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# The Impact of Private Equity

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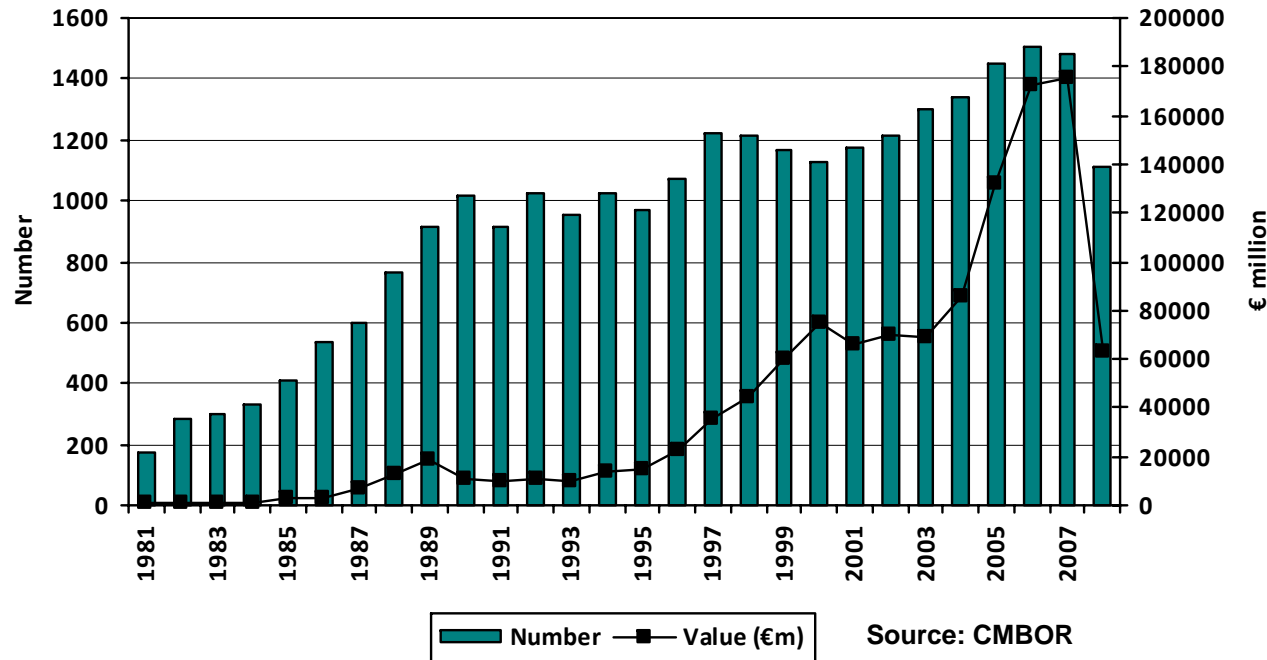
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# Centre for Management Buy-out Research (CMBOR)

- First specialist Centre on buy-outs and private equity
  - Organised first European buy-out conference in 1981
  - Est.1986 at Nottingham University Business School
  - Not-for-profit research centre; full-time academics
  - To examine developments in UK & European buy-out markets in comprehensive and independent manner
- 27 years of research into PE & MBO/MBIs
  - Established world leading database of buy-outs
    - Currently >25,000 buy-outs in UK and continental Europe
- Publications generated from database including:
  - UK Quarterly Review and European MBO Review
  - Academic Articles

# Development of Private Equity



- Private Equity & Buy-outs have become prevalent worldwide since late 1990s with the SECOND wave ending in 2007
  - Large deals accounted for c90 out of 1,500 European deals in peak year of 2007 & now back to 2002 levels; most deals family/divestment deals
- Much debate based on anecdotal examples, yet is widespread evidence on impact of private equity stretching back over 20 years
- Over 100 systematic studies of Private Equity

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# Do Buyouts Improve Firm Performance ?

- Operating profitability of PE backed buyouts greater than for comparable non-buyouts over first **three** buyout years
  - Industry specialisation of private equity firm important
- Total factor productivity (TFP) in 36,000 UK manufacturing establishments, including 5,000 buyouts
  - 2% less productive than comparable plants before transfer ownership but after buyout substantial productivity increase
  - [cf. US data where are more productive before buyout]
- Changes driven by management team shareholding & active PE firm monitoring
  - Industry specialism & experience of deals done
- BUT Public to Privates [PTPs]
  - US and UK evidence suggests accounting returns on 1990s/2000s deals not as great as for 1980s deals

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# How Does PE Affect Growth, Investment & Sell-offs?

- Buy-outs improve entrepreneurial actions
  - New product development
  - CAPEX & R&D mixed evidence
- Divisional buyouts greater growth in sales, efficiency & profits (Meuleman et al. 2009)
- PE backed buyouts increase patent cites
- Substantial sell-offs mainly in the few large & PTP deals; and more than in non-buyouts
  - BUT small share of total deal volume and value
  - e.g. in 2007 109 sell-offs, 1,500 new deals; €12 billion sell-off value, €180 billion new deals

# Does PE adversely affect employment & wages?

Employment change in:	Years relative to year of deal				
	t + 1	t + 2	t + 3	t + 4	t + 5
<i>MBO</i>	-2.28%	2.96%	7.46%	21.43%	26.02%
<i>MBI</i>	-10.22%	-9.70%	-11.10%	-3.35%	-5.02%

Source: Wright et al. (2007)/Work Foundation (2007)

## ■ Employment

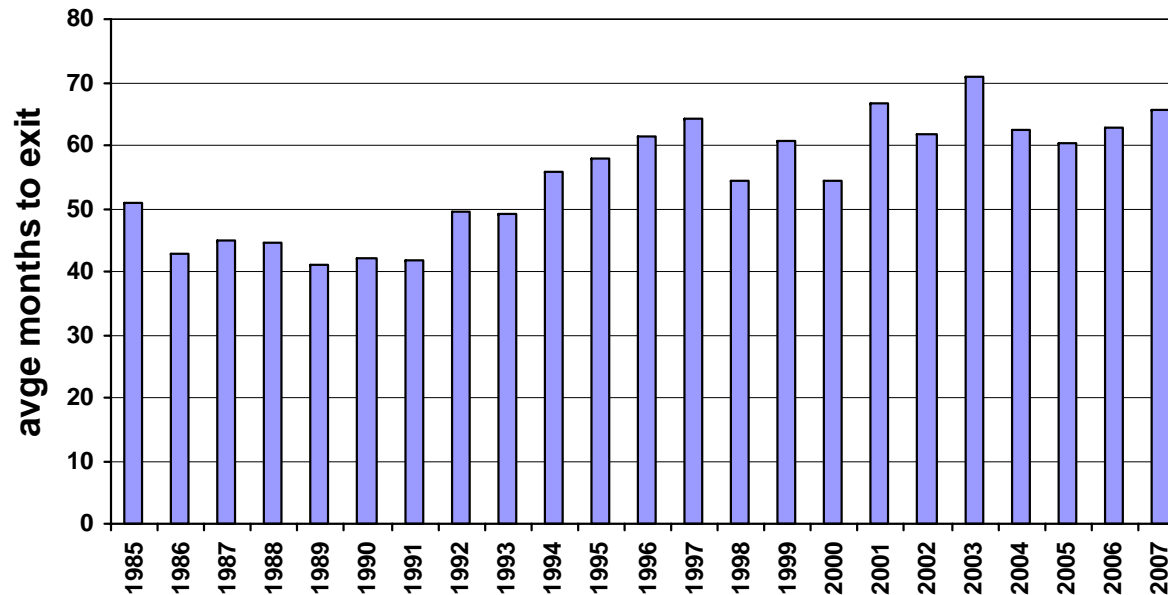
- Davis et al. (2008, 2009) employment grows more slowly & declines more rapidly in PE until t+4; greenfield growth
- (Amess & Wright, 2008; Amess, Girma & Wright, 2008)
  - Majority of deals increase employment after initial fall
  - Employment growth in MBOs higher than non-Buyouts but lower in MBIs
  - M&A has more negative effect than PE on employment
- Wage growth in MBOs & MBIs, lower than non-Buyouts
- Productivity gains reflected more in higher wages in PE than non-PE; reorganization of remuneration structures within firms

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# How Do PE Buyouts Impact Employee Relations?

- Bacon et al. 2008 study of 190 Pan-Europe PE buyouts
  - Little change in union recognition, union member density, management attitudes to unions or issues negotiated
  - More consultative committees, more influential; increased focus on production, employment & financial issues and future plans
  - General increase in high commitment management practices (e.g. team working and training)
  - Occupational pension schemes: increase but shift to defined contribution schemes based on investment performance and contributions open to new members
  - 47% did not inform union representatives pre-buyout
  - 66% no unions, but if present generally neutral or supportive

# Do PE Deals Involve Short Term Flipping of Assets?

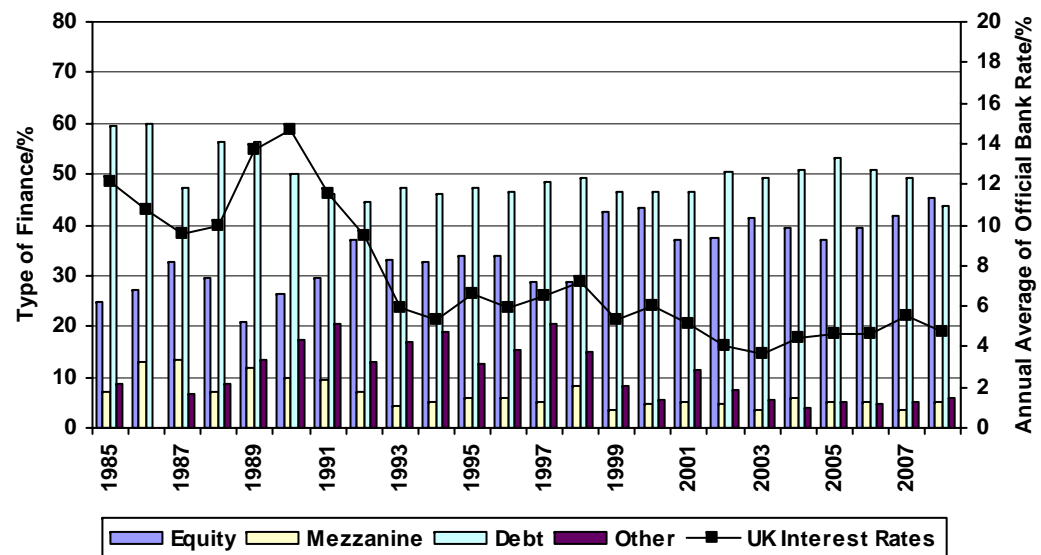


Source: CMBOR

- Overall increasing time to exit but heterogeneous longevity
  - (see also Stromberg, 2008)
- Secondary buy-outs take longer to exit

# What Has Happened to Leverage in PE Buyouts?

- Dramatic fall in senior secured debt in financing structures in 2008 above £10m UK deals
- Substantial increase in senior debt pricing above LIBOR, especially for less traditional layers



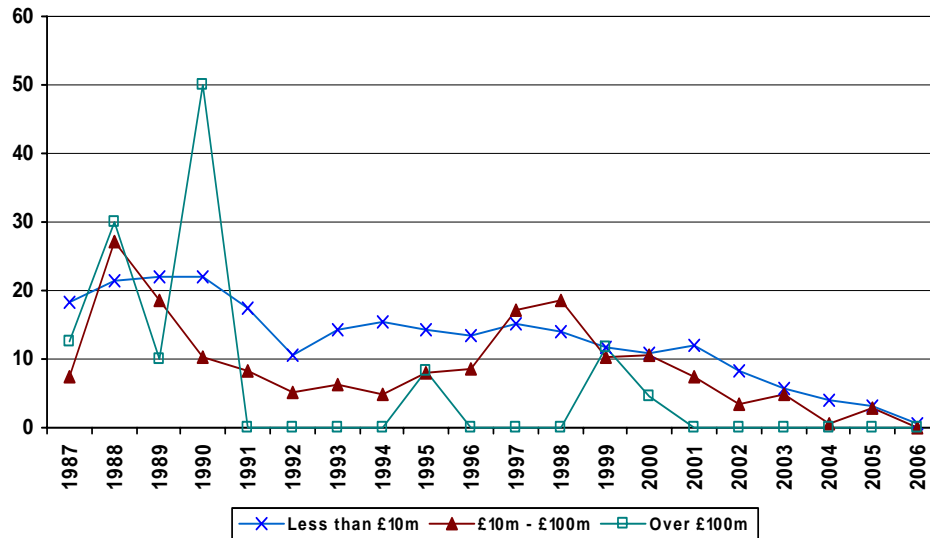
Type of Senior Debt (risk levels)	04	05	06	07	08
Tranche A	225	218	224	217	285
Tranche B	275	250	262	265	338
Tranche C	327	283	308	303	396

Note: Data shows basis points above LIBOR

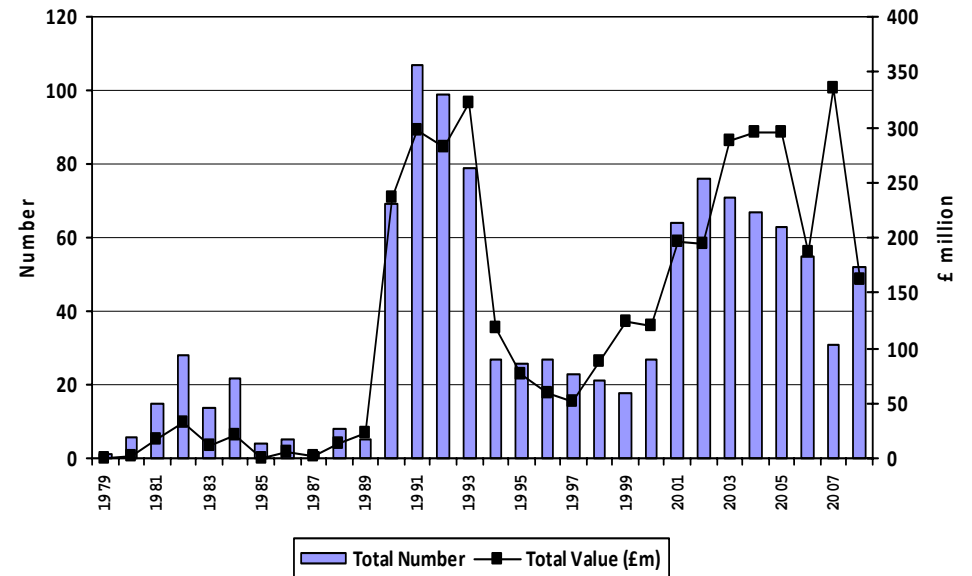
Source: CMBOR/Barclays Private Equity

# Distress & Failure

Failures of Buyouts



Buyouts from failed firms



- About 12% of UK buyouts fail
- Buyouts of failed firms important in recessions

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# Distress & Failure

- **Failed vs non-failed buyouts**
  - Failure rate affected by leverage, timing of deal & by default probability on buyout (Wright et al., 1996)
- **PE buyout failure vs non-buyout failure**
  - Leveraged firms [of any kind] more likely to fail
  - After taking into account leverage and other factors:
    - Private Equity backed buyouts less likely to fail than non-buyouts
    - 7million firm-years (1995-2008) including all UK companies (Wilson, et al.2009)

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# Summary & Conclusions

## ■ Positive aspects

- ❑ Firm levels returns driven by incentives, PE involvement, efficiency, growth & entrepreneurship
- ❑ Employment increase in MBOs & better than in M&A
- ❑ Increase in high commitment HRM
- ❑ Productivity gains more strongly reflected in wages
- ❑ Little evidence of stripping & flipping
- ❑ PE buyout failures less likely than non-buyouts
- ❑ Buyouts of firms in distress

## ■ Negative aspects

- ❑ Information to employees during process
- ❑ Employment & wage impact in MBIs negative compared to MBOs [but nature of deals]
- ❑ Leverage associated with failure

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# Thank You!

## Further Reading

- John Gilligan & Mike Wright, *Private Equity Demystified*, London: ICAEW, 2008.
- Mike Wright, Kevin Amess, Charlie Weir & Sourafel Girma, *Private Equity and Corporate Governance: Retrospect and Prospect*, *Corporate Governance: An International Review*, 2009 forthcoming
- [www.cmbor.org](http://www.cmbor.org)