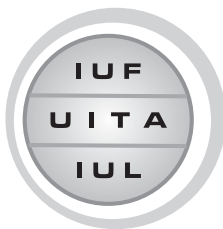




A Workers' Guide to Private Equity Buyouts

International Union of Food, Agricultural, Hotel, Restaurant,
Catering, Tobacco and Allied Workers' Associations

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printed on recycled paper

The IUF encourages the widest possible distribution of A Workers' Guide to Private Equity Buyouts, provided the IUF is acknowledged as the source. We wish to particularly thank IUF staff members Hidayat Greenfield and Peter Rossman for their contributions to this brochure, and Willy Garver for providing the original graphics.

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Preface

In response to a growing number of requests from affiliates around the world, the IUF has produced this brief introduction to private equity buyouts and their impact on the environment in which our members organize and collectively bargain. This impact cannot be overstated: in just five years, private equity funds have established themselves as major short-term owners of companies employing hundreds of thousands of IUF members around the world.

In 2006 private equity funds spent over USD 725 billion buying out companies – an amount equivalent to buying the national economy of the Netherlands, or the economies of Argentina, Poland and South Africa combined – with billions of dollars to spare.

Buyout funds today can potentially mobilize in excess of USD 2 *trillion* in purchasing power. This is equivalent to a private equity shopping spree with a basket deep and wide enough for 22 Unilevers, or 31 British American Tobacco (BATs), or 38 McDonald's or 47 InBevs at their current market value.

In just the past two years the size of individual buyouts has increased dramatically, with record buyouts exceeding USD 35 billion in 2006. The year 2007 is now touted as the year of the USD 50 billion or even a USD 100 billion buyout. This means that virtually no company in which our members work is immune from takeover by private equity funds.

Originally based in North America and Europe, private equity funds have rapidly expanded their reach – buying up companies in Argentina, Australia, Brazil, India, Japan, Poland and South Africa – as well as taking over major transnational companies

with worldwide operations. The threat to our workplaces and our trade unions is truly global.

The private equity buyout business is geared towards extremely high rates of return, averaging 20 to 25%, with the biggest funds promising a staggering 40% return to investors. As the bitter experience of our members has shown, these astronomical returns can only be achieved by a short-term drive to extract huge sums of cash from the acquired companies. The main weapon in this drive consists of loading the acquired company with debt – at the cost of long-term productive investment, jobs and employment security. To generate these short-term super-profits, private equity funds have aggressively undermined the foundations of collective bargaining built up through decades of union struggle.

By their very nature, private equity buyout firms cannot have a long-term perspective that recognizes the rights and interests of union members. In their brutal calculations they cannot see a workplace as a place of employment, but only as a “bundle of assets” to be manipulated and squeezed for as much cash as possible in the shortest time before they “dispose” of the investment.

In the face of the global threat posed by private equity buyouts, this brochure seeks to provide trade unionists with an overview of what is happening and the consequences for workers, their workplaces, their unions and society as a whole. We do so in the belief that, despite the enormous size and reach of private equity funds, they can be challenged and beaten back through trade union action.

Ron Oswald

IUF General Secretary

May 2007





PRIVATE EQUITY BUYOUTS

“GOING PRIVATE”

Private equity funds acquire companies (or divisions of companies) by buying controlling shares in a company or buying up all of the public shares of a company listed on the stock market. The purchase of controlling shares is often a first step to gaining full control. When private equity funds buy up all of the shares the target company then has a single shareholder - the buyout fund - and is no longer publicly traded. This is called **“taking a company private”**.

WHAT IS A PRIVATE EQUITY FUND?

Private equity is a pool of money raised and managed for the purpose of investing directly in private companies. A private equity fund is a fund manager or management company that actively manages this money. Investors in private equity funds expect substantially higher rates of return on their private equity investments than on the stock market. When a private equity fund buys out a company that is listed on the stock market, the company “goes private”, meaning it is no longer listed and publicly traded on the stock market. Investors in private equity funds include corporate pension funds, private pension funds, public pension funds, commercial banks, investment banks, insurance companies, wealthy individuals, and endowments and foundations.

Private equity fund buyouts of companies are principally financed through debt or **“leverage”**. Private equity takeovers were called leveraged buyouts (**LBOs**) in the 1980s, only adopting the friendlier name of “private equity” in the mid 1990s following a series of spectacular failures and criminal prosecutions in the USA. Only the name has changed: debt is still the key to their aggressive takeovers.

A corporation will typically have a balance of 80% equity to 20% debt, on which it pays interest. In a private equity buyout this ratio is reversed, since 80% to 90% of the purchase is financed through borrowing. The private equity fund usually provides just 10% to 20% of the equity as cash and the rest is borrowed. The assets of the company being acquired are put up as collateral to secure the debt and – once taken over – the target company (and *not* the private equity fund) must take this debt onto its accounts and meet the interest payments.

Example The Case of Danish Telecom

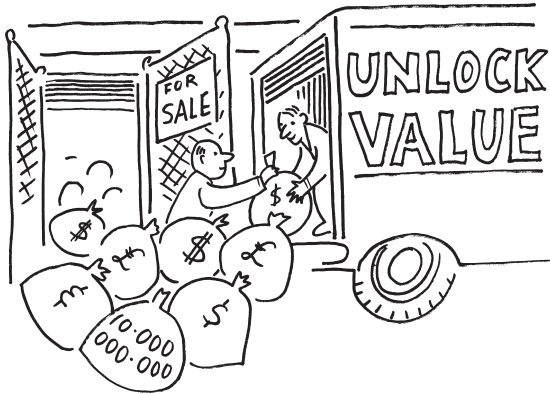
In 2005 the Danish telecommunications operator TDC was taken over by a group of five of the biggest private equity firms - Permira, Apax, Blackstone Group, KKR and Providence Equity for €12 billion. Over 80% of the purchase price was debt financed. As a result the company’s debt to asset ratio jumped from 18% to over 90%. The equivalent of over half the company’s assets were then immediately distributed in shares to the new owners and top managers. To pay off the debt, cash reserves that the company had set aside for long-term development were quickly depleted. The owners plan to sell the company within 5 years of its purchase.





“UNLOCKING VALUE”

Private equity firms claim to be uniquely capable of **“unlocking value”** from a company and releasing it for investors in the fund. Going private is said to shield the company from the pressures on publicly listed



businesses which inhibit the full extraction of potential returns. In practice, this simply means that huge amounts of cash are squeezed out of the company by loading it with as much debt as possible and paying out exorbitant dividends. The main aim of “taking a company private”

is to unlock the company’s value by locking on to and pumping out the cash flow behind closed doors, with no transparency, reporting requirements or public accountability.

In addition to saddling the target company with debt, private equity firms charge the target company a massive fee for ‘advice’ on the deal. A typical example is the takeover of Celanese Corporation by the private equity firm Blackstone Group in 2004. Blackstone Group charged Celanese Corporation USD 45 million for ‘advisory’ services on its own takeover!

The private equity fund managers get an annual management fee of 1-2%, plus additional fees for each financial service, which typically consist of loading more debt on to the acquired company’s books. Acquisition fees, management fees and “financial advisory” fees can total as much as 5% of the amount of the fund under management. Given that the funds under management run into billions of dollars, these fees easily add up to hundreds of millions. So the fees alone can

make a buyout deal extremely profitable for a private equity firm even if the company purchased is no longer profitable!

When the acquired company is sold, the private equity fund manager gets a percentage of the profit, usually around 20%, known as **“carried interest”**.

This is one of the key areas where a private equity buyout differs fundamentally from the more familiar pattern of corporate mergers and acquisitions. Where the costs of acquisition would normally be paid for by the buyer, **in a private equity buyout the target company pays the costs of its own acquisition through debt and fees.**

In many cases property assets of a company are separated from the operating business and re-mortgaged to release cash to finance the buyout. This is common in the case of hotel and restaurant chains bought by private equity firms as well as retail businesses like supermarkets and department stores. Real estate is sold, then leased back in deals that generate fees and cash returns to fund managers but which burden the business with increased operating costs in the long run. Mortgaging or re-mortgaging property to finance the buyout simply adds to unsustainably high debt levels.

But the debt doesn't stop there. Once a company is bought by a private equity fund, the new owners quickly take on additional debt to finance large dividends payments through a mechanism known as **“dividend recapitalization”**, or **“dividend recaps”**. This simply means that the company borrows money and the money borrowed is paid out to the private equity fund as a dividend. Here again we see a key difference with established notions of corporate accounting. Whereas dividends normally reflect a positive balance sheet, private equity uses debt to fund dividends and bonuses. These “dividend recaps” now account for close to one-third of all income flows back to the new owners in the global private equity sector.





Examples 'Cashing in' Through Dividend Recaps

In September 2004, three private equity firms – KKR, Carlyle Group and Providence Equity – put just USD 550 million into a USD 4.1 billion deal to take over the satellite operator PanAmSat Corporation. The remainder was financed through 'leverage'. Only a month after the deal was done, PanAmSat Corporation took on additional debt and KKR, Carlyle Group and Providence Equity paid themselves a USD 250 million dividend.

In 2001 the European private equity firm, Permira, put €450 million into a deal to buy the German chemical company Cognis for €2.5 billion. In the year prior to this takeover, Cognis had an after-tax profit of €109 million. Following its takeover by Permira and a dividend recap, Cognis was so burdened with accumulated interest payments that despite rising sales it registered a loss of €136 million in 2006 – yet Permira and Goldman Sachs are reported to have already taken €850 million out of the company. The debt was refinanced in May 2007 by issuing new loans and notes worth some €1.65 billion.

Dividend recaps are the most direct route for a private equity firm to cash in on its temporary ownership of a company even before they sell it off. They allow the private equity owners to quickly extract more cash out of a company by simply piling more debt on the balance sheet. As the above two examples illustrate, dividend recaps increase the level of debt even beyond the 20% equity/80% debt ratio that characterizes traditional leveraged buyouts. As debt expands to even greater heights, the physical demands on the workforce increase and bankruptcy alone sets the limit.

The short-term, unsustainable system of dividend recaps perfectly illustrates the logic of private equity buyouts. Private equity firms buy a company as a financial asset with the potential to generate an instant cash flow to the new owners in the short term. Huge returns are generated through aggressive restructuring to cut costs and by financial reengineering based on large quantities of debt. *The billions of dollars*

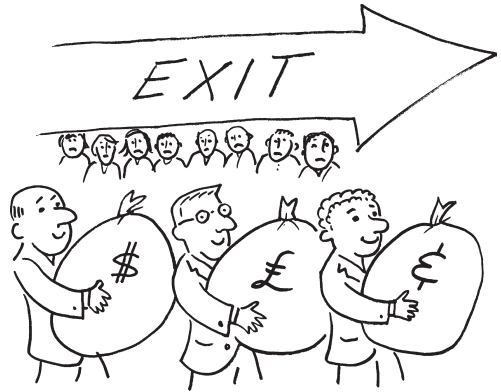
*involved in these deals must not be confused with productive investment: the goal is to suck cash **out** of the enterprise, not invest **in** production, services, or employees. As we will see below, a crucial element in the funds' financial strategy is their ability to avoid taxes on these huge cash flows to themselves and to investors.*

“Private equity firms are using slick new tricks to gorge on corporate assets, helping themselves to fat fees while leaving the companies they sell dazed and depleted.”

Business Week, 30 October 2006

“EXIT”

A buyout firm acquires a company not only to exploit its short-term ability to generate cash. At the time of purchase, the private equity firm is already planning the sale of the business, or “**exit**”. The projected life cycle of the operation, from takeover to exit, is generally 3 to 5 years, often much quicker.



This is another key difference between a private equity buyout and traditional corporate mergers and acquisitions. Almedia Capital, in its private equity “glossary”, defines it in the following terms:

“**Exit** – Private equity professionals have their eye on the exit from the moment they first see a business plan. An exit is the means by which a fund is able to realise its investment in a company – by an initial public offering, a trade sale, selling to another private equity firm or a company buy-back. If a fund manager can’t see an obvious exit route in a potential investment, then it won’t touch it.”



GLOSSARY: PRIVATE EQUITY BUYOUTS DECODED

asset class	an investment category: such as stocks (equities), bonds (fixed income) or cash (money markets).
buyout	the purchase of a company or a controlling interest of a corporation's shares.
capital gains tax	a tax charged on the profit realized on the sale of an asset that was purchased at a lower price. The most common capital gains are realized from the sale of stocks, bonds, precious metals and property.
carried interest	a share in the profits of a private equity fund that goes to the fund manager. Carried interest is normally expressed as a percentage of the total profits (based on the target profit rate) of the fund, usually 20%. The fund manager will normally receive 20% of the profits generated by the fund and distribute the remaining 80% of the profits to investors.
dividend recapitalization	or dividend recaps: where the acquired company borrows money to make a cash payment to the private equity firms that own it. Such dividend payouts appear on the balance sheet of the company as debt. This is one of the ways that buyout firms cash in on their investments before they exit.
exit	the strategy of private equity funds for generating profits on their investment. This may involve selling the company directly to another company, merging it with another company, selling it to another private equity fund or taking the company public again by issuing shares through an Initial Public Offering (IPO).
flipping	to buy and sell an equity within a short period of time to take profits.
going private	private equity funds acquire companies (or divisions of companies) by buying controlling shares in a company or buying up all of the public shares of a company listed on the stock market. The target company then has a single shareholder - the buyout fund - and is no longer publicly traded.
hedge funds	a pool of money managed by a management team for performance fees investing actively in a range of markets including foreign exchange, commodities, derivatives, equities etc., usually short term, often heavily leveraged. Because of the bigger risks involved in unregulated, complex, and leveraged investments, hedge funds are normally open only to professional, institutional or otherwise accredited investors. Typically, hedge funds charge 20% of gross returns as a performance fee. While hedge funds are increasingly buying into public equity markets and helping to finance private equity buyouts, they are a separate and distinct investment class from private equity funds.

junk bonds	a bond is a debt security, in which the issuer owes the holders a debt and is obliged to repay the original amount borrowed and interest at a later date. Junk bonds are bonds below what the rating agencies call “investment grade” issues. Investment grade bonds are considered to be minimal or low risk. Junk bonds, because of their high speculative component, offer higher yields but also carry higher risk. Junk bonds are used to borrow the money to fund a private equity buyout.
leverage	the use of debt to acquire assets, build operations and increase revenues.
leveraged buyout	or LBO: the acquisition of a company using borrowed money (bonds or loans) or debt to finance the purchase. Often, the assets of the company being acquired are used as collateral for the loans. Debt can reach as high as 90% to 95% of the target company’s total capitalization. The debt will appear on the acquired company’s balance sheet and the acquired company’s free cash flow will be used to repay the debt. The purpose of leveraged buyouts is to allow firms to make large acquisitions without having to commit a lot of capital.
private equity	the holding of stock in unlisted companies – companies that are not quoted on a stock exchange. Specifically, private equity refers to the way in which the funds have been raised, i.e., on the private markets as opposed to the public markets.
private equity funds	the pools of capital invested by private equity firms. Private equity funds are generally organized as either a limited partnership or limited liability company which is controlled by the private equity firm that acts as the general partner. All investment decisions are made by the general partner that also manages the fund’s investments which is commonly referred to as the portfolio . Most private equity funds are offered only to institutional investors and individuals of substantial net worth. This is often required by the law as well, since private equity funds are generally less regulated than ordinary mutual funds.
unlocking value	the code name for diverting company cash flow into the buyout fund. Strategies for unlocking value can include the sale (and sometimes lease back) of property assets, the sale of physical assets other than real estate, depleting cash reserves, and the use of assets to secure new loans. These practices generate greater free cash flow and so it is said that the value of the company’s assets has been unlocked.
venture capital	a type of private equity capital typically provided by professional, institutionally-backed outside investors to new growth businesses.





Having taken a company private and “unlocked value” through debt, dividends, fees and dividend recaps, private equity firms exit by taking the company public again through a stock market offering (IPO) or by **“flipping”** it – selling it to another private equity fund (‘secondary buyout’). The next fund then finds new ways to generate cash flow through new debt and asset stripping (selling assets and emptying cash reserves). Globally, an estimated 40% of companies owned by buyout funds are currently in secondary, tertiary or even more buyout phases, trapped on a financial merry-go-round. When a company makes the rounds from fund to fund, job cuts bite deeper as debt levels rise even higher.

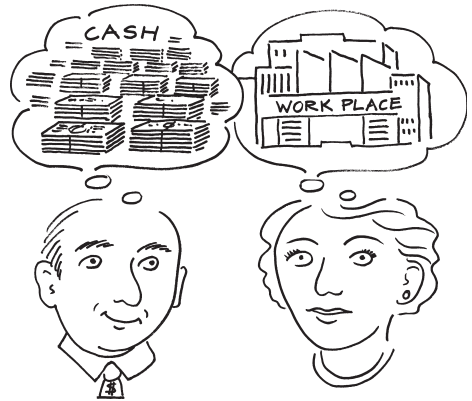
CASHING OUT

In 2003 Debenhams, a major UK department store chain, was taken private by CVC, Texas Pacific Group and Merrill Lynch Private Equity using £1.4 billion in debt and just £600 million in equity. The buyout was financed by mortgaging the real estate on which Debenhams stores are situated, as well as loans made against the company’s assets. Through dividend recaps, company debt was increased to £1.9 billion to finance a dividend payout of £1.2 billion to the 3 private equity firms. They ‘exited’ the investment by floating Debenhams shares on the stock market – just 30 months after taking it private. With the £1.2 billion dividend alone the private equity firms doubled their money in just 30 months, leaving Debenham’s seriously indebted.

THE IMPACT ON UNIONS:

Continuous Restructuring, Vanishing Employers

Unions have always fought management attempts to cut costs and maximize profits. The relentless pressure of restructuring is not new. What *is* new is the radical transformation of management priorities under private equity ownership. When a buyout fund takes control, the management's focus is not on actual business operations – output of goods or provision of services – or even increasing operating margins. Instead, the exclusive concern of corporate management is to extract maximum cash out of the companies in the quickest amount of time *regardless of the long-term impact on output, productivity and profitability*. Assets – including land and buildings – are used to raise more loans, increasing debt levels. Individual workplaces may be restructured, closed or sold-off regardless of productivity and performance levels. Closures, layoffs and massive outsourcing often leave only a shell of a company. The leveraged buyout of Nabisco, part of the then record KKR buyout of RJR Nabisco in 1988, left only the Nabisco brands minus much of the productive capacity – and unionized jobs which built their success.





As cash is diverted into dividends, recaps, fees and interest payments on debt, there is an inevitable decline in real investment. In companies taken over by private equity firms the new owners stop investing in new machinery, training, research and product development as cash is diverted out of the company. This decline in real investment undermines employment security and casts doubt over the long-term viability of a factory, hotel etc. Sales and turnover may increase, but the burden of accumulated debt and fees can drag a balance sheet into the red.

Declining Investment: The Case of Eircom

Eircom, Ireland's national telecom provider, was a company in need of long term strategic investment. The company was privatized by the government in 1998 and acquired by the private equity consortium Valentia in 2001. Eircom paid for the loans by issuing bonds which raised its debt from 25% to 70% of its assets. Eircom capital expenditures declined from €700 million in 2001 to 300 million in 2002 and 200 million in 2003 and 2004. *While cutting back radically on investment Eircom paid a €400 million dividend to Valentia.*

Private equity firms view the companies they target for takeover as merely **"a bundle of assets"**, not as a service-provider or manufacturer of goods, or as a place of employment. Management focus is on manipulating this bundle of assets through financial re-engineering to generate maximum, short-term cash outflow – and this is what drives management decisions on restructuring. In this equation, workers figure primarily as expenses as assets are unbundled, sold, mortgaged and re-sold.

“Private equity funds ... typically look to exit from the investment two or three years after the purchase. There is no complex web of stakeholders to worry about, nor much concern about the relationship with employees. Employees are thought of principally as expenses.”

Business Review Weekly (BRW), August 2006

What does this mean for unions and collective bargaining?

In much of the world collective bargaining is traditionally based on the assumption that employers invest, that this investment produces gains in productivity, and that workers – through the collective power of their unions – are able to translate these gains into improved living standards and working conditions. *Because the purpose of a leveraged buyout is to extract cash through debt in the shortest possible time, private equity dissolves the traditional link between productivity, profits and wages, a link which unions have struggled to establish over more than a century.*

When the workplace is just ‘a bundle of assets’ workers face:

- **continuous restructuring to generate cash outflow**
- **falling levels of productive investment**
- **institutionalized short-termism**
- **increased outsourcing & casualization to cut costs**
- **sell-offs & closures regardless of productivity & profitability**
- **deteriorating working conditions**
- **diminished employment security**
- **invisible employers**





Invisible employers?

Another crucial difference between a private equity buyout and corporate takeover through merger and acquisition is that under most national laws **private equity buyouts are not treated as a change in ownership affecting industrial relations**. European Union regulations also fail to recognize and enforce employer responsibility in this regard. The EU Acquired Rights Directive, which is intended to ensure continuity of employment terms and conditions in the event of a takeover, does not apply in the event of a wholesale transfer of share ownership.

This has far-reaching consequences for unions, since the absence of any legal recognition of a change in ownership allows private equity firms to evade responsibility **as an employer** in the collective bargaining process. When pushed by unions to enter into collective bargaining negotiations (as described in the cases below), private equity funds have claimed that they were only involved in 'refinancing' the company and are just another 'shareholder'.

BLACKSTONE GROUP: NOT AN EMPLOYER?

As one of the largest private equity firms in the world, Blackstone Group owns companies employing a total of 380,000 workers worldwide. But while Blackstone Group actively intervenes in workplace management decisions, aggressively imposing restructuring plans involving wage cuts and layoffs, it claims not to be an employer. According to its company profile, Blackstone Group has only 750 employees!

Private equity funds strongly reject being categorized as employers, preferring to describe themselves in purely financial terms as **“an asset class”** or an investment vehicle. Current laws and regulations uphold this fiction. When it comes to the workplace, and relations with employees, the employer simply vanishes.

The struggle at Gate Gourmet

In 2002 Gate Gourmet, the catering division of SwissAir, was bought by the private equity firm, Texas Pacific Group (now known as TPG), in a heavily debt-financed deal. To restructure the company for a lucrative exit of its investment, TPG dictated a punishing global cost reduction program.

In the UK the plan was to reduce employment by one-third. In Germany, the target was a 25% reduction in wages in Düsseldorf and 20% at the other sites.

Private equity thus launched Gate Gourmet on a collision course with unions, beginning with the well-known struggle at Heathrow Airport in the UK, which was kicked off when the company secretly hired hundreds of contract workers in the middle of collective bargaining negotiations. The anti-union offensive then moved to Germany's Düsseldorf airport. In a clear challenge to the established collective bargaining framework, the company demanded enterprise-level concessions on working hours, holiday leave and shift pay. The Food and Allied Workers Union NGG took strike action on 7 October 2005.

Private Equity's “Operational Guidance”

“While we do not seek to become involved in the daily operations of our portfolio companies, our wealth of experience, deep industry expertise and large global network of affiliated partners position us as a vital resource from which management can draw strategic, financial and operational guidance.”

Texas Pacific Group website





After 8 weeks of industrial action, a compromise was negotiated between the union and local company management in early December 2005, but Texas Pacific Group intervened and the settlement was unilaterally scrapped by Gate Gourmet corporate headquarters. When the NGG called on Texas Pacific Group to directly participate in the negotiations, the private equity firm denied responsibility for industrial relations at Gate Gourmet.

The conflict was only settled in April 2006 - following a bitter 6 month strike. The unity and determination of the union members enabled them to beat back the company's demand for a 10% reduction in payroll.

Exit by Stealth

On 2 March 2007, Reuters reported the following:

"A day after Texas Pacific Group joined other powerful private equity houses in a call for more transparency, the firm's mystery sell-off of Gate Gourmet reveals just how much work the industry has ahead of it. Texas Pacific Group, which bought the airline catering firm in late 2002 from Swissair, has quietly reduced its stake in the business over the past year without any disclosure, selling the last piece to Merrill Lynch on Thursday."

Gate Gourmet workers learned about this through the press!

At the time of the buyout, Gate Gourmet employed over 25,000 workers in 29 countries with 140 flight kitchens. The company today operates 97 flight kitchens with 20,000 employees.

The struggle at Tokyu Tourist Corporation

The far-reaching impact on trade union rights and collective bargaining is also illustrated by the buyout of Tokyu Tourist Corporation by the private equity fund Active Investment Partners in Japan in March 2004. The Tokyu Tourist Trade Union, a member of the IUF-affiliated Service Tourism Rengo, was informed of the buyout only a day before the deal was finalized. The union immediately sought guarantees that the existing collective agreement and the conditions and benefits of its union members would be maintained. But what was presented by management as merely a change in share ownership in fact involved a dramatic shift in the organizing and bargaining environment for the 1600 workers at Tokyu Tourist Corporation.

From the outset Active Investment Partners refused to recognize the union and instead launched a series of attacks on trade union rights – including the creation of a company-controlled ‘Employees Association’ in December 2004. Throwing out key bonus provisions in the collective agreement, Active Investment Partners pressured members of the Tokyu Tourist Trade Union to withdraw their union membership and join the Employees Association. A series of systematic attacks on wages and benefits then followed.

According to union president Tatsuya Matsumoto,

“Active Investment partners not only collected information on the financial situation on the company but also on the union and probably decided that our union was an ‘impediment’ to restructuring the company.”

So while Active Investment Partners set about removing this ‘impediment’ through a series of unfair labour practices, the union continued its struggle for recognition and maintained solidarity among its members in the workplace.





These workplace struggles also translated into political intervention at a national level, with Service Tourism Rengo joining a broader debate led by Rengo on the need to regulate private equity funds by enforcing employer responsibility. In 2005 a parliamentary investigation undertaken in response to union pressure concluded that major shareholders (including private equity funds) cannot evade their responsibility as an employer by claiming that they are merely shareholders. However, this important conclusion got no further than the parliamentary committee. A major challenge remains for unions in Japan – and elsewhere – in turning these findings into an enforceable legal framework that recognizes private equity funds as employers and binds them to laws and regulations on trade union rights and collective bargaining.

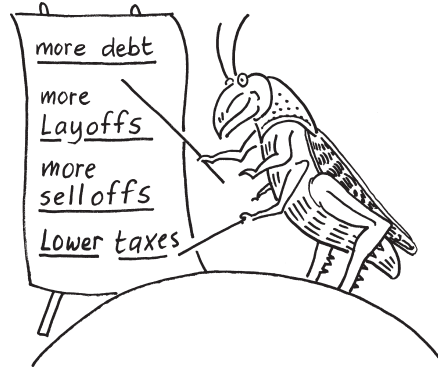
“So who is an “employer”?”

One day an investment fund comes along and acquires a majority of the company’s shares. According to the law on trade unions, an investment firm is a shareholder, not an employer. An employer is a company and the counterpart of negotiations with a union is also a company. But in reality the company is controlled by an investment fund and so the company is left with only limited authority. In other words, a company can no longer exert authority as the employer. Through the industrial dispute we experienced, we found it meaningless to negotiate with the company under such circumstances.”

Tatsuya Matsumoto, President, Tokyu Tourist Trade Union

UNDERCUTTING THE PUBLIC INTEREST

Faced with growing criticism as “locusts” and “asset strippers”, the private equity funds and their lobbyists claim that taking companies private makes them leaner, more competitive and ultimately capable of growth. They can point to companies which, under private equity ownership, have hired new staff, increased sales or been successfully floated on public stock markets. This



argument ignores the fundamentals of the buyout business. The handful of “success stories” of the private equity buyout industry are built on a short-term view in which the company exists to provide maximum short-term gains to the investors and fund managers. The reality is that:

- private equity as a business model – based on the use of high levels of debt to extract maximum profits in the short term from the company – imposes a fundamental transformation of the workplace.
- the use of extreme levels of debt places in question the sustainability of those companies trumpeted as success stories.
- increases in employment, where they do take place, are only achieved at the cost of employment security, working conditions, wage levels and the long-term future of the enterprise.



- the enormous wave of debt-funded private takeovers is fueling the spread of high-risk, low-grade corporate bonds to an extent which threatens the viability of the financial system as a whole. A major default or the collapse of one of the funds could trigger a financial crisis destroying masses of jobs and workers' pension funds – both public and private.
- short-termism is institutionalized at the workplace and in society. Massive debt, minimal or no taxes, and an exclusive focus on short-term financial gains damage society as a whole.

BUYOUTS vs. VENTURE CAPITAL

Although private equity firms try to soften their asset-stripping “locust” image by pointing to the importance of venture capital for starting up new businesses, the fact is that venture capital funds and private equity buyout funds operate in different worlds. Over 70% of funds raised by private equity firms are used to buy out existing companies. This in fact diverts investment away from genuine venture capital funds that are focused on the longer-term development of new businesses.

Venture capital or start-up capital funds tend to contribute to job creation since they provide capital to a new business, while private equity buyout funds are geared to destroy jobs and undermine employment security in their drive to suck cash out of the target companies they acquire. Over the last 5 years, venture capital for start-ups has continually shrunk in relation to funds raised for buyouts. In the UK, which has seen the fastest growth of private equity buyouts outside North America, venture capital has declined to less than 7% of private equity investment. Yet the private equity firms continue to organize their political lobbying through so-called ‘venture capital associations’.

Behind Closed Doors

The gradual imposition, over many decades, of accountability, disclosure and reporting requirements on publicly held companies has been an indispensable tool in setting certain limits to corporate power and defending the public interest. When a company is taken private through a private equity buyout, these restrictions disappear at a stroke. There are no shareholder meetings, because there is only one shareholder – the fund. There are no disclosure requirements, meaning regular information on the performance of the business – and its financial health – is not accessible to its employees or to the wider public affected by its activities.

Private equity firms have resisted calls for transparency in their operations by responding that investors in the funds have full access to the information they need. As with the discussion of the funds' impact on employment, this response sidesteps the basic issue.

Investment in private equity is by definition highly restricted, accessible only to very large institutional investors and extremely wealthy individuals. Information on public companies, by contrast, is universally accessible – even to non-shareholders. The structure of the private equity industry gives the fund managers free rein to impose the management team of their choice on the companies they buy. The only demand on the fund managers is that they deliver high returns by diverting cash out of the companies into the fund.

The Assault on Public Revenue

The rapid expansion of private equity firms has been boosted by a highly favourable tax environment. While all businesses benefit from the tax deductible status of interest on borrowed money, buyout funds clearly benefit to a much greater extent because of their exclusive reliance on debt as a tool for “unlocking value”. In fact the buyout power of debt only functions because of tax loopholes and the absence of significant restrictions on the balance of debt to equity ratios in companies.





In addition, private equity firms are able to treat fees, recaps and carried interest as **"capital gains"**, rather than income. In most countries there is a higher rate of tax applied to income than capital gains. This gives private equity firms an enormous tax loophole which they have fully exploited. According to one recent estimate, the US-based Blackstone Group saved USD 310 million in taxes on the USD 1.55 billion it raked in on "carried interest" fees in the year 2006 alone by reporting the fees as capital gains (taxed at 15%) rather than income (35%).

Buyout funds also extract maximum tax benefits through overseas tax havens. While the private equity *firms* are located in major financial centres, the *funds* they manage are registered in offshore tax havens. By exploiting all available tax loopholes, the buyout firms not only bring in astronomical returns, they also undermine public revenue. For example, 5 of the 10 largest private equity-owned companies in the UK effectively paid zero corporate tax in the UK in 2005/06. Despite combined sales of over £12 billion and operating profits of more than £400 million, in total the 10 companies received a £11 million corporation tax credit! United Biscuits, the UK's largest biscuit manufacturer, owned by Blackstone Group and PAI Partners, had operating profits of £202 million on sales of £1.2 billion in 2006. Nevertheless, the company received a tax *credit* of over £22 million.

Minimizing or eliminating corporate tax is a core element of the leveraged buyout - leaving other companies and society as a whole to fund the deficit. What is the future of public spending for health, education and pensions if in 2006 alone companies bought by private equity firms using USD 725 billion in funds paid little or nothing in taxes? Private equity is assaulting public revenue at a time when governments claim they face a shortfall of revenue for essential social services.

TRADE UNION ACTION – THE ORGANIZING CHALLENGE

Private equity buyouts clearly bring about a fundamental shift in the environment in which unions organize and bargain.

How should trade unions respond?

With virtually all public companies now susceptible to a private equity takeover, trade unions are operating in a permanent pre-bid environment. Defensive bargaining tactics prior to a takeover can include union action aimed at:

- strengthening company and sector-wide bargaining agreements to reduce disparities in collective agreements and consolidate bargaining power. Disparities in collective agreements and levels of union organization within a company, and the weakening of national or sector-wide agreements, invite the kind of anti-union aggression typified by the struggles at Gate Gourmet, where the new financial owners consciously targeted the strongest agreements and union organizations in order to isolate them and roll back conditions within the company as a whole.
- negotiating succession clauses or clauses on ownership change that guarantee continuity in employment security and union recognition in the event of a takeover;
- ensuring that such clauses are respected as a legally binding condition of sale when management approaches potential private equity buyers;
- negotiating more comprehensive clauses that act as a “poison pill” to make the company less attractive to private equity funds (similar to shareholder rights or shareholder voting plans in





publicly listed companies), e.g. clauses stipulating that union agreement is needed prior to any restructuring, workforce relocation, transfers or divestment prior to and after a change in ownership.

Negotiating with Private Equity at Linde

When the German Linde Corporation put its forklift division, Kion, up for sale to private equity in 2006, the union was able to impose a review of prospective buyers' business plans for the company as a condition in the bidding process. The private equity firm KKR eventually won the sale by agreeing to maintain investment and employment up until 2011. The Kion case demonstrates that potential private equity owners can be dragged directly into the bargaining process and corporate financing put on the bargaining agenda where unions can exercise sufficient bargaining and mobilizing power.

Collective bargaining strategies may be combined with shareholder strategies and broader legal strategies:

- Union shareholder strategies, using union pension fund investments in a company or through alliances with other shareholders, or both, have been successfully used in some cases to block a private equity takeover.
- Private equity takeovers can also be challenged on legal and regulatory grounds if it can be demonstrated that they would breach competition laws, threaten pension fund schemes, or fail to deliver a public service as stipulated by law.

If a buyout has already taken place, unions can seek to

- aggressively target and directly confront private equity funds as employers in the context of collective bargaining and
- challenge, through the collective bargaining process, the financial arrangements which dictate the new management strategies and negotiate their impact on employment and working conditions. Union bargaining power must be exercised to try to prevent the plunder of corporate resources by, for example, preventing the accumulation of additional debt through dividend recaps etc.

Negotiating effectively with the new financial owners requires a degree of coordination and an ability to respond rapidly to threats which is beyond the current capacity of most trade unions. There is an urgent need to strengthen union work in these areas, in the first instance by increasing research and organizing resources, at national and international level.





TRADE UNION ACTION – MOBILIZING & INTERVENING FOR RE-REGULATION

Just as the private equity buyout funds use various kinds of “creative financing” to subvert the public interest and undermine the rights and employment security of millions of workers, trade unions need to develop **creative organizing** strategies to reassert the public interest.

The power and reach of private equity relies on a favorable combination of changes to the rules governing financial markets, pension fund investments and corporate taxes. In other words, de-regulation.

The growth of private equity buyouts was built on specific changes to specific laws and regulations implemented as a result of strategic lobbying campaigns and political activism by the private equity buyout industry. These changes are designed to increase the sources of capital available to the buyout funds and reduce or eliminate corporate tax on operations involving substantial debt and the sale of businesses. Such changes in laws and regulations vary in detail from country to country but generally follow the same pattern.

Unions need to mobilize politically to build a regulatory environment that promotes productive investment based on:

- the long-term interests of working people
- long-term employment security
- employment creation based on a decent work agenda
- comprehensive protection of trade union rights

In 2003, for example, changes to US tax law redefined certain forms of corporate income for tax purposes and encouraged the growth of dividend recaps in leveraged buyout deals. Also in 2003 the Social Democratic government of Germany abolished capital gains tax on the sale of businesses. This change, introduced at the urging of the financial lobby, paved the way for private equity as a significant presence in that country. New German legislation, which will take effect later in 2007, will allow the incorporation of private equity funds as limited partners, encouraging their further expansion.

In Australia changes to tax laws were introduced in December 2006 to exempt foreign investors from a 30% capital gains tax. This led to a surge in foreign private equity buyout bids, with buyout offers jumping to AUD 33.4 billion compared to just AUD 1.9 billion in all of 2005.

Every stage in the growth of the buyout funds has had the way paved by prior legislative and regulatory changes. These can and must be reversed through political action.

Identifying the critical stages in the step-by-step transformation of tax regimes and financial market regulations which promote private equity buyouts is a necessary element of a trade union strategy for fighting back. Understanding this evolution can help us to challenge and reverse these regulatory changes – and build public support by clearly exposing the role of private equity buyout funds in destroying social wealth.

The leveraged buyout boom in the US in the 1980s crashed to a halt because of movements in interest rates and the stock market which were unfavourable to the buyout business. Some of the funds went bankrupt, others reduced their profile and their activity. Today they're back with a vengeance, and global in their attack. The damage of the 1980s, however, cannot be undone – companies were ravaged and thousands of unionized jobs were scrapped. While some junk bond dealers went to jail, nothing significant was done in the way of regulation to prevent a recurrence – and that is the essential lesson.





Workers – and society as a whole – cannot simply wait for the current cycle to run its course, as financial authorities and private analysts are increasingly predicting it soon will.

At present, there is growing criticism of private equity buyouts, and the buyout funds are on the defensive. The industry response is to continue operating as they have, while espousing the virtues of “self regulation”. Trade unions must reject such attempts at self-regulation (or “Codes of Conduct”) and pursue a political campaign for regulation by governments.

Reversing and **re-regulating** the deregulation of past years can choke off the more destructive destinations for investor capital and channel it back into useful investment which benefits society as a whole through contributing to sustainable long-term growth. Binding government regulation is the only sure defence against the buyout funds.

A fundamental element in campaigning for re-regulation is to demand that the same disclosure requirements which apply to publicly listed companies be applied to companies acquired through private equity buyouts. These regulations, however inadequate, have been constructed to ensure a degree of transparency and public disclosure and must be applied to private equity buyout funds too.

Transparency is essential not only to shed light on the activities of the funds as a whole, but to permit public scrutiny of their financial operations at the level of the individual companies they buy and sell. We have seen, in the example given earlier of the Linde/Kion deal, how disclosure of the business plans prior to the takeover was a key element in halting the immediate stripping of company assets and securing employment guarantees. We have also given examples of companies reduced to a hollow shell through leverage, recaps and the sell-off of valuable assets. Enforced transparency is a necessary, if not sufficient, condition for blocking this kind of wholesale financial looting.

Markets – and financial markets in particular – have always required regulation, not least to keep them from self-destructing. The private equity firms and their ideologists and apologists claim that returning “value” to investors is in everyone’s interest, because investors know best how to invest. This is patently false, as the past and current experience of leveraged buyout booms has demonstrated. What is best for the individual investor is not necessarily best for the individual company, its workers, the wider community or the economy as a whole. Regulating the buyout business and its financial workings is an urgent task of social self-defence.

Meeting this task will take trade union action, at national and international level, to ensure that the funds are curbed and rolled back.





Appendix: the Top 50 Private Equity Buyout Funds

In the period 2002-2006, the top 50 private equity buyout funds raised USD 551 billion, accounting for 75% of global buyout activity. Using a conservative multiple of 5, the funds exercised a total buyout power of USD 2.76 trillion.

(Source: Private Equity International http://www.six-uk.com/PEI/PEI50_Brochure_final.pdf)

Top 50 Buyout Funds Ranked

1	The Carlyle Group	\$32.5 billion
2	Kohlberg Kravis Roberts	\$31.1 billion
3	Goldman Sachs Principal Investment Area	\$31 billion
4	The Blackstone Group	\$28.36 billion
5	TPG	\$23.5 billion
6	Permira	\$21.47 billion
7	Apax Partners	\$18.85 billion
8	Bain Capital	\$17.3 billion
9	Providence Equity Partners	\$16.36 billion
10	CVC Capital Partners	\$15.65 billion
11	Cinven	\$15.07 billion
12	Apollo Management	\$13.9 billion
13	3i Group	\$13.37 billion
14	Warburg Pincus	\$13.3 billion
15	Terra Firma Capital Partners	\$12.9 billion
16	Hellman & Friedman	\$12 billion
17	CCMP Capital	\$11.7 billion
18	General Atlantic	\$11.4 billion
19	Silver Lake Partners	\$11 billion
20	Teachers' Private Capital	\$10.78 billion

21	EQT Partners	\$10.28 billion
22	First Reserve Corporation	\$10.1 billion
23	American Capital	\$9.57 billion
24	Charterhouse Capital Partners	\$9 billion
25	Lehman Brothers Private Equity	\$8.5 billion
26	Candover	\$8.29 billion
27	Fortress Investment Group	\$8.26 billion
28	Sun Capital Partners	\$8 billion
29	BC Partners	\$7.9 billion
30	Thomas H. Lee Partners	\$7.5 billion
31	Leonard Green & Partners	\$7.15 billion
32	Madison Dearborn Partners	\$6.5 billion
33	Onex	\$6.3 billion
34	Cerberus Capital Management	\$6.1 billion
35	PAI Partners	\$6.05 billion
36	Bridgepoint	\$6.05 billion
37	Doughty Hanson & Co	\$5.9 billion
38	AlpInvest Partners	\$5.4 billion
39	TA Associates	\$5.2 billion
40	Berkshire Partners	\$4.8 billion
41	Pacific Equity Partners	\$4.74 billion
42	Welsh, Carson, Anderson & Stowe	\$4.7 billion
43	Advent International	\$4.6 billion
44	GTCR Golder Rauner	\$4.6 billion
45	Nordic Capital	\$4.54 billion
46	Oak Investment Partners	\$4.06 billion
47	Clayton, Dubilier & Rice	\$4 billion
48	ABN AMRO Capital	\$3.93 billion
49	Oaktree Capital Management	\$3.93 billion
50	Summit Partners	\$3.88 billion





In February 2007 the IUF launched a new website for trade unionists: **The IUF's Private Equity Buyout Watch**. The purpose of this website is to monitor private equity buyouts and their impact on workers. The website includes resources that supplement this booklet:

- **News** – links to news on major buyouts by private equity firms, particularly companies in IUF sectors
- **Research & Analysis** – background material, research briefings and analysis of specific sectors (such as the food, beverage, hotel and catering industries) targeted by buyout funds
- **Regulation/ Political Action** – documents, submissions, letters, reports and media coverage of trade union calls to regulate private equity buyouts and industry and government responses.

WWW.BUYOUTWATCH.INFO

The International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Associations (IUF) is an international federation of trade unions representing workers employed in

- agriculture and plantations
- the preparation and manufacture of food and beverages
- hotels, restaurants and catering services
- all stages of tobacco processing

The IUF is currently composed of 366 trade unions in 122 countries representing a combined membership of over 11 million workers.

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In the face of the global threat posed by private equity buyouts, this brochure seeks to provide trade unionists with an overview of what is happening and the consequences for workers, their workplaces, their unions and society as a whole. We do so in the belief that, despite the enormous size and reach of private equity funds, they can be challenged and beaten back through trade union action.

