responsibility. With employee-owned firms, employees tend to take a longer-term view because they benefit from both job security *and* consistent financial returns when the company does well over a long period. Not surprisingly, therefore, employee-owned companies are more resilient during periods of economic upheaval and employee-owners are less likely to lose their jobs, which means families and local communities benefit as well.[2]

Employee Engagement and Ownership: Striking the Right Balance

Studies have shown that the benefits of employee ownership are magnified when employee-owners are empowered to make decisions and actively involved with the management of the company, although the strength of this relationship depends on the specific forms of ownership and participation used.[3] In employee-owned companies, it can be a challenge to balance the need to include employees in decision-making while also preserving the important role of leadership. Friesens has found a balance that works, supported a legacy of leadership that truly believes in the value of employee ownership.

With a trust-based model, individual employees don't have formal governance rights, although the trust has a fiduciary responsibility to act in the best interests of employees. But to cultivate an ownership culture, leadership at Friesens actively engages with employees at all levels of decision-making. At the strategic level, the executive meets with a Staff Council (composed of 30-40 employees) twice yearly to discuss company plans. The dialogue is structured as an equal discussion between the executive and employees, which means open and honest communication is essential. For operational decisions, management employs a couple of different mechanisms. Individual employees have regular one-on-one meetings with their immediate managers to discuss individual concerns. Work teams engage in regular 'huddles' where they discuss ideas to improve operations. And although employees don't have the formal right to elect Directors to the Board, the company makes considerable efforts to ensure employee owners are supportive of Board appointments.

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[2] The National Center for Employee Ownership has sponsored extensive research on these and other benefits of employee ownership. For more information, visit https://www.nceo.org/article/research-employee-ownership.

[3] For more information, see Poutsma, E., Kalmi, P., & Pendleton, A. D. (2006). The Relationship between Financial Participation and Other Forms of Employee Participation: New Survey Evidence from Europe. *Economic and Industrial Democracy*, 27(4), 637–667. https://doi.org/10.1177/0143831X06069006.

Employee Ownership Benefits: Now or Later?

This commitment to active, engaged employee ownership has led to significant financial returns for the company. While much of this profit is re-invested in the company to ensure long-term growth, CEO Friesen believes that employees also need to see the benefits of ownership on a regular basis. However, some employee ownership trusts make annual or periodic distributions to employees. Others are set up as retirement funds, meaning that employees don't receive the benefits until they leave or retire.

Because the company has a separate and mandatory pension plan for employees, CEO Friesen believes it is important to issue distributions from the trust on an annual or more frequent basis to link ownership culture with company-wide performance. For him, treating employee ownership as a retirement plan diminishes the incentives associated with ownership:

> *"We don't want to tie up all employee ownership value for retirement. Employee owners are going to benefit from ownership every year. We can't guarantee what will happen in any given year, but it's important that they understand how ownership is tied to performance."*

Balancing Loyalty and Contribution

Friesens has developed a unique approach to employee distributions. Once approved by the company and sent to the trust, distributions are divided into two pools and allocated to employees based on specific formulas for each pool. The "seniority pool" allocates the distribution by dividing the percentage of years of service of each employee by the total years of service of all employees. The "earnings pool" allocates the distribution by dividing the 5-year earnings of each employee by the total 5-year earnings of all employees. The goal of this two-part distribution scheme is to reward both loyalty and contributions to company value. Because the latter is difficult to measure directly, it is approximated by individual earnings, which include overtime earnings and commissions.

For every distribution, the company also pays a minimum value. For CEO Friesen, it is important that all employees see the benefits of ownership, even if they are new to the company:

> *"We try to pay a minimum of $500 to every employee-owner when we announce a distribution. So, even if you just started with Friesens, you immediately benefit from ownership. It's a meaningful amount that each employee is getting. Many of our new employees get $1500 or more in distributions in their first year. That's pretty significant money in your first year on the job, right?"*

Balancing seniority, tenure and organizational performance are important considerations when evaluating different models of employee ownership. Friesens is completely owned by all its employees, so they have chosen a distribution scheme that suits their needs. But other companies may only have partial ownership by some employees, so balancing these important considerations can be tricky.

Conclusion

Friesens has been in operation for over 115 years, with some degree of employee ownership for almost 70 years. Not only has the company created significant wealth for employees, it has also been a stalwart supporter of the local community. For example, every year the company sets aside a pool of money for donations and asks all employee owners to vote on where they want it to go. For CEO Friesen, another big benefit of employee ownership is that employee-owned businesses tend to remain in and support Canada's smaller communities.

In the next decade, thousands of small and medium-sized Canadian companies will be forced to contemplate their future as the baby-boomer generation retires. These companies can be sold to larger companies or to private equity firms, or they can simply be wound down. In all these scenarios, the employees who helped build these companies risk losing their jobs. Friesens has shown that another option, employee ownership, warrants consideration by owners who are planning to sell their companies. Because an employee ownership trust can borrow money to buy the company on behalf of employees, it allows the original owners to get a fair price for their holdings while ensuring that all employees enjoy the benefits of ownership.

For CEO Friesen and the rest of the employee-owners at Friesens Corporation, the recent government announcement validates what they have known for a long time: broad-based employee ownership is a viable way to structure business enterprises that create great jobs and generate the long-term profits and wealth that sustain local communities.

Discussion Questions

1. Friesens experimented with three employee ownership models. Originally, employees had direct legal ownership of the shares. As a result of buybacks, a hybrid model emerged, with some direct ownership and some indirect ownership through a trust. Concerned about mitigating employee risk after the financial crisis, the company moved towards 100% indirect ownership through a trust, which is the model still used today … and is the model that was announced by the Canadian government. What are some of the pros and cons of an indirect, trust-based model as compared to direct employee ownership of shares?

2. Friesens divides annual distributions to employee owners into two pools: one based on seniority, and one based on individual earnings. Why do you think it was important for Friesens to make this distinction when rewarding employee-owners?

3. Not all models of employee ownership make periodic distributions. Some are structured as retirement funds, which means employees only realize the value of ownership when they retire or leave the company. Friesens has instead chosen to use a trust that can make annual distributions (and sometimes more frequently). What are the pros and cons of Friesens' chosen approach for its workers and the company?

4. Friesens has not only found a profitable niche despite the wholesale shift towards digitalization; it has also outcompeted other printers to emerge as the leading short-run printer in Canada. How might employee ownership have contributed to creating and preserving a unique competitive advantage at Friesens?