Abstract: This paper develops a firm-level analysis of how the quality of employment relations following acquisition by private equity firms [PEFs] is contingent upon the strategic intent of those firms and the post-acquisition organizational choices they make. The efficiency gains that PEFs seek in acquired companies are expected to encourage restructuring towards a minimalist organization. However, the form such organization takes is seen to depend on whether PEF strategy is oriented primarily towards extracting short term value from acquired assets rather than towards renewing and developing those assets. An extraction strategy seeks increased value from the existing assets of the acquired firm, including its employees. A renewal strategy releases the acquired company from previous constraints on making investments, especially in innovation. Contrasts in the process of restructuring and in organizational form associated with these two strategies will have different implications for the quality of employment relations, as assessed by the trust and commitment that employees have vis-à-vis management. The way in which PEFs restructure the companies or units they acquire is the key intervening factor between the strategic intent of PEFs and impact they have on the quality of employment relations. It is argued that future research should therefore give more attention to the organizational consequences of PEF acquisitions.

Introduction
Private Equity Firms [PEFs] have been active in corporate acquisition and transformation since the 1960s. However, the rapid growth of the private equity industry in more recent years has drawn the attention of scholars and the business media to its economic, organizational and social impacts. The publication in 1990 of Barbarians at the Gate, a case study of the takeover of RJR Nabisco by the private equity firm KKR (Burrough and Helyar 1990), stimulated considerable speculation about the organizational consequences of PEF acquisitions although it provided little information on them. Trade union claims that private equity [PE] acquisitions lead to job losses have also intensified academic interest in their impact on the level and quality of employment.

Debate about the employment consequences of private equity acquisition continues and empirical studies have produced varying results (Cumming, Siegel and Wright 2007). On the one hand, it has been argued that pressures for PEFs to deliver high short-term returns to their investors encourage them to reduce employment and to treat employees exploitatively in the companies they acquire (Froud and Williams 2007). It has been suggested that because of their excessive preoccupation with value extraction, PEFs tend to neglect other stakeholders in favour of the principals (Froud and Williams 2007; Cheffins and Armour 2007). Similarly, comparative studies of corporate governance have argued that the shareholder-oriented style and mode of governance characterizing PEFs tend to reduce employment and affect employment relations adversely (Almond, Edwards and Clark 2003; Lane 2003). On the other hand, there is also evidence that PEFs often improve performance in acquired companies, and provide the basis for a growth in employment through correcting shortfalls in innovation, improving human resource practices, and undertaking new investment (Bruining, Boselie, Wright and Bacon 2005). Surveys in Europe and the United States have found that employment levels tend to follow a ‘J-curve’ pattern of initial losses followed by later and usually larger gains (Davis, Haltiwanger, Jarmin, Lerner and Miranda 2008; EVCA/CMBO 2008; Shapiro and Pham 2008). The EVCA/CMBO research also indicated that private equity acquisitions tend to improve employee earnings, to increase the use of high commitment employment practices, and to increase employee commitment. Research into the effects of PEF acquisitions on the quality of employment relations has mostly been conducted at a
macro level through broad surveys such as these. However, surveys have a limited ability to investigate qualitative issues in depth. This, combined with a scarcity of cases reporting in any detail on the kind of restructuring that takes place in individual companies after they are acquired by PEFs (e.g. Bruining et al. 2005) means that we have limited knowledge of the processes whereby PEF acquisitions affect the quality of employment relations.

Given our limited knowledge at the micro level, we argue in this paper that it could be misleading to ascribe just one strategic intention to PEF acquisitions, and to expect only one kind of effect on the quality of employment relations. Moreover, different kinds of organizational restructuring could well intervene in this process. We therefore develop a firm-level analysis suggesting that the quality of employment relations is contingent upon the strategic intent of PEFs and the post-acquisition organizational choices they make. The first step in our argument is that PEFs acquisitions differ in their strategic intent and orientation. The next step maintains that, while PEF acquisitions tend to be followed by restructuring towards a minimalist organization, the way this is conducted and applied will vary according to the strategic intent of the PEF. The final step is to suggest that this variation will have different implications for the quality of employment relations, as assessed by the trust and commitment that employees have vis-à-vis management. The paper offers a framework and propositions in the hope that these will stimulate closer investigation of the firm-level processes through which private equity impacts on the quality of employment relations.

The argument

Strategic intent

Froud and Williams (2007) suggest that private equity firms’ strategy involves choices that tend to favour some stakeholders in particular, namely financial institutions, other large investors, and top management. This alignment of interests gives rise to a strategy that combines high leverage, management ownership and strict control. Kaplan and Strömberg (2008) indicate that when the deal involves taking a listed company from the stock market, the dealer pays a premium between 15 to 50 percent over the stock price. However, the PEF is compensated in various other ways, through an annual fee, a share of profits and monitoring fees. The interest of both the firm and associated funds are aligned by the PEF injection of capital into the deal and through returns to investors, while managers may be granted enhanced ownership rights. Thus, when a company is acquired by a PEF, the strategies that follow the acquisition aim to generate enough value to these three key players in particular.

Some authors have argued that such strategies help PEFs to extract value from other stakeholders in favour of owners (Froud and Williams 2007). While as private companies PEFs acquisitions do not strictly-speaking have shareholders, they may nonetheless adopt a shareholder value concept of the firm because of their emphasis on maximization of value and profitability as an ideal. Fiss and Zajac (2004) have broadly defined shareholder value as a set of normative beliefs about power allocation, while others defined it as a rhetoric which maintains that shareholders/owners interests should unequivocally be considered as the primary and sole objective of firms (Fligstein and Shin 2005). Stern and Chew (1997) depict shareholder value as a quasi-religious fundamentalism, in which finance is the motivation and main focus of action. Likewise, Fligstein and Shin (2005) suggest that the shareholder value concept of the firm is an ideology which tries to convince investors that profitability can be improved through the adoption of appropriate policies. It maintains that managers need to meet the expectations of financial institutions and capital markets, with the share price representing the most appropriate parameter to evaluate company performance (Williams 2000; Schnepener and Guíllen 2002).
‘Value management’ is not simply a strategy; it is a mindset that unifies decisions at all levels of the organization with a culture that is shaped to create value to the shareholder. As Knights and Tinker (1997:103) comment, ‘the entire organization must be aligned around value management’. This often involves restructuring the firm and redefining relationships with employees. In that sense, the shareholder value principle involves a set of ideas about how firms should be organized and managed and therefore, serves to justify certain management policies and practices (Benson 1977). While shareholder value cannot be assumed to account for all the strategic intentions of a PEF, as a theory of ownership it is likely to inform its strategic choices.

The belief that the firms should exist to serve the interests of owners is the element that provides meaning to private equity acquisitions and accounts for how they deal with agency problems. One way in which a PEF is able to create exceptional value to owners is to gain the commitment of managers by offering them a stake in ownership or high rewards contingent on their serving owners’ interests. Another way to align managerial actions and owner goals is to bring in new management which will generally find it easier to undertake restructuring than will an incumbent management. Change of ownership provides an opportunity for the incoming management to re-arrange the acquired firm’s structure so that it yields maximum rents for key shareholders (Blair 1996; Shleifer and Summers 1988). This is achieved through restructuring the firm into slimmed-down ‘minimalist’ organization, which may also provide the means to redefine relationships with employees.

However, PEFs should not be considered as one of a kind. The kind of contract investors make with PEFs is relevant to their post-acquisition policies. In deals supported by mutual funds investors can withdraw their funds as they please, which may lead to them prioritizing short-term returns. This contrasts with closed-end deals in which investors cannot withdraw the funds until a given deadline. Moreover, the level of leverage may also be relevant. PEFs with greater leverage can be expected to look to reducing their risk exposure through securing short-term returns rather than investing in the development of new skills and new technology (Lei and Hitt 1995). These factors may lead to distinctive strategic orientations among PEFs and variations in the way they deal with risks, with closed-ended and less leveraged arrangements permitting a longer-term post-acquisition strategy (Kaplan and Strömberg 2008). This suggests that private equity firms differ in the time horizons they apply to the enhancement of owner value. Strömberg (2007) argues that acquisitions in which PEFs support MBIs tend to be more short-term oriented than other types of acquisitions, while acquisitions in which previous management is maintained tend to have a longer duration. The difference in time horizon is in turn likely to be reflected in the strategy adopted for realizing that value. When PEFs adopt a short time horizon, they are likely to seek quick gains from their acquired companies derived from a combination of increased productivity and the disposal of poorly performing and/or non-core units. When they apply a longer time horizon, they are likely to seek to renew and develop the resources of acquired companies so as to create new profitable opportunities through innovation.

The distinction being made here is between a policy of asset extraction and one of asset renewal. Asset extraction refers to the extraction of increased value from the existing assets of an acquired firm, including its employees, through paring down costs and intensifying the use of the assets. It may also involve the sale of non-core assets. By contrast, asset renewal refers to a policy in which private equity investment releases incumbent managers from previous constraints on making investments and/or enable them to bring in expertise and professional
advice to support improvements (Munari, Cressy and Malipiero 2007). Bruining et al. (2005:346) similarly distinguish between ‘a cost reduction and an investment perspective’ in management buy-outs. The two strategic options of extraction and renewal reflect Porter’s (1980) well-known distinction between a cost-leadership and a differentiation strategy. There is also some parallel between them and the distinction March (1991) made between exploitation and exploration with reference to knowledge assets. The exploitation of given assets and knowledge is efficiency-oriented and requires adaptation rather than innovation. By contrast, the exploration of new possibilities requires investment in training and innovation. It entails greater short-term risk, with the prospect of superior long-term gain. These considerations lead to:

**Proposition 1:** PEFs with closed-ended investor deals or higher leverage will adopt a short-term strategic intent toward their acquisitions oriented towards extraction, while PEFs with open-ended investor deals or lower leverage will adopt a long-term strategic intent oriented towards renewal.

**The minimalist organization**

The change of ownership and focusing of priorities that follow acquisition by a PEF could drive the implementation of either strategy. As we shall note, both strategies are likely to give rise to structuring into a slimmed down ‘minimalist organization’. The term minimalist organization has been employed in different ways within the organizational literature. A common interpretation portrays it as the antithesis of the bureaucratic form because it economizes on supervisory compliance roles and hierarchy (Aldrich et al. 1990; Halliday, Powell and Granfors 1987; Seabright and Delacroix 1996). Our general contention is:

**Proposition 2:** In view of their intent to enhance owner value, PEFs will restructure the companies or units they acquire into minimalist organizations.

Minimalist organizational structures can provide economic gains along two broadly alternative paths. Extraction and renewal strategies are likely to follow these alternative paths which have very different characteristics and implications for the quality of employment relations. The first is by substituting stringent performance-related output controls for managerial supervision; this economizes on management and also focuses effort. The second is to encourage employees to enlarge their roles and to take on greater initiative and responsibility. The contrast here echoes that between McGregor’s Theory X and Theory Y (McGregor 1960). The first approach aims at exploiting the given assets of employees to extract quantitative productivity gains. The second approach aims at renewing those assets through encouraging employees to contribute developmental and innovation gains.

Another feature associated with the minimalist organization is a reduction in organizational size. The extraction approach tends to view reductions in employment and the rationalization of equipment and sites as the route to productivity gains that can usually be realized quite quickly. The renewal approach is more likely to regard reductions in organizational size as an opportunity to focus investment onto key personnel and other assets within a smaller organization that fosters innovation by reducing the incidence of bureaucracy.

In both cases, a more compact organization is often achieved today by externalizing some activities and the units performing them. The increase in outsourcing during the past two decades is a prime manifestation of this approach (Espino-Rodriguez and Padron-Robaina 2006). A move in the same direction is for firms to operate a dual labour market,
distinguishing between core and peripheral employment such that people in the latter category do not enjoy the same benefits, security and continuity of employment as those in the former category (Loveridge and Mok 1979). This led Handy (1989) to suggest that the minimalist form is like an ‘inverted doughnut’, in which a firm combines a fixed strong core with an outer ring of more flexible activities and employment arrangements. The various interpretations given to the minimalist organization concept therefore have in common the slimming down of organizational structures and employment. They differ, however, in whether the primary aim of this process is one of extraction or renewal. If the former, the intention is to secure greater efficiency and control. If the latter, the intention is to move toward a more organic organizational system that is supportive of development and innovation (Burns and Stalker 1961). Many commentators have associated PEFs with the former approach, as we now indicate.

The minimalist organization for extraction

It has been argued that the minimalist structure emerging from LBOs tends to be driven by an emphasis on a shareholder value culture at the expense of other stakeholders, and that it attaches priority to achieving financial targets (Jurgens, Naumann, and Rupp 2000). Because this type of minimalist organization has to operate under a high debt-to-equity ratio, and also normally reflects a ‘clear view to exit’ strategy, such organization is subject to an enormous pressure to achieve results quickly. In many instances, the managers of acquired firms are subject to constant pressure from their external PEF owners, who in many cases not only appoint managers but also bring in trusted professionals to monitor them (Thornton, E. 2007). Börsch (2004) suggests that a shareholder value management implies a concentration on core markets, sanctioning, selling or shutting down under-performing business units, and introducing stock options for management and performance-related rewards for employees. Some accounts of private equity management suggest that it shows little tolerance for unprofitable business or for activities outside core competencies. It also seeks to eliminate ‘organizational fat’ through a reduction in managerial positions (Morin 2000; Rogers, Holland and Haas 2002). This approach relies on centralized top-down pressures for improvement.

The pursuit of short-term financial return can lead to the minimalization of organization through the elimination of entire departments and units. In addition to the shock and distress experienced by those who lose their jobs, there may be major negative consequences for those who stay. Employees may lose their current status and/or allocated to other geographically distant units. People can be dislocated from their previous roles through downsizing or outsourcing, and employees are normally required to take on the load of those who left (Boyer 2000). The intensification of work is a common means of extracting greater productivity from employees as well as physical assets. Employees may also suffer a collapse in morale through a sense of anger or guilt at the way their former colleagues were treated. They experience the so-called ‘survivor syndrome’ (Littler 2000). Informing such practices is a belief that smaller firms yield better rates of return and that under the whip hand of finance, people in the company will work harder and faster (Froud et al. 2000). Given the orientation of this approach toward short-term cost reduction, there is unlikely to be an significant investment in upgrading employee skills or allowance for the organizational slack that is necessary to stimulate innovation.

As an illustration, the acquisition of a Brazilian state owned telecommunications enterprise by a private equity consortium was followed by a massive and sudden reduction in the number of departments and employees (Authors 2008a). This reflected a strategy of re-focusing the company onto its core business and outsourcing other activities through creating new
companies, especially to run call centres. The employees who survived the downsizing had to work longer hours and to take on the responsibilities of colleagues who were made redundant. The whole process had a highly negative effect on employee morale. Its manifestations included an expectation of being the next in the list for downsizing or work intensification, and the need to respond to tougher targets and monitoring. These changes created unbearable stress for some employees. Others have documented similar negative effects that downsizing can have both on employee morale and company performance, especially if it is introduced suddenly and brutally in a ‘non-responsible’ manner (e.g. Cascio 2002). The insecurity preceding and following downsizings tends to foster a climate of distrust between management and employees (Cameron 1994; Feldheim and Liou 1999).

Similar consequences have been described in the media following the acquisition by PEFs of Debenhams, AA, and others such as Freescale in the USA. In addition to cutting costs after its acquisition by a private equity consortium in 2003, Debenhams adopted a strategy that involved reducing prices, cutting the cost of inventories by a successive marking down of slow-to-sell goods, and renegotiating payments to suppliers. It also increased the workload of management and staff, since it reduced its workforce by 1,000 at the same time as the company opened new stores and lengthened opening hours. There were other signs of a minimalist approach to the management of the store. Some analysts noted out that some shops became poorly maintained. Others pointed out that the poor conditions of the shops and a lax attitude towards the distinctive characteristic of the shop could threaten the company image and brand that began to look like a bazaar rather than an emporium (Rigby, 2007).

Following the acquisition of the AA by Permira, it was reported that some 3,000 jobs were lost. Patrols after midnight and training were the first to be cut. Media reports have suggested that workers at the AA have had to shoulder a greater workload with negative consequences for the quality of services and work organization. Wachman (2007:1), for example, reported that ‘cut backs and efficiencies at call centres have prompted a welter of complaints, with the GMB reporting that toilet trips and meal breaks by the staff are now timed as part of performance-related deals’. However, employment at the AA subsequently rose by 7 percent in the year to March 2008 (The Times 2008). This may be an example of the so-called ‘J curve’ by which employment is cut initially following by renewed growth after four to five years (WEF 2008).

A move towards a minimalist organization that is motivated primarily by short-term extraction is likely to display a distorted shape, characterized by a fat head on a thin body (Froud et al. 2000). This results from several factors. One is the close monitoring of performance that is introduced, stimulated by the high cost of leverage in financing acquisitions. Another is the high cost of securing managerial cooperation through offering attractive compensation packages. Surveys indicate that executive salaries in PEF acquisitions have grown disproportionately in comparison with those of employees. Moreover, the general partners of PE funds also tend to take a large slice of the return from companies who have been subject to acquisition by private equity. A number of PEFs include consulting in the purchase contract, so creating opportunities for charging extra fees from the acquired company (Robinson 2007). In this way, the externalization of control is a means to extract extra value from the acquired company.

Taken together, these considerations suggest:

Proposition 3: When PEFs adopt an extractive intent towards their acquisitions, the form of minimalist organization they introduce will be characterized by ‘non-responsible’
restructuring, top-down pressures for results, intensification of work, little investment in employee skills, low organizational slack and reduced security of employment.

The minimalist organization for renewal
A minimalist organization adopted for purposes of enhancing owner value through the leveraging of possibilities for renewal is likely to assume a substantially different form to a minimalist organization adopted to enhance owner value through extraction. In both cases there may be an element of de-bureaucratization and an externalization of non-core activities resulting in the slimming down of the organization. However, rather than pressurising employees to increase productivity, a renewal intent requires a very different organizational environment in which creativity and innovation can flourish.

The characteristics of an organization conducive to renewal through innovation contrast markedly to those associated with extraction (Damanpour 1991; Foss 1993; Arundel, Lorenz, Lundvall and Valeyre 2007; O’Reilly and Tushman 2004; Zoghi, Mohr and Meyer 2007). It is likely to be decentralized, with leadership taking the form of guidance and support rather than downward pressure. Employees are encouraged to take initiatives and offer suggestions. Information exchange both within the organization and with external parties is open, and a creative synthesis between the contributions of specialized employees is facilitated by integration mechanisms such as cross-functional teams. Incremental innovation in particular is also fostered by a willingness on the part of employees to share their tacit knowledge (Nonaka and Takeuchi 1995). A renewal strategy pursued through such provisions is also likely to benefit from a degree of organizational slack in terms of the additional time that is required and the additional cost of integrating overlays to the organization’s structure such as teams. It is an approach that clearly contrasts with an emphasis oriented purely toward efficiency and cost-reduction.

The analysis of survey findings on work organization and innovation mode in 14 European Union countries conducted by Arundel et al (2007) provides indirect, but suggestive, indications of contrasts in the forms of work organization adopted by non-innovating and innovating firms. Their data indicate that firms not conducting in-house innovation, or not innovating at all, tend to adopt a Taylorist or ‘lean’ form of work organization. This configuration is consistent with the extractive approach. By contrast, firms that have creative in-house innovation activities or innovate by modifying existing technology appear more likely to adopt a ‘discretionary learning’ form of work organization. This form ‘is distinctive for the way that high levels of autonomy in work are combined with high levels of learning, problem solving and task complexity’ (Arundel et al 2007: 1183). It is consistent with the renewal approach. On the whole, these associations were evident both in manufacturing and services. They lend credibility to our argument that different PEF strategic intentions are likely to result in contrasting forms of organization.

The kind of minimalist organization consistent with a renewal intent is that associated with so-called ‘new form’ organization (Pettigrew and Fenton 2000; Child 2005). In common with the extraction-oriented minimalist organization, this model aims to reduce hierarchy, to concentrate on key value-adding activities and to focus on performance. However, the intention behind reducing organization to a minimum is a different one. It is to use the opportunities provided by a smaller organization to reduce the bureaucratic constraints and dead-hand of hierarchy that risk alienating high quality employees and their loss to competitors. Moreover, if the smaller organization can be made more organic by reducing internal barriers, this should also facilitate the development of a strong organizational culture.
that provides common values and norms to substitute self-motivation for managerial pressures and external controls. The renewal mode of minimal organization aims to upgrade work, permit the creative exercise of discretion, and to incorporate knowledge workers into the firm as an organic community. Firms adopting this model tend to attach very high value to the quality of their employment relations, at least so far as core employees are concerned.

Insofar as smaller organizations tend to be more innovative (Nooteboom 2000), a move toward a minimalist organization can have positive consequences for renewal. However, the achievement of these positive consequences is likely to depend on how post-acquisition change is managed. A policy of ‘responsible restructuring’ (Cascio 2002) is more likely to secure the employee commitment on which renewal depends. Under responsible restructuring, change is introduced in a relatively non-threatening way, with careful planning, use of selective downsizing, involvement of employees in the process, open and honest communication, help for people who leave, and re-training and other support for the employees who stay.

KPS Capital Partners provides an example of this approach to post-acquisition change. It is a PEF which aims to foster constructive partnerships with trade unions in the turnaround of companies that are in bankruptcy, in default of banking covenants or struggling with oversized debt and losses. Rather than stripping acquired companies for cash, KPS tries to work with unions on agreed measures to grow the companies out of trouble. These usually include cost-cutting but also involve plans for renewal (Arnold 2009).

Bruining et al. (2005) describe two management buyouts largely funded by PEFs – Unipart and Boekhoven-Bosch – in which a long-term renewal policy was adopted. In both cases the new companies adopted responsible restructuring either through retraining displaced workers or through not filling vacancies. In neither company were there any forced redundancies. Both invested in the enhancement of employee skills and encouraged an employee contribution to improvements through adopting a Japanese approach to incremental innovation in Unipart and through encouraging decentralised initiatives in Boekhoven-Bosch.

Although it is not PEF-funded, Cisco Systems also serves to illustrate how a firm can expand through acquisition in a way that enhances its innovation and renewal capabilities. Cisco adopts a responsible restructuring approach by planning the integration of its acquisitions with great care because it recognizes that it is primarily acquiring human capital as a resource not only for product diversification but also for innovation. It is therefore particularly concerned to ‘keep those people whole’ – in other words not just to retain the employment of knowledge workers in the acquired companies but also their enthusiasm and commitment. A routine feature of Cisco’s acquisition procedure is to ensure that the core product development teams in the acquired firm suffer minimal disruption and to guarantee the job security of acquired employees for at least one year. In this way, it is not only leveraging existing product development assets but also extending its capacity to explore new avenues for the future (Ranft and Lord 2000).

These considerations suggest:

Proposition 4: When PEFs adopt a renewal intent towards their acquisitions, the form of minimalist organization they introduce will be characterized by responsible restructuring, enhanced employee discretion, upgrading of skills, organizational slack, and relatively high security of employment.
The breach of trust and quality of employment relations

We have already intimated that the two forms of minimalist organization just discussed, and their underlying philosophies, are likely to result in qualitatively very different sets of employment relations. The extraction model runs the risk of becoming self-defeating by damaging employee commitment and losing key staff. The renewal model may to a greater extent be able to avoid these negative consequences. Such consequences are provoked essentially by a breach of trust in employment relations. The extraction model of minimal organization is likely to generate a perception of conflict and a sense of mistrust between management and employees. Insofar as this model involves an intensification of work and moves towards low-discretion work roles, it accords with a fundamentally low trust syndrome (Fox 1974). By contrast, the renewal model depends on a willingness by employees to cooperate with managerial goals. The preservation of employees’ trust in managements is an essential condition for the renewal approach to work, and this in turn implies that they have to receive an assurance best endeavours to maintain employment security or at least of fair terms in the event of severance.

The breach of trust in employment relations through private equity acquisition has received attention from two different perspectives, corporate governance and psychology. From a corporate governance perspective, Shleifer and Summers (1988) advanced an explanation for how a change of ownership created the conditions for the breach of trust. According to this theory, much of what is defined in an employment contract in terms of the obligations between employer and employee remains implicit. It becomes too costly, even impossible, to detail each circumstance in which a breach of these commitments might occur. An example is when employees invest in specific training and learning which applies only to their jobs or to the particular firm. In return for that commitment, employees expect that managements will offer security of employment and pensions (Blair 1995).

The breach of trust that may result from this kind of operation may be more or less serious depending on the kind of financial engineering that is undertaken. With a MBO usually there is no change of the management team, and consequences for employment are less harsh. In the case of a MBI the incoming management is likely to feel that it does not have any ‘moral’ obligation to maintain the implicit contracts made by previous managers. Such circumstances can give rise to a breach of trust between employers and employees (Authors 2004, Blair 1995, 1996, Deakin and Konzelmann 2003, Shleifer and Summers 1988). The transfer of wealth from employees to owners arising from the loss of employment can be substantial. There are indications that in the USA employees who are forced to find new jobs often lose between 15 and 20 percent in wages plus the value of benefits that they cannot take with them (Osterman, 1999).

The psychological perspective indicates that restructuring and downsizing are often accompanied by breaches in the ‘psychological contract’ (Robinson 1996). The idea of a psychological contract was first introduced by Argyris (1960), and later developed by Rousseau (1989) with reference to organizational members’ perceptions of mutual obligations in an employment relationship. Schein (1965:11) suggests that the psychological contract refers to perceptions of ‘the whole pattern of rights, privileges and obligations between the worker and the organization’. A breach of the psychological contract may be perceived to amount to a breach of trust if employees perceive that management fails to fulfil their promises and obligations. The perception of breach of trust is subjective and may or may not reflect the actual terms of the contract (Rousseau 1989; Roehling 1997).
One serious consequence of a breach of trust can be the loss of staff who embody valuable experience and tacit knowledge and who are therefore key resources for post-acquisition renewal. In the Brazilian telecommunications company previously mentioned, numbers employed were reduced from around 47,000 to 8,000. Restructuring was primarily focused on a radical reduction of costs. There was little concern for keeping those employees who held tacit knowledge, and as a result of its strategy of mass dismissals the company lost several of its key engineers (Authors 2008a). The loss of employees with key knowledge is likely to be a concern with many acquisitions (Ranft 2006), but particularly for those conducted by PEFs because of the sharp change in employment conditions that often occurs. In the case of Debenhams, for example, senior staff started to defect. One former Debenhams executive said that the atmosphere had changed: ‘Their attitude was like 'you lot at Debs, it wasn't like the incumbents were part of the team'.’ Andrea Warden, who ran the home division, left for Heal's; Stephanie Chen, head of design, quit for BHS, and Steve Lawton became head of menswear at BHS. Then in 2005, Paul Marchant, Debenhams' divisional trading director, joined New Look (Rigby 2007).

These considerations lead to:

**Proposition 5.** Restructuring on the basis of the extraction approach will lead to a breach of trust and deterioration in the quality of employment relations.

If a private equity acquirer intends to secure a good return on its investment through renewal - enhancing the assets of the acquired company, preserving its human capital and promoting that company’s capability for innovation - it cannot afford to breach the trust of the people it takes on. While a breach of trust can reduce the effectiveness of an extraction strategy, it is unlikely wholly to undermine that strategy because it relies on the carrot and stick rather than on commitment and loyalty. By contrast, a breach of the trust in their employer held by the knowledge workers and other key employees on whom the implementation of a renewal strategy depends could be fatal to that strategy. Indeed, given their high marketability, it is likely to induce many of them to leave.

By contrast, the combination of responsible restructuring with high commitment employment policies associated with a renewal strategy is also is the post-acquisition policy most likely to retain the trust of employees even when employment is reduced. There is wide agreement that trust in business and employment relations depends on a shared belief that the parties concerned have mutual goodwill and the competence to deliver on their promises (Nooteboom 2002; Sako 1998). Post-acquisition practices that provide job security, allow for participation, invest in employee training and skill-development, and offer favourable rewards stand a good chance of being interpreted as goodwill on the part of the new employer. Moreover, investment in such provisions and in innovation is also likely to be interpreted as the new management looking to the future and displaying strategic competence.

This gives rise to:

**Proposition 6:** Restructuring on the basis of the renewal approach will avoid a breach of trust and deterioration in the quality of employment relations.

**Discussion**

The argument we have advanced makes two fundamental points which deserve to be given greater emphasis in future work on private equity and employment. First, PEFs should not be seen as one of a kind with respect to their strategic priorities. While there is likely to be a range of such priorities, we have for purposes of analysis drawn a contrast between two ideal...
types focusing respectively on short-term extraction and longer-term renewal. Each of these strategies is seen to have different consequences for the quality of employment relations in PEF-acquired companies and units. The second point is that these differential consequences for employment relations arise from the contrasting forms of organization adopted in the light of the two strategies and the impact these forms are likely to have on employees’ trust in, and commitment to, management.

Figure 1 depicts the two alternative processes we have discussed and the steps they contain linking PEF strategy to employment relations outcomes. The key intervening factor is seen to be the way in which the PEFs restructure the companies or units they acquire. Both paths involve moves towards a minimalist organization, but there are differences in how they achieve the change and in the character of the organization that emerges. The first path is likely to achieve cost reduction through productivity gains. The second path may also secure cost reductions but will also create conditions conducive to a renewal of the acquired organization through innovation.

The first path, guided by an extraction policy, moves towards a minimalist organization though job loss and, in many instances, outsourcing. It emphasizes cost reduction and seeks to achieve this through the intensification of work and the use of targets, rules and other methods that reduce employee discretion. Deployment of resources is tightly contained and allows little flexibility for reacting to new opportunities.

The alternative path also proceeds towards a slimmer organization, but the strategic intent behind it is to steer the acquired company towards renewal and development. It achieves this change through responsible restructuring, while at the same time investing in key resources, accepting the organizational slack required for innovation, and pursuing a high commitment approach that offers security and discretion to employees. This path is more likely to create a favourable organizational context for the development of new products and services through knowledge seeking and investment in R&D. Through enlisting the cooperation of employees it is likely to improve the organization’s capacity to absorb and utilize new knowledge. This path contrasts with the first route in which the mode of downsizing is likely to give rise to an insecure and de-motivated workforce.

The two approaches are seen to impact on the quality of employment relations primarily through their effects on the trust employees have in management. The extraction approach is highly likely to breach employee trust, resulting in low morale and commitment to the new management. The quality of employment will suffer accordingly. This approach is therefore likely to result in a reduction of the acquired unit’s capabilities with a loss of employees’ tacit knowledge (or a reluctance to share it with management), little or no innovation, and damage to the PEF’s corporate image. By contrast, the renewal approach has a good chance of maintaining employee trust in management, resulting in good morale and a sustained level of commitment. This approach is likely to result in an enhancement of the acquired unit’s capabilities with retention of employees’ tacit knowledge and a willingness to share it with management, innovation, and a strengthening of the PEF’s corporate image.
The basis for making these predictions lies in the role of organizational restructuring as a mediating factor. The way in which re-organization takes place is key to preserving tacit knowledge and employee morale. A short-term approach geared to producing high immediate returns may be conducive to a ruthless downsizing with little concern for preserving employees’ tacit knowledge. Such an approach could destroy implicit assets of literally immeasurable value for the longer-term competitiveness of the firm. Moreover, a major source of potential value for the acquiring firm is likely to be access to the technical and social capital that resides in the executives and personnel of the acquired company (Child, Faulkner and Pitkethly 2001, Deiser 1994). One weakness in the extraction approach, especially in the form of management buy-ins, is that it can displace incumbent executives who may possess strategic knowledge. The intensification of pressures for short-term results may also of itself lead key staff to resign. A renewal approach, by contrast, aims to preserve and renew the stock of tacit knowledge through a policy of responsible restructuring.

The two paths are likely to apply respectively to MBIs and MBOs because of the kind of governance and strategic intentions associated with each of these operations. MBI acquisitions are likely to follow the extraction route with its consequences for employment relations. Not only do those deals carry greater risks because they bring in new management who are not fully acquainted with the business, but new managers are also unlikely to feel obliged to maintain the terms of employees’ previous contracts and may therefore incur a breach of trust (Blair 1996). MBIs may require greater supervision from PEFs with management becoming more centralized and oriented towards achieving targets imposed externally. Hedge funds are also likely to choose the extraction route because of their strategy to exit after having extracted the highest value in a short time.

By identifying the possibility of different strategic intents among PEFs and different modes of restructuring, our analysis points the way towards a contingency perspective on the subject. The first step towards a contingency analysis lies in the contrasts we have encapsulated in our analysis which, if valid, raise the question of contingent explanatory variables. We have identified several factors as relevant contingencies. One concerns the nature of the PEF, particularly whether it has a short or long-term orientation and its associated attitudes towards risk. We have argued that PEFs dependent on short-term funding are more likely to pursue an extraction strategy. A further contingency is whether managerial control remains with the acquired company, as with MBOs, rather than becoming externalised as with many MBIs. We have suggested that MBIs are more likely to adopt an extraction approach to restructuring resulting in a breach of trust with employees. Third, a PEF that focuses its activities within a given sector may be more inclined to pursue a renewal strategy insofar as it has the prospect of achieving synergies among the companies and units it acquires. Moreover, within the two paths we have identified, earlier stages set the conditions, and therefore act as contingencies, for their effects. Thus strategic intent establishes the conditions for organizational restructuring, which in turn impacts on the quality of employment relations.

To conclude, this paper has contributed an analysis of the process whereby PEF strategies have consequences for the quality of employment relations in acquired companies. It has argued that more attention should be given to the organizational consequences of PEF buyouts and that it would be appropriate to develop a contingency perspective on the factors that help shape PEF strategies and which stimulate their different approaches to restructuring. It is hoped that the analysis and attendant propositions we have offered will encourage systematic empirical testing, which will progress our understanding by identifying exceptions and suggesting refinements.
Notes
1. We follow the World Economic Forum (2008) in defining private equity transactions as ‘equity investments by professionally managed partnerships that involve leveraged buyouts or other equity investments with a substantial amount of associated indebtedness’ (WEF 2008: vii). These investments include financing the acquisition or management buyouts of public companies as well as the acquisition of parts of such companies and of private companies.

References


Figure 1. Private equity fund acquisition and two postulated paths to the quality of employment relations

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<td>Via asset extraction</td>
<td>Minimalist organization: • economical structure achieved by forced job loss and outsourcing • emphasis on cost-cutting • intensification of work</td>
<td>Breach of trust</td>
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<td>Via asset renewal</td>
<td>Minimalist organization: • economical structure achieved by responsible restructuring • investment in key resources • security and discretion to core employees</td>
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