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PRIVATE EQUITY BUYOUTS AND CORPORATE GOVERNANCE : CONTRASTING THE '80s AND '00s.

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Working paper series : REFGOV-CG-17

European FP6 – Integrated Project
Coordinated by the Centre for Philosophy of Law – Université Catholique de Louvain – http://refgov.cpdr.ucl.ac.be
WP –CG-17

PRIVATE EQUITY BUYOUTS AND CORPORATE GOVERNANCE:

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This paper highlights the historical significance of the current private equity-driven takeover movement sweeping the industrialised world. The central argument advanced is that, while the guiding purpose of large-scale leveraged buyouts in the United States in the 1980s was the restructuring of mature, over-capacitated and stable-technology industrial corporations, this rationale is no longer a prominent factor behind such arrangements. Rather, the distinctive characteristics of many major buyouts today suggest that medium-to-long-term entrepreneurial growth, rather than short-term financial restructuring, is now the dominant motivation for large-scale public-to-private transactions. This has profound implications not only for the practices of private equity boutiques themselves, but also for public equity investors given the potential "knock-on" effect of private equity financing and governance techniques on dominant managerial practices within listed companies.

Introduction

Private equity is a controversial financial practice that entails the purchase of controlling stakes in listed companies through extensive debt issuance, normally using the target firm's own future cash flows and asset base as security for creditors against default.[i] While practitioners and scholars supportive of this highly specialist technique typically laud private equity transactions as a much-needed wake-up call for lethargic or ill-focussed corporate managers (see Jensen, 1989; Shleifer and Vishny, 1990), other commentators such as trade unions and political figures have been traditionally quick to denounce private equity firms as nothing more than short-termist "asset strippers", who strive merely to make a quick economic return by mortgaging the very future of otherwise healthy and sustainable businesses (see, e.g., Hutton, 2007). Indeed, in the United Kingdom and continental Europe today, private equity is attracting a similar degree of popular vilification to that attached to its former incarnation, the leveraged buyout or "LBO" deal, which took the United States by storm during the previous debt-charged takeover boom of the mid-to-late-1980s.

From the point of view of corporate governance, private equity is a source of fascination. This is because highly leveraged (i.e. debt-financed) control transactions arguably subvert the underlying basis of corporate governance as a distinct topic of social-scientific inquiry, which is the inevitability (in the absence of legal or other institutional mechanisms) of a material degree of *separation* between the dual interests of owners and controllers within highly capitalised business firms (see Berle and Means, 1932; Jensen and Meckling, 1976). Of specific current interest, meanwhile, is the fact that, while LBO deals in the 1980s were primarily motivated by the relatively short-term gains to be wrought from the financial restructuring of mature and over-capacitated firms in stable-technology industries, the historically peculiar nature of many of today's largest corporate buyouts suggests a more extensive and enduring role for private equity in American (and indeed global) finance and industry.

I begin this paper by exploring the economic backdrop to the emergence of leveraged buyouts in US corporate finance and governance, together with the rapid and revolutionary development of the "LBO" deal in the 1980s. I then examine the profound indirect effect of 1980s LBO practices in shaping dominant *listed* company governance practices in the United States over the course of the 1980s and '90s. On this basis, I identify the historically peculiar features of the contemporary private equity movement sweeping the United States, Britain, continental Europe and Australasia. I conclude by suggesting that contemporary private equity activity has the potential to once again transform governance practices in public companies, but in a *converse* manner from the original LBO movement of the 1980s.

The foundations and development of "LBO" deals in the United States

In its initial historical phase, the private equity movement arose in the midst of, and largely as an antidote to, the harmful macro-economic consequences of the so-called "golden era" of American capitalism. In the 1950s and '60s, buoyed by post-war optimism on the part of consumers and new entrepreneurs, the US economy entered a prolonged period of growth, with citizens enjoying a corresponding era of prosperity on a scale unseen since the heady pre-crash heights of the 1920s (Smith and Dyer, 1996). Additionally, the necessities of post-war reconstruction across much of Europe and East Asia during this period meant that, for at least the first two decades of peacetime, the largest American corporations were largely unimpeded in their quest to command a progressively greater share of the country's huge and growing markets for consumer and producer goods (Baker and Smith, 1998). The combined effect of these factors was to exacerbate the already dominant characteristic of oligopoly within American industry, as a relatively small number of giant corporations together assumed a considerable degree of control over the allocation and pricing of goods within key national sectors such as steel, oil, electrical equipment, brewing, retail and automobile manufacture (Berle, 1962; Smith and Dyer, 1998).

Accordingly, the dominant strategic paradigm of the era became that of "retain and reinvest", as managements sought to retain any earnings that they made for subsequent reinvestment with a view to enhancing the overall scale and scope of business operations (Lazonick and O'Sullivan, 2000). The greater size of the firm's operations in turn enabled management and other key corporate employees to claim a correspondingly large share of economic output in the form of higher salaries and more lucrative official perquisites (Galbraith, 1974). Moreover, this process of corporate expansion increasingly entailed not only vertical mergers with companies operating at different stages in the same basic production process, but also horizontal mergers with firms from other industrial sectors altogether. This is what gave rise to the now infamous conglomerate movement of the 1950s and '60s, in which cash rich corporations were recorded as diving headlong into swathes of largely unrelated projects, as managements slowly expanded the reach of their various "empires" across significant chunks of the domestic and (to a lesser extent) international marketplace (Chandler 1994; Baker and Smith, 1998).

The early 1970s witnessed the beginning of the end for American capitalism's golden era, though. The first external "shock" to the US conglomerate movement came in the form of rapidly growing overseas competition from Germany and Japan, particularly in stable-technology industries such as consumer electronics and automobiles (Chandler, 1994). Largely as a result of innovative industrial and educational practices, Germano-Japanese firms continually excelled their Anglo-Saxon rivals on product quality and other productive efficiencies, thereby posing the first major threat to the continuing capacity of US corporations to generate steady and positive levels of retainable earnings on a year-by-year basis (Lazonick and O'Sullivan, 2000). At around the same time, a second major blow to the managerialist corporation came in the form of the 1973 Arab-Israeli War and resultant international "oil shock" (Jensen, 1993; Chandler, 1994; Smith and Dyer, 1998). The subsequent ten-fold increase in US firms' energy costs was felt not only by producers themselves, but was also passed on to consumers in the form of rises in the price of basic goods. The resultant period of inflation and unemployment in both countries piled further pressure on the US conglomerates, many of which had become over-capacitated, excessively bureaucratised, and thus ill equipped to deal with the structural changes forced upon them by the macro-economic environment.

In the late 1960s and early '70s, meanwhile, enterprising employees within some US investment banks had begun to develop an innovative financial product known as the "bootstrap" deal, which, remarkably, enabled the acquisition of over-capacitated or otherwise underperforming firms using the target firm's *own cash flows and assets* (see Baker and Smith, 1998; Burrough and Helyar, 1990). Although the financial minutiae of these transactions were often highly complex, their underlying economic logic was fairly simple. Typically, an investor would identify a company that enjoyed regular high cash flows but which, at the same time, lacked sufficient opportunities for the productive investment of those funds. Using extensive borrowings from wealthy individuals, commercial banks and other financial institutions, the investor would purchase a controlling stake in the firm at a premium over its current market or owner value. Following completion of the takeover, the new controller could then either: (a) cause the target company to assume the acquirer's liabilities under its contract with any creditors (known as "novation" of the debt); or (b) restructure the takeover debt so as to obtain a more manageable medium-to-long term repayment schedule (normally by means of a bond issue on the international debt markets), pledging the newly acquired company's asset base and/or future cash flows as security for the sums advanced (known as "securitisation" of the debt).

Additionally, the investor would use the company's cash reserves, together with the proceeds from liquidation of any of its undervalued businesses or assets, to fund the rapid fulfilment of the firm's obligations towards lenders and bondholders. This in turn forced management, under the close control of its new majority owner, to wrench efficiencies from the firm's operations as quickly as possible, through a combination of rationalisation or divestment of existing business operations, improvements in managerial quality and/or structure, and selective investment in cash-generating strategic projects or acquisitions. Following this necessary process of restructuring, the firm in question would in theory emerge “leaner and meaner”: stripped down to its core business competencies, absent any unprofitable divisions or wasteful bureaucratic structures, and fit to excel its competitors on the marketplace.

In short, management’s job was “to pull the business up by the bootstraps”, hence the name that was first given to these transactions, although they would later become more commonly known in the American business world as leveraged buyouts or LBOs. Although unforeseen at the time, the ultimate effect of this originally peculiar arrangement would be to plug the gaping accountability deficit that had developed at the heart of the managerialist corporation and, in turn, execute the final *coup de grace* on the floundering conglomerate movement. Indeed, from its early status as a marginal Wall Street activity at very best, the LBO transaction expanded in popularity and significance throughout the 1980s to become a central practice of Anglo-American corporate finance and governance. The most famous exponents of the device were the specialised New York LBO “boutiques” such as Kohlberg Kravis Roberts (KKR), Clayton, Dubilier & Rice, and Forstmann, Little. By fostering close working relationships with major commercial banks and other financial institutions, these investors succeeded in building progressively larger buy-out funds, enabling them in turn to fund the acquisition of correspondingly larger targets.

This process of development was further hastened in the early 1980s when Michael Milken, an employee of the Wall Street investment bank Drexel, Burnham and Lambert, pioneered a liquid market in “junk bonds”. These were high-risk/high-yield subordinated debt securities, typically marketed at large institutional investors and entailing lengthy deferments on payouts coupled with minimal protection again bankruptcy risk. With the aid of these sophisticated instruments, it became possible for relatively lowly capitalised financial firms to fund multi-billion dollar bids for the largest listed corporations (Coffee, 1988), in classic David-Goliath-style showdowns that captured the attention of both the financial press *and* popular media. Consequently, over the mid-to-late 1980s, the takeover boom reached epic proportions in the United States, culminating in KKR's 1988 buyout of the Atlanta tobacco and foods conglomerate RJR Nabisco for a then record sum of $25 billion.

The most common form of large-scale buyout was the public-to-private transaction, whereby a limited partnership, typically comprised of senior members of the buyout firm plus a small number of other large equity investors, acquired the majority of a listed corporation's share capital. The acquired company would then be de-listed from the stock market and re-registered as a private company, whereupon at least one investor to the limited partnership (normally a member of the buyout firm itself) would take a seat on the company's board of directors. In addition, that company's management would be given the opportunity to purchase a sizeable equity stake in the firm, conventionally 10 – 20%, at a discounted price. The limited partnership for any particular buyout would always have a definite life span, normally in the region of 7 – 10 years. At the end of this period, the partnership would necessarily dissolve, with the investing partners entitled to the return of their initial investment plus any profit accruing thereon. However, barring extraordinary circumstances, the expectation in most cases was that the acquired company would either be re-floated or else sold on to another private buyer within little more than half that time, with the buyout firm and its external investors receiving their "reward" in the form of a considerable surplus over the original price paid for control of the company (see Baker and Smith, 1998).

This limited time span encouraged the buyout firm, through the voice of its director(s) on the company's board, to be particularly active in either pressurising management to bring about efficiency gains from the company's existing operations, or else suggesting novel financial strategies for restructuring the company's operations so as to extract "hidden" value for shareholders. If the buyout firm failed to produce material returns for external investors, then its reputation and resultant ability to raise funds in future would be significantly hampered, thus ensuring a constantly high level of proprietary discipline in the governance of any acquired company. Meanwhile, a further incentive for active and ongoing managerial oversight stemmed from the buyout firm's *own* significant potential gains from any transaction, in the form of its sizeable "carried interest" on any deal (typically a 20% cut of the overall profits generated by each of the firm's buyout funds), an annual management fee of around 1.5 – 2.5% of fund profits for any year, plus any ultimate capital gains from equity invested in a portfolio company on the buyout firm's own account.

In view of the growing popularity of public-to-private transactions in the 1980s, together with the parallel growth in managerial share ownership and owner involvement in the corporate boardroom, it became fashionable for a while to decry the future of the widely held corporation itself. Michael Jensen even went so far as to opine that the "[t]he publicly held corporation, the main engine of economic progress in the United States for a century, has outlived its usefulness in many sectors of the economy and is being eclipsed" (Jensen, 1989, p. 1).

The impact of 1980s LBO activity on the US public company sector

In spite of Professor Jensen's negative appraisal of its future prospects, the public corporation was, at the beginning of the 1990s, in fact *anything but* dead. In the wake of the 1987 world stock market crash and the subsequent collapse of the junk bond market, and faced with fierce political and legal opposition across the United States, hostile leveraged tender offers receded in frequency and size (Jensen, 1993; Holmström and Kaplan, 2001). Consequently, the Berle-Means public corporation, characterised by dispersed ownership and professional management, was destined to become unchallenged for the rest of the century as the dominant organisational form for large-scale business enterprise in the United States. At the same time, though, the influence of the 1980s takeover boom was primed to run far beyond the events of that era alone, given the profound *indirect* effect of the LBO movement in transforming the dominant financial structures and operating goals of the *listed* company sector.

Over the course of the 1980s, and roughly ensuing the LBO movement, there was a sharp increase in the use of leverage (debt) deployed by public corporations as an ongoing component of their financial structure. In particular, the 1980s witnessed a notable rise in many companies' debt-to-equity ratios, denoting a generally higher level of debt assumption by listed firms relative to the value of their assets and retained earnings (Coffee, 1988). The most obvious (but by no means the most significant) factor behind this development was the financial consequences for those public companies that were actually subject to a leveraged buyout, which, as explained above, invariably forced target companies to disgorge themselves of free cash flow and low-yielding assets in order to cover their acquirer's post-takeover liabilities to creditors (Stewart, 1991).

A more prominent factor behind public companies' generally higher resort to leveraging techniques in the 1980s and '90s, though, was the destructive effect on target companies' cash flows of managerial takeover defences aimed at averting imminent or potential LBOs (Chandler, 1994). One such pre-emptive strategy, fairly common in the 1980s, was the controversial practice of target companies paying substantial "greenmail" premiums to potential acquirers, enabling the firm to repurchase the latter's shareholding and also gain a confidential undertaking from them to cease any further advances on the firm for a specified period of time. In view of most incumbent managers' personal pre-disposition to oppose attempted acquisitions even at extensive cost to their companies, the practice of greenmailing became a popular technique of corporate "raiders" such as Carl Icahn, T. Boone Pickens and

Sir James Goldsmith, who specialised in amassing large minority holdings in targets with the primary aim of obtaining a lucrative ransom (or "goodbye kiss") payment from the company without ever actually gaining control over it. Obviously, the raider's gain from such practices was the target company's loss, and many companies that were subject to greenmailing in the 1980s were forced to resort to the debt markets in order to compensate for their resultant shortfall in investment capital.

However, even those companies that were not directly subject to LBOs or greenmailing techniques in the 1980s nevertheless continued to operate under the threat of such action, and by the late-1980s managers had become well-aware of the "signalling effect" of a low share price in indicating the under-utilisation of a company's assets and hence the potential for their exploitation by a "wholesale" acquirer of control (on this phenomenon generally, see Manne, 1965). The most popular pre-emptive strategy for a corporation and management faced with the ominous spectre of the market for corporate control was in effect to "fight fire with fire", by attempting to mimic the structural and incentive conditions instilled within takeover targets following their acquisition by a private equity buyer. In particular, by returning otherwise retainable cash flow to public shareholders in the form of dividends or capital repayments, while at the same time borrowing heavily against their assets in order to fund any necessary re-investments, many potential takeover targets were able to generate ongoing levels of shareholder value that were more than sufficient to "correct" any prior under-valuation of their shares relative to total asset value (Coffee, 1988).

By engaging in such "leveraging up" practices (especially debt-financed share repurchases), public company managers not only succeeded in directly increasing the current stream of cash flows on each share, but they also effectively "tied their own hands" by restricting the company's future capacity for internal refinancing. This forced mature industrial corporations increasingly into the external markets for equity and debt capital, thereby rendering their future capacity for re-financing contingent upon the assessment of investment bankers, ratings agencies and other influential financial intermediaries (Easterbrook, 1984). In this way, managers publicly "bound" themselves to the task of minimising their company's future cost of equity and debt capital by ensuring a continually high share price and also consistently high levels of cash flow over the medium-to-long term (Stewart, 1991).

Indeed, even in the case of those public companies not subject to any realistic threat of outside takeover, the positive incentive of managers to maximise the value of their own wealth tied up in shares or stock options was liable to motivate similar value-creating strategies aimed at increasing the attractiveness of the firm as a financial investment (Jensen and Murphy, 1990). Accordingly, the dual practices of "leveraging up" and "shareholder value creation" had by the 1990s evolved into dominant managerial norms within the US public company sector *in their own right*, persisting independently of the negative influence of the LBO buyouts that initially inspired them and hence outliving the 1980s takeover boom itself.

Mainly as a result of the above factors, then, the financial structures and operating goals expounded by the 1980s LBO movement were in the 1990s progressively developed and subsequently instilled as dominant managerial norms within the American public corporation. This meant that, even though the 1980s takeover boom proved to be a temporary phenomenon, the legacy of the leveraged buyout was to endure within the very institution that it had previously seemed destined to supersede. Accordingly, while the future of the public corporation seemed secure at the turn of the 21st century it was in many ways a radically different type of organisation from its mid-20th century predecessor.

The historically distinctive features of the 21st century private equity movement

Placed against the above historical backdrop, the rapid re-emergence of large-scale LBO or "private equity" transactions over the latter half of the '00s represents a highly significant development. One of the criticisms most commonly levelled at private equity in the past, especially in the 1980s, was the allegation that it encouraged the predatory advances of "asset strippers" keen to make a short-term return through liquidation of the company's productive capital in order to pay off post-takeover debts. While "financial engineering" of this nature undoubtedly remains an integral part of private equity's activities today, with asset divestitures and business "spin offs" a continuingly common consequence of debt-financed buyouts, it would nevertheless appear that such occupations have become a decreasingly prominent part of leading private equity firms' tactical repertoire over recent years.

In this light, one of the most notable features of the contemporary private equity phenomenon is the fundamental importance attached by many leading firms to the activity of "operational engineering", denoting the deployment of industry-specific expertise either to cure latent deficiencies that constrain the further development of a portfolio company's business, or else simply to offer an alternative entrepreneurial perspective on any one or more strategic issues (Jensen *et al*, 2006, p. 16 *per* Steven Kaplan). To this end, many private equity firms have taken considerable steps over the last couple of years towards increasing their bank of *business* (in addition to purely financial) expertise, with the sector's superior economic returns and lower regulatory-bureaucratic burdens providing a powerful dual attraction to both former and even current CEOs of listed companies (Guerrera and Politi, 2007).

This has enabled leading buyout firms to build an arsenal of industry-specific managerial capital, in many cases providing a significant source of informed support and challenge to incumbent senior executives of portfolio companies. For example, Brian Hoesterey, a Partner of the private equity firm AEA Investors, claims that the much larger base of business investments held by private equity firms relative to their listed company counterparts gives them better opportunities for "spreading" the cost of recruiting a diverse body of managerial capital, thereby enabling portfolio companies to "take a piece of that insight instead of having to build their own infrastructure" (Jensen *et al*, 2006, p. 27). In other instances, the recruitment or involvement of a particular managerial figure may provide the rationale for attempting to acquire control over a specific company in the first place, with that expert's own industry knowledge and future plans for the business representing a significant component of the pre-bid due diligence process. KKR's recent acquisition of the UK retail chain Alliance Boots, for instance, was conducted in conjunction with the company's deputy chairman and largest shareholder Stefano Pessina, on the understanding that Mr Pessina would assume joint control over the company following its transition to private ownership.

Arguably the greatest economic advantage of private over public equity ownership today, however, is its relatively long-term time horizons. In particular, contemporary private equity arrangements are structured so as to provide incentives for investment in projects that, within a listed company context, would likely be postponed on account of their potentially detrimental effect on periodic earnings. As Blackstone's chief executive and co-founder Stephen Schwarzman argues:

> *"[t]he tyranny of quarterly earnings has created a systemic issue"* whereby *"[i]n many cases, senior managers have terrific ideas of what to do with their companies but they are not prepared to do it because their shareholders are not willing to put up with delayed gratification". (Quoted in Guerrera and Politi, 2007).*

This is mainly due to the fact that the typical limited partnership established to handle any private equity transaction will be paid the "back-end" value of the deal, which means that the initial equity investors will normally not receive any return until the acquired company is either re-floated on a public equity market following its successful reorganisation, or else sold on to another private buyer. As in the case of 1980s buyouts, the implication of this is that returns to equity investors are effectively deferred for a period typically ranging between four and eight years, although, depending on the specific nature of the industry in question, the deferment period may potentially extend to over ten years (Jensen *et al*, 2006).

In the 1980s, however, the largest public-to-private transactions were mainly motivated by the drive to reduce overcapacity in mature (typically industrial) firms with large cash reserves but little scope for market expansion (Jensen, 1990). Within this environment, leveraged buyouts tended to be primarily *corrective* in nature, aimed at remedying underlying organisational stagnancies and managerial incentive problems. Accordingly, the general expectation was that an acquired company would be restructured and subsequently re-floated or otherwise re-sold within a fairly short time frame, thus enabling future public or private owners to exploit the newfound growth potential of the reorganised and refocused business. The private equity firm's financial gain from any deal stemmed primarily from its "pricing" of the opportunity to exploit the relevant company's post-reorganisation growth potential, which would typically be realised via the sale of the buyout firm's holding in the company to outsiders at a considerable profit over the initial acquisition price paid, immediately or soon after completion of the necessary process of restructuring. This meant that, while the private equity firm was intimately involved in engineering the successful initial turnaround of a portfolio company, it had no need or incentive to remain involved in the business on a longer-term entrepreneurial basis.

Large-scale public-to-private transactions today, on the other hand, are more often than not motivated by very different considerations. In fact, the characteristics of many recent high profile buyouts would suggest that, in contrast to the largest LBOs of the 1980s, private equity activity today is concerned at least as much with entrepreneurial investment strategies for *directly exploiting* business growth potential as it is with financial techniques for providing the structural conditions for that growth to occur in the first place. In particular, it would appear that private equity ownership is an appropriate institutional form today for capital-intensive businesses with stable demand profiles, which produce exceptionally high and regular cash flows (thereby enabling them to shoulder heavy and lengthy debt repayment schedules) but which at the same time entail the extensive deferment of economic returns on large-scale investment projects. Public utilities and infrastructure businesses such as power generation, road building, hospital management, telecommunications provision and airports operation stand out as notable examples in this regard. For this reason, it is remarkable, albeit unsurprising, that two out of the three largest private equity transactions recorded worldwide at the time of writing involve the acquisition of a major utility or infrastructure business, these being KKR and Texas Pacific Group (TPG)'s ongoing $45 billion buyout of the Texan power generator and distributor TXU, and also the groundbreaking $33 billion takeover of Hospital Corporation of America (HCA) by KKR, Bain Capital and Merrill Lynch in 2006.

The TXU deal provides a particularly pertinent example of private equity's arguably unique propensity today for supporting radical and long-term investment strategies. As a fundamental component of their post-acquisition strategy for TXU, KKR and TPG have committed themselves to investing heavily in new low carbon "clean-energy" technologies as an alternative long-term fuel solution, while also ensuring the continuing satisfaction of the State's vast and growing energy requirements. These undertakings lie over and above the consortium's extensive obligations towards creditors stemming from their record-breaking

$45 billion leveraged bid to secure control over the company, which included the assumption of TXU's $13 million worth of outstanding debt. A key factor underlying the consortium's ambitious investment strategy for TXU is the company's current monopoly over Texas' system of power lines, plus its dominant position within the State's power generation and energy retail markets, which together give it a sound base of steady projected cash flows on which to plan for the extensive and risky capital outlays necessitated by long-term considerations of sustainable production.

Likewise, in the US telecommunications sector, TPG and Goldman Sachs' recently successful $27.5 billion bid for the wireless broadband operator Alltel Corp. was reportedly motivated by the potential long-term gains to be wrought from extensive investment by the company in a new wireless network. This would enable higher speed broadband communication for users and thereby position Alltel to compete for the first time with larger rivals such as AT&T. The consortium's ambitious leveraged purchase of Alltel on this basis was possible only by virtue of the target company's exceptionally high and regular cash flows (Alltel made $2 billion in revenues over the first quarter of 2007 alone), as derived from a wide and growing customer base of 12 million-plus broadband subscribers.

A notable European case in point, meanwhile, is the private equity buyout of the UK airports operator British Airports Authority (BAA) by the Spanish construction group Ferrovial in 2006. On gaining control over BAA via a £10.3 billion leveraged public-to-private transaction, Ferrovial immediately committed itself to advancing the UK government's ambitious expansion plans for the country's airports sector which, in particular, entail BAA dedicating a projected £9.5 billion over the next decade towards alleviating extreme under-capacity problems at the company's London-based passenger airports. These plans include the construction of a new £4.5 billion fifth terminal at London Heathrow Airport due for completion in 2008, plus a second runway and overall tripling of capacity at

London Stansted Airport, and possibly even a further sixth terminal and new third runway at Heathrow (see UK DfT, 2003). This is on top of BAA's extensive liabilities to bondholders consequent upon the record-breaking £8 billion-plus debt-securitisation deal that enabled Ferrovial to finance its acquisition of the company in the first place. However, like the previous examples of TXU and Alltel, BAA's extraordinary demand profile and projected cash flow patterns render the company particularly well equipped to handle a dual investment and repayment schedule on this scale: the company is sole owner of eight European passenger airports (including one of the world's largest hubs at Heathrow), where it enjoys monopoly power over the granting of landing, parking and take-off rights to airlines in return for pre-determinable charges.

Conclusion:

The implications of today's private equity boom for public company governance

The above examples illustrate how the institution of private equity ownership and financing has undergone considerable change over the past two decades. The financial restructurings and corporate raids of 1980s America, which centred primarily upon the mature and over-capacitated market leaders of days gone by, are no longer a prominent motivation behind the world's largest leveraged buyouts in the 21st century. On the contrary, the main targets of public-to-private control transactions today are high growth companies that enjoy ample opportunity for the productive and profitable investment of their earnings, albeit those which generate sufficiently vast and stable cash flows to sustain onerous post-takeover debt repayment schedules over and above their day-to-day strategic commitments. This has profound implications not only for major private equity boutiques themselves and their buyout targets, but also for the wider functioning of the international *public* company governance system. If (as is commonly regarded to be the case today) stock market pressures tend for various reasons to encourage a short-termist inclination on the part of managers and a resultant neglect by companies of potential growth and investment opportunities, then today's evolved market for corporate control may represent an effective solution to this problem in two key respects.

First, the growing perception that dynamic high growth companies are at least as likely to capture the attention of LBO boutiques as their floundering mature counterparts is prone to reduce the apparent "negative" role of the market for corporate control as a device for disciplining (through dismissal) those managers that fail to return free cash flows to shareholders for subsequent re-investment at macro level. Correspondingly, there will be an enhancement in the "positive" profile of the market for corporate control as a mechanism for providing amplified incentives and resources for driving forward pre-existing trajectories of growth under incumbent management. And secondly, many large-scale private equity buyouts today may have the ultimate effect of encouraging public equity investors to place greater faith in managers' declared long-term growth projections when making purchasing and "hold" decisions, if only with a view to exploiting potential control premiums by taking minority holdings in firms that are regarded to be "ripe" for a leveraged takeover in future.

Therefore, although the current volume of large-scale public-to-private transactions is almost certainly unsustainable, today's private equity buyers may nevertheless find that they have brought about a lasting paradigm shift in international corporate governance by simultaneously engendering: (a) a greater managerial propensity towards retention and reinvestment of corporate earnings; and (b) a stronger willingness on the part of public equity investors to defer to management on decisions regarding the ongoing allocation of cash flows. For better or worse, then, private equity boutiques may ironically end up *counteracting* their own earlier achievements in reducing managers' discretion over how public companies spend their money.

[i] In its widest sense, the term "private equity" is used to refer to any investment in the equity of a business where that equity is illiquid (or of limited liquidity) and hence not easily tradable on a public investment market. This notably includes venture and rescue capital projects. Notwithstanding, in this paper I use the term "private equity" in the narrower but commonly accepted sense of referring exclusively to public-to-private transactions.

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