Book review

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New perspectives on private equity performance and impact

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Jeffrey Hooke, *The Myth of Private Equity: An Inside Look at Wall Street's Transformative Investments,* New York, Columbia Business School Press, 2021, 240 pp., $35.00 (hbk), ISBN 978-0-231-19882-0

Laura Katz Olson, *Ethically Challenged: Private Equity Storms US Health Care*, Baltimore, MD, John Hopkins University Press, 2022, 425pp., $34.99 (hbk), ISBN 978-1-4214-4285-3

A veritable industry of research and investigative reporting has emerged in recent years to examine the growing role of private equity (PE) in the US economy and Main Street companies. While private equity now has a global footprint, its largest imprint is still in the US (with $1.3 trillion in deal making in 2021). It particularly thrives in largely unregulated environments like the US and UK, where governments fail to require transparency or reporting on PE's deal-making and financial practices. The regulatory vacuum provides huge opportunities for private equity – which refers to private investment funds or private pools of capital – to buy out companies, take control of boards of directors and top management, extract wealth by financial 'engineering', and sell them in a five-year period. The companies are often left in financial shatters, with employees, vendors, consumers, and creditors bearing the costs.

Two new books are must reads for those interested in private equity: Jeffrey Hooke's *The Myth of Private Equity: An Inside Look at Wall Street's Transformative Investments* (2021), and Laura Olson's *Ethically Challenged: Private Equity Storms US Health Care* (2022). These books are based on sound scholarly research and designed to address the private equity business model as one avenue through which financialization of our societies is occurring. They are meant for a broad audience – from scholars and students in finance and society, management and labour, and healthcare studies to policy makers and the general public. They analyse the complexities of private equity's financial engineering strategies and translate them into real world implications and outcomes.

Hooke provides an important updated account of the PE business model – how PE raises capital from investors (the limited partners that consist of institutional investors such as pension funds and endowments, as well as high wealth individuals). He translates financial jargon into lay language to explain how PE funds use investor money to buyout companies and extract wealth. More importantly, he provides a damning critique of the private equity business

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model and why the industry has created a ‘myth’ regarding the positive value of PE buyouts.

And his critique has great credibility. With over forty years of experience in investment banking – including stints at Lehman Brothers, the World Bank, a global private equity firm, and his own consulting firm – Hooke knows the industry and its actors inside and out. Note that while PE funds are called ‘investment funds’, the majority of the PE capital is used to simply buy out the shares of existing stockholders in order to take complete control of a company. Whether any serious ‘investments’ in the company actually occur is questionable at best, but as PE is non-transparent, we just don’t know.

Beginning with ‘A Day in the Life’, (Chapter 1), Hooke walks us through the landscape of financial actors and institutions and how they interact. He continues with a similar walkabout through various types of investment funds (private equity, venture capital, hedge funds) and publicly traded stocks and bonds, showing how they are different or similar. This provides a useful framework for those unschooled in finance capital 101. He then moves on to the guts of the private equity business model, especially leveraged buyouts, in Chapter 3 (‘How Does the Private Equity Industry Work?’). Hooke explains in lay terms how PE firms and their partners make money, which I will not repeat here. But in brief, they use other people’s money to take high risks by buying out companies through the use of high debt (which is loaded on the company). Hence, they put very little of their own money at risk so if something goes wrong, they can walk away virtually unscathed. They engage heavily in cost-cutting to service the interest on the debt; and asset sales and other financial tactics to extract money (dividends for themselves and their investors) from the Main Street companies they own. By doing this in the first few years of ownership, they position themselves to exit the company within a five-year period. That way, they don’t have to worry about the long-term consequences of their short-term actions to extract wealth.

These chapters provide the backdrop for Hooke’s most important contribution: Laying bare the myths of the PE industry’s assertions that it creates value, creates jobs, and creates ‘outsized returns’ (those that substantially beat the stock market) for its investors. Hooke details the economic evidence that contradicts PE’s assertions: That PE funds no longer beat the stock market (as they did in the early years of the industry); that the very high fees they charge their investors (the ‘limited partners’) are not worth it; and that customers, employees, and others bear the costs of PE’s extraction of wealth.

The final chapters seek to explain how and why this industry is so difficult to change – with a discussion of the wide range of ‘enablers’ and ‘fellow travellers’ – investment banks, industry analysts, institutional investors, politicians – who have helped institutionalize the industry because the also have much to gain from it.

Moving specifically to private equity’s impact in healthcare, Laura Olson provides a deeply researched study of the penetration of private equity in US healthcare – with annual deal-making increasing by roughly twenty-fold between 2000 and 2020. Olson’s clearly written and accessible narrative tells us why we should all be morally outraged by PE’s extraction of wealth at the expense of providers, patients, and communities. Like Hooke, she begins by demystifying the financial terminology of private equity and explains how its creation and use of buyout funds works (to their advantage) (Chapter 1). She continues with a brief history of how and why PE emerged as an ‘alternative asset class’ (Chapter 2). The rest of the book focuses on private equity’s activities in healthcare – its overall business model in healthcare that has made it the leader in market consolidation and concentrated power (Chapter 3) and its role and impact in specific segments: Physicians, (Chapter 4), Dentists (Chapter 5), Homecare and Hospice (Chapter 6), Substance Use and Eating Disorder clinics (Chapter 7), Autism Services (Chapter 8), and Medical Ambulances (Chapter 9).

Each chapter shows that the fundamental PE business model has consistencies across segments: the initial buyout of a healthcare provider (say physicians' practice) as the basis for 'adding-on' the buyout of other providers to create a large regional or national chain; the use of substantial debt loaded on the platform; and cost cutting to create 'efficiencies' and to service the debt. How PE extracts wealth depends on the industry segment: For example, selling -off real estate assets (when available) to pay themselves dividends; upcoding to garner higher reimbursements in the case of government funding; targeting of high value-added services that reimburse at high relative rates; or locating in high income suburbs to take advantage of commercial insurance coverage. Each chapter also carefully chronicles how, when, and why private equity moved into a particular niche market, who the PE and provider actors were, and what changed as a result.

The guts of Olson's book are the blow by blow accounts of PE buyouts of small providers across different segments – again and again and again. The evidence, which at times seems repetitive, drives home the central argument that private equity has deeply penetrated all parts of the US healthcare system

The soul of Olson's book is her unearthing of innumerable stories of PE buyouts in which healthcare professionals, workers, and patients reported negative consequences. While some physicians insisted that private equity made their management practices more efficient, many more expressed regret that the PE buyout of their practice brought ongoing pressure to increase patient volumes and sell products, systematic upcoding, and lost autonomy over patient care decisions.

Her wide-ranging interviews across specialties and locations, many with founder-owners who were bought out by private equity, provides credible evidence that the negative effects of private equity are not due to a few bad apples. The business model that promises limited partners 'outsized returns' drives cost cutting decisions that lead to understaffing, faulty equipment, inadequate supplies, and in some cases negligence and abuse. Olson also documents how PE owned services increase their revenues via unnecessary treatments and drug prescriptions and overcharging for care.

The chapter on air ambulances shows how private equity firms have taken advantage of loopholes in insurance coverage. As hospitals have outsourced emergency services, including emergency rooms and medical ambulances, to third-party providers, the services are no longer covered by the hospital's insurance contract. PE funds have led the way in charging out-of-network 'surprise bills' that are substantially higher than 'in network' charges. The most vulnerable suffer, including rural populations whose community hospitals have often closed, and who consequently, must rely on air ambulances when medical crises hit. PE firms have cornered two-thirds of the air ambulance market, typically charging $50,000 or more per trip – over twice that charged by other carriers.

Olson brings together her narrative in a strong concluding chapter that synthesizes her evidence from many corners of the healthcare landscape. She convincingly argues that PE's activities have led to industry consolidation, concentration of power, cost cutting, and wealth extraction – all posing a serious threat to the viability of US healthcare and its ability to deliver quality care at affordable prices.

The most vulnerable people – elderly, low-income, disabled youth, the mentally ill – are often the victims. Private equity ownership in healthcare has contributed to what Drs. Wendi Dean and Simon Talbot (2022) call 'moral injury': Healthcare workers are not just overworked or 'burned out' – they are injured by being pressured to act in ways that transgress their deeply held moral beliefs and the very reason that they entered the healthcare profession in the first place. 'Ethically challenged' PE firms have no place in healthcare.

Both books provide clear and accessible accounts of private equity and contribute importantly to our understanding of its role and impact in the current economy and society. While based on US data and examples, they provide lessons for those in countries around the world who are concerned about the financial antics of global finance that often skirt existing regulatory frameworks.

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