European Foundation for the Improvement of Living and Working Conditions

The impact of investment funds on restructuring practices and employment levels

Executive summary

Introduction

Investment funds have increased in number and become more important to the global economy in recent years. Europe is no exception. The term 'investment fund' refers to private equity (PE), hedge funds (HFs), and sovereign wealth funds (SWFs) – sometimes also referred to as alternative investment funds (AIFs). Although these funds have some common features, they differ in important respects – such as investment strategies, time horizons and extent of ownership of their investment targets.

Investment funds are still small in comparison with other types of institutional investors such as pension funds, mutual funds and insurance funds. However, their greater direct influence on companies and the rise in activity by these funds has led to heated debates on their impact on restructuring practices, employment levels and industrial relations at the firms they invest in. Fund managers have claimed that they play a valuable role in reviving underperforming companies, thereby contributing to long-term employment growth. By contrast, many employee representatives and those on the political left have argued that these new funds concentrate on maximising financial returns at the expense of labour.

This study analyses both sides of the argument. It includes an extensive literature review, a national overview of investment fund activities in several key countries, and a presentation of the views of the social partners and relevant peak organisations in Europe. Case studies of 24 companies affected by investment fund activity, from seven countries across Europe, are presented in an annex published online.

Policy context

Although discussions about regulating hedge and private equity funds have taken place at European level for many years, the financial crisis focused attention on the regulation of financial activities in general and on AIFs in particular.

With regard to the regulation of investment funds on a European level, in 2009 the European Commission proposed a Directive on Alternative Investment Fund Managers (AIFMs) 'with the objective of creating a comprehensive and effective regulatory and supervisory framework for AIFMs at the European level.' One of the core proposals in this Directive is that funds managing investments above a certain threshold should disclose more information about structure, strategy and investors. The intention was to create new regulatory standards and to improve the transparency of funds for investors and public authorities.

The Directive adopts an approach that does not regulate the different AIFs themselves, but is aimed at the managers of these funds. The latter are seen as responsible for all key decisions in relation to the management of the fund.

In 2010, the scope of the Directive was extended to cover not only funds based in the EU but also funds based outside the EU that distribute their financial products within the Union.

Key findings

Investment funds have become important actors in Europe, albeit with significant differences between the different types of investment funds. PE tends to be associated with the highest degree of restructuring activity due to its typical acquisition of a majority stake and its objective of gains over the medium term. SWF investments tend to be associated with the lowest level of restructuring due to a longer-term approach to investment and, possibly, because of the desire to avoid public controversy. In between are activist HFs, which generally only acquire minority stakes and attempt to implement relatively simple changes through a strategic redirection of target companies.

The labour outcomes as a result of investment fund activity vary widely from company to company, with the potential of both positive and negative impacts on labour. Overall, the balance of evidence suggests that PE has more effect on firms and their employees. Activist HFs tend to have less effect, though in some cases successful HF activism can trigger major changes. In the case of SWFs, minority investment and passive ownership has had least effect, but where a SWF acquires a large block of shares or acquires a firm outright this has the potential to strongly affect corporate strategy.

In terms of work organisation, investment fund activities tend to have little effect.

In the case of industrial relations, the case studies indicate that AIF activity produces little change. Employees are seldom informed or consulted when a fund intervenes or acquires a company, but the advent of a fund does not seem to have negative effects on union recognition and membership and the dealings between funds and their workforces have overall been cooperative. However, there are exceptions to this across and within countries. Once firms have been acquired by funds where there are statutory and customary rights to information, consultation and codetermination, these seem to have been respected. In many cases employee representatives have been involved in restructuring decisions to the extent that existing regulation and company traditions allow.

Regulation and institutions matter as mediators of investment fund activities on labour outcomes. Labour regulation does not deter funds from intervening in a firm and is not inconsistent with corporate restructuring. However, labour regulation does give employees a voice and does affect outcomes in ways favourable to employees.

The evidence on the role of national regulation is mixed. Variations in employment protection regulation do not inhibit fund-acquired companies from undertaking large-scale restructuring. However, national regulations affecting employee voice and worker representation do appear to affect the extent to which employee representatives are informed and consulted in post-acquisition restructuring, if not during the acquisition itself.

The financial and economic crisis since 2007 has had an effect on the number and value of fund interventions and acquisitions. As yet, it is unclear whether firms owned by funds will have fared better or worse in the crisis. Already, however, there are some signs that funds may be expanding.

Overall, the study indicates that investment funds are neither wholly bad or wholly good in terms of the impacts on labour in their invested firms. In most cases the funds are committed to 'growing the business', with restructuring seen as laying the foundations for this, but the activities of these funds can create uncertainties over job transfers, possible future sales, and divestments.

Pointers for further research

There are still major gaps in knowledge about AIFs and their impact on employment. Cross-national data, especially statistics, on these types of owners and on the companies they invest in is scarce. Survey information covering the views of both managers and employees and their representatives on employment and labour outcomes would be extremely useful. Also, for a proper evaluation, a sufficiently long time period is desirable. A longitudinal study comparing fund cases with appropriate non-fund cases could bring valuable insights. Lastly, on PE in particular, exploring origin-country effects and effects resulting from differences in the size and financing structure of deals would increase our understanding of the factors that influence the outcomes in terms of restructuring practices and employment levels.

Further information

The report on *The impact of investment funds on restructuring practices and employment levels* is available online at www.eurofound.europa.eu/publications/htmlfiles/ef1064.htm.

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