

Report of the Alternative Investment Expert Group – Developing European Private Equity

Stakeholder comments



UNI-Europa welcomes this opportunity to respond to the European Commission's stakeholder consultation on the role of European private equity.

UNI-Europa, the European regional organisation of the global trade union federation, UNI, represents some seven million European workers across a variety of sectors including commerce, telecommunications, finance and IT and business services.

Since the 1980s, European trade unions have been dealing with the spectre of private equity involvement in their companies. What once was labelled 'asset-stripping' has been gentrified into 'alternative investment'. Nobody can argue, however, that the industry has not greatly increased in significance in the last twenty years.

While the report of the alternative investment group rightly highlights the achievements of this nascent industry, it is unsatisfactory in its asymmetrical analysis of the effects of private equity and outright blind to wider employee and social considerations.

UNI-Europa has concerns over a number of expected and unexpected consequences of the increasing role of private equity. These concerns focus on, but are not limited to: restructuring; job creation; and corporate social responsibility.

Corporate social responsibility (CSR)

The report makes considerable claims regarding private equity's contribution to corporate governance, among them:

- *Private equity financing can improve management and governance in companies and provide them with a springboard for sustained success. (p. 31)*

UNI-Europa's experience in the cases of many equity investments, particularly leveraged buy-outs (LBOs), does not reflect this statement. All too often the new regime, which no longer has to report to the stock market, stymies or completely withdraws from social dialogue.

- *The industry adheres to self-imposed industry standards which have been created in conjunction with investors/clients. (p. 2)*

The industry describes this as self-regulation, but the Commission should ensure that the industry accepts standardised, external checks and balances if a fundamental conflict of interests is to be avoided and stakeholder confidence is to be restored.

- *Private equity plays an important role in... facilitating the adoption of advanced and transparent governance rules. (p. 2)*

It's interesting to note that the word 'transparent' crops up in the text (alongside proclamations, pledges and promises as to the industry's standards) some eleven times. 'Disclosure', coincidentally, also appears eleven times. In almost every case, it is to argue that Community actions should be taken "...without triggering mandatory disclosure or conduct of business rules." (p. 31). An industry that is so clearly committed to transparency appears more acutely devoted to maintaining its under-regulated, non-registered nature.

This is, perhaps, the key problem with regard to CSR in equity-led organisations. The desire for secrecy often constitutes an impediment to initiating and maintaining effective social dialogue. While it should not be necessary to remind the Commission, perhaps, the industry itself should familiarise itself with the provisions of Chapter XI (particularly articles 136-9) of the Treaty on the European Community, as well as those of the European Social Charter and the Community Charter of the Fundamental Social Rights of Workers.

UNI-Europa expects all employers, regardless of ownership or public/private status, to engage in meaningful social dialogue with the relevant social partners. Furthermore, LBOs are not exempt from the existing directives on information and consultation, nor on the establishment of European Works Councils.

Questions continue to be posed regarding the private equity industry's reporting techniques, as well as its performance measurement accounting.¹ It is crucial that the Commission seeks to remove uncertainty by eradicating unreliable, 'rogue' fund managers and advisors.

Job destruction or job creation?

UNI-Europa welcomes the positive impact made by certain private equity investments toward job growth. However, the failure of this report to present a balanced perspective is as predictable as it is lamentable.

Some companies benefit from investment and are able to expand during the life cycle of this investment, but this is far from being universal.

Let's look at one example, that of Bulgarian Telecommunications Company (BTC). Sold in January 2004 to equity interests backed by the US-based Advent group, the last 30 months should sound a cautionary note to all stakeholders.

In little over two years, the new owners have shed nearly half of the 25,000 strong workforce, using means which contravene the Bulgarian Labour Code and European law. The redundancies have been accompanied by the sale of much of BTC's principle building assets.

In a restructuring process the rights protecting workers, such as the ones stated in the EU Directives on collective redundancies (98/59/EC) and information and consultation (2002/14/EC), have to be respected. These have not and neither has the very principle of social dialogue itself.

The BTC case offers an alternative perspective to the glowing terms of the report. Using the terminology of one credit analyst, this was a clear case of a "drive-by" - opportunistic and wholly irresponsible equity restructuring.²

¹ It is interesting to note that such criticisms do not emanate solely from outside the industry. See Ray Maxwell's presentation for INVESCO Private Capital 'Lies, Damn Lies and Private Equity Statistics' (2002).

² 'Private equity firms warned that high debts are hurting buyouts' *The Guardian* (UK) August 15 2006

Investment

However, job losses alone are not the end to the negligent and unsustainable practices of some private equity investments.

Huge levels of debt persist throughout the industry. In Europe's most developed equity environment, the UK, borrowing from private equity firms is GBP680bn. Put more starkly, this figure equals a little less than half of the entire value of all the companies listed on the FTSE100.

'Value' is another term that peppers the group's report. Quite how subjecting businesses to such astronomical debt adds or creates value is open to serious question. As is the sustainability of such debt should the economic outlook change. Finally, obese debt levels can have serious implications for existing bond holders, who see the value of their investment stripped overnight. These bondholders are often pension funds. Adding to the existing problems of the pension system in Europe is another (unforeseen) negative externality of the private equity surge.

As private equity has grown in importance, its stretch over European industrial topography has increased in turn. Now, investments are being made in traditionally public sectors and those recently privatised. The management of services of general interest (SGI) and services of general economic interest (SGEI) is crucial to the growth of existing Member States, the transition and development of new and candidate Member States and the growth of Europe, more generally.

Often, SGIs or SGEIs require massive infrastructure or network development, to meet both commercial and public policy objectives. UNI-Europa is concerned that this kind of investment will be made even more difficult or, in the worst cases, impossible in already debt-laden businesses. The Commission's stated desire to create an information society, for example, could be threatened by the inability to invest in next generation communications networks.

Here's the view of Professor William Melody, of the Centre for Information and Communication Technologies (CICT), on last year's LBO of TDC, the Danish telecom incumbent,

(The LBO) dramatically increases TDC debt, interest rates, risk exposure and investment capacity. TDC's credit ratings have been downgraded twice since the first announcements. An immediate cash dividend of four times per share annual earnings has been paid. ... TDC's future investment capacity will be significantly impaired.³

A similar phenomenon has been witnessed at Eircom in Ireland. The recent beneficiary of a 'turnaround' buyout (the kind that even the industry recognises as job destructive⁴), Eircom now boasts record levels of debt and crippling investment inertia. The loss of competitiveness to the economy as a whole, within which telecom is a 'driver', has been clear. Ireland is now at the foot of the broadband league table and the government has recently been forced to give over EUR300m in grants to new broadband operators, having failed to ensure quality of service from Eircom.

Taxing times

The report's consideration of fund structuring makes a cogent case for capital gains tax to be levied solely in the home country. It is not in the remit of UNI-Europa to analyse the relative merits of different taxation systems.

³ Melody, W 'TDC's Uncertain Future Under New Owners' CICT Newsletter No. 3 (2006)

⁴ Meyer, T 'Private equity does not destroy jobs' Deutsche Bank Research February 8 2006

However, we insist that the development of the industry should not be based on so-called 'tax-dumping'. Competition on the basis of national tax regimes would be a regrettable evolution of both the industry and Europe's internal market.

Conclusion

UNI-Europa does not dispute some of the very real benefits brought about by the expansion of European private equity. Yet, as the value and number of such investments continues to boom, the Commission must ensure that not only the industry's demands are heard. This new type of capital creates a wide range of externalities that must be fully analysed and understood, in order that potential or actual negative effects may be mitigated as much as possible.

UNI-Europa further calls on the industry to affirm its commitments to corporate governance, social responsibility and ongoing social dialogue in all its operations.

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This response may be published.

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