Leveraged buyouts do not lead to job insecurity

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Finance

Key topics

Jobs and Labour, Policy

Existing EU legislation has been based on prejudice and not due diligence

This year, the European Parliament will meet to discuss Alternative Investment Fund Managers Directive II (AIFMD II). This legislation will build on the first AIFMD directive from 2011, which places certain reporting obligations on – among others – private equity firms.

This legislation was built to effectively constrain such funds in response to concerns raised by the trade union movement and the Party of European Socialists. At the heart of this debate was the question of leveraged buyouts (LBOs): investors such as private equity funds or incumbent managers acquiring underperforming firms through taking on debt, with a view to selling on the improved operation (and the debt) some years down the line.

The complainants argued this activity, particularly when backed by private equity funds, leads to job insecurity as consequence of restructuring. This argument was backed by case studies, showing a propensity to "strip and flip" in such buyouts: in short, another way for big money to profit at the expense of the working person.

Added scrutiny, lack of context

This is a pertinent topic given both the forthcoming AIFMD II legislation, and an increase in private equity-backed LBO activity in recent years. The *Financial Times* reports that, since 2012, banks have made more than $10 billion per year worldwide advising and underwriting such deals, with the annual global volume of LBOs standing at around $100 billion since 2010.

But this does not represent the peak of LBO activity. This style of acquisition first came into vogue in the 1980s, culminating in the $25 billion hostile takeover of food and tobacco conglomerate RJR Nabsico by KKR in 1988 (the subject of book and well-received HBO television movie *Barbarians at the Gate*). There was also a concentration of activity between 2003 and 2007, with $400 billion worth of LBO activity in 2007. The Great Recession put a dampener on things until the recent resurgence of activity. For critics of LBOs, however, the damage was done, leading to the passage of AIFMD.

> In no instance did we find a clear trend that suggested LBOs result in a higher level of job insecurity

In making their case, unions highlighted examples of LBO activity they contended had resulted in heightened job insecurity in the acquired firms. These selective case studies, however, did not and do not show the whole picture. For one thing, they do not take into full account the wider circumstances in which the companies in question found themselves. In this light, LBOs might in fact be seen as an essential step in ensuring a struggling firm lives to fight – and employ – another day.

Moreover, they did not consider the effect of LBOs in an empirically systematic fashion. Indeed, systematic analysis has been roundly missing from the dialogue. This is something Professor Nick Bacon of Cass Business School, Professor Kim Hoque of Warwick Business School, and I have sought to remedy by producing just such a study – published in the *British Journal of Industrial Relations*.

Do certain LBOs result in greater job insecurity?

The UK-focused paper draws on data from the Centre for Management Buy-Out Research at Imperial, and the UK Government's *2011 Workplace Employment Relations Study* to assess the true impact of LBOs.

In the eyes of their critics, not all LBOs are made equal. Private equity-backed LBOs, short-term LBOs (where the sale is made in under four years), management buy-ins (led by outsiders to the firm), and high-debt LBOs are all perceived as creating higher levels of job insecurity. Worst of all is those where all of these factors are present: "perfect storm LBOs".

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We explored the impact of each of these types of LBO on different facets of job security, including: workforce reduction practices, i.e. redundancy rates, job security/no-compulsory redundancies policies and redundancy consultation; dismissal rates; labour use practices, i.e. non-permanent employment contracts and outsourcing; and employees' job security perceptions.

What we found stood in stark contrast to the fears commonly bandied about by critics of LBOs. While the occasional example seems to corroborate the negative hypotheses, in no instance did we find a clear trend that suggested LBOs result in a higher level of job insecurity; not for any of the types of LBO we analysed – including the dreaded "perfect storm". On none of the metrics did we see the threatened negative impact on job security. In short, on taking a balanced and more rigorous view, LBOs cannot be said to foster job insecurity. Ergo the theory that such buyouts work only in favour of investors, and not other stakeholders, does not hold water.

No rulings without rigour

This highlights the dangers of operating without due diligence but with prejudice – particularly where legislation is concerned. To set LBOs up as barbarians at the gate risks constraining activity that could well be the difference between survival and failure for struggling firms. The latter, of course, would be the most devastating in terms of job loss.

The anti-LBO lobby often levels accusations of short-termism against those who affect them. We would argue the opposite. With LBOs not subject to the quarterly financial reporting requirements imposed on stock market-listed firms, they are, if anything, able take a longer term approach to restoring ailing businesses to full health – with the concomitant positive effect on job security.

This article draws on findings from "Is Job Insecurity Higher in Leveraged Buyouts?" by Professor Nick Bacon (Cass Business School), Professor Kim Hoque (Warwick Business School) and Professor Mike Wright (Imperial Business School), forthcoming in the British Journal of Industrial Relations*.*

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Private Equity Online

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About Mike Wright

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Mike Wright was Professor of Entrepreneurship at Imperial Business School from 2011–2019. He was also Director of the Centre for Management Buy-Out Research, the first centre devoted to the study of private equity and buyouts.