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Private Equity, HRM and Employment  
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## **Private Equity, HRM and Employment**

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### **Abstract**

We analyse the employment, wages, HRM and industrial relations impact of private equity, drawing upon empirical evidence from various countries and institutional contexts. We identify different types of private equity backed buyouts and highlight the impact of creating value through long and short term ownership, and strategies emphasizing increased efficiency or growth. We show that the effects may vary between buyout types and that it is inappropriate to regard most private equity LBOs as a zero-sum game with value transferred to shareholders at workers' expense. We conclude that regulating private equity in favour of the organizational model of managerial capitalism is unlikely to necessarily further workers' interests.

### **Full paper**

The impact of private equity backed leveraged buyouts (LBOs) has attracted increased regulatory scrutiny in the past two decades. This reflects the private equity industry's growing economic importance from the 1980s onwards, and also the increased activity of private equity firms beyond their traditional US and UK markets. Private equity's growing presence in continental Europe in particular caused considerable public controversy in terms of the implications of LBOs for workers and labour unions.

For several years a concerted campaign by the Party of European Socialists in the European Parliament and the European Trade Union Confederation (ETUC) increased regulation of alternative investment funds including private equity. Some European politicians and labour unions argue that private equity takes a short-term approach to corporate ownership and increased regulation is required of an industry portrayed unfavourably as 'locusts', 'asset-strippers' and 'parasites'. These attacks form part of a broader concern that a new era of financial capitalism threatens employment and social protection in the European social model in particular. As increased regulatory scrutiny and the financial crisis in 2008 raised the stakes for both investors and critics of the private equity industry new legislation was introduced in Europe and the US. The European Commission's Alternative Investment Fund Managers' Directive (AIFM) came into force in July 2011 with transposition by member states by July 2013. In the US, the Wall Street Reform Act & Consumer Protection Act 2010 required Securities and Exchange Commission registration for private equity firms.

Against this highly-charged backdrop, this paper explores the impact of private equity LBOs on three labour management issues central to recent debates: employment and wages; human resource management practices; and industrial relations. We concentrate on these aspects because the impact of private equity LBOs on labour management and workers' interests continues to inform debates concerning the appropriate regulatory framework in which the private equity industry operates. Unless a cost-benefit analysis informs this regulatory framework, poorly-designed legislation may fail to protect workers' interests and hinder economic recovery and growth by favouring potentially less efficient organizational forms (Schuberth, 2010).

Both sides of the debate have cited cases to support their arguments. As there is no reason to suggest that examples from the private equity industry are any more objective than those from the unions, we draw on evidence from a wide variety of systematic prior empirical studies to assess the overall impact of LBOs, the heterogeneity of private equity deals, and the varied effects in different business and national contexts. In addition, we contrast labour management in private equity LBOs with labour management under alternative forms of ownership.



The paper makes the following contributions. We develop a framework to analyze the labour management aspects of private equity LBOs emphasizing the impact of long and short term ownership, and whether increasing value involves efficiencies or growth. We show that the effects may vary between buyout types and it is inappropriate to regard most private equity LBOs as a zero-sum game with value transferred to shareholders at workers' expense. Our conclusions are that further regulation of private equity in favour of alternative forms of ownership such as managerial capitalism will not necessarily advance workers' interests. In so doing, we reflect briefly on the relationships between financial markets, firms and workers in the 21st Century (Rousseau & Batt, 2007; Uchitelle, Battenberg, & Kochan, 2007).

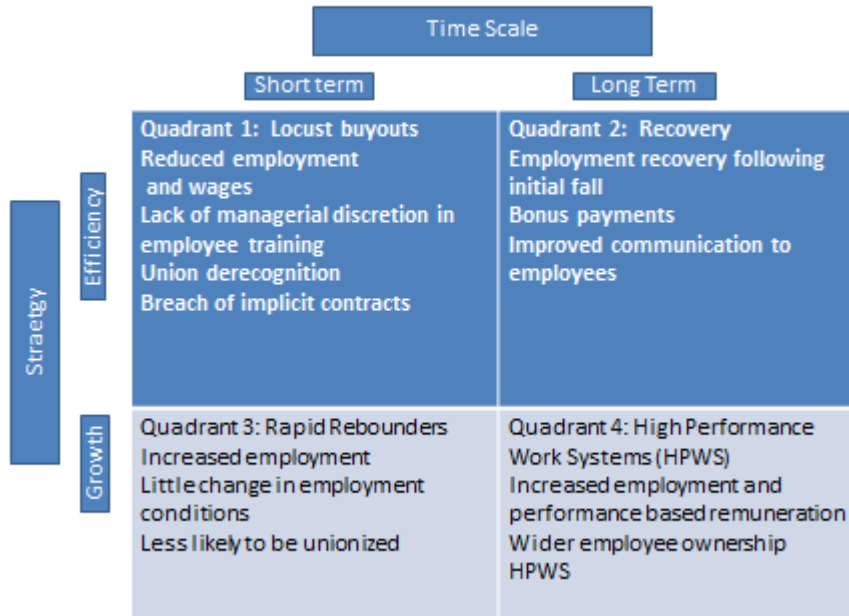
### **Cost cutting or developing growth potential?**

Private equity firms use investment funds to purchase other firms in LBOs and improve their performance before exit and sale to the market. Agency theory suggests LBOs involve a more efficient ownership structure because principal/agent problems in public corporations lead managers to act in their own interests rather than the interests of shareholders (Jensen, 1989). Private equity LBOs seek to overcome such conflicts of interest by incentivizing managers to act in shareholders' interests through the use of equity incentive schemes and the requirement to meet debt interest payments restricting free cash flow and managerial discretion. The active involvement of private equity representatives on the boards of portfolio firms and their role in appointing new executives also introduces business and operational knowledge into the firm to improve performance.

Jensen (1989) argued that private equity LBOs represent a new long term organizational form. In contrast, Rappaport (1990) viewed private equity LBOs as a short term organizational form. Subsequent developments emphasized the heterogeneous nature of private equity LBO longevity (Kaplan, 1991; Wright, Thompson, Robbie, & Wong, 1995) depending upon the contextual features of the financiers, the firm and the management team (Wright, Robbie, Thompson, & Starkey, 1994). While private equity LBOs were initially viewed as adopting strategies focused upon reducing diversification and obtaining efficiency improvements (Wiersema & Liebeskind, 1995; Harris, Siegel, & Wright, 2005), Wright, Hoskisson and Busenitz (2000; 2001) developed a heterogeneous strategic approach which also involved exploiting opportunities for entrepreneurial growth as a strategic option. Accordingly, we adopt these time and strategy dimensions as the basis for a framework to analyze the labour management aspects of private equity LBOs (Figure 1). Following practice elsewhere (e.g. Wright et al., 2000), we supplement our conceptual arguments derived from the literature with example cases to illustrate each quadrant.



**Figure 1: Buyout Types and Employment Relations**



We locate most critics of private equity firms in Quadrant 1 as they suggest private equity 'locust buyouts' involve short term ownership and a focus on increasing organizational efficiency to extract value. This involves a zero-sum game with value transferred to shareholders at the expense of workers' jobs and wages (Appelbaum, Batt, & Clark, 2011; Fox & Marcus, 1992; ITUC, 2007a; PSE, 2007). It is argued that portfolio firm managers are incentivized by remuneration packages and the high debt levels incurred on buyout to divest value-destroying parts of the business, reduce employment, and reduce wage costs. According to this 'buy it, strip it, flip it' view (ITUC, 2007b, p. 3), servicing debt repayments also encourages a short-term approach to business and undermines the capacity to develop internal labour markets, pay workers' for productivity improvements, and undertake long-term investment in workers' skills. Private equity LBOs are regarded as hostile takeovers with temporary ownership encouraging breach of implicit wage and benefit contracts, thereby undermining trust and reciprocal commitments between owners, portfolio firm managers and workers (Shleifer & Summers, 1988). Some critics of private equity defend the alternative organizational form of managerial capitalism and the public corporation as involving longer term ownership and the use of retained earnings to protect employment, increase workers' wages, and invest in training and development (Appelbaum & Batt, 2012, p. 10).

Specific private equity LBOs that have been used to illustrate these concerns include Birds Eye and the AA in the UK, TXU in the US, and Cognis in continental Europe. We concentrate here on the LBOs of Birds Eye in separate European and US deals. The private equity firm Permira purchased the European fish finger and frozen peas business from Unilever in 2006 for €1.7bn. It closed the Birds Eye factory in Hull (England) six months later with the loss of over 600 jobs to concentrate production in Germany. According to Amicus the Union, 'The staff involved were not kept fully informed and had no protection from the rapacious and relentless decisions made about the company's viability and their job security' (Amicus, 2007). In the US, Vestar Capital bought Birds Eye in 2002 and reduced the workforce from 4,000 to 1,700 as it sold underperforming facilities (Altner, 2012). Restructuring continued after Blackstone Group's secondary buyout of Birds Eye in 2009 with the closure of the Birds Eye plant in Fulton, New York, in 2012 with the loss of 277 jobs (Selway & Braun, 2012).



Such LBOs often implement restructuring to reverse the value destroying investment decisions or delayed decisions made under previous owners prior to the buyout. For example, Unilever planned to close the Hull factory prior to the sale of Birds Eye in Europe (Thornton, 2007: 15). As performance improved following the LBO with five consecutive years of growth it was up for sale for around €3bn in 2012 attracting interest from trade and private equity purchasers as a 'buy and build project' (Leyland, 2012). Birds Eye in the US also appeared to require restructuring prior to buyout as it lost \$131m in the year before sale to Vestar Capital. The business returned to profitability under private equity ownership and made a profit of \$54m in 2009 before sale to Blackstone (Altner, 2012).

The contrasting view in Quadrant 4 suggests that private equity LBOs are a positive-sum game, creating value for shareholders and workers from a long term approach to ownership and an emphasis on organizational growth to increase value. Investment in profitable growth and improved productivity in these LBOs provides for sustainable employment, wage growth, and training to upgrade workers' skills (Achleitner & Klöckner, 2005; BVCA, 2007). These outcomes reflect private equity firms' allocation of capital to better executives and managers who introduce superior strategic and operational knowledge to improve performance in LBOs. This involves an increased business focus on value-creating activities and divestment from unprofitable operations. These LBOs require a long-term perspective because, although private equity firms are not permanent owners, investment for long-term growth is required to increase the value of the buyout realized on exit (Tåg, 2012). Workers may benefit from the creation of a more viable enterprise able to deliver increased employment security, wage growth and investment in workers' skills required for business development.

Netherlands-based NXP Semiconductors, Europe's third largest chipmaker, illustrates the positive role of private equity LBOs in developing and growing businesses in volatile market sectors. The lighting company Phillips sold its semiconductor business to a consortium of private equity firms in 2006 for €3.45bn in the sector's largest LBO. Phillips had not attached a high priority to developing its semiconductor business given the sector's volatility. Private equity firms took on this risk outside Phillips' constraints and enabled growth prospects to be realized. This involved private equity investors reallocating R&D expenditure to product areas with greater potential, in contrast to Phillips' concentration on investing in the medical sector. Whereas Phillips had tolerated senior management underperformance this was quickly addressed following the LBO, with improvements expected within 3-6 months. As a result, 15% of NXP senior managers were replaced and a more professional approach to executive recruitment introduced. This contributed towards improvements in capacity management and utilization. HR executives reported consultation with unions gained a sharper focus as the NXP European works council concentrated on issues affecting the NXP workforce and private equity representatives attended each year, in contrast to the broader remit of the Phillips European works council.

LBOs such as these involve higher risks than public corporations are able to undertake and some fluctuations in employment growth may be expected. A downturn in the semiconductor market initially led to plant closures and layoffs in 2008-2009. Even when the market improved in 2010 and NXP returned to economic growth, weak financial performance made it difficult for private equity firms to exit without significant losses on their investments.

Short term ownership under a private equity LBO may also support firms seeking capital and know-how for rapid growth ('rapid rebounders' in Quadrant 3). These LBOs grow quickly and increase employment by expanding their current business activities. In rapid rebounders, continuity in business activities suggests that though there may be some adjustments, many HRM practices are likely to continue unchanged after the LBO. Gondola in the UK owning the Pizza Express, Ask and Zizzi brands illustrates this type of LBO, as does Domino's Pizza in the US. Gondola was formed by acquisitions under private equity ownership during 2003-5 but had subsequently underperformed after floating on the stock exchange in 2005. The company had been valued as a growth business but was not growing. Management tried to satisfy shareholders by cutting investment in the base business, making a poor investment decision in a state of the art distribution center working at 25% of capacity, acquiring a loss-making international business, and making redundancies. It was taken private for a



second time with Cinven's LBO in 2007 to enable efficiencies and firm growth. It merged two separate management teams, created shared services, introduced a professional marketing department and a commercially-oriented accounts department, and created a common supply chain. As the number of restaurants quickly increased, Gondola made some modest adjustments to HRM to accommodate this growth in a sector with traditionally high staff turnover, such as introducing a leadership program, improving training levels, placing a strong emphasis on internal recruitment, creating career ladders offering promotion, and introducing incentive pay to reward and retain managers. Employee engagement increased and staff turnover reduced as a result of these changes.

Other private equity LBOs are 'recovery buyouts' (Quadrant 2) and involve a long-term ownership commitment to build an efficient business. Copenhagen-based ISS illustrates this type of LBO. ISS was established in 1991 and eventually became one of the world's largest private sector employers with over 530,000 staff in more than 50 countries providing outsourced cleaning and other services. ISS had initially grown through acquisitions until tight financial management to limit debt constrained business growth after 2000. Profit margins and stock price had been declining after a period involving what were perceived as expensive acquisitions and the company embarked on focusing on profitable customers with a negative impact on organic growth. The \$3.8bn LBO in 2005 enabled the introduction of a new strategy to develop the business over a 5-9 year timescale before exit. Acquisitions increased the number of countries in which ISS operated and extended the range of integrated services offered to clients. ISS demonstrated a long term approach to labour management in signing a pioneering global agreement with the UNI Global Union in 2008. This agreement includes concrete commitments to support union organizing rights and ILO Conventions (Transport International Magazine, 2009). When ISS wins new contracts it seeks to make use of the EU Acquired Rights Directive and take on existing onsite workers while protecting their wages. When it loses contracts it seeks to retain and redeploy workers rather than reduce wages to win contracts.

Critics of private equity LBOs categorize most if not all deals as locust buyouts involving short-term ownership and seeking to realize value through efficiencies at labour's expense. Our framework suggests this is a partial description of private equity LBOs as many involve a long-term commitment to develop assets with upsides for labour. As described above, private equity may hold assets for both short and long periods, and they may seek to deliver value through opportunities to increase efficiency and growth. We suggest private equity LBOs involve different combinations of strategic alignment of ownership form, investment timescale, business strategy, and the appropriate operational practices required, including labour management practices. Within the quadrants in Figure 1, companies may be majority or minority owned by private equity firms and the management teams involved may be incumbents (a management buyout, MBO) or from outside (a management buyin, MBI). These different deal types may arise because of the different company circumstances pre-deal and give rise to different strategies and time horizons post buyout with different implications for labour. In addition, concentrating on efficiency improvement or growth does not exclude an interest in the other strategy. Many LBOs involve both, although most focus on either growth or efficiency.

Thus far we have argued that only 'locust buyouts' involve a zero-sum game with value transferred to shareholders at the expense of workers' jobs and wages. The key question is whether most LBOs resemble 'locust buyouts' as argued by critics of this organizational form. Assessing this requires consideration of evidence concerning the overall impact of private equity LBOs on labour management. The following sections review the main findings to date.

### **Employment and Wages**

Critics of private equity in Europe suggest that LBOs involve reductions in workers' employment and wages (PSE, 2007). Recent US critics have gone further suggesting private equity is partly responsible for the increase in the low wage segment of the US economy and stagnant wage growth. For example, Appelbaum (2010, p. 58) argues low wages and stagnant wage growth has been 'exacerbated by hedge funds and private equity firms that load companies with debt and then rely on the 'discipline' of high interest payments to pressure them to strip assets, reduce wages and benefits, and downsize employment in order to raise margins'. This section reviews the many studies that



have estimated the overall impact of private equity LBOs on employment and wages to assess such claims.

## **Employment**

The majority of initial studies assessed overall employment effects in the US and the UK. These studies use broadly similar methods to identify private equity LBOs from different databases and employment data from company accounts or other databases. Reviews of 18 different studies by Wright, Gilligan, and Amess (2009) and Wright, Bacon, and Amess (2009), and Lutz and Achleitner's (2009) review of 49 studies, all highlight the mixed findings of individual studies, but conclude that overall private equity LBOs do not appear to systematically erode employment. Tåg's (2012, p. 278) recent review of employment effects in 17 studies similarly finds 'weakly negative or no effects on employment'. The studies reviewed include a range of methods, such as firm level surveys, data from firms' annual accounts and plant-level data, and cover different countries. Overall they suggest critics are wide of the mark as long-term employment growth differs little in private equity-owned firms compared to other firms in the private sector. However, more fine-grained analysis reveals some notable variations within this general picture.

The vendor source of the transaction matters. Achleitner and Klöckner's (2005) European survey suggests employment effects ranging from 7.1% growth in family firm buyouts to a 3.8% decrease in turnarounds. The disposal of non-core parts of the business following buyouts does appear to result in an immediate but short-lived post transaction employment decline at the firm level (Wright et al., 2009; Davis, Haltiwanger, Jarmin, Lerner, & Miranda, 2011; Amess & Wright, 2010; Amess, Girma, & Wright, 2008). This initial decline in employment reflects divestments from unprofitable or non-core business. However, caution should be exercised in concluding that this initial employment decline in LBOs equates with job destruction, as divestments may involve the sale of establishments as going concerns to new owners. Most studies suggest buyouts then concentrate on building the core profitable business and increase employment before sale of the business. The most comprehensive analysis of private equity LBOs in the US terms this process 'creative destruction'. LBOs are involved in the process of divesting non-core business while at the same time acquiring and developing new business (Davis, Haltiwanger, Jarmin, Lerner, & Miranda, 2011). As a result, private equity LBOs reduce employment at a faster rate in existing establishments and increase employment at a faster rate in newly-created establishments. Such findings support matching theory predictions that ownership change is an effective mechanism for sorting establishments and workers to more efficient uses (Siegel & Simons, 2010).

Comparisons with private sector firms under alternative forms of ownership further help assess the impact of private equity on employment. The most complete analysis of private equity LBOs in the UK comparing LBOs with other private sector firms from 1995 to 2010 shows less employment volatility and overall employment growth in LBOs (Wilson, Wright, Siegel & Scholes, 2012). Analysis of recent US data shows private equity LBOs are more likely to close establishments with low labour productivity than other firms (Gurung & Lerner, 2009). Employment growth may not emerge until some years after the buyout transaction (Cressy, Munari, & Malipiero, 2011). Following the first few years of the LBO, the subsequent acquisition of new business and greenfield job creation increases employment levels (Gurung & Lerner, 2009). Although employment growth via the acquisition of establishments does not reflect job creation (Appelbaum & Batt, 2012, p. 19), much of the employment growth following US LBOs involves 'new jobs in new establishments' (Davis, Haltiwanger, Jarmin, Lerner, & Miranda, 2011, p. 24).

Recent studies have explored the impact on employment in continental Europe using archival data. Boucly, Sraer, and Thesmar (2011) report 13% higher employment growth in 830 LBOs in France compared to a control panel of private sector firms. Post-buyout growth occurred in private-to-private transactions rather than divisional buyouts or public-to-private buyouts. LBOs in Spain reported employment growth 4% higher than a control panel (Marti Pellon, Alemany, Zieling, & Salas de la Hera, 2007) and a study of 53 Belgian LBOs from 1998 to 2005 reported higher employment growth than a control panel (Toubeau, 2006). This employment growth may reflect the important role of



private equity investment to assist firm growth in European capital markets with constrained credit. These findings suggest private equity LBOs have clearer positive effects on employment than in the US and UK. However, these studies do not distinguish between MBOs and MBIs.

Many studies have not distinguished between the heterogeneity of private equity LBOs to explain the impact of different types of deals on employment. Different findings have been reported between management buyouts, where incumbent managers take a leading role and management buyins and investor-led deals, where external management and private equity investors take the leading role. In general, where studies do make a distinction they find that management buyouts on average tend to have a significant positive effect on employment while management buyins and investor-led buyouts on average tend to have a significant negative effect.

Amess and Wright's (2007) study of 1350 UK LBOs found no significant effect on employment up to five years after buyout, but employment growth in management buyouts was higher than non-buyouts and lower in management buyins. Wilson et al. (2012) also report management buyouts had a stronger positive effect than management buy-ins on employment and they attribute this to the greater likely involvement of incumbent management teams in buyouts where they identify opportunities for growth that cannot be developed under their current organizational form. A further study focusing only on investor-led private equity LBOs of UK listed corporations between 2000 and 2006 reported a negative employment effect up to three years later (Goergen, O'Sullivan, & Wood, 2011).

Employment reductions as a result of private equity LBOs should not necessarily be considered equivalent to increased job insecurity. Olsson and Tåg's (2012) study of 201 private equity LBOs in Sweden between 1998 and 2004, using linked firm-employee data, reports no overall firm-level employment growth and a decline in unemployment risk of 12.7% over 4 years. Unemployment risk declined because lower establishment employment growth was attributable to reduced hiring rather than increased lay-offs. Interpreting the employment implications of LBOs is further complicated because the distribution of any employment reductions is rarely studied. It is not necessarily the case that LBOs involve reductions in blue collar workers who may experience harsh penalties from job loss. Although we lack recent studies, Lichtenberg and Siegel (1990) reported significant declines in US white collar employment rather than blue collar employment in LBOs of manufacturing firms.

The management of redundancies in private equity LBOs is rarely studied. The only study to date is a representative mail questionnaire survey conducted by the authors and published by the industry which suggests the main reasons for redundancies in European private equity LBOs are to increase competitiveness and result from reorganizing production methods (EVCA, 2008). Most private equity LBOs in the study offered help to workers if making redundancies, with enhanced severance packages provided by 65% of LBOs, training offered by 46% of LBOs, and outplacement assistance to displaced staff offered by 46% of LBOs (ibid.). Of the LBOs making workers redundant, 75% had consulted workers or labour unions prior to making the decision in line with EU statutory requirements. As a result of these consultations, 20% of LBOs increased redundancy payments and 12% reduced the number of redundancies.

The broader impact on employment in sectors where private equity is most active sheds important light on whether private equity has spill-over effects on job creation and job destruction. Bernstein et al.'s (2010) longitudinal study of 14,300 LBOs in 26 OECD nations across 20 industries shows higher employment and productivity in industrial sectors where private equity firms have invested. Furthermore, less employment volatility was recorded in industries where private equity had invested. The findings hold for continental Europe as well as the US and UK (Gurung & Lerner, 2009).

All the studies mentioned above draw on surveys or datasets involving surviving buyouts. It is also important to assess whether bankruptcy rates are higher among LBOs as this may involve significant job destruction. Widespread insolvency among highly leveraged buyouts was identified as a significant threat to economic recovery and growth following the 2008 global financial crisis (Vitols, 2009) but recent empirical studies have not substantiated such fears. Controlling for a range of risk factors, Wilson and Wright (2012) using financial and non-financial data for virtually the population of





UK companies, find that private equity LBOs have a higher failure rate than non-buyout companies probably because companies that are bought out are not a random subset of the population but are usually firms that have been identified as under-performing in some way. Wilson and Wright (2012) also find that a greater likelihood of failure is significantly associated with higher leverage for all firms. Post-2003, however, when changes to the UK bankruptcy process were introduced, through 2010 there is no significant difference in insolvency risk between private equity LBOs and the non-buyout population. They also find that management buyins have a significantly greater insolvency risk than management buyouts. Hotchkiss, Smith and Stromberg (2011) using US data similarly find that private equity LBOs are not more likely to default than other firms with similar leverage characteristics, and that private equity LBOs in distress are more likely to survive as an independent reorganized company. Bernstein et al. (2010) offer several potential explanations of these findings, suggesting private equity firms may be more likely than other investors to continue to provide equity financing during downturns, higher debt levels may force private equity LBOs to adjust more quickly to weather downturns, and they are not at risk of the withdrawal of funds by short-term investors. Gurung and Lerner (2009) further report the productivity growth differential in favour of private equity LBOs compared to other firms increases during periods of financial stress, explaining this reflects the greater tendency of private equity LBOs to close less productive establishments and reallocate resources to more productive establishments.

Overall, the findings in this section suggest private equity LBOs are an effective mechanism for sorting establishments and workers to more efficient uses. The type of deal and its vendor source may reflect whether the strategy to improve performance emphasizes efficiency or growth, with consequences for changes in employment. The national context may also influence employment effects.

### **Wages**

Relatively few studies have assessed the impact of private equity LBOs on workers' wages (Gilligan & Wright, 2012). Lichtenberg and Siegel's (1990) study of over 12,000 US manufacturing plants reported the compensation of blue collar workers following LBOs was unchanged whereas it declined for white collar workers. Using UK accounts data, Wright et al. (2007) report wage growth in both MBOs and MBIs compared to before the buyout, but wage growth is lower than in non-buyouts according to studies in both the US and UK (Amess & Wright, 2007; Lichtenberg & Siegel, 1990). Furthermore, Amess et al. (2008) find that wage growth is less in UK private equity LBOs than in traditional acquisitions.

Recent studies have reported more positive wage outcomes. Gurung and Lerner (2009) report productivity gains are shared with workers in the form of higher wages in private equity LBOs, the relationship between productivity gains and wage increases is stronger than in other firms, and the productivity gains are higher than in other firms. Boucly, Sraer, and Thesmar (2011) report higher wage growth in their sample of 830 LBOs in France compared to a control panel. The factors that private equity LBO managers take into account in deciding pay levels and awards appear similar to the factors managers taken into account under other forms of ownership (EVCA, 2008). As a result of these recent studies, Tåg (2012, p. 287) concludes the evidence overall suggests 'slight positive effects on wages' after private equity LBOs. However, the extent of this effect appears to vary between national context and deal type.

Pension schemes are a further area of concern given the consequences for workers on retirement. The limited research conducted to date, based on representative mail questionnaire survey responses, suggests European LBOs do not have a negative impact on occupational pension provision (EVCA, 2008). The proportion of LBOs offering occupational pension schemes increased from 76% pre-buyout to 81% post-buyout. In line with trends across all firms, pension schemes post-buyout tended to evolve more towards open defined contribution money purchase schemes, while the share of defined benefit salary-related schemes decreased. Few LBOs in this study reported deterioration in the post-buyout terms of occupational pension schemes, with only 1.4% of LBOs reporting a material reduction of the security of pensions in the event of hypothetical insolvency.



## **Human resource management in LBOs**

Recent work has further explored changes to HRM practices in private equity LBOs. Critics of private equity suggest a short-term orientation and emphasis on reducing costs to service debt prevents LBOs from making long-term investments in high performance work systems (HPWS) to develop employee skills, increase employee commitment, and elicit discretionary effort. This is an important issue because HPWS are associated with higher levels of organizational performance, and both extrinsic (employment and wages) and intrinsic (job satisfaction and commitment) benefits for workers. In contrast to employment and wages, evidence on HRM and on industrial relations aspects which we consider below is not available from published sources; studies are thus based on representative questionnaire surveys.

Survey evidence from across the globe suggests positive aspects of private equity LBOs on HRM. Evidence from Europe indicates that private equity LBOs, both management buyouts and buyins, are more likely to report increased rather than decreased use of practices associated with HPWS (Bacon, Wright, & Demina, 2004; Bacon, Wright, Meuleman, & Scholes, 2012; Bruining, Boselie, Wright, & Bacon, 2005). Gurung and Lerner (2009) similarly report that private equity owned firms are better managed in terms of merit-based hiring, firing, pay and promotions practices than government, family and privately-owned firms, although the differences with dispersed shareholding firms are not significant. Bloom, Sadun, and van Reenan's (2010) survey of over 4,000 medium-sized manufacturing firms in the US, Europe and Asia, found private equity LBOs to be among the best-managed group of firms with no significant differences with dispersed shareholder firms. This included 'strong' human resource management practices (hiring, firing, pay and promotions) 'consistent with the literature on HPWS' (Bloom, Genakos, Sadun, & van Reenan, 2012, p. 13), albeit with a narrow focus on performance monitoring, target setting and incentives, and lean operations management practices. These studies suggest private equity LBOs provide an important stimulus in encouraging the adoption of productivity-enhancing practices.

However, within these general findings, there are important indications that opportunities for private equity LBOs to improve performance by introducing HPWS practices vary by institutional context. Evidence from both representative mail questionnaire surveys and case studies indicates that private equity LBOs in liberal market economies report increased use of HPWS practices to address the under-investment in human capital and short-term approach of previous owners. Private equity LBOs in coordinated market economies acquired firms with many statutory HPWS practices concerning training and information-sharing already in place that appear to continue largely unchanged (Bacon, Wright, Demina, Bruining, & Boselie, 2008; Gospel, Haves, Pendleton, Vitols, & Wilke, 2010).

Although little work has explored the impact of private equity on job quality the findings produced so far do not support critics' claims that private equity ownership involves 'work intensification' (Appelbaum & Batt, 2012, p. 35). Amess, Brown, and Thompson (2007) using UK workplace survey data report skill-biased organizational change with higher employee discretion in firms that had experienced LBOs compared to firms that had not. Increased employee discretion is compatible with previous US findings that LBOs involved a reduction in non-productive workers in manufacturing sites (Lichtenberg & Siegel, 1990).

Private equity LBOs' investment in HPWS practices may improve performance by addressing the failure of publicly-owned firms to invest in human capital, particularly in the US and the UK. Opportunities to increase value by investing in HPWS may exist where financial controls in diversified publicly-listed companies prevent managers from investing in human capital.

Rather than discouraging HPWS (Levy & Kochan, 2011) private equity LBOs may represent a long-term governance structure to support long-run investments (Gurung & Lerner, 2009). Private equity firms maintain investments in portfolio firms for longer than investors in publicly-listed companies (Gottschalg, 2007) and this increases the likelihood of realizing returns on such investments. As Figure 1 suggests, timescale to exit is important. A longer anticipated timescale to exit is associated



with increased investments in human capital in portfolio companies (Bacon, Wright, Meuleman, & Scholes, 2012).

Further, the fortunes of private equity investors, senior executives, and often portfolio firm managers are directly tied to the success of venture, whereas managers in public companies often do not appear to be held accountable for their decisions. We question the suggestion that the fortunes of managers in public companies rise and fall with the company, and are tied to long-term success (Appelbaum & Batt, 2012). The relationship between senior executive remuneration and company performance is far from evident, managers often leave companies at early signs of financial difficulties for more lucrative employment, and divisional managers are often internally reassigned every few years before the initiatives they introduced may be assessed.

The alignment of investment timescale and business strategy in private equity LBOs appears to increase the strategic alignment of HR practices and underpins investments in human capital to support growth strategies. Linking business strategy to value creation and private equity plans for exit supports appropriate HR practices connected to the ownership form and investment timescale. LBOs competing on the basis of the quality of products or services rather than price, and those pursuing 'buy and build' strategies, are more likely to report adopting HPWS practices (Bacon, Wright, & Demina, 2004). This process may be connected to the close working relationships and intense engagement reported between portfolio firm HR Executives, their chief executive and active private equity investors. This contrasts with HR Executives in publicly-listed firms, especially multi-divisional firms, where financial control systems make it difficult to invest in human capital, HR Executives are often excluded from the boardroom, divisions attach little value to central HR programs, and HR specialists are not able to invest in HPWS to improve firm performance. Portfolio firm HR Executives appear to develop a close working relationship with other executives, and appreciate the hands-on involvement of private equity investors in the run up to the buyout event as HR objectives need to be aligned throughout the organization (Boselie & Koene, 2010).

Improvements in the stock of HR expertise and talent by appointing new HR executives in portfolio firms may further explain the strategic approach to HRM reported. The HR executives appointed have often worked in private equity LBOs previously and provide two reasons why they only wish to work for private equity LBOs. First, they often move between private equity LBOs alongside a chief executive with whom they have a long standing working relationship. Second, private equity LBOs provide greater opportunity to craft HPWS practices to drive-forward performance.

### **Industrial relations in portfolio firms**

Private equity firms have also attracted increased attention as new actors in the industrial relations system. Concerns have been expressed as to whether LBOs have a negative impact on employee voice in corporate and workplace governance. The International Trade Union Confederation (ITUC, 2007a, p. 5), for example, has accused private equity firms of a 'refusal to engage in collective bargaining and outright harassment of workers who organize in trade unions'. This may be partly assessed by considering the effects on labour union recognition and the range of issues subject to consultation and negotiation. Note however that most LBOs take place in non-union firms.

Union de-recognition was relatively rare following UK buyouts in the 1980s (Wright & Coyne, 1985). Evidence from the mid-1990s reported that five percent of UK buyouts lost union recognition immediately on buyout but this subsequently increased back to pre-buyout levels (Bacon, Wright, & Demina, 2004). Dutch buyouts with a higher level of union recognition in general also showed a similar pattern (Bruining, Boselie, Wright, & Bacon, 2005). A recent representative pan-European questionnaire survey reported that private equity LBOs did not result in changes to union recognition, membership density, or changes in management attitudes to labour union membership (Bacon, Wright, Scholes, & Meuleman, 2010).

Labour unions have nevertheless expressed frustration that negotiations take place with portfolio firm managers rather than owners, with private equity firms sometimes referred to as invisible employers



(Appelbaum, Batt, & Clark, 2011). The European Commission's AIFM Directive suggests this argument is somewhat specious as unions usually negotiate with managers rather than owners; it would be exceptional to insist investors negotiate directly with labour unions and the European Commission has not imposed this requirement. Such a step appears unnecessary for private equity firms because LBOs recognizing unions do not report reductions in the range of issues subject to negotiation or consultation. Private equity LBOs are more likely to introduce than abolish consultative committees, portfolio firm managers are more likely to regard consultation as influential on their decisions, and consultation increases on future plans to improve firm performance (Bacon et al., 2010). These effects appear to vary between countries as stronger national regulations in some European countries affect the extent to which labour unions are informed and consulted over post-buyout restructuring (Gospel et al., 2010).

An important caveat is that labour unions seldom report being informed and consulted during the buyout process (Gospel et al., 2010). The AIFM Directive seeks to address this by requiring private equity firms to encourage portfolio companies to disclose relevant information to labour representatives or workers, including during the buyout process. This involves disclosing intentions and the "likely repercussions on employment, including any material change in the conditions of employment". Payne (2011: 22-23) is probably correct to note 'the obligation will be fulfilled by fair but general information' and 'It does not seem likely that these provisions will materially improve the position of stakeholders in a portfolio company facing a purchase by a private equity fund'. The European Commission has regarded as unnecessary the European Parliament's proposals for additional worker's rights to protect employment during private equity LBOs.

## **Conclusions**

This paper developed a framework of four different types of private equity LBOs to assess the implications for labour management. We argued these implications are affected by whether private equity LBOs sought to create value through long or short term ownership, and strategies emphasizing increased efficiency or growth. In suggesting private equity LBOs have negative implications for worker's interests most critics concentrate on 'buy it, strip it, flip it' locust buyouts, involving short term ownership and a focus on improving efficiencies (Quadrant 1 in Figure 1). Our analysis of the employment, wages, HRM and industrial relations consequences suggests most private equity LBOs are not of this type but fall into the other quadrants in Figure 1. The type of private equity LBOs most likely on average to fall within Quadrant 1 appears to be management buyins and investor-led buyouts of listed corporations, typically because of pre-LBO performance difficulties. But some deals of this type may also fall within the other quadrants.

Drawing upon empirical evidence from various countries and institutional contexts we sought to capture the global impact of private equity. Comparisons with control groups of firms under alternative forms of ownership provided insights into the possible consequences of regulations to discourage the private equity business model. Appreciating the different types of private equity LBOs enabled a better understanding of the impact of new organizational forms and financial markets on labour management.

We reported that long-term employment growth differs little in private equity LBOs compared to other firms in the private sector. 'Creative destruction' in private equity LBOs involved the rapid process of divesting non-core businesses, acquiring and developing new businesses. There is little evidence that the bankruptcy rate of private equity LBOs is greater than for other firms, particularly in the recent recessionary period. Private equity LBOs appear to be an effective mechanism for sorting establishments and workers to more efficient uses. We also found no overall evidence of negative effects on wages after private equity LBOs. However, we emphasized the importance of recognizing the heterogeneity of LBO types, with the employment and wage effects being generally more positive in management buyouts than in management buyins. We also noted that the employment and wage effects may differ according to the vendor source from which the LBO emanated, with management buyins and investor-led buyouts of listed companies on average experiencing more negative consequences than management buyouts of divisions or from family firms.



Studies conducted in Europe, the US, and Asia, generally suggest positive effects of private equity LBOs on employment and wages, and that private equity LBOs are better-managed than firms under other alternative forms of ownership. However, country and institutional context appears to matter, with employment and wage effects appearing to be more positive outside the US and the UK. Many introduce practices associated with HPWS and consultation to enhance employee and organizational performance, but more so in liberal market economies than in coordinated economies in Europe. Labour union derecognition and reductions in consultation is exceptional in European private equity LBOs, especially in highly regulated economies. Portfolio firm managers report consultation with unions on a broader range of issues. These changes represent a strategic alignment of investment timescale, business strategy, and labour management in private equity LBOs.

On the basis of these findings, we conclude it is inappropriate to regard private equity LBOs as mainly resembling a zero-sum game with value transferred to shareholders at workers' expense. Comparing private equity LBOs with other alternative forms of ownership does not suggest that increased regulation of private equity ownership will necessarily further workers' interests. In the remainder of this paper we discuss the implications for further research and then public policy, managers and labour unions, reflecting briefly on the relationships between financial markets, firms and workers in the 21<sup>st</sup> Century.

### **Further research**

Although much is now known about the impact of private equity LBOs on labour management, interesting questions remain to be addressed. Although there is some earlier evidence of the impact of private equity LBOs on the occupational distribution of employment reductions, notably on the balance between white and blue collar workers (Lichtenberg & Siegel, 1990), recent evidence is scant and lacks comparisons with non-LBOs. With respect to wages, improving on previous studies will require moving beyond wages measured as the total wage bill per employee to account for hours worked. There is also a need here to assess the distribution of wage changes, in particular, whether portfolio firm managers and workers are treated differently in LBOs than in other types of firms.

The overall employment and wage effects of private equity LBOs may be marginally positive but understanding the circumstances under which they are not may help to mitigate negative effects on labour. Such an analysis requires recognition of the heterogeneity of private equity LBOs. Our framework has identified four broad private equity buyout types and provides a basis to further examine these different circumstances. We have also noted that the variety of deal types within our quadrants in Figure 1, may give rise to different strategies and time horizons post buyout with different implications for labour. Although progress has been made in recognizing the differences between MBOs and MBIs, more fine-grained analysis is required of the different strategy processes that are implemented following these different types of deals.

More evidence is also required on practices adopted to inform and communicate with staff prior to and during the buyout. A lack of preparation in this regard may make it more difficult to retain staff and build staff engagement post buyout. Future studies may usefully explore potential tensions between the requirements of financial disclosure and confidentiality agreements, given the requirement to inform and consult labour unions in a timely manner.

### **Implications for public policy, managers and labour unions**

The ETUC regards regulatory reforms of private equity contained in the AIFM Directive as too weak and the regulatory agenda as 'far from having been completed' (Botsch, 2010, p. 50). It remains the aim of US critics to 'discourage the entire business model' through a series of reform proposals (Kuttner, 2010, p. 35). Excessive regulation of private equity LBOs may however restrict investment required to fund economic growth and recovery (EVCA, 2009). Evidence that the performance of private equity LBOs is more resilient than in other firms (Wilson, Wright, Siegel, & Scholes, 2012) further suggests increased regulation may hinder sustainable economic growth. Private equity LBOs



appear to have an important economic role in helping sort establishments and workers to more efficient uses. Regulating this process of 'creative destruction' requires a balanced public policy approach. Private equity LBOs invest in new entrepreneurial activities that generate future employment in existing and new establishments. Jobs in uncompetitive establishments and low return activities appear economically unsustainable regardless of ownership. As such, public policies to support smooth transitions to new employment are arguably more appropriate than protecting inefficient employment.

Adequate protection for incumbent workers during the buy-out process is an important feature of a balanced public policy approach. As share transfers in LBOs involve a change in ownership and employer continuity existing terms and conditions of employment are covered by legislation in many countries on contractual conditions and continuous employment rights (OECD, 2008: 14). An extension of acquired rights legislation to share transfers including private equity LBOs appears unnecessary without more evidence of extensive and detrimental changes to workers' terms and conditions following LBOs. Workers' terms and conditions in ongoing establishments divested by European LBOs and acquired by another employer are protected by national laws transposing the EU Acquired Rights Directive. Establishment closures are subject to national statutory requirements relating to redundancy including consultation, selection, redeployment and assistance in finding new employment.

National legal requirements for consultation or participation such as via works councils are unaffected by changes of ownership (OECD, 2008: 14). The EU's AIFM Directive imposes additional responsibilities on private equity firms to encourage portfolio company managers to inform and consult labour unions, including disclosing its intentions during the buyout process and the likely repercussions. Such changes are likely minimal in practice as the EU's Information and Consultation of Employee Regulations already require employers to inform and consult labour unions. Labour unions may pursue legal redress where employers fail to comply with legal requirements in these areas. Providing unions with powers to veto share sales to private equity firms would constitute a radical change in corporate governance and ownership rights. In addition to legal requirements, the private equity industry has developed industry guidelines to improve disclosure and transparency. This includes commitments to engage with stakeholders more effectively in the future (EVCA, 2009, p. 5) against which the industry will be assessed.

The private equity industry was underprepared for the sustained labour movement campaign and regulatory inquiries in recent years. The privacy traditionally valued by the industry to provide breathing space to restructure and build more effective firms contributes towards public distrust. Both the private equity industry and labour movements have engaged in extensive political lobbying and political patronage in recent years. Private equity firms have sought to reduce employment protections and labour unions sought to discourage the private equity business model. This attritional battle of political wills is damaging on several levels. It undermines effective working relationships in LBOs and may deter instances where private equity firms, managers and labour unions work together to help save distressed firms. It may also entail further significant costs. Costs for private equity include regulatory pressure, low public confidence, industrial disputes, and low stakeholder/employee commitment. Costs for labour unions include legislative proposals to weaken existing worker protections, and employer reluctance to recognize unions and engage in meaningful negotiation.

Moving on from this impasse requires establishing new relationships between financial markets, firms and workers in the 21st Century (Rousseau & Batt, 2007; Uchitelle et al. 2007). It requires alliances of substance within corporate governance structures to encourage an alignment of interests between new financial actors such as private equity firms and labour. This requires more imagination than simply reproducing the social compact of the managerial capitalism period in the US and UK. This produced conflictual arms-length labour-management relations, low productivity industries, and large-scale redundancies.

New accords are hard won on both sides and require strategic foresight at peak levels. Building on the social dialogue established during recent regulatory debates requires the development of a



shared understanding as to the respective legitimate contributions and genuine concerns of each side. A new social contract between finance and labour likely requires labour's commitment to portfolio firm success and support for the process of sorting establishments and workers to more efficient uses. In return, active investors likely need to involve labour in key decision-making and make explicit commitments to gain-sharing. The obstacles to a new social contract between finance and labour are significant but the following suggest they are not insurmountable. Labour unions routinely accept the case for closing loss making establishments and may help with establishment transfer of ownership to prevent closure. The extensive literature on labour participation in decision-making offers examples of how to transform labour-management relations and increase cooperation. As active investors, private equity firms are involved in monitoring managers and assisting in the long term strategic direction of portfolio firms. Including labour in this process may improve the shared commitment required to maximize investment value. Private equity firms are experienced in designing appropriate incentives to share gains through forms of employee ownership, profit sharing and stock options. The strong relationship between pay and performance used in management incentives may be usefully extended to all workers. We suggest private equity firms and labour representatives have the necessary skills and experience to craft this new social compact in the years ahead, but whether they regard it as in their interests to do so remains to be seen.

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