

INSIGHTS FROM CFA SOCIETY SINGAPORE

Book review: Rethinking private equity



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PEOPLE stop in their tracks when they see the cover of the book I'm reading – *Plunder* – with its frightening depiction of a skull and crossbones. "What are you reading? It must not be happy subject matter!"

Private equity (PE) investing is not everyday talk among friends. But considering its size and growth as an investment choice and its possible impact on the broader economy, it should be everyday conversation among investment professionals.

Author Brendan Ballou presents a meta-analysis of the worst of PE investment practices, thus compelling investors to have a deeper look into their illiquid PE commitments. He was formerly a federal prosecutor and special counsel for PE at the US Department of Justice.

Ballou presents a comprehensive study that will influence decision-makers' analytical and ethical approach to the asset class. It will shake you up. It also serves as a call to action to monitor PE's specific and repetitive activities that bene-

fit the operators and no one else.

Like me, you might have a substantially different personal history with PE investing from the author. More than 30 years ago, corporate executives and investors were seeking systematic ways to improve operating and financial efficiency. The concept of kaizen was sweeping Corporate America, even though it originated in Japan. It specifically dealt with the "continuous improvement" of a business through the elimination of waste.

Just-in-time inventory management became a buzzword in corporate earnings calls. This sort of tough medicine was the cure for what ailed US business.

Consider the plundering by such "pirates" as "Chainsaw Al" – Albert Dunlap, infamous corporate raider and author of *Mean Business: How I Save Bad Companies and Make Good Companies Great*. We read of him almost every day when he was active in his business dealings, which seemed so mean to existing employees, suppliers, and customers. Still, it was widely thought that such practices were needed.

The present reality and possible future of PE investing in the US are Ballou's focus. He presents industry-specific examples of PE at its worst, prompting readers to evaluate their own experiences with it, both personal and professional.

As he delves into the heavily affected industries – specifically housing, nursing homes, prisons, retailers, for-profit education, and healthcare – the persistent tools of the trade of typical PE operations emerge: leasebacks, dividend recapitalisations, strategic bankruptcies, tax avoidance, roll-ups, and murky corporate structures.

Yet, Ballou also acknowledges the possible benefits of PE investments, such as providing access to funding (or access at a lower cost), expert management by industry specialists, efficient global sourcing, operational and financial improvements, and even improved corporate and employee relations.

Customers may benefit from greater consistency in product, faster access, and better pricing. PE firms can potentially profit from economies of scale and profession-

al management at all levels; but in the cases presented in *Plunder*, their way of doing business results in disastrous conditions for employees and clients and the death of once-viable, cash-rich companies.

The carried interest loophole is probably PE's most prized tax benefit – it affects a substantial portion of the money made in the business. The typical fee of 2 per cent of assets under management is taxed as ordinary income, while the PE firm's 20 per cent share of profits earned above a specified threshold is taxed at the lower capital gains tax rate.

Talk of ending this tax advantage has been floating around the US Congress for at least 20 years. Notwithstanding Dodd-Frank regulations and the 2019 attempted passage of the "Stop Wall Street Looting Act", the plunder continues.

The author notes that PE is a potent force in congressional matters; these firms have donated more than US\$896 million on a bipartisan basis to candidates and members since 1990. Additionally, PE could pose systemic risk to the economy, particularly because of its expansion into insurance, retirement funds, and private credit.

The author's wish list of solutions to PE abuses seems like a litany of impossible dreams to me, especially considering talk among some in Congress of achieving per-

PLUNDER

Private Equity's Plan
to Pillage America



BRENDAN BALLOU

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manent spending cuts by reducing or eliminating certain departments that oversee business.

Nevertheless, to constrain PE firms' abuses in specific industries and prevent the worst excesses, substantive actions could be taken through the Department of Justice, Department of Health and Human Services, the Securities and Exchange Commission, and most notably, the Internal Revenue Service and the Treasury Department.

Some of Ballou's suggested solutions are more realistic and prac-

tical than others. I commend the author for releasing this exceptionally well-researched exposé of the industry. His extensive notes expand the book's content and impact.

Plunder has made me question the merits of PE, an asset class I originally considered to have a high level of investment integrity and a positive influence on corporate governance.

The writer is a former senior portfolio manager with PNC Wealth