

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

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Thank you Leeora and good evening ladies and gentlemen.

We at ANZ are delighted to support this event and congratulate the Australian Centre for Corporate Social Responsibility for providing a forum to discuss the topic this evening of “the effect of private equity takeovers on CSR”.

Some time ago, ANZ sought to describe itself as “the bank with a human face” and a key element of that aspiration was ensuring that our social and environmental agenda kept pace with our financial achievements, which have been world-class in recent years. As a large banking organisation where success is traditionally measured in dollars and cents, I will concede that this is a non-trivial challenge for us – but we are committed to corporate responsibility, because we know that living the values delivers significant outcomes for our customers, our people, our shareholders and our communities. For those in the audience who have a particular interest in what ANZ is doing on the sustainability front, you might like to collect a copy of our Corporate Responsibility annual report on the way out.

Tonight I have been asked to speak to you on the CSR implications of private equity, a little understood activity that has literally emerged from the shadows over the past two or three years to become a part of mainstream finance in this country.

As I sat down to write a few notes on the topic, I recalled a class debate way back in Grade 4. It was on the topic of “when commercialism intrudes, basic principles depart”. After a spirited debate, the class had to vote on the topic, and vote it did, 27-1 in favour of the affirmative.

Now the reason that my classmates back in Grade 4 voted overwhelmingly in this way is that the proposition is fundamentally correct. The pursuit of profit can come at the expense of obligations held to legitimate stakeholders.

Private equity, as an activity unashamedly dedicated towards the pursuit of profit – and loads of it – therefore suffers from the same bias, but I do wonder whether it is at all much different from superannuation fund managers, who, by the way, manage about 50 times more money than private equity firms do. During the recent assault on Qantas, we heard many of these superannuation fund managers vocal in claiming that the offer of \$5.45 was not enough, but not a single soul amongst that group was heard to say “*I am not going to accept this offer because it is not in the interests of the airline and its various stakeholders*”.

Tonight, I wanted to cover three main areas of direct relevance to our topic: (1) what is private equity; (2) what private equity does, and importantly doesn’t do; (3) how it might be better controlled than it is today.

What is Private Equity?

Private equity in Australia is today a \$25 billion industry. It has been around for close to 30 years but has only become significant in the past 5 years as our national savings have found their way towards private equity firms in the search for high investment returns.

There are two perspectives that I like to refer to in order to illustrate how omnipresent private equity is in Australia. The first perspective is that just about all Australian workers will have some amount of their superannuation in the hands of private equity firms, through the asset allocation decisions of their fund managers. The second perspective is that private equity is now responsible for more than 8% of private sector employment, a number which would pass 10% if Coles is acquired by KKR. The corresponding statistic in the UK stands at 17%.

What Private Equity Does (and Doesn't Do)

The public perception of the private equity industry quite unfortunately is stuck around the antics of Gordon Gekko and the 1980s : "greed is right, greed works, greed clarifies, cuts through, and captures the essence of the evolutionary spirit" as we heard in the movie Wall Street.

There is an overwhelming perception that private equity is all about buying undervalued companies, slashing costs, firing workers, spinning off divisions and then listing the company at an absurd profit before anyone realises that the company is not a sustainable long-term investment proposition.

That, ladies and gentlemen, is not how private equity operates in Australia these days. Private equity firms set out to buy whole companies, as opposed to fund managers who will typically buy small shareholdings in larger listed companies. Just like fund managers, private equity firms look out for great Australian businesses that have performed well in the past and have excellent prospects for growth into the future.

There are two key differences in how private equity behaves. Firstly, as an owner of businesses, it has a much greater involvement in decision making at the company than a fund manager holding a few percent of the shares would. Secondly, private equity usually comes with a finite investment horizon of between 3 and 5 years before it realises its investment.

These factors result in private equity owned businesses being environments where a lot of change can happen and it can happen quickly. That in itself is not the sole doing of the private equity owner, but in many cases a consequence of inertia or lack of management focus under previous ownership – the stunning reversal in fortunes at Myer is one good example that immediately comes to mind. In many cases, private equity is not the catalyst for change, rather the inefficiencies and over-regulations that exists today with our listed company environment.

Change in the context of private equity ownership is around making a good business great – and we commonly see this in terms of new jobs, new stores, new products and new markets.

Let me give a couple of examples. A recent study by PricewaterhouseCoopers showed that 76% of private equity backed companies expected to hire additional workers in 2007. According to Dun & Bradstreet (ironically, now a private equity investment backed by ANZ!), the corresponding economy-wide measure is just 5%. The same study showed that three quarters of private equity companies launched new products in the past year, while only 27% did so prior to private equity ownership. More than 20% of private equity backed companies offer apprenticeships and 82% provide ongoing technical training to their workers.

There have been many great Australian companies which would simply not have emerged without private equity funding – including Seek, Aural, Wizard, JB Hi-Fi.

However impressive this track record might be, there is an emerging debate around regulation and supervision of these private equity firms (including their cousins, the hedge funds), and that is the final issue that I will speak on this evening.

How Might Private Equity Be Better Controlled?

The term “private equity” is rather apt because much of what happens in the governance of private equity firms takes place behind closed doors. Most private equity firms are privately-owned partnerships which are highly protective of their obscurity.

Whilst the size of the private equity industry approximates the market capitalisation of ANZ, private equity firms are by comparison practically unregulated. There is next to no visibility, no transparency and no accountability today. In the examples of Qantas, Coles and Alinta, we have witnessed early skirmishes involving governance. It is not hard to extrapolate these situations and see a significant crisis occurring with private equity funds within the next five years – and governance will without doubt emerge at the core of the public debate.

So what should we be doing about this situation now? I think that the answer is to be found with the primary providers of funds to these private equity firms – the people with their hand on the money tap, so to speak – who, in Australia, are our industry and public sector superannuation funds and of course this is a group which holds sustainability principles as being important considerations.

As the primary providers of funds to private equity firms, our industry and public sector superannuation funds are in a unique position to express their views and to seek commitments to sustainability and corporate responsibility as part of their funding allocations – if you won't make the commitment, then you won't get funded!

That, in conclusion, is likely to be the most effective means by which we can elevate sustainability principles across the private equity industry, and in doing so support and augment the important way in which private equity goes about creating jobs and investment in this country.

Thank you.

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