Statement of
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"Private Equity's Effects on Workers and Firms"
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Mr. Chairman and members of the Committee, thank you for the opportunity to appear before you today to discuss this critical issue facing our nation.

My name is Andy Stern and I am President of the Service Employees International Union (SEIU). With 1.8 million members, SEIU is America's largest union of health care workers, property services workers, and the second largest union of public services workers. A top priority of SEIU members is to unite working families, business leaders, community leaders, policy-makers, and other unions to find solutions to the challenges facing workers and our nation as our economy undergoes the most rapid transformation in history.

As the private equity buyout industry grows in size and influence, the impact of its practices on American workers, industries, the financial markets, communities and the nation as a whole must be examined more closely and I applaud the Chairman and this Committee for taking on these issues.

Today's economy and its impact on workers

The story of America's success is a story of work and working people. The hard work of nurses, teachers, janitors, food service workers, home health and care workers, and millions in other professions have made our economy into the most successful, productive, innovative, and prosperous in the history of the world.

The greatness and promise of America has always been that, if you work hard, you will have your work valued and rewarded. You will be able to provide for your family, have a decent home, access to affordable health care, a secure retirement and time to spend with your family. You will have the opportunity to achieve the American Dream.

And throughout our history, this promise has driven millions to our shores. Every generation has done better than the last. But we are now at a moment in our history when the promise of the American Dream is in jeopardy.

Today, a majority of Americans say they believe their children will actually be worse off than they are, according to recent polling by Lake Research, which also found that an astounding 65 percent of working Americans now feel negative or uncertain about the American Dream.

Survey after survey tells us that Americans of all political persuasions think the nation is headed in the wrong direction. One poll last month conducted on behalf of *NBC News* and *The Wall St. Journal*, found that 66 percent of Americans feel this way.

Today's economy is simply not working for working people.

- More than 46 million Americans do not have health insurance. Tens of millions more are underinsured. More than 9 million American children have no health care coverage.
- Pensions are disappearing and retirement security is becoming a thing of the past.
- Schools are crumbling and failing our children—and not only in low-income communities, but in middle class communities too.
- Wages for working Americans are stagnant. In 2006, private sector wages dropped to 43 percent of national income, the lowest level in more than half a century.
- We have the highest rate of income inequality in this country since 1928. According to a recent study by the economists Thomas Piketty and Emmanuel Saez, the top 300,000 Americans have almost as much income as the bottom 150 million Americans combined.

People are working harder and longer for less. Opportunities that have always been there for Americans who work hard and build the value of our economy are disappearing.

But what is so puzzling to working people is that this is all happening during a time of unprecedented prosperity in America, a time that some are calling America's new "Gilded Age."

- Productivity is continuing to rise
- Corporate profits have more than doubled since 2000. In 2006, profits as a share of national income were at their highest level ever.
- The five largest companies in the world, Wal-Mart, General Motors, Exxon Mobil, Royal Dutch/Shell, and BP are each financially larger than all but 24 of the world's nations.
- CEO salaries are at record levels—the average CEO makes more than 431 times the amount of compensation of the average worker, a gap that has been growing steadily.

Productivity is up, but wages are not. Profits are up, but business investment is not. This is an economy that is not lifting all boats—just the luxury liners—and that's not good for our country.

Private equity is at the center of the today's economy

Private equity is a major driver of this economy. And while there are a number of private investment vehicles in the financial markets, including venture capital and hedge funds, today Mr. Chairman I am addressing the issues surrounding private equity leveraged buyouts.

Today, private equity is buying and selling larger and larger companies and reshaping whole industries. The buyout industry, armed with more than a half-trillion dollars of capital, is today engineering financial deals on a scale that until a few years ago seemed unimaginable.

- There were a record $197 billion worth of private equity mergers in first quarter of 2007.
- In the last five years, the volume of private equity deals has grown 600 percent—from $42 billion to $250 billion.
- The biggest five private equity deals together are larger than the annual budgets of all but 16 of the world's nations.
- The annual revenue of the largest private equity firms and their portfolio companies would give private equity four of the top 25 spots in the Fortune 500.
- Private equity firms control companies that employ more than 5 million workers. If the industry continues to grow at just half the rate it has grown in the last five years, by 2012 one out of every eight private sector workers – more than 15 million Americans—could work for a company owned by a private equity firm.

But the story of private equity is the incredible wealth being created for the small number of individuals at the top of the industry. As leveraged buyouts worth billions become more and more commonplace, private equity firms are extracting fees of hundreds of millions of dollars from the companies they buy and often generating profits of 20 percent or more.

In short, the income being accumulated by private equity is a major contributor to the concentration of wealth among the top 1 percent of Americans.

Private equity executives claim that while they are doing well, the wealth they are generating is helping fund retirement benefits for millions of public employees, university endowments, and foundations that support worthy causes. That is true. But make no mistake, there is more than enough money in the booming private equity industry for the firms to continue to do very well, for pension funds to continue to benefit, but also to make sure workers share in the economic opportunities being created by private equity.

Concerns about private equity

Against the backdrop of this record accumulation of wealth, private equity's practices are helping drive forces that raise significant concerns about their impact on workers, companies, and the financial markets.

<u>Risky Deals Put Workers and Companies at Risk</u>

A cornerstone of private equity is the corporate restructuring that follows a typical buyout. The industry claims it creates efficiencies in companies and helps turn around underperforming operations, building the long-term value of these companies and increasing the overall productivity in the economy. But the manner in which these restructurings are often undertaken raises serious concerns for workers and the companies themselves.

The high degree of leverage involved in buyout deals can create significant pressures to cut costs that are counter-productive to the stated goals of private equity firms and investors to create long-term value and productivity in the companies they buy.

In a highly leveraged buyout of a nursing home chain or hospital company for example, increased debt payments could squeeze capital expenditures necessary to maintain and update vital medical equipment. And what happens to operating budgets that go toward maintaining the staffing levels necessary to provide quality patient care? As private equity buys the market leaders in major service industries such as health care, the impact of private equity restructurings may create a ripple effect creating downward pressure on standards of care and potentially harming the long-term value and productivity of whole industries.

Another example is the case of the Bain Capital buyout of KB Toys, which was featured in SEIU's recent report "Behind the Buyouts: Inside the World of Private Equity." [Report available at www.BehindtheBuyouts.org] In 2000, Bain Capital purchased KB Toys in a highly leveraged buyout worth nearly $300 million. Bain's $18.1 million in equity accounted for only about 6 percent of the cost of the purchase—the rest was financed by loans and IOUs.

In 2002, Bain engaged in the increasingly common practice of a leveraged recapitalization of KB Toys. The company added additional debt to KB Toys—in order to pay Bain and several KB Toys executives a special dividend worth $120 million. Such dividend recaps increase a company's vulnerability to potential operational fluctuations or external changes that could result in either bankruptcy or restructuring.

In the case of KB Toys, the result was a bankruptcy filing in January 2004. As a result, more than 4,000 employees lost their jobs and 600 stores closed, the harsh result of a risky debt-driven business strategy.

Despite the cautionary tale of KB Toys, leveraged recaps increased from $3.9 billion in 2002 (the year Bain used the strategy at KB Toys) to $40.5 billion in 2005, according to Standard & Poor's. That's a lot of risk private equity is putting on these companies to pay themselves special dividends.

As we have seen most recently from the results of job cuts at Circuit City, layoffs are not the panacea many corporate managers would like them to be. Instead of viewing workers exclusively as a line-item on a balance sheet, or a cost to be cut, private equity must view workers first as the women and men who build the value of their companies and are the backbone of economic and civic life in their communities.

<u>Private Equity "Exuberance"</u>

The economy today has a case of buyout fever. Private equity firms raised $215 billion in 2006— the most ever. The total exceeds the amounts raised during the last private equity bubble, in 2000. With all this capital being raised, it increases the competition for deals, adding to the likelihood some firms will overpay for deals or do deals that are far more risky. A significant downturn in the public equity markets would severely impair the ability of private equity to exit deals that were poorly conceived, highly leveraged, or overvalued.

If even one major deal fails, very serious concerns have been raised about its impact on the credit markets, on investors such as pension funds, and not least, the workers at the affected company.

Quick Flips and Sell-Offs

The industry advertises its ability to achieve long-term business growth, free of the scrutiny of the public markets. But in recent years, private equity has sought to increase its funds' investment returns by liquidating part or all of their investment more quickly than the traditional time period of three to five years. To accomplish this, firms engage in "quick flips," relisting companies within a year or two of taking them private, with more leverage, but few if any operational improvements.

In the case of the buyout of Hertz car rental by the firms Carlyle Group, Clayton Dubilier & Rice, and Merrill Lynch, Hertz was taken public less than a year after being bought by the private equity firms. The Initial Public Offering for Hertz raised $1.3 billion, more than 95 percent of which paid for special dividends for the firms, which recouped more than half the equity they invested. Far from producing long-term growth, Hertz reported a 2006 decline in net income of two-thirds and this year announced an initiative to eliminate more than 1,500 jobs.

Conflicts of Interest

The managers and directors of a public company owe a fiduciary duty to maximize returns to shareholders. But when private equity invites those same managers or directors to participate in a leveraged buyout, their interest shifts to helping the private equity group get the lowest price possible for the company.

This conflict of interest, which unfortunately is all too common in buyout deals today, raises significant questions about the deals that are being put together and whether or not the companies being bought are being adversely affected over the long term. It has been suggested by more than one commentator that management participation in buyouts should be prohibited.

For example, in the proposed $6.1 billion Cerberus buyout of Affiliated Computer Services, questions are being raised about the role of ACS Chairman Darwin Deason's role in the offer. Cerberus has an exclusive agreement with Deason to negotiate a take-private transaction of the company, which has led ACS's lead director to raise questions about how competitive a bid can be.

At the very least this is a matter that requires much more study, as private equity buyouts occur with larger and more prominent companies that serve important public interests.

Transparency and Disclosure

Unlike publicly traded companies that are subject to securities laws, it is well known that private equity buyout firms operate out of the public eye, with little oversight. With the pressures of high debt levels and the increasing practice of quick flips and sell-offs, it is critical that the industry provide more transparency and disclosure so that the people who might be affected by a given deal—workers, community members, shareholders and others—are aware of the potential impact on their lives.

Though the list may vary depending on the circumstances, a given private equity firm could disclose at the time of a deal and then periodically thereafter, information such as total debt, employment levels, management or other fees, any potential conflicts of interest, and/or major business decisions they plan on making at the company.

This would be a step in the right direction for workers who now have almost no voice in the deals, little information about their new employers, and no say about the plans that could negatively impact their lives.

Missed opportunities

Perhaps most importantly, buyout deals present real opportunities for our country. For all the hundreds of millions of dollars in fees and billions in profits taken out in these deals by the private equity firms, the workers at most of the portfolio companies receive no increases in pay or benefits—not even a more generous 401(k) contribution. The same goes for the contract workers—the janitors, security officers, food service workers, and others—who provide valuable services. Their jobs are controlled by these companies, but they are paid mostly poverty-level wages and more often than not have no affordable health care, sick days, or retirement benefits of any kind.

Take for example the Blackstone Group's recent $39 billion buyout of Equity Office Properties, the nation's largest office landlord. Less than a month after the deal had closed Blackstone had sold $21 billion worth of the Equity portfolio.

It is easy to see how Blackstone benefited from the deal—but what about the tens of thousands of property services workers—janitors and security officers—who work hard every day and build the value of these properties—but who may be struggling to provide for their families.

The $360 million in transaction fees from the Equity deal could have provided health insurance for one year for more than 150,000 property services workers.

The $4.4 billion in fees paid to private equity firms in the 10 largest buyout deals of the last two years would pay for family health plans for 1 million American workers.

I would ask you Mr. Chairman and the members of the Committee to imagine the economic impact on families, on hard-hit neighborhoods and whole cities if these billion-dollar private equity deals were structured in such a way to ensure that workers and communities shared in the economic benefits of deals involving companies they helped to make successful.

Private Equity: The Opportunity

When it comes to private equity buyouts there have been both hits and misses. But for working people, there unfortunately have been far more misses than hits.

We could argue over a lot of issues, including whether or not private equity creates more total jobs than it destroys. The fact is there is not enough reliable information to make that determination across the board.

A better question for today, perhaps, is what kind of jobs are being created by private equity? In this economy, too often the jobs created are part time with low wages and no benefits. These are jobs with no future that cannot support families.

There is no argument, however, over the correlation between unions and good jobs and good jobs and increased opportunity for American families.

It would be best if the industry made changes itself and took steps to ensure that private equity works for working people and the rest of the country.

- That means making sure workers and communities that are impacted have a voice in the deals and benefit from their outcome.
- It means the industry should play by the same set of rules as everyone else and provide for more transparency and disclosure.
- It means they should eliminate conflicts of interest.
- It means that unions, if one exists at a company being bought, should be at the table as soon as possible when a buyout deal is being put together.
- If no union exists, private equity firms should see to it that they and their new portfolio company remain neutral on the question of unionization and allow workers to choose to form a union using the majority sign-up process.

But if private equity firms will not take steps to change, Mr. Chairman, Congress should legislate.

America has been at its best when a broad group of people have shared in the prosperity being created in the economy. We’ve gotten away from that in recent years.

It is ridiculous in America that everyone cannot share in the success and prosperity they helped create.

There is more than enough wealth in the buyout business for private equity firms to continue to prosper while also adapting their existing business model to expand opportunities to benefit workers, communities, and the nation. Everybody can win if we set our sights on that goal.

Improving the jobs of millions of Americans whose companies are involved in leveraged buyouts will have an impact on reducing the income inequality that is weakening our country, undermining our democracy, and harming the long-term sustainability of our financial markets.

The incredible wealth that exists in the private equity buyout industry presents a historic opportunity. It’s time to repair the broken promise of the American Dream.

I thank the Chairman and the members of the Committee for their time.

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