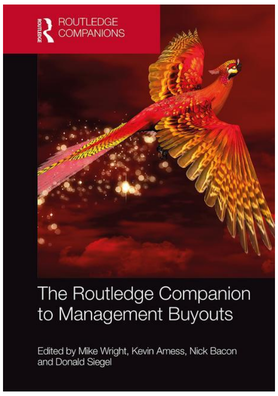

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The Political Economy of Finance-Led Capitalism

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THE POLITICAL ECONOMY OF FINANCE-LED CAPITALISM

Connecting financialization, private equity, and employment outcomes

Ian Clark

Introduction

Observers of comparative political economy have outlined changes in the nature of capitalism that have since the late 1970s. It is suggested that full-employment capitalism was replaced by a finance-led capitalism centered on neo-liberalism (Harvey, 2007; Crouch, 2011). The financial crisis of 2008 reinforced the trajectory of finance-led capitalism and neo-liberalism. Central to this change is a process whereby the principles of deregulation and privatization were further embedded in the institutional framework of countries such as the UK. Recent contributions to this literature link together economic restructuring, associated neo-liberalism, and the emergence of finance-led capitalism. It is suggested that these changes represent a social revolution from above, designed to restore the power of capital over labor (Cox & Nilsen, 2014: 136; Srnicek & Williams, 2015: 52–67).

A literature on financialization (a particular outcome of finance-led capitalism) subsequently emerged that asserts capital markets increasingly regulate firm-level behavior. Financialization involves three processes. First, the ascendency of shareholder value that prioritizes the interests of investors at the expense of other firm-level stakeholders (van der Zwan, 2014). Second, the emphasis on shareholder value legitimizes a more aggressive management of corporate assets to prioritize financial objectives, for example high stock prices and maximizing the release of cash flows to investors, at the expense of other stakeholders (Thompson, 2011). Third, it popularizes a range of financial techniques whereby investors extract the gains from corporate restructuring and divestment rather than re-investing savings in the firm or sharing the gains with other stakeholders. Although these processes are described at an abstracted level, the consequences for work and employment at firm level are less clear.

The main arguments developed in this chapter are that the UK played a key role in facilitating the transition to finance-led capitalism and financialization, and that the financial instruments popularized by private equity (PE) through leveraged buyouts spill over to affect the corporate sector more broadly. The chapter is divided into three sections. The first section provides a theoretical framework which outlines the emergence of finance-led capitalism, the associated diffusion of financialization in the UK economy, and its potential effects on labor. The following section outlines the negative implications for work and employment as PE instruments enable and encourage investors to appropriate value from firms. The final section illustrates the arguments with empirical material drawn from two detailed case studies relating to the AA under PE ownership and the collapse of the British Homes Stores (BHS) pension scheme.

Full-employment capitalism to finance-led capitalism

From the end of the Second World War until the early 1970s the UK operated within a broader Western economic system in which fixed exchange rates facilitated international trade in manufactured goods. This system involved Keynesian state intervention to deliver sustained economic growth and improved welfare provision (Ruggie, 1982; Harvey, 2007). Western economies balanced a commitment to the market economy with intervention to promote full employment and social welfare. This capital–labor compromise was designed to avoid the economic collapse and associated depression of the 1930s that contributed towards the Second World War (Harvey, 2007: 11–12). In the UK, this compromise took the form of capital controls, nationalization, a commitment to the welfare state, and trade union representation. However, economic growth up until the 1960s obscured long-run relative economic decline (Gamble, 1988). From the 1970s onwards, neo-liberals proposed to reverse economic decline by an alternative policy agenda focused on anti-inflation, balanced budgets, reducing union militancy, and curtailing the drag effects on the market of welfare expenditure and state monopolies. The subsequent sterling crisis in 1976 followed by increases in industrial action led to successive Conservative governments (1979–1997) that focused on financial deregulation and privatization to shift the balance of the economy from manufacturing to financial services (Harvey, 2007: 19–30; Crouch, 2011). These changes were consistent with the demise of the Bretton Woods fixed exchange rate system which underpinned the expansion of export trade between developed nations. Financial markets expanded with the beginnings of what became a globally unregulated international financial system (Eichengreen, 2008).

By the City "Big Bang" in 1986, the increasing size of the financial sector positioned the UK economy center stage in global capitalism. New financial actors such as global asset management for hedge funds, PE firms, and sovereign wealth funds dominated the City of London (Augar, 2009). The presence of support services for these intermediaries in the City and neo-liberal governments removed regulatory obstacles to international capital movements and foreign ownership of UK firms (Harvey, 2007: 62, 70–73; Pendleton & Gospel, 2014: 88). From the late 1990s, the financialization of the UK economy had involved the deregulation of capital markets and legal restrictions on industrial action by the labor force. The systematic financialization of UK capitalism required managers to prioritize shareholder value and downgraded relationships with other stakeholders such as the labor force (Lapavitatas, 2013: 15). From the late 1970s, financial market actors have developed and diffused innovations to increasingly extract value from firms.

The transition to finance-led capitalism was achieved by financial deregulation and international integration which readjusted UK capital into a global form. This reworking legitimized the central concern of capital markets, with the market for corporate control exerting discipline on managers that did not seek to maximize shareholder value (Münnich, 2016: 285). The consequences for UK labor included higher job insecurity, increased wage inequality, and the dismantling of collective representation. The connection to the labor process and the broader political economy of labor is therefore clear. Finance-led capitalism and the market for corporate control require a relentless search for investor value that ruptures established relations between capital and labor. This has most notably involved the decline in wages as a share of national income from 61% in the 1970s to less than 56% since 1982 (OECD, 2015). The wage share is defined to include wages and non-wage benefits such as pensions and national insurance contributions, which represent reproduction costs for labor. This represents a breach of the post Second World War social contract between employers, labor, and the state. New business models aimed to cheapen labor to boost short-term profits, through increased labor flexibility (Atkinson, 1984), privatization, and management buyouts (Wright et al., 2000, 2002). The "take private" PE business model highlighted the extent to which capital was no longer willing to make continuous commitments to labor or even firm ownership. More recently so-called "gig economy" firms such as Uber, Deliveroo, and Airbnb that are associated with "platform capitalism" (often funded by venture capital and PE) have focused more determinedly on the externalization of employment (Srnicek, 2015).

The movement to finance-led capitalism re-purposed the UK state towards restoring opportunities for profitable capital investment, notwithstanding low levels of productivity in manufacturing and services. Indeed, since the late 1970s, the privatization (often in the form of buyouts) of utilities, housing, transport, health, education, and infrastructure were key acts by which neo-liberalism pumped profitability back into the private sector (Mason, 2015: 278). A particular firm level outcome of this transition is that managers are more likely to respond to the demands of financial markets than labor markets. Neo-liberalism undermines alliances between the state, managerial elites, and organized labor at its heart. Restoration of profitability depended on breaking organized labor and a re-commodification of labor (Cox & Nilsen, 2014: 141–147). This was achieved by monetary policy which allowed unemployment to fluctuate and restricted organized labor and welfare state expenditure (Glyn, 2006: 27–31). The following section focuses on the role of PE as an instrument of finance-led capitalism.

Private equity: an instrument of finance-led capitalism

The previous section highlighted the role of state policy in the transition to finance-led capitalism. Therein structural innovations in capital markets – the market for corporate control and a relentless search for investor value – disrupt established relations between capital and labor. A disdain for customers, employees, and attachment to locality are hallmarks of a globalized approach to business that disconnects circuits of capital and labor (Appelbaum et al., 2013). Accordingly, this section briefly defines PE, explains how mega "take private" PE funds became a macro instrument of finance-led capitalism under the UK's New Labour government (1997–2010), and then details how the micro instruments of PE challenged established workplace employment relations settlements.

Private equity

PE is an asset class that is funded by investors who commit monies to an investment fund for a defined numbers of years, usually fewer than ten. Professional fund managers invest these monies on behalf of investors in organizations which become portfolio firms either owned outright or majority controlled by PE fund partners. So a PE fund is a fund management company either in the form of a limited partnership or a plc business that actively manages the pool of money. The limited partnership model is the favored vehicle for two reasons. First, a limited partnership has no legal personality yet individual partners can operate collectively. Second, both managing partners in a partnership and limited partners who provide the bulk of investment funds are taxed as individuals whereas the partnership itself has no liability to taxation. Accordingly, the taxation liability of managing and limited partners, as a result of financial engineering, is often reduced to a level less than the taxation levied in the UK by booking income as a capital gain, utilizing none-domiciled status, offshoring a portfolio firm, or writing off interest against borrowing.

The PE sector is broad in scope and includes venture capital, which is a form of capital typically provided by professional institutionally backed outside investors who support the growth of new businesses. In addition to venture capital and mid-market PE funds which take stakes in an established business to help it roll out nationally, larger, multinational PE funds acquire plc firms or divisions of plc firms by buying all the shares or a controlling percentage of the shares which are listed on a public stock market such as the London Stock Exchange. The purchase of a controlling percentage of the available shares is often the first move to complete control, and once a fund has control of all the shares in a portfolio company then it becomes the single or majority shareholder and the firm is no longer a publicly traded plc company; this is what is referred to as the take private, PE business model. So venture capital, mid-market funds, and mega-funds which specialize in taking listed firms private are different factions of PE capital, but what they do have in common is the manner in which funds are raised – on private rather than public markets. But how did the take private model deployed by mega-funds come to prominence in the UK?

Private equity under New Labour: a macro instrument of finance-led capitalism?

The New Labour government (1997–2010) further rebalanced the economy towards finance-led capitalism by promoting the interests of financial capital, in particular hedge funds, PE funds, and financial capital asset managers (Augar, 2009). This rebalancing operated in two ways, by taxation and fiscal policy. With regard to taxation, New Labour's 1998 budget exempted business assets held initially for ten years from capital gains tax, but then very quickly, business assets held for only two years. This exemption was designed to stimulate venture capitalists and small business start-ups, but the deregulation was drafted so loosely that it created a tax break available to all capital. Hedge funds and PE funds which specialized in buying "asset rich" listed firms took advantage of the regulations to fund these acquisitions with massive levels of leverage, up to 70% in some cases. After the 1998 budget changes, chargeable gains were tapered against the length of time an asset was held with the taper applied to net gains that were chargeable after the deduction of any allowances including interest on loans secured to buy an asset. This produced the lowest possible charge. Considering business assets held for two years, only 25% of the gain would be chargeable creating an effective higher rate taxation at 10% (IFS, 2008: 214; Seely, 2010: 3). In benign economic conditions and with rising asset values these assets were realized relatively quickly at a massive gain to vicarious investors in these funds and the limited partners who put the deals together.

With regard to fiscal policy, from the 1998 budget onwards New Labour's policy on financial regulation legitimized the argument that firms were only accountable to vicarious rentier, investor-owners, associated asset managers, and shareholders. This commitment secured an alliance with finance and the City that extended over three general election victories (Heyes et al., 2014). Hence the financialization of government fiscal policy involved serving the interests of venture capital and business, and served the interests of newer more innovative factions of financial capital – asset managers, hedge funds, and PE funds. These factions while operative and in some cases registered in the UK, are internationalized operations which act in the interests of global financial capital.

Theoretically, the development and growth of PE (the take private variant in particular) as an instrument of finance-led capitalism lies within the growth of corporate finance as an academic discipline and the associated theory of efficient capital markets (Jensen, 2007). The theory of efficient capital markets contains an efficient-contracting orientation to the firm, that is (capital) markets allocate resources to investments that secure the highest returns. The attraction of PE funds, particularly those that specialize in take private buyouts is the comparatively high rates of return which averaged between 15% and 20% prior to the financial crisis (BVCA, 2008).

These returns led academic supporters and practitioners to argue that PE-backed firms secured higher returns for investors and shareholders, had higher productivity, and created more jobs than equivalent plc firms, (Bacon et al., 2004, 2008, Bruining et al., 2005; BVCA, 2008). In many cases the business model did secure the benefits identified in these claims and the studies that supported them; however, below the survey method that the majority of these studies employed there is far less evaluation of the effects of PE ownership at firm or workplace level other than reference to the benefits of active ownership, rapid organizational change, and powerful management incentives.

The logic behind PE, like many other business models associated with finance-led capitalism, sees a business as a bundle of assets that can be managed on a contractual and transactional basis. The ultimate purpose is to generate cash flow and profit streams over short-term time horizons by financial and organizational manipulation returning these revenue streams to investors. So while PE as a faction of capital claims to be a long-term investor, it is the long-term interests of the fund that they refer to not the portfolio firms that they control. Rather, portfolio firms are viewed as short-term investments from which significant value can be appropriated and redistributed to investors. So in what ways do the micro instruments of the take private business model both enable and encourage investors to appropriate value from what become portfolio firms?

Micro instruments of PE and the appropriation of value from portfolio firms

At firm level the instruments of a PE buyout operate in several ways including share buybacks, corporate restructuring, asset sales, and the securitization of firm-level assets, pension scheme contribution holidays for employers, and contractual approaches to managing a company pension scheme. Each instrument detaches from firm-level performance and the development of core operational capability in a business. The application of these instruments represents a strategic choice for a new owner to either appropriate value from a business and return it to investors and new owners in interim dividends and payments, or invest money in developing the business (House of Commons, 2016: 6). Share buybacks for example are designed to reduce the pool of shareholders, raise the price of shares, and facilitate the return of monies to investors and are often deployed just prior to a firm being taken private. Securitization may also enable corporate restructuring by divesting firm-level assets and then managing them through contractual rather than in-firm relational methods. Securitization and associated lease back arrangements take value bearing but less liquid assets such as buildings, equipment, transport fleets, and sometimes pension schemes and through financial engineering transpose assets into a security. For example, a mortgage-backed security is secured by a collection of mortgages or ownership rights to premises or vehicles. Cash flows are generated as financial institutions and non-financial firms use securitization to immediately realize the value of a revenue-generating asset such as buy-to-let mortgages or the value of investments and payments which fund a defined benefit pension scheme. These instruments are frequently used by non-financial firms too, which illustrates the diffusion of particular techniques and instruments associated with finance-led capitalism into the non-financial economy.

In the case of defined benefit pension schemes securitization is further complicated by the availability of insurance company buyouts of pension schemes. Specialist pension management firms buy up final salary pension schemes usually on the proviso that they are sold to them "closed" to new members and some current members. However, in some cases such as the buyout of BHS and then the secondary sale of BHS to Retail Acquisitions, it can prove difficult to secure a pension scheme sale (House of Commons, 2016: 20). It may be the case that following an employer pension scheme payment holiday instigated by a new PE-backed owner that the scheme is in substantial deficit and by association that the Pensions Regulator will not allow a sale to proceed (House of Commons, 2016: 14–19). The implications of a business failure for the workforce are dramatic and as the cases at Comet Electrical stores, Jessops the camera retailer, and MG Rover previously demonstrated, resulted in significant write-downs in the value of pension contributions for the workforces and those already retired (Bailey et al., 2010). More significantly the liability for pension protection in cases of a business in administration is transferred to the pension protection fund. This is a fund levied on all final salary pension funds, many of which are significantly smaller than those in these larger funds which were written down as a result of the application of unsustainable business models. It is true that all forms of firm can enter administration, but as the recent Work and Pensions Department inquiry into the collapse of the BHS fund concluded, in some cases of acquisition by PE-supported investors, pension payment holidays are one method by which such investors strategize "taking money out of a business" and redistributing it to investors (House of Commons, 2016: 55–56).

As an instrument of PE acquisitions employer pension contribution payment holidays enable financialized business models to "mine" firm-level assets. Often expressed in the term "recapitalizations", the monies previously allocated to employer pension scheme contributions are instead returned to investors. Consideration of recapitalizations which divert employer pension payments is important because pension payments represent reproduction costs for labor which many new investor-owner models that are emblematic of finance-led capitalism seek to minimize if not avoid.

Some instruments that are designed to appropriate value under PE ownership, such as corporate restructuring and associated dividend and debt recapitalizations, operate within approaches to corporate governance developed under finance-led capitalism. These approaches work in the specific interest of capital and seek to minimize liability to taxation and transparency by delisting firms ("taking them private") and in the use of offshore registration for now private firms. Private firms and those which are offshored are not subject to the same transparency requirements or related codes of conduct as publicly listed firms. Indeed it is often the case that the stated purpose of taking a firm private is to reduce both transparency requirements and liability to taxation in the country where it was previously listed. Alliance Boots, for example, is no longer a UK firm; it was bought in 2007 in a deal fronted by KKR PE which led six other PE investors where the firm was re-domiciled as a private Swiss company substantially reducing its liability to taxation. In 2012 Walgreens, the US drug store retailer, bought 45% of the business and in 2014 confirmed its option to acquire the rest of the business in 2015; hence Alliance Boots is now a UK-based, Swiss-registered, US-owned multinational firm.

The logic of going private and offshoring is further reinforced if a firm-level final salary pension scheme is in deficit as a result of employer payment holidays or where the deficit is so large that it potentially undermines the business as a going concern. As the next section of the chapter illustrates, detailed case study evidence strongly suggests that a central reason for deficits in the era of finance-led capitalism is that monies allocated for employer pension fund contributions are frequently diverted to pay down debt or are paid to owner investors as dividend recapitalizations. At firm level these claims flow towards investors who position themselves as new claimants to value, both its appropriation from the labor process and its extraction from contracts which new owners choose to default on (Lazonick & Mazzucato, 2013: 1096). The appropriation of value by PE owners which have taken a firm private may be enacted directly by investor activism, leveraged buyouts, and associated restructures which lead to intensification of the labor process (Clark, 2011, 2016). It is the case too that these instruments can operate retrospectively, as managers acting on behalf of capital appropriate, sell, or take contribution holidays from restructured pension schemes – the previously earned-deferred income of labor (Grady, 2013).

Redundancy

A clear-cut instrument designed to appropriate value for PE investors is the use of redundancy. Again critics of the argument developed in this chapter will argue that all firms involved in merger and acquisition undertake some consolidation; clearly that is true but PE-backed acquisitions have specific advantages over listed businesses and listed business acquisitions. At the height of the take private boom in 2007 many PE firms denied that they were in fact an employer but that instead they represented many smaller scale investor-owners who were in fact the real owners of a business. The Treasury Select Committee, which investigated the PE sector in 2007–2008, held that such arguments were disingenuous (House of Commons Library, 2008). It is, however, the case that PE acquisitions which remain a publicly listed firm or those taken private are classed as a change of majority shareholder not a transfer of undertaking protected by the UK's TUPE – transfer of undertaking protection of employment regulations. This enables PE investors to disregard agreements unilaterally formulated by previous owners or those negotiated between a recognized trade union and an employer in collective bargaining. This derogation from the legislation allows PE owners to lawfully deny some "employer responsibilities" in respect of information and consultation prior to acquisition and deny and de-recognize any existing collective bargaining agreements more easily than traditional employers. In cases where a portfolio firm does not have a recognized trade union and therefore no collective bargaining arrangements, these changes can amount to unilateral employer action. While unilateral changes to pay rates, holiday entitlement, and pension provision represent serious breaches of contract, those affected by them may be asked to agree to such changes or find their job subject to potential redundancy. This leaves many workers subject to unilateral changes with no option but to accept them or accept them but seek to minimize the effects of any unilateral change.

The AA and BHS under private equity

At the start of this chapter it was argued that finance-led capitalism and its associated motives and instruments in PE required state sponsorship to enable the transition to financial capitalism. Deregulation of financial services abolished established rules covering specific privately owned exchanges and financial enterprises. As the previous sction explained, in the case of incentives for PE, these rules were replaced by capital-friendly government regulations. The employment implications will now be outlined in two case studies. Developments at the AA highlight the direct impact of PE buyouts on employment. A further important impact of financialization is the spillover of the instruments developed in PE buyouts that affect labor in the broader corporate sector. This impact is explained by considering the pension scheme at BHS.

Private equity at the AA

The AA was formed in 1905 following a meeting of motoring enthusiasts who were concerned about the deployment of speed traps by the police. The group operated as a campaigning pressure group on road safety and road signs. After the Second World War, the AA campaigned against the continuation of petrol rationing and in 1949 it introduced a breakdown and recovery service. Insurance services were rolled out and in the early 1970s AA "roadwatch" began reporting details of traffic congestion and roadworks on commercial radio stations. In 1973 the AA introduced AA Relay, a service which undertook to transport all occupants of any covered vehicle to any destination in the UK in the event that a vehicle could not be repaired or restarted at the road side. By the mid 1990s the AA had over 8 million members and was ranked first in the *Which* surveys of roadside assistance providers. The AA website claimed that in 2007 the group had 15 million members. In 1999 AA members voted to de-mutualize the company and AA managers sold the company to Centrica, the holding company owners of British Gas for £1.1 billion, gifting each fully paid up member of the breakdown service a £100 payment. In 2004 Centrica sold the AA to two PE firms CVC and Permira for £1.75 billion. In 2007 the AA merged with the Saga group, which was owned by a third PE group Charterhouse. A new holding company, Acromos Holdings, was created which was owned by CVC, Permira, Charterhouse, and Charterhouse staff. The deal secured £3.35 billion for the AA and at the time valued the combined group at £6 billion, placing it as the 20th biggest company in the UK.

Union recognition at the AA

The GMB trade union held sole recognition rights at the AA. The union had a substantive agreement with the AA over collective bargaining for pay and working time and a procedural agreement over job security and redundancy, termed a "job security and business development agreement". The latter included a collective agreement on redeployment and severance terms, which in turn was incorporated into individual contracts of employment. In comparison to statutory terms the details of this agreement were well developed; for example, AA staff liable to redundancy were subject to a four-month notice period and within this in the first instance, if staffing levels had to be reduced, volunteers were sought to avoid the need for compulsory redundancies. Moreover, all staff subject to redundancy were offered alternative employment opportunities which, if on a lower pay rate, were protected by pay red circling. Lastly, statutory severance payments for voluntary or compulsory redundancies were supplemented in the AA-GMB agreement by an additional one month's salary for each year of service up to a maximum of 25 months. Redundant staff were able to leave the AA with full entitlement to severance pay immediately on notification. The agreement was signed by the AA group managing director and the group personnel director, the GMB national chairman, and the GMB national secretary and covered all AA staff in post before January 1, 1996 and remained operational until the AA was acquired by Permira. In 2004 the GMB's membership density stood at 70%.

Union recognition under PE

The GMB was de-recognized by the AA in 2005, and the union was denied all access to the workplace, and check-off arrangements for collection of union subscriptions was terminated. The GMB senior organizer stated that GMB members were told that a new section of the GMB was in consultation with the AA. From February 2005 the applicability of all GMB AA substantive and procedural agreements came to an end. The staff association was in fact the AA Democratic Union (AADU), which changed its name to the Independent Democratic Union (IDU) in October 2007. The IDU is registered with the certification officer as an independent trade union under the Trade Union and Labor Relations (Consolidation) Act, 1992. Since 2005, the IDU is the only union recognized for the purpose of collective bargaining at the AA, and its rule book is only available by written request of members and is not available in any form on the IDU website (www.idu.org.uk). In March 2007 the IDU General Secretary claimed to have more union members at the AA than the GMB (1,500) which still claimed to have 2,300 members, many of whom it was still acting for either as employees or former employees in unfair dismissal cases (www.gmb.aa.org.uk). In April 2007 the IDU claimed 70% union membership across the AA, when the AA's Human Resources director declared the company to be satisfied with relations with the IDU in the context of negotiating and agreeing a 4.5% pay award (Berry, 2007).

Even though the IDU has a certificate of independence, the GMB national organizer maintained that it was and remains a "scab" organization which was founded by a disgruntled GMB official (who is now the IDU General Secretary) in collusion with AA management and their PE owners. The evidence suggests that the AA's PE owners wanted to de-recognize the GMB union and that they had the assistance and capability of local staff to enable them to do so (Clark, 2011, 2016). Recognition of the AADU/IDU aligned PE owner interests with those of the workforce by enabling management, on behalf of PE owners, to downgrade the financial scale and scope of substantive and procedural agreements. By retaining collective bargaining integrity to these agreements AA management and their PE owners were able to claim the GMB de-recognition and the recognition of the IDU was an inter-union dispute and nothing to do with them.

Impact on AA employees

Within a month of recognizing the AADU in 2005 the AA PE owners commenced a restructure by initiating a performance management program via letters sent to all patrol staff informing them that they would be placed in one of two categories: those meeting or exceeding expectation and those whose performance does not meet expectations. Patrol staff who met expectations were awarded a £2,000 bonus. Those who did not were called to one-to-one roadside meetings without representation from the AADU or the GMB and offered £18,000 to leave the AA or accept placement on an improvement program which would lead to summary dismissal if they did not accept this change to their terms and conditions to which the AADU had agreed (GMB archive 1).

Through this process 3,400 patrol workers (50% of the patrol force) left the firm. These departures were not redundancies but voluntary resignations recorded on an AA RSS Patrol decision form. In the decision box AA employees are given two options: either "I wish to accept a mutual termination of my employment" or "I wish to continue my employment with the AA as an RSS patrol" (GMB archive 2). In addition, these resignations were covered by an "authority to advise on compromise agreements" (GMB archive 3).

> I hereby authorize xxxxxxxx xxxxxxx to advise me regarding the compromise agreement between myself and the AA. I understand the rules of the union representation/advice in connection with this compromise agreement is given by the AADU national secretary or representative nominated by the AADU national secretary on condition that 1, I will remain a member of the AADU and continue to pay the normal contribution rate while the proceedings continue and 2, I will cooperate fully with the representative nominated by the AADU, act upon their advice and provide as far as possible, all relevant information. I understand that if I fail to comply with conditions or wilfully provide false information to the union or my representative, representation may be withdrawn by the AADU.
>
> The £18,000 exit award was far lower than those previously agreed between the now de-recognized GMB union and the AA, which on average could see a patrol worker retire or take voluntary redundancy with a payment of around £30,000 and in some cases up to £50,000 for long serving workers. The firm also intensified working by the introduction of the "last job of shift" which could significantly lengthen a worker's shift. "Last jobs" could be called within the final 30 minutes of an 8-hour shift, which could potentially lengthen working time by as much as a further 5 hours. Third, the firm introduced 195 annual "standby hours", which in effect equated to unpaid overtime. These individual developments were recently rolled up into new contracts which cut core earnings but inserted incentives for jobs completed to compensate for last job of shift and stand-by hours and further incentives for sales commissions, for example on membership upgrades.

While remaining de-recognized in 2016, the GMB retains over 800 members in the AA's current workforce of 4,000, giving it a density of 20%. The majority of these members work in the patrol service where 2,300 workers are currently employed. Although the GMB's aim is to secure re-recognition, this may prove hard to secure other than if patrol workers are taken as an initial bargaining unit, which would give the GMB an approximate density of 30%. The GMB has scored regular successes in employment tribunal cases where the union represented AA workers as individuals and has now secured the right under the Employment Relations Act 1999 for GMB shop stewards to represent union members on individual issues which the AA previously denied them. The AA agreed that its position that AA workers could not be accompanied by a certified GMB representative did not reflect the procedural position laid out in legislation.

The financialization of the AA

In 2014 the AA and Saga were de-merged with both firms re-listed on the London Stock Exchange. The cost of the de-merger and all associated flotation costs were placed on the AA balance sheet (Automobile Association, 2013). This marked the acceleration of financialization at firm level. The ownership structure employed by the AA PE owners – the limited partnership – enabled them to become the firm's new investor-owners via a change of majority shareholder and continue to run the firm as it was before they acquired it. This allowed the new owner to place any costs associated with its acquisition of the firm and any further costs associated with any restructure on the balance sheet of the business. Debts associated with leverage and any loans or dividend payments to themselves, consultancy fees, and accumulated debt interest can be charged to the portfolio firm (the AA), which Acromas Holdings owned. That is, the AA was mined for returns to investors and shareholders and then charged for the direct and indirect costs of this appropriation of value. The original purchase by PE partnerships CVC and Permira was highly leveraged with loans of £1.3 billion or 75% of the £1.75 billion purchase price secured against the AA's assets. The following year the owners increased their loans by a further £1 billion, 50% of which they appropriated as an interim payment. Two years later in 2007 Acromas Holdings funded the merger of the AA and Saga via a refinancing deal which resulted in £4.8 billion of debt on the AA/Saga balance sheet. Some £3 pounds was used to buy back existing debt at the AA and Saga while the remainder of the debt was used to make a further interim payment to management and PE investors in Acromas. The 2014 de-merger was refinanced with a further £3 billion loan secured against the AA's assets and future revenue streams. A management team at the AA bought 70% of the firm with backing from 10 City fund managers for approximately £1 billion to fund an accelerated stock market listing valued at £1.4 billion.

At the time of its stock market listing the accumulated debt on the AA's balance sheet was roughly twice the value of its listing valuation. In March 2015 the AA announced plans to raise a further £1 billion to help improve its finances and repay "PIK" (payment in kind) notes in an effort to reduce annual financing interest costs of £195 million. In June 2015 the AA's market capitalization value was £2.32 billion. Since flotation the AA has been headed by a new chief executive, who previously headed a rival car recovery service, Green Flag, a business run on a franchise model. Interviews with the GMB national organizer, senior southern region organizer, and regional organizers suggest that this model may be one that the new management team may seek to diffuse at the AA, that is, retreat from an employment-based model to one of self-employment.

The collapse of BHS

The acquisition of BHS by Sir Phillip Green and the Taveta Investment Group followed by its sale to Retail Acquisitions illustrates the regulatory weaknesses in the UK's finance-led capitalism. In particular the BHS case highlights permissive governance in private investment vehicles modelled on the take private, PE business model and its associated acquisition methods and practices. These arrangements have significant implications for the regulation of defined benefit pension schemes. The retailer was bought by Sir Phillip Green for £200 million in May 2000 and was immediately sold to Taveta Number Two Investments for the same amount of money in a deal which was 100% leveraged over eight years, that is Taveta put no money into the deal. The BHS group paid £423 million in dividends and lease back deals for property in the period until 2004, £307 million of which went directly to the Green family (House of Commons, 2016: 5). However, by 2014 BHS was in a financially precarious position and was effectively kept in business by loans from the Green family totaling £250 million. Sir Phillip Green made a strategic choice to appropriate considerable value from BHS in its earlier profitable years and made no attempt to increase investment in the firm to sustain its competitive edge. More specifically Taveta Number Two Investment was a 100% leveraged offshore investment vehicle. To reduce taxation and transparency liability, it combined with another offshore firm, Carmen, owned by the Green family, which too reduced taxation liabilities on its revenues from leases on BHS properties.

At the same time as extracting and appropriating value from BHS, via the application of instruments pioneered in PE, under Sir Phillip Green's leadership the firm declined to make the necessary employer pension contributions to retain the sustainability of the pension fund. By 2009 the deficit on the two BHS pension schemes was £166 million, whereas in 2000 when the firm was acquired the two schemes had a surplus of £43 million. It is clear from the deliberations of the DWP inquiry into the collapse of the BHS pension schemes that Sir Phillip Green sought to avoid these payments. Moreover, some of the monies which should have gone into the pension schemes went into dividend payments, management charges, sale and leaseback payments and associated charges, inter-firm loans, and use of BHS shares as collateral for loans to fund company purchases. The Pensions Regulator asked for this material to be provided but BHS declined to do so (House of Commons, 2016: 16). The pension scheme deficit prevented the sale of the firm to an appropriate and credible buyer; for example, Sports Direct declined to buy the firm for precisely these reasons.

By 2012 the BHS pension scheme deficit was £233 million and Sir Phillip Green began seeking a buyer for the business. After several abortive attempts including the one with Sports Direct in 2015, BHS was sold to Retail Acquisitions for £1. The firm was sold as a going concern that had financial support from the Taveta Investment Group and, according to the BHS 2013–2014 annual report, was capable of trading without threat of liquidation for 12 months (BHS, 2013, 2014). To establish credibility Retail Acquisitions had to provide £35 million of equity to BHS and secure working capital from Farallon, a US-based PE and investment firm. On the basis that Retail Acquisitions had both the equity and the working capital, the deal went ahead; however, the purchaser had neither. The £35 million was supposed to come from the sale of the BHS headquarters building in Marylebone but failed to transpire. In contrast Farallon Capital issued only a non-binding term-sheet offer to Retail Acquisitions which set out the details of a possible loan which was subject to satisfactory resolution of BHS pension liabilities with The Pensions Regulator. The funding was in fact three £40 million loans, each of which was payable after the repayment of the previous loan. The only working capital that Retail Acquisitions was able to secure was a £25 million loan facility from Sir Phillip Green. Despite this, Retail Acquisitions appropriated £7 million on its first day of ownership to pay advisors, its board, associated salary costs, and transaction management fees. Moreover, Retail Acquisitions removed all profitable assets from BHS and placed them under its ownership and appropriated £11 million in fees and salary costs in its 13-month ownership of BHS. Retail Acquisitions assumed full responsibility for the BHS pension scheme deficit but made no payments into the scheme, and by April 2015 when BHS was wound up by HMRC the deficit stood at £345 million. The 20,000 current and former BHS employees faced an uncertain future as the pension scheme liabilities were passed to the pension protection scheme, which proposed write downs on pension payouts of up to 31% where the average across the BHS schemes was 25%. However, in May 2016, Sir Phillip Green agreed to pay £363m to insolvent BHS pension funds, and the proposal is that staff get on average 80% of full benefits. The 9,000 scheme members with pension pots of less than £18,000 will be offered cash settlements and the other 10,000 members will receive top-ups (of between 80–88% of original entitlements) in a new scheme. In the end Green decided to offer these payments because of the reputational damage associated with the inappropriate use of pension payment holidays – diverting monies to investors and owners. At the time when these payments were made, it remained lawful to sell a firm as a going concern despite The Pensions Regulator having moral hazard concerns on any proposed restructure. That is, Green knew The Pensions Regulator would discover what came out in the DWP inquiry but sought to sell out to Retail Acquisitions to legally absolve his investment vehicles of any legal responsibility. Accordingly, in this voluntary arrangement scheme, members will still lose at least 12% of their deferred income.

Conclusions

As many contributions in this volume illustrate, management buyouts are often very successful and lead to innovative sustainable businesses where owners, managers, and employees all share in financial returns. There are though cases where the very success of the take private business model and the deregulation which surrounds it has significant firm-level distributional consequences. The two cases examined here are not necessarily typical of all PE buyouts. However, each illustrates that the state acting in capital's interest has created conditions whereby both finance-led capitalism and financialization extract value from firms at labor's expense. It is within the current framework of finance-led capitalism that the instruments of PE and management buyouts operate. The cases do present worst cases scenarios of how deregulation in the UK context can lead to deteriorating employment relations settlements for labor following on from buyouts. Indeed the AA case in particular and the trade union media campaign which surrounded it led directly to a Treasury Select Committee examination into the sector. Moreover, the publicity which surround the AA buyout and the Parliamentary investigation into the sector resulted in many PE-backed owners and managers moderating their previously aggressive behavior towards labor and agreeing to work with trade unions in a process of managed change. The BHS case illustrates the diffusion of micro instruments associated with PE into non-financial firms. It also illustrates the scope of deregulation when a firm in financial distress is potentially supported by PE investors in a secondary sale. The argument demonstrates how state-facilitated finance-led capitalism enables the priorities, motives, and instruments of financialization to assert the interests of capital over labor. PE investors, in particular larger so-called mega-funds, which often launch buyouts for listed firms, became in the late twentieth and early twenty-first centuries a key instrument in finance-led capitalism actively supported by the state.

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