“The Effect of Private Equity Takeovers on Corporate Social Responsibility”

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Let me begin by stating I am not here to argue publicly-traded companies – good, private equity investment – bad. Nor, management by operational specialists – good, management by financial specialists – bad.

In Australia and internationally, trade unions do not want to further perpetuate stereotypes, but look at where value can be added. I do not want to feed into the stereotype of private equity investment as buyouts for fast profit, on sale of assets, stripping value from companies, the quick turn around model. We are interested in how the private equity industry can add value – to companies, the national and international economy, and broader societal prosperity. How much can private equity contribute to disciplining management practice, dealing with inefficiencies, and fulfil the role as responsible corporate citizens? What is the industry willing to do to earn that respect? Otherwise the stereotype is perpetuated, that of a corporate intention to “strip and flick”.

Private equity firms have become owners and movers of vast volumes of capital, are important to vital economic sectors and are major employers.

But internationally, the experience of workers and trade unions with private equity firms has been negative. We have seen a reduction in services and quality, job losses, a reduction in pay, conditions and entitlements (including retirement incomes) and in some case, operations have ceased.

When ownership and structural changes result in disadvantage to workers, to the public, we do have a concern and have a say. As businesses loaded with debt become riskier and more likely to go bankrupt, those most at risk are the workforce. Workers and unions are key stakeholders in ensuring a profitable and competitive business environment, and in ensuring corporate social responsibility.

The key concern for trade unions relates to the obligations of private equity funds as real employers – with respect to all relevant employer obligations (collective bargaining, information, consultation, transfer rights, conditions and entitlements).

This is a new way in which investment operates in Australia. Internationally, trade unions are seeking to engage private equity managers to accept their responsibilities to their workforce and the wider community, to open the industry to greater transparency and disclosure, particularly of the rewards paid to, and the tax paid by, top private equity executives. The massive financial incentives paid to senior management as a result of private equity deals raises potentially serious issues of conflict of interest and insider trading which affects the transparency and effective operation of capital markets. The incentive structures applying to senior management, under private equity ownership, unfairly benefits a narrow group of participants at the expense of share holders.

The discussion is about whether private equity can establish long term sustainability and not just fuel a short term, high risk bubble.

Some companies taken over by private equity have prospered, and their employees with them. Private equity has provided crucial start-up capital for new businesses. But a key concern is, do the private equity partners accept a real responsibility to the workforces they take on, indeed to the wider community and to the range of business stakeholders.

In the trade union movement, we say private equity investment should be measured against the pillars of sustainable development – economic, environmental and social.

We need to guard against short-termism; promote long term value creation; decent work and sustainable development, of enterprises and the economy.

There is a strong concern that the private equity model poses risks to the stability of the international financial system and the sustainability of national economies.

The share of private equity investments in the total volume of mergers and acquisitions exceeds 20 percent in some OECD economies. This has huge impacts on the economy, taxation system, capital gains, government revenue, redundancies, social security and employment conditions and security for employees.

At the World Economic Forum in Davos, in January this year, the Trade Union movement held discussions on the role of private equity and taxation and sought the creation of an international regulatory taskforce on private equity.

The trade union movement believes that the growth of private equity investment requires a co-ordinated regulatory response by the international community. Regulatory reforms should address four areas:

1) Transparency - formal levels of disclosure, prudential rules and risk management: There needs to be a level playing field between those alternative funds and other collective investment schemes with regard to transparency and reporting on performance, risk management and fee structure. There also needs to be transparency on rewards, which feed into the executive pay debate. This requires reporting on a host of key aspects of business operations.

2) Workers' rights to collective bargaining, information, consultation and representation within the company should be regarded as key ways by which the long-term interests of companies can be secured and promoted.

3) Tax regulation - including tax deductibility of debt service, tax on capital gains and tax havens - needs to be reconfigured to cover private equity regimes so that tax systems remain investment-neutral and are not biased toward short-term investor behaviour. Some countries have already either proposed tax legislation to curb the negative tax effects of the activities of private equity funds (e.g. Denmark) or announced that they would investigate the effect on their tax systems of such activities. Comprehensive answers should be developed so that the increasing activities of private equity funds does not jeopardise government revenues from corporate taxes.

4) Corporate governance: Current national corporate governance frameworks focus on publicly traded companies and generally have far more weaker requirements for un-listed companies. In addition, they do not have sufficient mechanisms to guard against short term value extraction and to promote long term value creation. They are not suitable to address the challenges of private equity's short-term ownership regime. The responsibility and powers of the boards of directors to preserve long-term interests of companies under private equity regime need to be reinforced.

Trade unions are working with OECD Ministers and G8 leaders, to promote a regulatory taskforce on private equity including the OECD, the IMF, the Financial Stability Forum, relevant UN agencies, and the ILO. The growth in PE investment requires a coordinated regulatory response by the international community and the Australian Government.

I would like to give a few examples. I will give the example of Qantas but a key concern for the trade union movement is not only with companies like Qantas which employs 35,000 people, but also with the targeting of “blue chip” public companies in Australia.

Qantas is a classic example, they did a lot to maintain low debt AAA rating which was achieved in part through “workers restraint”. The private equity Consortium (APA) refused to rule out job and condition losses. This is similar to an example in Canada. Yesterday, *Cerberus Capital Management who bought Chrysler*, provided a written letter that pledges no layoffs of union members as a result of the ownership change. The new owners are knowledgeable about the auto industry, are interested in building a stronger company rather than “slice and dice” it.

There is also the case of *Onex Corp* in the US – Boeing Wichita aircraft plant (Boeing’s biggest international supplier) widely praised as a promising new labour model, of “if you want to share the pain, then give us a stake in the enterprise”. 800 people lost their jobs. The remaining workers were offered a 10% equity stake, US$246 million in cash and stock options. This was accepted by that group of workers. 18 months later, each machinist received $61,440 in cash and stock. Business Week: Feb 19, 2007: “Soaring Where Boeing Struggled”.

Permira, the largest private equity group in Europe, last year bought Birds Eye from UNILEVER and pledged to keep workers’ employment terms for at least 3 years. Within 5 months, it had closed plants and cost 600 jobs.

With some US$600 billion in such acquisitions spent in 2006, double the volume of the previous year, questions about transparency, corporate governance and sustainability are critically important, not least for the working men and women whose employment, rights and working conditions are often threatened by the behaviour of these funds. Trade unions interests are in strengthening international trade and investment rules covering core labour standards and the social responsibility of businesses. As in promoting corporate social responsibility, the fundamental issue of accountability is one we need to continue to work on. This is the beginning of a conversation and an important dialogue in Australia.