NONFICTION

Going Bankrupt in the Name of Efficiency

Two new books offer harsh assessments of private equity firms that specialize in buying up companies only to saddle them with debt and squeeze them for profits.

By Jennifer Szalai

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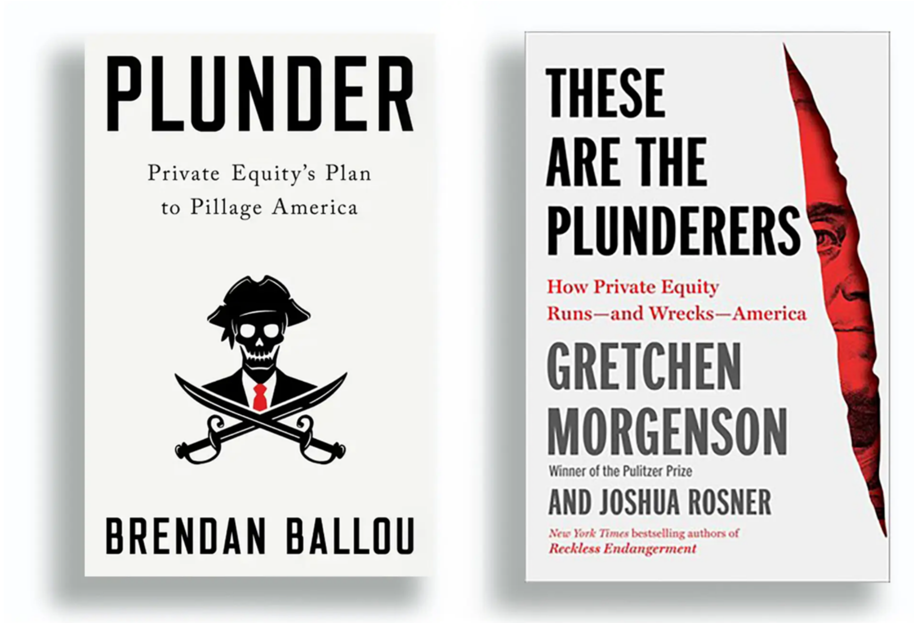
PLUNDER: Private Equity's Plan to Pillage America, by Brendan Ballou

THESE ARE THE PLUNDERERS: How Private Equity Runs — and Wrecks — America, by Gretchen Morgenson and Joshua Rosner

In "These Are the Plunderers: How Private Equity Runs — and Wrecks — America," a new book by Gretchen Morgenson and Joshua Rosner, the arguments are about as subtle as a wrecking ball. It's a measure of just how inflamed the rhetoric can be that when I arrived at the chapter called "'Like When Hitler Invaded Poland in 1939,'" I assumed the authors were the ones drawing the analogy. In addition to the "plunderers" of the title, their book is full of "money-spinners," "buyout boys," "pirates," "pillagers" and "marauders"; a resident at a private equity-owned nursing home was forced to undergo, in the authors' ghastly description, "a Bataan-like death march of therapy sessions."

But it turned out that the line about Hitler's invasion of Poland came from Stephen A. Schwarzman, the chairman and chief executive of Blackstone, one of the world's largest private equity firms. He said it in 2010, in response to President Barack Obama's proposal to eliminate a tax loophole that favored billionaires. Some of the billionaire behavior depicted in this book is so self-regarding and over-the-top — spending $3 million on a birthday party, calling a former colleague Iago in a court filing — that I have to admit the overheated language isn't entirely out of step with the overheated world the authors describe.



Besides, Morgenson and Rosner marshal considerable evidence for their case, which happens to be bolstered by another new book that bears a similar argument and title: “Plunder,” by Brendan Ballou. Morgenson is a financial reporter for NBC News and a former business columnist for The Times; Rosner is a financial analyst; Ballou is a federal prosecutor who served as special counsel for private equity at the Justice Department. Both “Plunder” and “These Are the Plunderers” set out to explain what private equity is and show the damage it can do. They describe how firms like Apollo Global Management, KKR and the Carlyle Group buy up companies using very little of their own money, load the companies with debt and then squeeze them for profits.

People in favor of private equity will say that the firms serve a crucial function, making troubled businesses more robust and efficient. The authors of these books allow that this does happen, but they counter that the industry has grown so enormous, with so much money chasing the same deals, that many private equity firms will acquire healthy companies and essentially make them sick, forcing them to pay off the money that was borrowed to buy them. The business model isn’t so much investment, Ballou says, but extraction. “Roughly one in five large companies acquired through leveraged buyouts go bankrupt in a decade,” he writes.

Toys “R” Us is such a sad and vivid example of private equity’s predations that it appears in both books — a storied company that was bought by KKR, Bain and Vornado Realty Trust in 2005. By 2017, after years of layoffs, crushing debt and being charged regular management fees by the private equity firms “for the privilege to be owned by them,” Ballou writes, Toys “R” Us was bankrupt. (It has recently emerged from bankruptcy.) Ballou adds that the rise of online retail wasn’t as much to blame as people said it was. Toys “R” Us had steady sales and decent market share. But almost all of its operating income was going to service the interest payments on its debt (to say nothing of those preposterous management fees). The company went from having $2 billion in cash when it was acquired to having no money to maintain its stores.

If the results are bad when the product is toys, they can turn deadly when the product is care. Private equity firms have acquired nursing homes, provided staffing for hospitals and services for prisons. Morgenson and Rosner quote David Rubenstein, a co-founder of the Carlyle Group, whose acquisition of HCR ManorCare, a chain of nursing homes, ended with bankruptcy after years of cascading health-code violations.

"While we're not perhaps guardian angels," Rubenstein said, "we are providing a social service, and that social service is making companies more efficient." The authors highlight the essential problem with this fetish for "efficiency." Industries that serve a social function require excess capacity, so that they can continue to provide care when demand surges or an employee calls in sick; nursing homes have to be properly and conscientiously staffed. Cut everything derided as "fat" and you will eventually cut to the bone.

So how does private equity continue to attract money? Pension funds are still among the biggest investors in private equity — a phenomenon that Morgenson and Rosner call "puzzling" and a "mystery," considering that the firms levy exorbitant fees on the pension funds while increasingly delivering middling or even subpar returns. And, of course, the cost-cutting measures typically imposed on acquired companies often include slashed wages and abandoned pension obligations. Ballou notes the irony of middle-class pension holders providing the financial fuel that strips other people of their own pensions.

There are so many outrages enumerated in these books that reading them may have you looking for a pitchfork, though I prefer Ballou's crisp prosecutorial delivery to Morgenson and Rosner's name-calling and sarcastic asides. Ballou also does an admirably clear job detailing how private equity firms use legal wrangling to their advantage. They compel their customers into arbitration, while pursuing their own interests in the courts. And the firms are structured in a cleverly lawyered way to avoid liability. To take just one example: After a family sued Carlyle for the death of their loved one, a resident at a ManorCare facility, "Carlyle argued that it didn't actually own ManorCare or its facilities," Ballou writes. "Rather, it claimed, it simply advised a series of funds that did."

Government, these books say, has been remarkably supportive of an industry that has helped hasten downward mobility and widen economic inequality. Lobbying and campaign contributions have done their part to ensure this support, Ballou says, along with the fact that senior government officials have found lucrative employment at private equity firms after leaving public service.

This observation reminded me of a book about private equity that was published in 2010 — basically a forever ago — by Josh Kosman, called "The Buyout of America." Kosman began by imagining a scene in which President Obama, up for re-election, is faced with private equity-owned companies starting to collapse en masse because they have been saddled with so much debt. The bearer of this dire news in Kosman's scenario is Obama's unnamed Treasury secretary — who, at the time, happened to be Timothy Geithner. Little could Kosman have known that just a few years later, Geithner would leave his government post and become the president of Warburg Pincus, whose website states up front: "Private equity is the firm's only business."

PLUNDER: Private Equity's Plan to Pillage America | By Brendan Ballou | 353 pp. | PublicAffairs | $30

THESE ARE THE PLUNDERERS: How Private Equity Runs — and Wrecks — America | By Gretchen Morgenson and Joshua Rosner | 383 pp. | Simon & Schuster | $30

Jennifer Szalai is the nonfiction book critic for The Times. More about Jennifer Szalai

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