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Private Equity and Employment



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Structure of Private Equity

Private equity houses are normally structured in the form of private partnerships, with the silent partners, typically institutional investors and the odd wealthy individuals providing the financing, while the general partners choose the firms to be acquired. The general managers charge a fixed management fee for their efforts and they also receive a percentage of the profits – confusingly called carried interest – when the private equity house exits an investee firm. Investee firms are typically acquired through debt finance with a fairly minor share of the financing being in the form of equity (Brealey et al. 2022). Private equity acquisitions – or for that matter, even for the

growing number of firms where private equity merely takes a minority stake – may have quite profound effects not only on financial performance but also on the long-term sustainability of the firm, and indeed, on a wide range of stakeholders, most notably employees (Goergen 2022). Broadly speaking, there are three major approaches to understanding – and studying – the effects of private equity transactions on the employees of the targeted firms: agency and efficiency; quantitative approaches to understanding the effects on organizations and the employees; and case study-based work. It is worth noting that some accounts conflate private equity with venture capital; however, the latter may be strictly defined and involves investment in early stage organizations; in contrast, private equity involves investment in more established organizations. This distinction is an important one in that in the case of the former, employment is much more likely to increase, while in the case of the latter, there are more likely to be accumulated organizational assets against which debt can be leveraged.

Agency and Efficiency

If, by means of being more proactive and possibly more specialist, private equity investors are better equipped to solve agency problems than traditional institutional or retail investors, then more attention is expected to be devoted to the bottom line. In turn, this will mean that existing

managerial empire building will be reined in, which is likely to result in downsizing, with surplus workers hired on the grounds of vanity and prestige being ejected (Jensen 2010). Moreover, a renewed focus on performance is likely to reduce employee shirking, and hence, enhance productivity, again reducing the need for excess labor. It has also been argued that tighter control and monitoring may enhance workplace safety (Cohn et al. 2021). There are two broad critiques of this point of view. Firstly, it discounts the possibility of other (sometimes called Type III) agency problems arising (see Allen 2001). For example, the general partners of the private equity houses may have an interest in maximizing the management fees due to them from limited partners (Appelbaum and Batt 2016; Phalippou et al. 2018). Not always benefitting from portfolio company fees and providing much of the capital, the silent partners are more reliant on the worth – and salability – of the organization some years down the line (ibid.). The attractiveness of the firm to potential buyers may be enhanced if the organization has retained an accumulated body of human capital, and indeed, the combined cognitive capital, of a committed workforce. Secondly, it assumes that private equity is automatically better at running firms than established managerial teams despite the diverse performance of private equity takeovers (Janney and Folta 2006). While downsizing may signal a commitment to changing the organization, the act of doing so does not mean that this is the right medicine for the organization in question.

PE Takeovers, Employees, and Organizations

Furthermore, there are approaches which closely seek to investigate the effects of private equity takeovers on organizations when compared to peer firms that have not been subject to such takeovers. This literature reaches somewhat diverse conclusions. What seems to matter here is the type of private equity acquisition. There are three main types. Management buyouts (MBOs) which consist of the incumbent managerial team

taking the firm private by buying out the existing shareholders. In contrast, management buy-ins (MBIs) result in a change in the management with the new management buying out the existing owners with financing provided by private equity houses. Finally, institutional buyouts (IBOs) also replace the incumbent management. However, here the entire operation is conducted by the private equity house. Firstly, there is work that suggests that MBOs tend to be mostly beneficial to the workforce of the target firms as such acquisitions enable and facilitate a more entrepreneurial approach by managers and staff, which may encompass the more effective usage of high performance work systems (Bacon et al. 2013, 2019). Secondly, there is literature that suggests in the case of MBIs and IBOs significant job losses take place when compared to peer organizations, but this does not necessarily lead to superior performance and improved productivity. Indeed, in the case of MBIs and IBOs, there is evidence that the relatively blunt approach to efficiencies may serve to break up and disrupt productive units within acquired firms, which serves to undermine the very productivity such job losses are designed to enhance (Goergen et al. 2011, 2014). Of course, an almost inevitable consequence is the overall destabilizing impact job reductions have on the remaining workforce with an associated impact on their productivity. Comparative accounts building on this work suggest that the effects of UK private equity are more deleterious than those of their continental European counterparts (Stevenot et al. 2018). There could be two reasons for this. First, while private equity houses are typically in the form of partnerships in the USA and the UK, in continental Europe, private equity houses tend to be divisions of banks and other financial institutions (Cumming et al. 2007). Second, most publicly listed firms in continental Europe tend to have large shareholders who would need to agree to the going private transaction (Achleitner et al. 2013). Indeed, it has been argued that other institutional investors, such as Sovereign Wealth Funds, may forge cooperative agreements with industrial families and foundations that would preclude PE takeovers (Haberly 2014).

Case Study Approaches

Finally, there are case study-based accounts, looking at the effects of private equity takeovers on individual organizations; these tend to take a broad approach, looking at a range of consequences of PE on a specific target firm. Notably studies have looked at the case of the AA (roadside assistance) and Debenhams (retail) in the UK, and Toys-R-Us in the USA. In each of these instances, accumulated organizational resources were liquidated and distributed, leaving a debt-ridden shell stumbling towards ruin (Froud and Williams 2007; Morgan and Nasir 2021). This literature is typically informed by theories of financialization, which hold that the increased power of financial intermediaries and financial markets has been detrimental to run-of-the-mill investors, firms, and workers alike (*ibid.*).

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