Labour and the Locusts: Private Equity's Impact on the Economy and the Labour Market

British-German Trades Union Forum Conference Report

2008

Anglo-German Foundation
Deutsch-Britische Stiftung

Hans Böckler Stiftung

Fakten für eine faire Arbeitswelt.

FRIEDRICH EBERT STIFTUNG
London Office

Deutsch-Britisches Gewerkschaftsforum
British-German Trades Union Forum

Labour and the Locusts: Private Equity's Impact on the Economy and the Labour Market

Conference Report

2008

Seventh British-German Trades Union Forum

16–17 July 2008

Conference Report

Labour and the Locusts: Private Equity's Impact on the Economy and the Labour Market

Report author:
Dr Johnna Montgomerie

Contributors:
Karel Williams
Centre for Research on Socio-Cultural Change, University of Manchester
Adam Leaver
Centre for Research on Socio-Cultural Change, University of Manchester
Alexandra Krieger, Hans-Böckler-Stiftung
Janet Williamson, Trades Union Congress
Jürgen Hennemann
Member of the Works Council, FTE Automotive
Paul Maloney, GMB National Secretary
Dierk Hirschel
German Confederation of Trade Unions
Jane Barker, UNITE
Roland Schneider, Trade Union Advisory Committee, Paris

November 2008

Published by

Anglo-German Foundation for the Study of Industrial Society

Hans-Böckler-Stiftung Düsseldorf

Friedrich-Ebert-Stiftung, London Office

Anglo-German Foundation for the Study of Industrial Society

The Anglo-German Foundation contributes to the policy process in Britain and Germany by funding comparative research on economic, environmental and social issues and by organising and supporting conferences, seminars, lectures and publications which encourage the exchange of knowledge, ideas and best practice, both between the two countries and between researchers and practitioners.

Friedrich-Ebert-Stiftung, London Office

The LONDON OFFICE of the Friedrich-Ebert-Stiftung *(Friedrich Ebert Foundation)* was established in 1988 to promote better political understanding in British–German relations and to support a continuing dialogue between the two countries on economic, social and legal affairs, and on European and domestic policy.

The Hans-Böckler Foundation

The Hans-Böckler Foundation is an institute of the German Trade Union Federation (DGB) which promotes co-determination, research and studies. In all its fields of activity it is committed to co-determination as a creative principle of democratic societies. It promotes this concept, supports mandate holders in co-determination positions and advocates the furthering of co-determination rights.

Anglo-German Foundation for the Study of Industrial Society/
Deutsch-Britische Stiftung für das Studium der Industriegesellschaft
34 Belgrave Square, London SW1X 8DZ
Tel: +44 (0)20 7823 1123   Fax: + 44 (0)20 7823 2324
E-mail: info@agf.org.uk   Website: www.agf.org.uk

Hans-Böckler-Stiftung
Hans-Böckler-Straße 39
40476 Düsseldorf
Tel +44 (0)211-7778 153/4
Fax +44 (0)211-7778 256
E-mail: Nikolaus-Simon@boeckler.de
www.boeckler.de

Friedrich-Ebert-Stiftung, London Office
Friedrich Ebert Foundation
609 The Chandlery
50 Westminster Bridge Road
London SE1 7QY
Tel: +44-(0)20-7721 8745
Fax: +44-(0)20-7721 8746
E-mail: feslondon@feslondon.org.uk
www.feslondon.org.uk/index.htm

Contents

Executive Summary

- The main purpose of this year's German–British trade union forum was to address the emerging challenges posed by new financial actors, such as private equity and hedge funds. Key topics included the ownership structure, lack of public disclosure and management strategies adopted to meet the new demands of capital markets.

- Most of the discussion addressed the unique challenges posed by private equity funds. The ownership structure and legal status of private equity funds bestow unique financial power, combining tax concessions with no public disclosure.
  - Private equity funds are limited companies, meaning they have no legal obligation to disclose their balance sheets.
  - The finite life of such funds (10 years) means private equity funds normally aim to dispose of the purchased company within a timeframe of 3 to 5 years.
  - Private equity uses a *point concept of value*: the primary aim is to make the firm most profitable just before it is relisted on public equity markets.
  - In many ways this strategy prevents long-term investment.

- The structure of fees benefits private equity General Partners, even though they take a minimal stake in the fund. The term '2 and 20' refers to the 2 per cent annual management fee private equity General Partners charge and the 20 per cent share of the profit they receive from investments.
  - General Partners (GP) typically contribute 2 per cent to the total equity and Limited Partners (LP) provide the rest.
  - GPs charge LPs a management fee of around 1.5–2.5 per cent of the total value of the fund, regardless of performance.
  - When profits from investments exceed a predetermined 'hurdle rate' (usually 5 per cent) the remaining profits are divided so that GPs get 20 per cent (called 'carried interest') and LPs receive the remaining 80 per cent.
  - Academic research shows that PE funds often earn more from fees than from the 20 per cent 'carried interest'.

- The excessive leveraging used by private equity funds is based on their business model which relies on a 70/30 debt–equity split. Typically, a corporation uses a 30/70 debt–equity ratio to fund investment. This excessive leveraging has been a key factor in the current global financial crisis and therefore needs to be addressed through regulatory reform.

- The rise of private equity funds in Germany has happened very rapidly over the past few years. Their arrival has created new corporate governance challenges and has contributed to the broader decline of the Rhineland model. Private equity funds took advantage of key changes in the direction and practices of German banks to engage in highly leveraged buy-outs. These activities are relevant to trade unions because private equity buy-outs have negatively impacted employee participation via works councils and supervisory boards.

- In the UK the private equity industry poses new challenges to trade unions which must respond by maximizing opportunities to engage in public and political debate whilst monitoring the impact of private equity on firms. The practices of private equity funds demonstrate how ineffective are the principles of 'enlightened shareholder value' – which believes that it is in the shareholders' economic interest to ensure that management treats employees well – in today's market conditions.

- The purchase of Germany's FTE Automotive by private equity firms HG Capital (GB) and PAI Partners demonstrates many of the negative outcomes attendant upon being owned by a private equity fund. First, the company's balance sheet was loaded with the debt used to finance the buy-out. Management used operating cash flow to repay the debt, leading to an absolute decline in investment for research and development and new capital equipment. The workforce faced longer working hours and abolition of Christmas and holiday pay, and 250 production jobs were moved to Eastern Europe.
  – This case shows that, in the German context, trade unions need to focus on implementing codetermination within companies as well as being involved in divestments and changes in company structure. Works council members need to have influence over the sale of the company. There should be stronger employee participation rights and a focus on demands for workers' share of the profits when firms owned by private equity are refloated on the stock exchange.

- In the UK, CVC/Permira's acquisition of the Automobile Association (AA) led to the GMB Union being delegitimized. The new management achieved this by stopping automatic payment of dues and preventing GMB representatives from coming on site. Forced overtime, electronic monitoring and dubious redundancy packages were some of the tactics used by the private equity managers. In the end the workforce was cut by 3,400, or one third.
  – More importantly, the GMB used media campaigns and headline grabbing direct action protests to highlight the worsening conditions for ordinary workers compared to the enrichment of the private equity partners overseeing the firm.

- Considerable attention was given to developing an array of national policy levers that would address worker's rights, transparency, tax reform and explicit regulation for the private equity industry.
  – *Transparency* – the benchmark for the level of transparency should be that of a publicly listed company, especially if the firm is of similar size or was previously a PLC. Private equity funds themselves should also be required to publish details of their partnerships and the details of the portfolios they manage. Detailed information is an important currency in markets and guarantees a more accurate picture of private equity performance and the level of risk it is exposed to. Information on Limited Partners in private equity funds needs to be disclosed as well – equivalent to a list of shareholders in a public company. Such information would provide a clearer picture of the level of investment and performance outcomes of the industry. A greater degree of disclosure would allow for the better monitoring of systemic risks. Finally, just as directors' pay in a PLC is public knowledge, so too should private equity General Partners disclose their remuneration packages to ensure parity of transparency between public and private equity markets.

- *Workers' rights* – potential policy levers to better represent worker's rights focused on ways of including employees in both the pre- and post–buy-out processes. In Germany, trade unions and works councils need to work within the current codetermination and co-management systems to ensure stronger rights for employee participation in the pre–buy-out process. In the UK, workers need to be consulted at the pre-takeover stage in order to ensure adequate compensation and protection, especially in highly leveraged deals.
- *Taxation* – the private equity industry enjoys numerous tax benefits both for business practices and on personal earnings from investments. Tax rules for corporate debt need to be reformed so that leveraged buy-outs no longer enjoy generous tax concessions. Trade unions must work towards abolishing this tax relief on debt without damaging the advantages of investment for growth, and for research and development. The capital gains tax status enjoyed by General Partners must be reformed to ensure fair and equal treatment for all. General Partners often invest as little as 1.5–2 per cent – in the case of large-cap funds – and receive a disproportionate amount of the profits relative to their initial investment – 20 per cent of profits over the hurdle rate and after fees. These gains are taxed as capital gains rather than income. Moreover, the 2 per cent management fee charged by the fund is not taxed at all even if it is transferred back to GPs as income when the fund closes. Taxation of General Partners should be the same as in other segments of the financial services sector. Gains from 'carried interest' should be taxed as a performance bonus, not as capital gains.
- *Regulation* – policy prescriptions for reform should advocate a specific regulatory framework for the private equity industry. Currently, different components of private equity funds' activities are regulated. For example, the pension funds that represent the largest source of funds, as well as the banks which provide the credit, are regulated independently, while private equity has no direct regulatory supervision. Designing a regulatory framework for the private equity industry should impose disclosure requirements on funds and the firms they own. Also, new regulations should safeguard against risky leveraging or the use of so-called 'cov-lite loans' (see below). Such measures would greatly reduce future risks to the financial system.

- Trade unions are developing a coordinated approach in political campaigns to turn the public eye towards the private equity industry. Trade unions in both Germany and Britain can benefit from additional forums – such as this year's Anglo-German Trade Union Forum – which bring together different people working on capital market strategy. Such events afford an opportunity to share information on the current activities of private equity and new strategies for engaging with this industry. Also, this provides for important knowledge transfer between participants concerning the technical components of financial markets.
  - At the trade union level new efforts to create a comprehensive capital stewardship programme and engaging with the management of pension funds can counteract private equity's activities.
  - The European Union offers a new avenue for effective policy levers to address the challenges posed by new financial actors. EU-level policy may have a greater chance of success than domestic avenues, especially with a coordinated political campaign by the trade unions.

- The concluding remarks at this year's Forum addressed the rapidly changing economic conditions and the potential consequences for trade union strategies to deal with the private equity industry – the period of cheap credit and excess liquidity of the past seven years is over.
  - With economic conditions so altered because of the global credit crunch, trade unions have a unique opportunity to argue that failing to regulate the private equity industry may prolong or worsen the current financial market crisis

Introduction: Capital Markets, Private Equity and the New Challenges for Trade Unions

How to respond to the political, social and organizational challenges posed by new financial actors such as private equity and hedge funds was the topic of discussion at this year's British–German Trade Union Forum, held at the University of Manchester in July 2008.

The aim of the Forum is to develop closer ties between trade unions and unionists in Germany and the UK, and to provide an opportunity to learn from policy and practice in the two countries. This annual meeting is the result of collaboration between the Anglo-German Foundation, the Friedrich-Ebert-Stiftung and the Hans-Böckler-Stiftung, bringing together European trade union activists working at different organizational levels. This year's Forum had over 30 participants including union activists, policy-makers, journalists and academics. Most of the two-day discussion concentrated on private equity funds with a specific focus on understanding the unique challenges facing workforces when firms are restructured to meet the requirements of capital markets.

This year's Forum began with a presentation by Manchester Business School academics Karel Williams and Adam Leaver detailing the complex ownership structure of private equity funds and the many advantages the industry enjoys as a result. The next session featured Alexandra Krieger of the Hans-Böckler-Stiftung and Janet Williamson of the Trades Union Congress (TUC), who outlined the new corporate governance challenges created by the recent onslaught of new financial actors such as private equity and hedge funds. These presentations highlighted the specific differences between UK and German corporate governance norms and practices. Nevertheless, the corporate sector in both countries is being transformed as a result of pressures from capital markets and new financial actors, albeit in different ways.

Experiences from two firms were offered as examples of these governance challenges, highlighting the downside for the workforce when owned by private equity. Jürgen Hennemann, of the Works Council of the German FTE Automotive, offered evidence from FTE Automotive's experience of being 'bled dry' by private equity. Productive investment dwindled when operating cash-flow was diverted to service the debts acquired to finance the takeover. Paul Maloney, GMB National Secretary, gave an account of the Automobile Association's (AA) restructuring after a leveraged buy-out by a private equity consortium, and also of how the GMB engaged in direct action initiatives, putting the public spotlight on private equity's activities which won the general public's support.

The Forum then evaluated potential policy levers that would address the challenges posed by new financial actors. Jane Barker, from UNITE, and others proposed a coordinated approach by unions to form a workers' capital committee. This committee would focus on the investment decisions of occupational pension funds, which are the largest investors in the private equity asset class. Dierk Hirschel, of DGB, highlighted potential national policy levers in both the UK and Germany which would address excessive leverage, taxation and transparency. Finally, Roland Schneider, of TUAC Paris, detailed existing networks which develop policy at the EU level in order to bring about direct regulation and oversight of the private equity industry.

1 What Is Private Equity?

Summary

- Private equity derives its economic advantages and profitability from its ownership structure.
- Finite life fund (10 years): this means that private equity funds normally aim to dispose of the purchased company within a timeframe of 3 to 5 years.
  - Private equity uses a *point concept of value*: the primary aim is to make the firm most profitable just before it is relisted on public equity markets.
  - In many ways this strategy prevents long-term investment.
- Structure of fees: the '2 and 20' formula ensures high rewards for GPs regardless of performance because of flat fees and offloading expenses.
  - General Partners (GP) typically contribute 2 per cent to total equity and Limited Partners (LP) provide the rest.
  - GPs charge LPs a management fee of around 1.5–2.5 per cent of the total value of the fund, regardless of performance.
  - When profits from investments exceed a pre-determined hurdle rate (usually 5 per cent) the remaining profits are divided so that GPs get 20 per cent (called 'carried interest') and LPs receive the remaining 80 per cent.
  - The term '2 and 20' refers to the 2 per cent annual management fee private equity GPs charge and the 20 per cent share of the profit they receive from investments.
  - Academic research shows that PE funds often earn more from fees than from the 20 per cent carried interest.
- A 70/30 debt–equity split is typical of private equity investment strategies.
  - Typically, corporations use a 30/70 debt–equity ratio to fund investment.
  - The 70/30 debt–equity split shows the high degree of leveraging private equity funds use to acquire publically traded firms.

'Private equity' is the equity financing of companies not quoted on the stock market and covers businesses ranging from small venture capital firms to large portfolio companies. The private equity industry is divided into three categories by scale and type of investing activity: venture capital, mid-cap funds (less than €100 million) and large-cap funds (over €100 million). Since the early 2000s mid-cap and large-cap funds have accounted for 70 per cent of private equity activity, while the remainder is venture capital. For mid-cap and large-cap funds there are two types of acquisition – management buy-outs (MBOs), in which existing management raises the funding to privatize the company, and management buy-ins (MBIs), in which management comes from outside. Most of the discussion concentrated on highly-leveraged management buy-ins and buy-outs, particularly large-cap private equity funds, rather than venture capital.

Large-cap private equity funds are structured as limited partnerships or other forms of tax exempt corporate vehicles and are often legally based in offshore tax havens. The lifetime of an individual fund is typically 7 to 10 years. Many large private equity firms manage multiple funds. General Partners (GP) manage the fund and typically contribute 2 per cent to the total equity. Limited Partners (LP) provide the remaining 98 per cent of the fund's equity and have no direct role in investment decisions. LPs are typically domestic and overseas institutional investors, such as pension funds, charities, not-for-profits, public authorities, insurance companies, endowments and private investors. GPs demand a management fee of around 1.5–2.5 per cent of the total funds managed, regardless of performance.

A key feature of private equity is its use of leverage to make acquisitions. The value of the equity stake in the company is usually around 30 per cent of the value of the target company, with the remaining 70 per cent provided as debt. Corporations, on the other hand, use the exact inverse ratio of 30 per cent debt and 70 per cent equity to finance investments within the firm. Private equity funds have been able to achieve such high levels of leverage because investment, commercial and retail banks have been willing to provide the needed credit. Before the credit crunch banks would issue loans with limited covenants (legal terms of the loan) – called cov-lite loans – which contributed to private equity's ability to use excessive leveraging to acquire ever-larger firms. The banks then distributed these loans to other institutions through credit derivatives markets using collateralized loan obligations (CLOs) and collateralized debt obligation (CDO). Private equity funds do not hold the risks of leveraged borrowing because the debt is taken on by the firm they acquire, not the fund itself. Therefore, firms purchased by private equity funds have their balance sheets loaded with the debt used to acquire them in the first place. Moreover, the firm is solely responsible for paying back the loans.

Private equity partners usually take an active role in the management of the companies in which the fund invests. The normal aim of a private equity buy-out would be to dispose of the purchased company within a timeframe of 3 to 5 years by trade sale or flotation. When the company is resold the institutional investors receive the first cut of the profit above an agreed target rate of return – or 'hurdle rate' – of 5 per cent to 8 per cent compounded per annum. The private equity General Partners get 20 per cent of the profit over the hurdle rate, while the other investors – Limited Partners – receive the remaining 80 per cent. This 20 per cent of the profit above the hurdle rate is referred to as 'carried interest' or 'carry' and is taxed as capital gains. The term '2 and 20 investment model' refers to how private equity General Partners receive an annual 2 per cent management fee as well as 20 per cent of the profit.

Key Disadvantages of Private Equity

- *Lack of transparency*: the fund is less accountable to the unions and the workers.
- *Risk of job destruction*: jobs are cut to lower labour costs.
- *Conflicts of interest*: private equity partners may have different priorities from other investors.
- *Short investment horizons*: the aim is usually to sell the company after a few years rather than focus on long-term growth.

- *Greater leverage*: companies are more vulnerable to economic downturns with the potential to pose risks to lenders and the financial system.
- *Risk to pensions*: through selling assets and loading companies with debt.

Ownership Matters

Manchester Business School academics Karel Williams and Adam Leaver claimed that private equity derives its economic advantages and profitability from its ownership structure. The 'political division of ownership', they argued, is pivotal to understanding what makes private equity unique. Basically, private equity funds structure their deals in such a way that the General Partners are exposed to minimal risks because they only contribute 2 per cent to the total equity of the fund, but are entitled to a 20 per cent share of profits. Moreover, private equity funds do not hold the risks associated with highly leveraged deals because all of the debt accumulated to acquire a firm is transferred onto the company's balance sheet.

Williams and Leaver asked: 'Why did private equity make so much money between 2000 and 2007?' They claim that the benign economic climate and key features of the private equity model of large-cap funds explain the astronomical profit rates.

- The economic conditions from 2000 to 2007, such as low interest rates and excess liquidity, created an ideal opportunity for private equity to expand. This period ended with the commencement of the credit crunch in August 2007. The industry is now in a period of deleveraging and falling asset prices as the threat of recession looms. It is necessary to understand the ascent of private equity and hedge funds from 2000 to the credit crunch within this broad political and economic context.

- Private equity funds are carefully constructed legal entities which take advantage of existing regulatory frameworks to maximize profits and minimize the personal risk of the General Partners. As legal entities private equity funds have a finite life of 8–10 years. This time horizon aims to maximize gains between years 5 and 8. As a result, private equity investments use a *point concept of value*, in which the primary aim is to make the firm most profitable just before selling it, rather than looking at long-term investment. This is in contrast to the *stream concept of value* that large corporations use, aiming to create a steadily increasing rate of return.

- Williams and Leaver claim that private equity managers rearrange or exploit property rights in order to gain advantages from financial up-scaling. General Partners' high incomes derive from the division of ownership claims which redistribute gains from value extraction in favour of GPs. Limited Partners (LPs) are outside investors; they put up 98 per cent of equity but have no control over the management of the fund or of the firms acquired. LPs are locked into investment for a fixed period and pay private equity funds an annual 2 per cent management fee. LPs receive their share of profits only after GPs deduct expenses.

- Fees and the profit pay-out structure benefit GPs above other investors and stakeholders. The 2 per cent management fee is a safe form of income for GPs as

> expenses and transaction costs are charged to the firm. Yasuda and Mettrick (2007) claim that US buy-out fund GPs make twice as much in revenue from flat fees as from any other investment income. More importantly, this fee is paid without any performance conditions. The 20 per cent 'carry' profit share is a windfall gain in returns for GPs who only put in a 2 per cent equity stake. In some cases GPs borrow their 2 per cent equity stake in the form of shareholder loans.

According to Williams and Leaver the rise of new financial actors since the 1980s has contributed to a situation in which the US and the UK have returned to pre-1918 levels of income inequality. Today, the new working rich, concentrated in finance and property, have replaced the old 'rentiers' of the pre-First World War period. While considerable attention is given to the pay and rewards realized by the CEOs of large multinational corporations, which number only in the hundreds, the thousands of high wage earners in the financial services industry – such as private equity GPs – is currently largely ignored.

To address the inequality at the centre of private equity investments there should be direct regulation of the private equity industry and greater politicization of the distortions in the tax system that allow GPs to enrich themselves at little personal risk.

2 New Financial Actors and the Challenges to Governance

Summary

- The rise of new financial actors in Germany is part of the broader decline of the Rhineland model of 'cooperation over competition' which allowed Germany to become the world's largest exporter.
  - Fundamental change in the German bank-based system released banks from their traditional social responsibilities without sustained social and political pressure.
  - The breaking point was the lack of consensus that stability and growth should come before profit. When banks were no longer the largest creditor to large firms the whole German system changed.
  - Private equity funds have taken advantage of the redirection of German banks to engage in highly leveraged buy-outs.
  - Private equity buy-outs have negatively impacted employee participation via works councils and supervisory boards.
- The importance of shareholder value in the UK makes company stock performance the single most important indicator of how well a company is doing.
  - Transformations in corporate governance pose new challenges to trade unions which must respond by maximizing opportunities to engage in public and political debate whilst monitoring the impact of private equity on firms.
  - The private equity model fundamentally challenges 'enlightened shareholder value' which accepts that it is in the shareholders' economic interest to treat employees well.
  - Private equity's management structure and lack of public disclosure requirements undermines the effectiveness of shareholder engagement as a means of corporate control.

Germany

In the case of Germany the rise of new financial actors is indicative of the broader decline of the Rhineland model. Codetermination gave employees a say in corporate governance and often thwarted takeovers. The understanding among stakeholders within the firm was that the profit rate should not be the be all and end all, but that workers, consumers and the wider economy should be taken into consideration.

Alexandra Krieger of the Hans-Böckler-Stiftung suggested that to understand the challenges faced by workers due to the advent of private equity we must first understand the strong role banks have played historically in the German model.

- Banks took responsibility for stable development and acted to protect companies.
- The strong influence of banks as credit donors secured the priority of stable and long-term company growth over short-term profits.
- Legal frameworks guaranteed veto and information rights for employees.
- By limiting the influence of shareholders on companies, employee participation acted as an additional safeguard against hostile takeovers.

Many large German companies were owned by banks and insurance companies. Banks acted as majority shareholders, sat on supervisory bodies, and were the main creditor as well as the main depository bank for many large firms. The German preference for credit markets over capital markets meant that bank credit was dominant in corporate financing, and capital markets played only a subordinate role. Fundamental changes in this bank-based system gave rise to new financial actors. In the traditional stakeholder model, company strategies included overall macroeconomic goals. Now securing jobs, the state's entitlement to tax revenues and negotiation-based coordination processes are no longer paramount. The breaking point was the disappearance of the consensus that stability and growth should come before profit. When banks were no longer the largest creditor to large firms the whole German system changed. Also, large firms were released from their traditional social responsibilities without sustained social and political pressure.

The arrival of new actors, such as private equity and hedge funds, created new governance challenges for German firms and the wider codetermination system. Private equity's ability to penetrate the German economy in just a few years and take over companies without facing any substantial resistance is the result of a substantial transformation within the German political and economic system. Employee participation via works councils and supervisory boards, as well as the trade unions' umbrella function, have no place within the shareholder value framework and takeover strategies of private equity firms.

The key turning point was when large German banks no longer wanted to act as lenders of last resort to rescue troubled companies. According to the banks to do so was merely to throw good money after bad. An example is the attempted hostile takeover of Continental by Italian tyre manufacturer Pirelli in 1990–93. This acquisition was prevented by Deutsche Bank mobilizing a consortium of smaller banks and other automobile manufacturers to acquire minority veto rights. However, in 1999 Deutsche Bank refused to issue additional credit to Philip Holzmann AG to prevent insolvency. Eventually, pressure from Chancellor Gerhard Schröder and Holzmann employee demonstrations in front of Deutsche Bank headquarters led to concessions. But these events resonated with the public as Deutsche Bank had directly and very publically rejected its social responsibility for a company under its supervision.

This change in attitude marks a sea-change in the Rhineland model as banks have abdicated their control functions on supervisory boards, no longer acting to prevent firms from going bankrupt or protecting outstanding loans. Also, large German banks have changed track, away from loans towards investment and commercial banking. For their part, firms are no longer satisfied with making a reasonable profit, but now seek huge profits and pursue mergers and acquisitions strategies. This trend has prompted German banks to withdraw from supervisory councils, claiming conflict of interest as many large banks lend to both agents in takeovers: company A borrows to prevent a takeover by B, and company B borrows in order to take over company A.

Alexandra Krieger went on to say that the gap created by banks when they withdrew as major shareholders was filled by financial intermediaries. Increasingly, takeovers are now financed via equity markets through private equity funds. This usually results in large firms being broken up into smaller specialized units, which fragments the unionized workforce. New financial actors threaten German trade unions as the general consensus of the tripartite system is falling apart. The German model runs the risk of moving away from the – politically grounded – right of employees to participate in the workplace to a purely functional and economic coalition which must justify its existence merely in terms of an economic rationale.

Advocates of economic reform of the German model claim that liberalized capital markets will stimulate investment, innovation, employment and economic growth. But it appears that the 'old boys' network' of the Rhineland model is simply being replaced with a new class of financial intermediaries, namely institutional investors and private equity funds. In Germany, 80 per cent of private equity business consists of buy-outs and 20 per cent of venture capital. Yet these developments have translated into a rapid decline in fixed capital investment since 2000. Most workers have experienced a real decline in wages and the crass redistribution of wealth towards the rich. Never before has Germany experienced declining wages during an economic upswing.

United Kingdom

In the United Kingdom corporate governance faces new challenges to the enlightened shareholder value model from the rapid rise of the private equity industry. The shareholder value model emphasizes accountability to shareholders through disclosure. The interests of stakeholders are considered secondary to those of shareholders and employee rights are contractual rather than structural. Janet Williamson of the Trades Union Congress (TUC) gave an account of the changing landscape of corporate governance in the UK since the 1991 Cadbury Committee Report's Code of Best Practice enshrined shareholder rights. The growing importance of shareholder value made company stock performance the single most important indicator of company performance. New incentive schemes to link executive pay to stock prices – stock options, bonuses – led to a growing pay gap between managers/directors and employees. Since then the TUC's main concern has been to advocate that remuneration committees be 'sensitive to the wider scene, including pay and conditions elsewhere in the group'. The astronomical ascent of executive pay has led to considerable social activism to politicize the remuneration committees of publically listed companies.

Another significant development in corporate governance has been the modernization of company law. The 1998 Company Law Review aimed to fundamentally change company law, but took place without trade union representation in the steering group. The intent was to address the stakeholder question by evaluating two different frameworks:

1. A pluralist model in which directors would be required to balance the interests of key stakeholders.
2. Enlightened shareholder value, in terms of which directors are required to service shareholder interests but should also take stakeholder interests into account.

The TUC has campaigned actively in favour of the pluralist model. It has made the economic case by showing that dividends increase faster than profits over time if enlightened shareholder value principles are adhered to. Also, the pluralist model of company law recognizes the importance of intangible assets such as intellectual capital. Moreover, there is a more substantial moral case to be made that employees bear a disproportionate risk from management strategies and therefore should be entitled to have their interests represented on company boards.

Because only corporate managers, financiers and lawyers were present the outcome of the review was heavily weighted towards maintaining the status quo. The outcome of the Company Law Review was that board members must promote shareholder interests, but that the law should be changed to make it clear that, in serving shareholder interests, directors should pay regard to stakeholder interests. The result of the 1998 Company Law Review was enshrined in the 2006 Companies Act. The directors' duties are to promote the success of the company for the benefit of its members and in doing so have regard to:

- the consequences of decisions in the long term;
- the interests of employees;
- supplier and customer relationships;
- community and environmental impacts.

There are some key problems with the enlightened shareholder value model and how it works in practice. The effectiveness of shareholder engagement as a means of corporate control is undermined by the priorities of investors and practical issues surrounding voting at company AGMs. Employment issues rarely figure in dialogue between companies and shareholders, despite the evidence of the direct impact of employment relationships on company performance.

The private equity model fundamentally challenges the enlightened shareholder value model. Enlightened shareholder value is based on the assumption that in the long term there is a convergence of interests between shareholders, employees and other stakeholders. However, the private equity model often pits the short-term interests of private equity owners against the long-term interests of employees and other stakeholders. The new directors' duties are insufficient protection against directors of private equity owned companies taking decisions that are not in the interests of the company in the long term. The growth of private equity exposes the flaws of enlightened shareholder value principles.

These transformations in corporate governance pose new challenges to trade unions who must respond by maximizing opportunities to engage in public and political debate whilst monitoring the impact of private equity on firms. The TUC's strategies for addressing these challenges include:

- A workers' capital stewardship agenda, developing tools and coordination for unions. The TUC Trustee Network currently covers 1,000 participants; its aim is to provide a participation charter/guidance for trustees.
- The Workers' Capital Agenda creates strategies to coordinate unions' own pension funds voting and participation.
- Send a clear message to companies and investors on employment conditions, especially consultation and negotiation rights.

Issues from the Discussion

Participants in this year's Anglo-German Trade Union Forum highlighted the new concepts and issues in terms of which the challenges posed by new financial actors must be addressed:

- 'Incoherence' and 'contradiction' might be more accurate terms for describing private equity and its impact on workers in the UK and Germany than the current notion of a paradigm shift.
- New avenues of participation need to pay considerable attention to influence in capital markets. The focus should be on who owns a particular company, and the degree to which owners/managers can do as they like.
- New political action could adopt new innovative techniques, such as borrowing voting rights. There should be a focus on investment chains as new areas of challenge because investors act as traders rather than owners.
- The distinction between those that work with their hands and those that work with their heads, or manual versus intellectual capital, is becoming exacerbated in Germany.

3 Case Studies

Summary

- Germany's FTE Automotive was purchased by private equity firms HG Capital (GB) and PAI Partners. As a result, the company balance sheet was loaded with the debt used to finance the buy-out. Management used operating cash flow to repay the debt, leading to an absolute decline in investment for research and development and new capital equipment.
  - Labour was the main focus of cost saving measures, first through longer working hours, then the abolition of Christmas and holiday pay and finally through the reduction in the workforce when 250 production jobs were moved to Eastern Europe.
  - This case shows that, in the German context, trade unions need to focus on implementing codetermination within companies as well as being involved in divestments and changes in company structure. Works council members need to be able to exert influence over the sale of the company. There should be stronger employee participation rights and a focus on demands for their share of gains achieved at their expense.
- The UK's Automobile Association was purchased by a private equity consortium led by CVC/Permira.
  - This led to the GMB being delegitimized, which the new management achieved by stopping automatic payment of dues and preventing GMB representatives from entering company premises.
  - The workforce suffered as 3,400 – or one third – of the AA's workers lost their jobs.
  - The GMB used media campaigns and headline-grabbing direct action to highlight the worsening conditions for ordinary workers compared to the enrichment of the private equity partners overseeing the firm.

German Case Study – FTE Automotive

Jürgen Hennemann, member of the Works Council of FTE Automotive, gave a detailed account of FTE Automotive's experience after being bought by private equity funds HG Capital (GB) and PAI Partners. FTE Automotive was a medium-sized automotive supplier and a leading producer of brakes and clutches, with 3,000 employees worldwide. In Germany FTE had a workforce of 2,400 employees in two locations, with 300 workers dedicated to research and development. From 1993 to 2002 FTE Automotive focused on investment and innovation. In 2002, FTE was sold by DANA (one of the five biggest automotive suppliers worldwide) to HG Capital (GB) for €180 million. According to Hennemann, FTE's purchase was 'valorization through acquisition of companies'.

Post-acquisition FTE experienced a steady decrease in share price and dwindling development and innovation. As a result, in 2005 FTE was bought out by PAI Partners, the biggest French private capital investment company, for €370 million.

On FTE's purchase by a private equity firm the debt used to finance the firm's buy-out was immediately put on its balance sheet. To service this debt the new management diverted funds from operating cash-flow. The result was an absolute decline in investment for research and development. Workers faced new pressures to perform and existing machines were used to full capacity – often forcing staff to work six days a week to increase production. Also, threats of outsourcing production put further pressure on workers. FTE's new management could have chosen to improve productivity with investment in new technology and machinery. Innovation and development projects were questioned or stopped on cost grounds alone. The need to save money from operating cash-flow became the primary management objective, which included a hiring freeze and temporary staffing via agencies. The necessary acquisition of equipment was blocked, and internal apprenticeships and further training were stopped. This created the likelihood of quality problems and even the loss of orders.

During this period FTE's stock price did rise, but this was largely due to financial engineering and short-term cost savings rather than long-term value creation strategies. Moreover, the leveraged debt used to purchase FTE allowed the private equity managers to benefit from tax relief, providing no revenues to the state. The tax bill was less even though FTE had previously paid higher taxes and still used the same infrastructure and benefited from the higher skills of worker. The new management focused on controlling labour costs; first, by introducing longer working hours, and later by abolishing Christmas and holiday bonuses (which was prevented by employees with the help of IGM). Finally, the workforce was downsized when FTE relocated 250 production jobs to Eastern Europe. Private equity investors essentially squeezed FTE to increase the stock price of the company because the market value was seen as the investors' only means of realizing a return. This meant that all capital locked in the company was seen as 'dead' or bad capital. As a result, the new private equity managers sought to reduce labour costs by lengthening the working day to realize additional operating profits. FTE's experience of private equity owners was that management did not seek to make money from the company over time, but solely to realize profit from selling the company in the near future.

Jürgen Hennemann sees the FTE case as providing useful insights for potential trade union strategies to deal with private equity. In the German context, trade unions need to focus on implementing codetermination in companies and should be involved in divestments and changes in company structure. Also, works council members should have influence over the sale of their company. Stronger rights for employee participation need to focus on demanding that workers receive a fair share of gains achieved at their expense. For instance, after the resale of the firm the added value should be shared with employees. Workers need to be pro-active, not defensive with regard to financial buy-outs. Workers should talk to investors before the buy-out in order to discover in what direction they will take the business. Employees should then go public about what financial investors are doing and the potential impact on jobs and company performance.

Other Recommendations

- New laws for investors are necessary, not only on the national but also at the European and even international levels. Unfriendly takeovers and the 'bleeding to death' of purchased companies must be made more difficult.
- Gains from the sale of firms and private equity funds must be taxed.
- There must be rules for the minimum capital required in purchasing companies.
- Representative participation or codetermination through employees' representatives in the company must be extended.
- Every sale of a private equity–owned company should give a portion of profits to the employees because of the work they have contributed. In this way, participation and codetermination can be secured and decisions can be influenced.

United Kingdom Case Study – The GMB's Experience with the Automobile Association

Paul Maloney, GMB National Secretary, gave a colourful account of the many measures taken by the GMB to draw public attention to the negative experience of the Automobile Association (AA) after it was acquired by a consortium of private equity funds. The AA was initially a mutual company, so all profits were put back into the firm. It was then demutualized and sold to Century, the owner of British Gas, to share database information. However, laws forbidding information sharing led to the AA being purchased by CVC/Permira for £1.75 billion. After three years, the AA was merged with Saga, also owned by a private equity company. The new Saga/AA firm was valued at £6.15 billion but contained £4.8 billion of debt. The two original companies, Saga and the AA, had only £2.8 billion of debt between them; the additional £2 billion in debt is due to the cash the private equity firms are taking out of the business as part of the deal. More interestingly, this huge addition of debt – in particular the interest payments on it – significantly reduced the tax bill.

In the pre-buy out phase of this initial acquisition of the AA, the GMB attempted to engage in discussions with the new private equity owners. They were told in no uncertain terms that 'private meant private' and that neither fund was under any obligation to discuss their management strategy with the union. In the post- takeover stage the GMB's membership was the first group targeted by the new private equity management. The first step was to isolate workers who had been sick or injured and offer them a redundancy package. Next, the GMB was delegitimized and the management stopped automatic payment of dues and prevented GMB representatives from coming on-site. The new private equity managers went on to set up an internal company employee organization – or 'scab' union – to assure workers they still had representation. In addition to reducing labour costs the management restructured and refinanced for £500 million and used this money to buy-back own equity thereby loading debt on the balance sheet but maintaining no personal stake in AA. This new debt justified further cut-backs to the workforce. New forms of workplace discipline such as electronic tracking of toilet-breaks and time-use eventually led to some workers being made redundant. In some instances workers were told directly 'you are on the way out – sign this and get some redundancy money'. But redundancy payouts were strategically withheld for three months, just long enough to avoid UK law on employment tribunals. The management began making redundancy notifications by text message. Many employees complained of forced overtime and bullying and harassment by managers. Overall the workforce suffered from new management tactics which culminated in the shedding of 3,400 – or one third – of the AA's workers.

The GMB sustained its campaign against private equity by publicizing the various measures adopted in CVC/Permira's post-takeover programme. The worsening conditions for ordinary workers were contrasted with the enrichment of the private equity partners overseeing the firm. Also, consternation arose following the decision by the General Partners to extend the level of debt loaded onto the AA's balance sheet from £1.3 billion to £1.85 billion in order to realize a £500 million 'special dividend' bonus payout.

Attempts to draw the private equity General Partners into consultation involved sensational direct action protests. The GMB staged a protest outside Permira managing partner Damon Buffini's church involving a camel and a small needle, referring to Jesus's remark in the New Testament that 'it is easier for a camel to go through the eye of a needle than for a rich man to enter the kingdom of God'. Also, AA/Saga boss Andrew Goodsell had a makeshift 'chicken farm' constructed in his village after he reneged on a deal to have the GMB re-recognized in the workplace. The GMB's media savvy actions attracted national press attention. These campaigns were enormously effective, gaining important column inches and television coverage. This organized and persistent campaign work successfully established an association between private equity and 'asset stripping', which prompted the government to call a Treasury Committee hearing on the private equity industry.

Recommendations for Future Action

- Continued union resistance to private equity through media publicity.
- Better coordination of political campaigns between all UK unions.
- Focus on legislation at the EU level, which would have more chance of success.

4 Policy Levers

Summary

- A clear consensus has emerged that the trade unions need to coordinate between themselves both domestically and across Europe to effectively counter the political clout of the private equity industry.
- Policy levers should require disclosure of private equity funds under the same conditions as public companies: remuneration, earnings and the balance sheet.
- At the trade union level new efforts to create a comprehensive capital stewardship programme and engaging with the management of pension funds can counteract private equity's activities.
- At the national level four main areas need to be addressed: transparency, workers' rights, taxation and regulation.
- The European Union offers a new avenue for effective policy levers to address the challenges posed by new financial actors. EU-level policy may have a greater chance of success than domestic avenues, especially with a coordinated political campaign by the trade unions.
- With economic conditions so altered because of the global credit crunch, trade unions have a unique opportunity to argue that failing to regulate the private equity industry may prolong or worsen the current financial market crisis.

The two primary questions asked by the participants in this year's forum were: (i) 'What targeted responses should trade unions have to the challenges posed by new financial actors?', and (ii) 'Should these policies be focused at the national or the EU level?' There was a clear consensus that the trade unions need to coordinate both domestically and across Europe to effectively counteract the political clout of the private equity industry. Efforts made by trade unions need to focus on direct political campaigning and going public with the details of what financial investors are doing in individual firms. One of the major challenges posed by private equity buy-outs is the lack of transparency and the absolute privacy the General Partners enjoy. Another issue is the tax concessions private equity uses to reduce the amount of both corporate and personal tax paid. Finally, the lack of sufficient regulatory oversight of the private equity industry as a whole and management practices post-acquisition in particular must be addressed by a sustained effort on the part of all major unions. Contributors and participants discussed many potential avenues for developing new policy levers. The discussion focused on three levels of action: trade union, national and EU.

Trade Union Level

Trade unions need a coordinated approach in developing political campaigns to keep the public eye on the private equity industry. Trade unions in both Germany and Britain can benefit from additional forums such as this year's Anglo-German Trade Union Forum, which bring together different people working on capital market strategy. Such events afford the opportunity to share information about the current activities of private equity and new strategies to engage with this industry. Also, this provides for significant knowledge transfer between participants concerning the technical components of financial markets.

Janet Williamson of the TUC suggested that trade unions could counteract private equity's activities by developing a comprehensive capital stewardship programme and engaging with the management of pension funds. The TUC is currently working on its Workers' Capital Agenda. Greater coordination between the unions would further develop new capital market strategy tools. Also, the TUC has created a Worker's Capital Committee which involves 'educating' pension fund trustees. Janet Williamson claimed that future efforts might involve:

- bringing evidence of the mediocre performance of private equity as an asset class to the attention of pension fund trustees;
- highlighting the negative experience of workers due to private equity funds;
- pointing out the potential dangers of loading firms' balance sheets with debts acquired in a leveraged buy-out.

Approaches to occupational pension funds involve convincing pension trustees of the downside of private equity investments. The GMB has focused on informing pension fund trustees at annual conferences where private equity funds promote themselves. The union's presence has provided much needed counter-arguments to the sales pitch offered by private equity funds. Although this approach can be fruitful, there are limits. Participants discussed the difficulties involved in influencing the largest occupational pension funds that invest in private equity and hedge funds. These occupational pension funds are primarily North American based and include large endowment funds such as Yale and Harvard. Their investment has been the driving force behind the recent boom. Therefore, a broader capital market strategy is needed to influence pension fund managers, as well as pension trustees. Ultimately, fund managers make the final investment decisions and are the key actors with a preference for private equity. Trade union efforts are relevant because 'narrative', or word of mouth, is the currency of the financial services industry, not necessarily actual performance numbers. Fund managers can easily be challenged on investing in private equity because it is the 'newest fad' and for not asking enough questions or monitoring actual performance. In practice, pension funds have been queuing up over the past eight years to throw money at private equity with very little to show for it.

National Level

Even with the substantial differences between the political systems in which trade unions operate in the UK and Germany there was agreement on potential national policy levers. Contributors and participants concentrated on four key areas: (i) transparency, (ii) workers' rights, (iii) taxation and (iv) regulation. The current economic climate has given rise to considerable discontent among the population, making these proposed reforms timely. Most of the policy levers discussed aim to solve many of the economic problems that the trade union movement has long opposed, and which have contributed to the current financial crisis and economic downturn. One of the biggest successes of the trade unions in recent times has been to give a higher public profile to the private equity industry. Controlling the systemic risks now associated with the activities of new financial actors, such as private equity and hedge funds, has been a dominant theme of recommendations for reform. It is now important to consider how these ideas can be debated publicly and gain the support of the political parties.

Transparency

The cloak of secrecy that private equity funds operate under needs to be remedied by means of policy levers aimed at compelling disclosure. The benchmark for the level of transparency should be that of a publicly listed company, especially if the firm is of similar size or was previously a PLC. Private equity funds themselves should also be required to publish details of their partnerships and of the portfolios they manage. Detailed information is an important currency in markets and will guarantee a more accurate picture of private equity companies' performance and the level of risk they are exposed to. Information concerning Limited Partners in private equity funds needs to be disclosed as well – equivalent to a list of shareholders in a public company. Such information would provide a clearer picture of the level of investment and performance outcomes of the industry. A greater degree of disclosure would allow for the better monitoring of system risks. Finally, just as director's pay in a PLC is public knowledge, so too should private equity General Partners disclose their remuneration packages to ensure parity of transparency between public and private equity markets.

In the UK, the Walker Report on transparency in private equity was unsatisfactory because it essentially leaves the industry self-regulated under its recommended voluntary code. The report developed a very narrow definition of transparency, which mainly concerned potential conflicts of interest between those who invest in private equity funds and are also shareholders in the acquired firms. Using this framework completely ignored other relevant issues such as public disclosure and workers' rights.

Workers' Rights

Potential policy levers that could better represent workers' rights focused on ways of including employees in both pre– and post–buy-out processes. Differences in the labour codes and legal structures of the UK and Germany yielded separate proposals for reform.

Germany

- Trade unions and works councils need to work within the current codetermination and co-management systems to ensure stronger rights for employee participation in the pre–buy-out process.
- The workforce needs to cultivate demands for their fair share of what they have achieved and produced through the acquisition process. Employees should not be the sole focus of restructuring and yet receive none of the gains.
- With every sale of a private equity–owned company shares should be given to the employees for the work they have done. This would allow employees to have their voice heard through the participation and codetermination process, allowing their interests to be secured and giving workers the ability to influence decisions

The UK

- Workers need to be consulted in the pre–buy-out stage and adequately compensated for job losses.
- Workers should be consulted in the pre-takeover stage in order to ensure adequate compensation and protection, especially in highly leveraged deals.
- Introducing a levy on private equity deals could be used to create a fund to provide redundancy packages in case the firm goes into administration.

Taxation

The British and German trade union groups paid considerable attention to developing potential national policy levers to reform their respective tax systems. The private equity industry enjoys numerous tax benefits both for their business activities and on their earnings from investments. Even though actual policy design would be tailored to the different legal systems in the two countries, the contributors and participants agreed on the key aspects of taxation that need to be addressed.

Tax Relief on Interest Payments

Tax rules for corporate debt need to be reformed so that leveraged buy-outs no longer enjoy generous tax concessions. The private equity business model is formed around the ability to borrow heavily to acquire a firm. Prior to the credit crunch leveraging allowed private equity to upscale its purchases while gaining considerable tax advantages in the process. For example, Boots, the UK retail chemist chain, paid £130m in corporation tax before it was bought out by a private equity consortium. The degree of leveraging used to finance the purchase meant that Alliance Boots paid no corporation tax because of tax breaks given for interest payments on the debt used to acquire the firm in the first place. Not only is this a considerable loss to the public purse but it is also highly discriminatory to other taxpayers by giving such an advantage to portfolio investments. Leveraged buy-outs have also precipitated a marked decline in investment for fixed assets and employee training because the cost of servicing interest payments is often taken out of operating cash flow.

Trade unions must work towards abolishing this tax relief on debt without adversely affecting the benefits of investment for growth and research and development. This entails devising policy levers that specifically target private equity activities.

- Allow tax relief on interest payments for loans of less than 100 million. This would guard against excessive leveraging without damaging organic investment for growth and innovation. Denmark and Germany have already made moves in this direction.
- Tax the buying and selling of companies.
- Impose legal limits on credit-financed company acquisitions and on special distribution of funds (such as a minimum equity ratio).

Capital Gains Tax

The favourable taxation status General Partners enjoy when they make transfers from the fund – which are currently taxed as capital gains – should be reformed. This needs to be done to ensure fair and equal treatment for all citizens. General Partners often invest as little as 1.5–2 pc (in the case of large-cap funds) and get a disproportionate amount of the profits relative to their initial investment: 20 per cent of profits over the hurdle rate and after fees. These gains are taxed as capital gains rather than as income. Moreover, the 2 per cent management fee charged by the fund is not taxed at all, even if it is transferred back to GPs as income when the fund closes.

- Taxation of General Partners should be the same as in other segments of the financial services sector.
- Gains from 'carried interest' should be taxed as a performance bonus, not as capital gains.
- Management fees should be taxed as part of remuneration.
- Tax avoidance by structuring income from private equity investments through offshore vehicles should be more rigorously investigated.

Regulation

Potential policy prescriptions for reform need to advocate a specific regulatory framework for the private equity industry. Currently only constituent parts of private equity business activities are regulated, such as pension funds; they are also subject to banking and general labour laws. Designing a regulatory framework for the private equity industry should impose disclosure requirements on funds and the firms they own. Also, new regulations could safeguard against risky leveraging or the use of covenant-lite loans. Such measures would greatly reduce future risks to the financial system by preventing the same kinds of conditions that allowed private equity to grow so quickly over the past seven years. It must be made clear that private equity activities are factors that led to the current crisis. Finally, any new regulatory framework would need to provide sufficient guidelines for the appropriate inclusion of workers' rights in the pre– and post–buy-out phases.

United Kingdom

Regulatory reform initiatives in the UK need to politicize the government's virtual abdication of responsibility for regulating financial markets. Highlighting the government's previous reluctance to adequately monitor the financial services sector by offering new solutions could be the focus of political pressure. Potential avenues for policy prescriptions include:

- banks offering credit to private equity for highly leveraged deals should be subject to a comprehensive minimum equity ratio for the private equity fund;
- creating a binding code of conduct for financial investors which includes protection of employment rights;
- devising investment limits for private equity in pension funds and insurance.

Current legislative frameworks that could be amended to enact private equity regulation include the Venture Capital Act and the Risk Limitation Act.

Germany

Since the German situation is completely different from that of the UK, the trade union strategy should concentrate on shareholder value and focus efforts on maintaining democratic control over the economy. Using national tax law, company law and stock exchange law, the national legal system needs policies that can control developments. Key areas include:

- rules on companies' minimum own capital;
- extension of representative participation (codetermination through employee representatives) in the company.

A key goal will be to find European partners, but German trade unions are also developing their own national political strategies.

European Union Level

The European Union offers a new avenue for effective policy levers to address the challenges posed by new financial actors. In many respects EU-level policy has a greater chance of success than domestic avenues, especially with a coordinated political campaign by the trade unions. The trade union movement needs to match the current presence and clout of the private equity industry within European policy-making circles. This includes counterbalancing such groups as the private equity trade association, the European Venture Capital Association (EVCA), which effectively campaigns within the EU and directly lobbies the European Central Bank. So far, the European private equity industry has managed to convince many within Europe that any additional regulation would hinder the industry's global competitiveness and business would be lost to the much larger – and less regulated – American private equity industry. With economic conditions so altered as a result of the global credit crunch, however, trade unions have a unique opportunity to counter these claims by arguing that failing to regulate the private equity industry may prolong the financial market crisis or, worse, give way to a new round of solvency and capitalization fears.

Policy levers could focus on the current EU regulatory framework for the financial industry which includes company law, the 1998 Risk Capital Action Plan, the Takeover Directive, the Financial Services Action Plan, the Lamfalussy framework and the Basel II agreement and its transposition into the Capital Requirements Directive. Trade unions need to create new policy frameworks for monitoring the private equity industry. These could include the following:

- In the interest of transparency information should be brought into the public domain:
  - disclosure requirements for private equity funds including General and Limited Partners' details and remuneration packages;
  - public disclosure of company balance sheets after acquisition by private equity.
- Rules-based regulation which puts risk management at its core:
  - Address the issue of leveraging through the law; for example, BASEL II–the Capital Reserves Directive could increase capital reserves for private equity investment. This would raise the cost of credit as private equity would have to pay for the risks it acquires through leveraging.
  - Bolster the Takeover Directive to prevent unfriendly takeovers and 'bleeding to death' purchased companies by loading the balance sheet with debt and reducing investment and growth by servicing debt through operating cash flow.
  - The monopoly of credit rating agencies must be broken up and a new EU rating agency created.

Forums for coordinating policy prescriptions for the EU already exist and can be better utilized by the trade unions. The Trade Union Advisory Committee (TUAC) in the OECD offers detailed research and potential policy levers within the EU and international forums. Together with Global Unions, coordination has already begun with seminars on Financialization (March 2007) and Regulating Private Equity (November 2007). These events led the trade unions to call on governments to respond to the challenges of financialization and private equity through regulatory reform. The EU Commission has published new FAQs on private equity and hedge funds. These FAQs try to answer the questions raised regarding the problems of overregulating and how these can be adequately countered by trade unions. Global Unions and the TUAC have issued many reports on private equity which could form the basis of integrating opposition within the European policy framework.

Issues from the Discussion

Participants in this year's Forum considered how best to advocate policy reform without stirring up opposition from outside the private equity and hedge fund industry. There are clear limits to proposing policies that would require disclosure from all private companies and the development of explicit rules on leveraging. Therefore, participants discussed the best strategy for targeting the private equity and hedge fund industry.

- In this time of financial crisis, the moral argument against the excesses of private equity is very strong, but detailed consideration must be given to the legal and policy practicalities.

- It may not be wise to get involved in advocating regulation of leverage which involves explicit limits because there is no way to determine what the 'correct' amount of leverage might be. Such an approach runs the risk of being dismissed out of hand.

- Developing a threshold for tax concessions for leveraging would cause some pain to the private equity industry, but would not deter it from long-term profitable investment. This could be a viable compromise within the policy framework. For example, Germany lowered the threshold for tax relief on interest payments (everything above a certain limit was no longer eligible for tax relief).

- Efforts must be made to divide private equity alliances. Any regulation targeted at private equity or hedge funds must avoid provoking opposition from the financial services industry or the business sphere in general. Any unwanted opposition from groups that would otherwise not oppose new regulations for private equity or hedge funds should be side-stepped wherever possible.

- Policies on transparency should stipulate that not *all* limited companies have to have the same disclosure as public companies. Creating transparency rules just for private equity firms, which use their status as limited companies to circumvent disclosure, would prevent small business groups from automatically opposing new regulations.

Conclusion: Trade Unions and the Future of Capital Market Strategy

The concluding remarks at this year's Forum addressed the rapidly changing economic conditions and the potential consequences for trade union strategies to deal with the private equity industry. Karel Williams of Manchester Business School pointed out that the cheap credit and excess liquidity of the past seven years are at an end. At the very least the conditions under which private equity operates are changing dramatically. The Bank for International Settlements estimates that $500 billion of private equity debt is due to mature by 2010, which could lead to a new wave of corporate collapses and renewed instability in the banking sector. Moreover, it now appears that the private equity industry has abandoned efforts to acquire ever-larger public firms and turned its activities to buying up distressed debts – or outstanding loans currently in default – from troubled financial markets. Limited Partners – such as occupational pension funds – have their financial commitments locked in for a fixed period, meaning that they cannot pull out their investments even in the midst of financial market meltdown. But with no disclosure of the financial situation of private equity funds it is impossible to know the extent of their exposure.

As the economic climate changes the trade unions must adapt their capital market strategies and policy proposals for reform. Additional issues brought up for consideration by Jane Barker of UNITE were:

1. Details of debts and covenants that private equity funds hold need to be disclosed. This includes existing and new financial obligations, such as interest payments and distressed debt, especially considering the greater risk of bankruptcy of firms bought out by private equity funds in the boom years.

2. Additional information is needed on the ways in which private equity funds create value and extract cash, such as sale and lease back and 'disposals'.

3. Uncovering how the new wealth/value created by private equity is being shared out – remuneration of GPs, details and basis of management bonus schemes.

4. Discovering who the ultimate owners are (investors in the private equity industry).

Ownership clearly matters in the twenty-first century and the unions must engage with issues surrounding ownership in order to better serve the workers. Changing forms of ownership are at the heart of the private equity and hedge fund industry.

To address the changing dynamics of ownership trade unions must create new and innovative policy levers. Jane Barker of UNITE highlighted the important work being developed through the Capital Stewardship Programme. This initiative seeks to scrutinize how pension fund managers manage workers' money. Its eventual aim is to use the unions' financial clout – by way of occupational pensions – to prevent money from being used to sack workers and strip assets. Given the high management fees and the considerable share of the final returns that private equity funds receive from managing pension fund money, it seems appropriate that their activities are in line with the ultimate investor in their product, the workforce.

At present there is considerable interest in constructing networks of social democratic civil society groups and trade unions on the issue of financial market governance. Such alliances would strengthen efforts to call on government to close loopholes and address advantages enjoyed by the private equity industry in both the UK and Germany.

Building on events such as the Global Unions and Service Employees International Union's 'Global Day of Action' would help to expose private equity. The events included protests, direct action and petitions. The 'Global Day of Action' received support from the GMB, Unite and Unison. Events such as this keep the public spotlight on the practices of the private equity industry.

Further Resources

United Kingdom

Walker Report on Transparency in Private Equity
http://walkerworkinggroup.com/sites/10051/files/walker_consultation_document.pdf

Treasury Select Committee Report on Private Equity
http://www.publications.parliament.uk/pa/cm200607/cmselect/cmtreasy/567/567.pdf

Final Report of Treasury Select Committee
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/919/919.pdf

Financial Services Authority Report on Private Equity
http://www.fsa.gov.uk/pubs/discussion/dp06_06.pdf

Trades Union Congress Reports on Private Equity
http://www.tuc.org.uk/economy/index.cfm?mins=564

TUC – Private Equity: A Guide for Pension Fund Trustees
http://www.tuc.org.uk/extras/peguide.pdf

Germany

http://www.boeckler.de/396_48994.html

European Union

European Central Bank Report on Private Equity-sponsored Leveraged Buy-outs
https://www.ecb.int/pub/pdf/other/largebanksandprivateequity200704en.pdf

International

Global Unions Campaign against Private Equity
http://www.union-network.org/uniindep.nsf/privateequity?openpage