

The Impact of Private Equity-backed Buyouts on Employee Relations

Executive Summary - December 2008

Conducted by CMBOR, the Centre for Management Buyout Research
In association with the European Private Equity and Venture Capital Association (EVCA)



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**THE CENTRE FOR
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About EVCA

The European Private Equity and Venture Capital Association (EVCA) was established in 1983 and is based in Brussels. EVCA represents the European private equity sector and promotes the asset class both within Europe and throughout the world. With over 1,300 members in 53 countries, EVCA's role includes representing the interests of the industry to regulators and standard setters; developing professional standards; providing industry research; professional development and forums, facilitating interaction between its members and key industry participants including institutional investors, entrepreneurs, policymakers and academics. EVCA's activities cover the whole spectrum of private equity: venture capital (from seed and start-up to development capital), buyouts and buyins.

About CMBOR

The Centre for Management Buyout Research (CMBOR) was founded at the University of Nottingham in 1986 as the first centre dedicated to monitoring management buyouts and private equity in a comprehensive and objective way. CMBOR has compiled the most comprehensive dataset of management buyouts and private equity in Europe comprising over 27,000 deals covering the period since the late 1970s. CMBOR provides regular monitoring of trends in management buyouts and private equity in Europe, as well as objective analyses of their effects for practitioner, policy and academic audiences. CMBOR also provides research on venture capital and entrepreneurs including early-stage venture capital for academic entrepreneurship, serial entrepreneurs, international venture capital and return entrepreneurship. In addition to the core team based in Nottingham, CMBOR has an active network of over 40 academic and practitioner collaborators in Europe and worldwide.

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In recent years, there has been a dramatic increase both in the number of companies acquired by private equity firms, and in the total value of these deals⁽¹⁾. The way in which employees of these businesses are affected by this shift in ownership is therefore a topic that merits rigorous scrutiny.

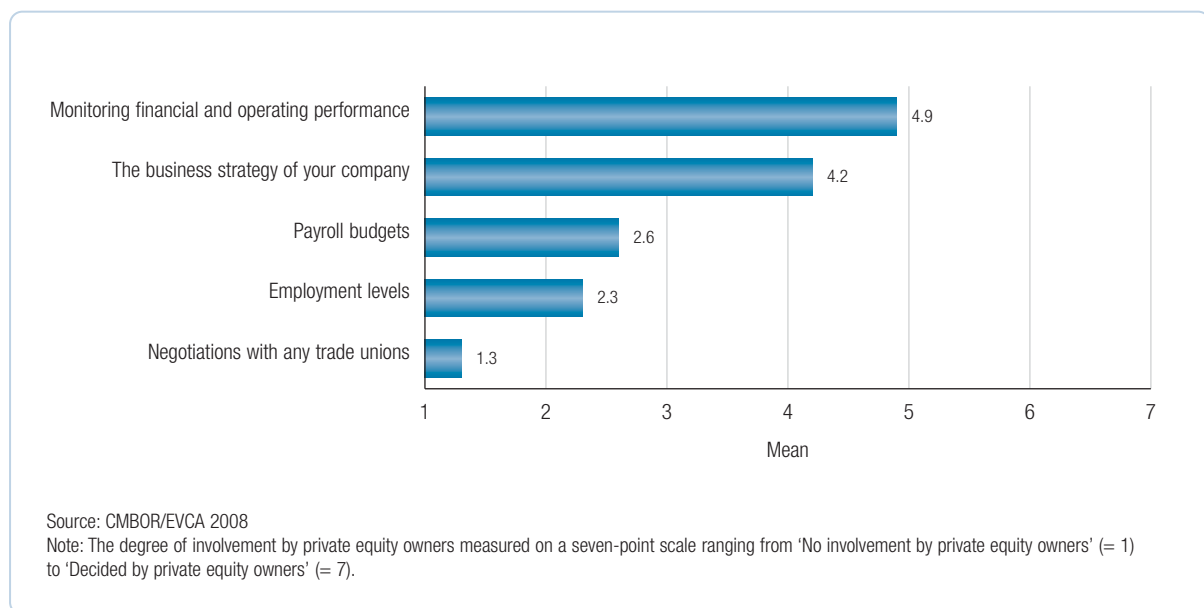
To this end, the Centre for Management Buyout Research (CMBOR) at Nottingham University Business School has conducted a comprehensive survey of 190 private equity-owned businesses that were subject to a buyout between 2002 and 2006.

1. The role of private equity investors in employee relations decision-making

1.1. Private equity investors' involvement

Private equity investors are mainly involved in the monitoring of financial and operating performance, and in the business strategy of their investee companies. The operational management of employee relations is mandated to the managers of the investee company, who work closely with the private equity investor to ensure that agreed performance targets are met.

Figure 1: Involvement of private equity investors



1.2. Business strategies and their impact on employee relations

The business strategies implemented by private equity investors are in most cases focused on growth (54% of respondents), or a combination of growth and restructuring (42% of respondents). Both of these require active employment practices.

⁽¹⁾ The European buyout market has grown significantly in value over the last two decades rising from €13 billion in 1988 to €171 billion in 2007. At the same time, the proportion of European buyouts that has had private equity investment increased from 40% of the number and 54% of the value in 1988 to 66% of the number and 96% of the value in 2007.

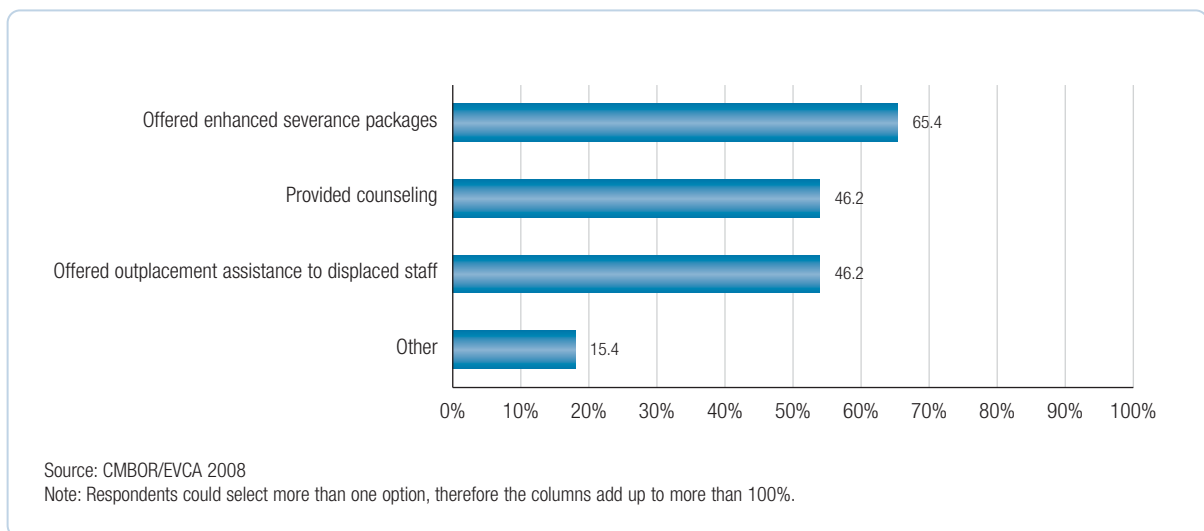
1.3. Managing employment changes

Private equity ownership resulted in a marginal 3% fall in the median number of employees in the target company immediately following its acquisition. However, in the subsequent period, there was a median 19.6% increase in employee numbers⁽⁹⁾, reflecting the growth strategies mentioned above. Furthermore, almost three-quarters of respondents said they had made no redundancies during private equity's ownership period.

When redundancies did occur, the motivation for 65% of respondents was to increase competitiveness, while 59% attributed the job losses to reorganisations of working methods.

Most companies that made redundancies (either at the time of the buyout or subsequently) consulted with employees or their representatives prior to making the decision, and/or offered help to employees that did lose their jobs through either one or a combination of the following measures:

Figure 2: Help for employees made redundant



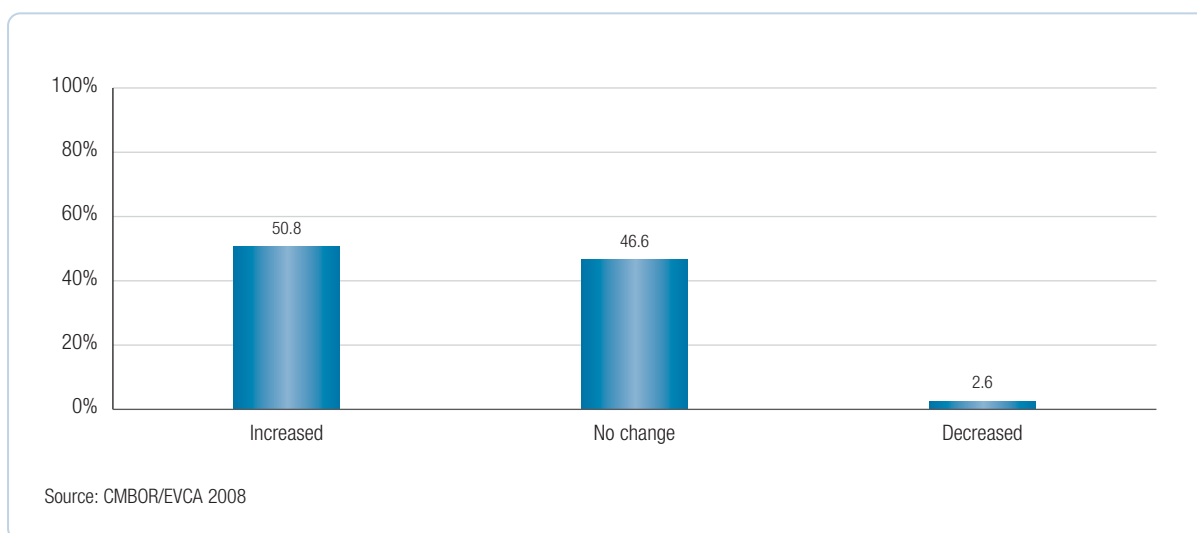
⁽⁹⁾ The average sample company had been under private equity ownership for a little over three years.

2. The effect on non-managerial employees' earnings and pension schemes within the target company

2.1. Non-managerial employees' earnings

Real earnings (i.e. adjusted for inflation) of non-managerial employees at the time of the survey compared to before the buyout had increased in just over half (51%) of all cases, while a large minority (47%) reported no change and just 3% reported a reduction⁽⁹⁾.

Figure 3: Real earnings for non-managerial employees post-buyout



2.2. Occupational pension schemes

The percentage of companies offering occupational pension schemes increased from 76% before the buyout to 81% after the buyout.

In line with trends across the corporate marketplace, pension schemes post-buyout tended to evolve towards defined contribution schemes based on investment performance and contributions, open to new members (rising from a share of 30.5% to 40% of respondents post-buyout), while the share of defined benefit schemes based on salary and/or years of service, open to new members, decreased from 29% of respondents pre-buyout to 26.5% post-buyout.

Furthermore, while small companies tended to provide slightly more defined benefit salary-related schemes (open to new members), large companies were more inclined to offer defined contribution money purchase schemes.

Very few respondents reported a deterioration in the post-buyout terms of occupational pension schemes. For instance, only 1.4% of the respondents reported a material reduction of the security of pensions in the event of insolvency.

⁽⁹⁾ Such findings are in line with the results presented in Amess, K. and Wright, M. (2007) The Wage and Employment Effects of Leveraged Buyouts in the UK, *International Journal of the Economics of Business*, 14(2), pp. 179-195. This study shows that more than 63% of UK companies having gone through either a management buyout or a management buyin increase the remuneration per employee.

3. Employee commitment within target companies

3.1. Pay schemes

In addition to an increase in real earnings of non-managerial employees in more than half of cases, buyout-backed companies also introduced incentive pay schemes to encourage employee alignment with and commitment to employer goals.

As well as increased use of payment by results and profit-related pay, buyout-backed companies also introduced a range of other practices to increase employee commitment post-buyout.

3.2. High commitment practices

Private equity investments in general do not only affect labour management positively in terms of the number of high commitment practices reported, but also in terms of an overall increased use of these practices:

- regular team briefings (used by 90% of respondents post-buyout compared to 71% pre-buyout);
- internal promotion as the norm (81% after compared to 72% before);
- work organised around team-working for the majority of staff (78% after compared to 68% before); and
- a formal grievance procedure allowing non-managerial staff to raise problems with management (79% after compared to 70% before).

Furthermore, smaller deals reported significantly more increases in high commitment practices.

3.3. Training

Meanwhile, 45% of target companies reported that the amount spent on non-managerial employee training (adjusted for inflation) had increased post-buyout. Just 3% reported a reduction.

4. Recognition of trade unions, employee consultation and information procedures

4.1. Trade union relations

The attitude of managers towards trade union membership and the proportion of employees who were trade union members changed very little post-buyout. Two-thirds of respondents declared to be either in favour or neutral towards trade union membership and some 71%^(*) reported to have some portion of their workforce unionised.

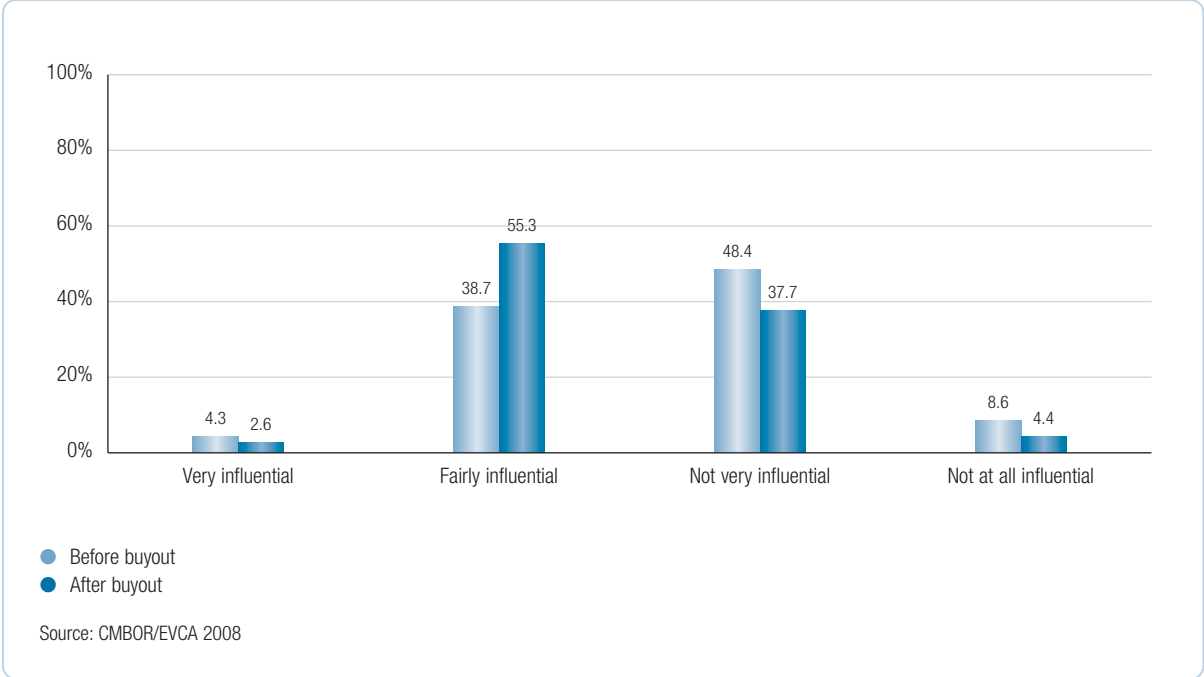
Furthermore, reflecting the growth aims described above, the study found that, on average, private equity investment does not reduce the terms and conditions subject to joint regulation in buyout-backed companies recognising trade unions, and that those companies reported a general trend towards more negotiation, consultation and information sharing with trade unions. This trend was observed for rates of pay, hours of work and staffing plans among other issues.

4.2. Consultative committees

The proportion of buyout-backed companies that had a consultative committee in place increased from 50% before the buyout to 63% post-buyout.

Furthermore, buyout-backed companies regarded consultative committees as more influential on management decisions in a majority of cases (55%) under private equity ownership than previously.

Figure 4: The influence of consultative committees



^(*) 86% of large companies had trade union members compared to 69% of medium-sized companies and 61% of small companies.

5. Differences in employee relations across Europe's regions

Employee relations remain highly influenced by national practices and regulations. This chapter looks at the differences between the effects of private equity investment on employee relations in different European social models⁽⁹⁾.

Effect on non-managerial employees' earnings and pension schemes across Europe

- Companies associated with liberal market economies reported the largest incidence of increased real earnings post-buyout (55% of the sample), followed by the Central European model (49%), the Mediterranean European model (47%) and finally the Northern European model (43%).

Very few companies experienced a decrease in real earnings and the range across social models was from an average of 0% of Northern European companies to 5.3% of Mediterranean European companies.

- Pre-buyout, Northern European companies favoured defined benefit salary-related schemes (74%), whereas companies in the Liberal Markets favoured defined contribution money purchase schemes (51%). Almost half of the Mediterranean companies had no scheme at all. Private equity involvement had little impact on these differences in employee relations between social models.

Effect on pay schemes and high commitment practices across Europe

- The introduction of payment by results and profit-related pay is more likely in Liberal Markets following a buyout.
- The United Kingdom and Ireland, as the least regulated social environment, experienced more and greater changes in high commitment practices post-buyout. Northern Europe as the most regulated social regime experienced no significant changes overall.

⁽⁹⁾ Countries are classified here according to the indicators used in the industrial relations literature reflecting differences in union density and structure, collective bargaining coverage and structure, and employment protection. See Hamann, K. and Kelly, J. (2008) 'Varieties of capitalism and industrial relations', in P. Blyton, N. Bacon, J. Fiorito and E. Heery (eds.) *The Sage Handbook of Industrial Relations*. London: Sage, pp. 129-148. For the purpose of this study, analysis has been made on the basis of the following social models: Liberal Market economies (Ireland and the United Kingdom), Northern Europe (Denmark, Finland, Norway, Sweden), Central Europe (Austria, Belgium, Germany, the Netherlands, Switzerland) and Mediterranean Europe (France, Italy, Portugal, Spain).

Table 1: Changes in high commitment management practices by social model

Practice	Liberal Markets	Northern Europe	Central Europe	Mediterranean Europe
Number of responses	84-85	20-21	44-45	35-38
Employee director or worker representative elected by staff on a supervisory board				
Before	7.1	57.1	26.7	18.4
After	12.0	52.4	31.1	34.1*
Flexible job descriptions not linked to one specific task				
Before	50.6	61.9	47.7	11.4
After	61.4*	66.7	51.2	25.7
Work organised around team-working for the majority of staff				
Before	74.1	52.4	77.3	50.0
After	84.7*	57.1	83.7	69.4*
System of regular team briefings				
Before	68.2	85.7	80.0	56.8
After	90.6*	95.2	95.5*	81.1*
Internal promotion as the norm				
Before	77.7	90.5	68.9	54.1
After	81.2	95.2	79.5	75.7*
Harmonised terms and conditions between management and non-management				
Before	52.9	76.2	56.8	44.4
After	64.7*	66.7	67.4*	72.2*
All staff required to spend a specified amount of time annually in formal training				
Before	23.8	28.6	40.0	21.1
After	32.1*	28.6	48.8	36.8*
A policy to maintain security of employment and minimise compulsory redundancies				
Before	51.8	52.4	53.3	51.4
After	62.4*	65.0	65.9*	47.2
Formal grievance procedure allowing non-managerial staff to make complaints/raise problems with management				
Before	88.2	66.7	68.2	32.4
After	98.8*	65.0	77.3	40.5
Flexible working time arrangements for most employees to balance work/family				
Before	37.6	76.2	62.2	34.2
After	44.7	80.0	65.9	44.7

Source: CMBOR/EVCA 2008
 Wilcoxon test for statistically significant differences in responses before and after the buyout.
 Before = % answering yes before buyout, After = % answering yes after buyout.
 * Significance = 0.05 or better.

Effect on employee consultation

Management/employee committees are more frequently found in Northern and Central European buyout-backed companies and less frequently in Mediterranean and liberal market buyout-backed companies (pre- and post-buyout). However, the prevalence and influence of these committees increased the most as a result of the buyout in the Liberal Markets.

The increased importance of certain issues was observed only for companies in Liberal Markets where discussions on employment issues and future plans were regarded as more important post-buyout.

Key Findings

Effect on trade union relations

- In both Northern European and Mediterranean European social model contexts, there was no significant change in trade union recognition after the buyout (Table 2).

Table 2: Trade union recognition across social models

	Liberal Markets	Northern Europe	Central Europe	Mediterranean Europe
Pre-buyout	20.7	71.4	43.2	65.8
Post-buyout	18.1	71.4	40.9	65.8

Source: CMBOR/EVCA 2008
Percentage of companies in each group responding 'yes' to the question of whether trade unions are recognised.

- Trade union membership across social models changed little as a result of the buyout.

Half of the companies in liberal market countries had no trade union members compared to only a fifth of the companies in Central and Mediterranean Europe and less than a tenth of companies in Northern Europe⁽⁹⁾.

More than half of Northern Europe-based buyout-backed companies had between half and full unionised workforces, notably higher than in other social models.

⁽⁹⁾ Country-level data across the European Union shows that in only eight out of the current 27 EU Member States more than half of the employed population are members of a trade union, with shares for the four most populated states being: Italy 30%, the United Kingdom 29%, Germany 27% and France at only 9%. In every EU country outside Scandinavia (except Belgium), trade union membership is either static or continues to decline. For further details see: <http://www.fedee.com/tradeunions.html>.

When a company undergoes a private equity-backed buyout, everything from high-level strategy to day-to-day operational procedures is subject to change.

This study has found that those changes tend to have either a neutral or positive impact on employee relations. This is perhaps unsurprising given that developing a growth strategy (54% of respondents) or a combination of growth and restructuring strategies (42% of respondents) implies the presence of active employment practices.

Private equity investors have limited day-to-day involvement in employee relations, leaving operational matters to management. But at the point of acquisition, private equity firms can have a major impact on how that company engages with its employees in the future. The generally positive response to that engagement found in this study reflects a growing awareness of responsibilities towards this key stakeholder group, as well as making sound business sense. One example of this win-win approach is the implementation of high commitment practices.

This study demonstrates that the interests of employees are given the same or greater weight under private equity ownership than was the case under the previous owners. For the majority of respondents, private equity investment meant a greater likelihood of access to a corporate pension scheme, higher earnings, more consultation across a number of issues and representation by trade union bodies.

The net effect of private equity involvement is to increase employee commitment through financial incentives and greater employee engagement, through regular team briefings, training programmes, and harmonised terms and conditions between management and non-management.

Analysis of the sample

The main characteristics of the surveyed companies⁽⁷⁾ were compared to all European buyouts in the CMBOR database, which includes 27,000 buyouts. Using this database, which is the most comprehensive in Europe, allows checks of whether the companies surveyed are reasonably similar to and therefore representative of the population of European buyout-backed companies in order to assess the validity of the results.

The representative nature of the sample was assessed on the basis of the country of location, industrial sector, deal size, employee numbers, whether the business had been profitable or loss-making at the time of the buyout, and deal type.

Taking all these dimensions into account, the sample exhibits the following representative characteristics:

- A good fit with the population across countries with two exceptions: French companies are under-represented, while British companies are slightly over-represented.
- The spread of industrial sectors is highly representative of the broader buyout market. Industrial products and consumer-related industries are slightly over-represented in the sample while services are marginally under-represented.
- In terms of deal size (as measured by transaction value in millions of euros), the sample comprised a higher proportion of large buyouts and a lower share of the smallest buyouts compared to the population.
- The distribution of companies in the sample in the small⁽⁸⁾, medium-sized⁽⁹⁾ and large⁽¹⁰⁾ categories was very similar to the distribution in the full buyout population. However, the sample contained a slightly higher proportion of larger companies and slightly fewer medium-sized companies.
- Both the sample and the population of companies present a broad range of performance before the buyout, from loss-making to highly profitable. The sample compared to the population contained a slight under-representation of poor performers.
- The distribution of management buyouts and management buyins in the sample and population shows that the sample is a good representation of the population.

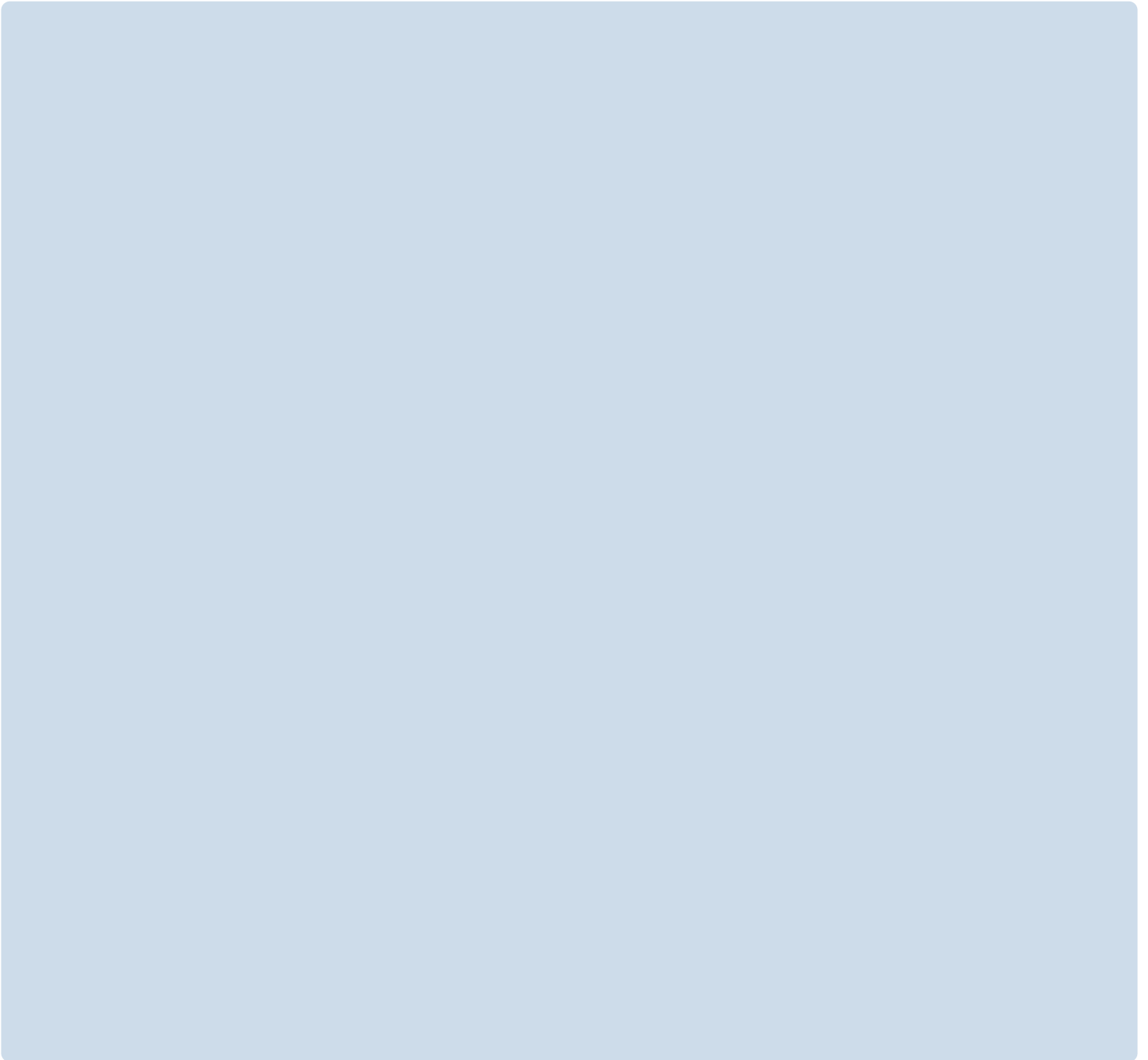
This study did not try to assess the quality of employee relations in the buyout-backed companies under the preceding shareholders. Rather, it looked at the impact of the buyout on employee relations and focused on whether or not those relations improved following the buyout.

⁽⁷⁾ The group of interest was private equity-backed buyouts/buyins completed between 2002 and 2006 with more than 50 employees and a transaction value above 10 million euros.

⁽⁸⁾ Companies with between 1 and 250 employees.

⁽⁹⁾ Companies with between 251 and 1,000 employees.

⁽¹⁰⁾ Companies with over 1,000 employees.





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