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How to make private equity serve the public good

BY DANIEL J. MORRISSEY, OPINION CONTRIBUTOR - 09/21/23 4:00 PM ET





Stephen Schwarzman, Chairman and CEO of The Blackstone Group attends the Burda DLD Nightcap 2010 at the Bellvedere Hotel on January 27, 2010 in Davos, Switzerland. (Photo by Alexander Hassenstein/Getty Images for Hubert Burda Media)

Private equity companies, the large funds that accumulate capital to buy and restructure companies, have come to dominate our economy.

In the typical private equity scenario, management of the companies that are bought out from their public shareholders are invited to stay and offered profitable participation in their reorganized formats — unlike the hostile takeovers of the 1970s and '80s, when supposedly underperforming management was ousted to make those firms more profitable. The private equity buyers use some of the capital they have raised for the purchase, but most of it comes from borrowed money with that debt loaded on to the newly acquired companies.

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These deals have surged over the past two decades. In 2020, there were 5,000 private equity firms in the U.S. and 18,000 private equity-backed companies. In July, the largest of these firms, Blackstone, announced it had over \$1 trillion in assets under management.

Like their hostile takeover predecessors, these friendly acquisitions are said to create value for the economy by reorganizing companies to make them more profitable, thus giving benefits to their investors. Yet some studies have questioned whether most of that gain goes to the insiders of the funds while their outside investors — such as pension funds, university endowments and wealthy family offices — get returns that aren't much better than from a more conventional ownership of a broad range of stocks.

There are at least three major concerns about private equity that raise serious questions about whether it serves the interests of ordinary investors and the common good.

The first involves a basic issue of corporate law. Do the officers of the target companies who cooperate with the sales of their firms — and benefit from them — breach fiduciary duties that they owe to their existing shareholders?

A recent example of a private equity buyout that is alleged to involve such wrongdoing is the \$8.4 billion acquisition of the Seattle-based software company Avalara by Vista Equity Partners. There, according to a complaint filed by company shareholders, two of Avalara's top officials had been touting a great future for the company, yet surprisingly they recommended Vista's buyout offer for a price that was below what Avalara's public market price. The complaint went on to allege that the low-ball deal was engineered by those company officials to benefit themselves by severance arrangements that allowed them to continue their control of Avalara at very lucrative post-close equity and compensation packages.

researched books conclude that society and ordinary individuals pay the price for that. Interestingly, their titles both use the same word — “plunder” — to describe the consequences of private equity for our country.

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One book is by a former antitrust lawyer at the Department of Justice, Brendan Ballou, titled “Plunder: Private Equity’s Plan to Pillage America.” The other, “These Are the Plunderers: How Private Equity Ruins — and Wrecks — America,” is by the former business columnist for the New York Times, Gretchen Morgenson and her coauthor, Joshua Rosner. A comment by Ballou encapsulates the theme of both books: “Private equity has reshaped the economy, by buying companies and raising prices, cutting jobs, and shifting money from ordinary businesses to themselves.”

Both books detail how the quest for higher profits by private equity firms has resulted in consumers getting poorer quality goods and services. They describe how those toxic effects have occurred in industries such as health care, consumer credit, retail and finance. Private equity has even had a harmful impact in prisons, where it has come to control not only their food service and health care, but also the phone companies that charge exorbitant rates to inmates for calling their families.

But perhaps the most distressing story is what private equity has done to nursing homes. One of Ballou’s chapters focuses on what happened when the Carlyle private equity firm, run by the politically connected billionaire David Rubenstein, bought Manor-Care, the second-largest chain of nursing homes in America. While Carlyle lushly profited by loading the company with debt and stripping away its assets, the nursing homes paid for that by

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All this has brought on what Ballou calls a “New Gilded Age” that has gone hand in hand with the growing income and wealth inequality in our country. As Timothy Noah [wrote](#) recently in the New Republic, the standard of living for middle class Americans has continued to decrease for over 40 years because their wages have deteriorated — while the share of our nation’s wealth going to the upper echelon has sky-rocketed.

This exorbitant increase in wealth and income inequality has accompanied the rise of private equity. It has made multi-billionaires out of its top officials like Rubenstein and Blackstone’s Steven Schwartzman, while workers at the companies they have acquired have been laid off and harmful cuts have been made in the services they provide.

There are several responses that our political leaders can make. One involves legislation [proposed](#) by Sen. Elizabeth Warren and others called “The Stop Wall Street Looting Act.” It includes a number of provisions requiring private equity firms to be responsible for the liabilities caused by their operations, which they often evade through questionable legal maneuvers.

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It would also end tax subsidies that encourage excessive leveraging and provisions like the carried interest loophole where the payments to fund managers are taxed not as ordinary income but at the lower capital gain rates. It also has a number of protections for workers, customers and communities that can be harmed by private equity.

Another response is to make private equity public. Several of the large private equity firms have public investors and thus must make filings with the SEC. Yet much more meaningful disclosure could be required about the environmental, social and governance impact that those firms have on the companies they acquire. The law could likewise mandate that all private equity firms make such disclosures.

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A third reform would be to require that private equity firms make a public impact statement detailing the full social and economic consequences of their actions before they undertake an acquisition. A public body like the SEC could then review it and evaluate whether the proposed change in control was in the public interest and should be allowed to go forward.

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Private equity may be making a contribution to our dynamic economy, as some of its defenders claim. Yet the concerns that its activities raise are serious, and some legal reforms are necessary to make sure it serves the common good of our society — and does not just enrich a privileged few.

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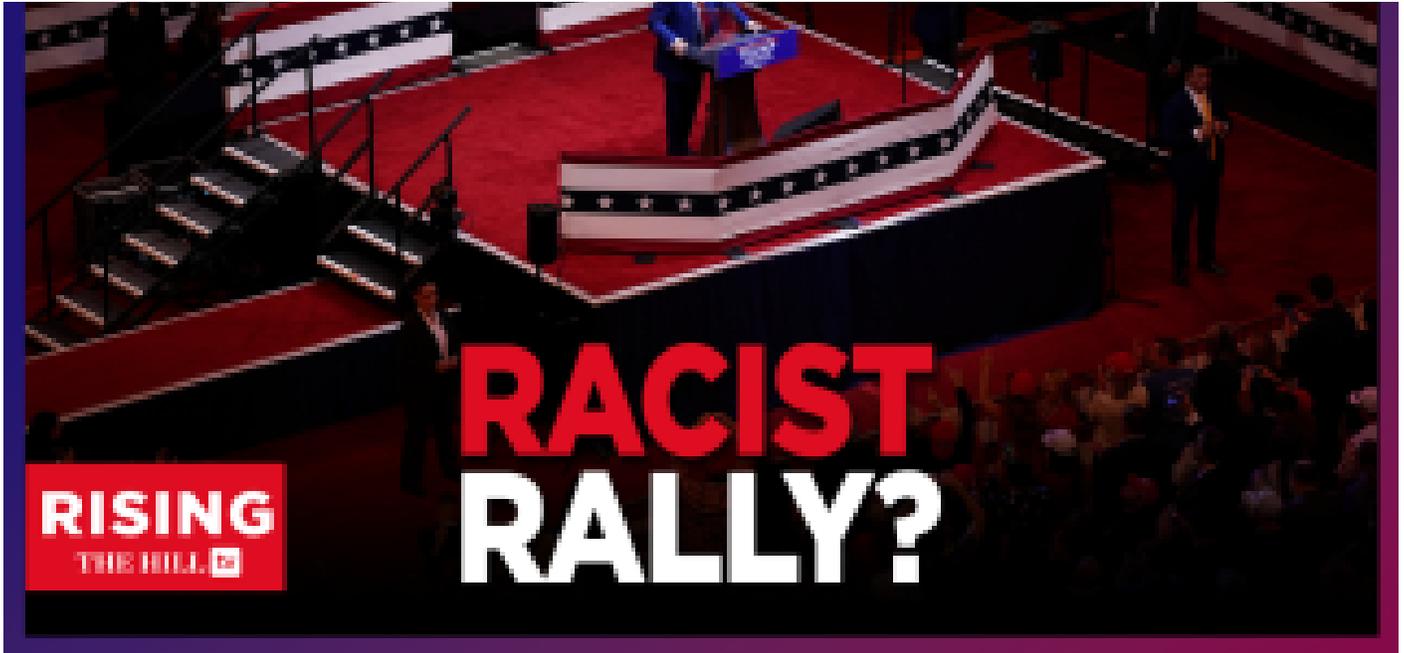
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