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Private Equity During Financial Crises

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ABSTRACT:

This thesis explores the behavior of private equity during financial crises, focusing on portfolio company-level resilience, fund performance and changes in strategic choices. PE has become a much more significant player in the capital markets, it is essential to understand its behavior during financial crises like the 2008 Global Financial crisis and the Covid-19 pandemic. As a literature review this thesis is supported by theoretical frameworks, such as Trade-off theory, Pecking order theory and Agency theory. The results suggest that PE-backed firms show greater performance during downturns due to active ownership and restructuring abilities. However, fund level performance findings are more mixed, where investors profits are often comparable to those of public markets due to the high fees present. These findings suggest that while PE ownership creates value at the company level, its role during crises needs careful consideration by investors.

Tämä tutkielma tutkii pääomasijoitusten toimintaa talouskriisien aikana. Painopisteenä PE-omisteisten yritysten kestävyys kriiseissä, rahastojen tuotoissa ja strategisissa muutoksissa. Pääomasijoitusten merkitys rahoitusmarkkinoilla on kasvanut, ja sen roolin tutkiminen kriisien aikana kuten 2008 finanssikriisin ja Covid-19-pandemian yhteydessä on tärkeää. Tutkielma on kirjallisuuskatsaus, jota tukee talousteoriat, kuten rahoitusrakenteen kompromissiteoria, hierarkiateoria ja agenttiteoria. Tulosten mukaan PE-omisteiset yritykset selviytyvät kriisien aikana paremmin kuin muut yritykset, mikä johtuu aktiivisesta omistajuudesta ja joustavien rahoituksen järjestelyiden ansiosta. Rahastotasolla tuotot kuitenkin ovat vaihtelevia, ja sijoittajien tuotot yleensä jäävät julkisten markkinoiden tasolle, etenkin kun kulut on otettu huomioon. Havainnot osittavat, että PE voi luoda lisäarvoa yritystasolla, sen laajempi rooli järjestelmätasolla vaatii huolellista arviointia sijoittajien puolesta.

KEYWORDS: Private equity, financial crises, leveraged buyouts, trade-off theory, agency theory, private equity returns, risk management

Contents

1. Introduction

Private equity (PE) has experienced significant growth in the last decades. In 2020 the total assets under management (AUM) of PE funds were 4.4 trillion US dollars. The AUM have seen a rise of 170% from the 2010 level (Borysoff et al., 2024). PE funds play a crucial role in raising new capital. PE has become the primary vehicle in raising new capital. In 2019 they raised about 550 billion USD globally and 350 billion in the North Americas (Borysoff et al., 2024). With Initial Public offerings (IPOs) on the decline and companies choosing to stay private for longer than they used to. The AUM of PE funds are expected to reach 9 trillion USD in 2025. PE firms valued over 1 billion USD used to be quite rare, but in today's climate there are over 1200 of these firms (Borysoff et al., 2024). PE funds' performance is an uncertain topic of research, with the returns remaining somewhat a controversial topic. Harris and others (2014) find in their studies on the returns of PE funds consistently outperformed those of public markets. Buyout funds outperformed the S&P 500 index with over 3% annually and by 20%-27% over the fund's life. These returns have made PE an attractive asset class for institutional investors. With the trend of PE funds growing and companies staying private longer it is important to research these funds and their impact on the financial markets.

Financial crises have been an important topic of research in recent decades (De Silva et al., 2024). Crises like the 2008 Global Financial crisis and the Covid-19 pandemic had a significant impact on the financial markets, in both private and public sectors (Lavery and Wilson, 2024). PE investments rely heavily on the use of leverage, which serves as a tool for achieving higher returns but also a potential source of financial distress. PE firms use substantial amounts of debt financing to amplify investment performance, create managerial discipline and benefit from tax reliefs. This use of leverage can expose portfolio companies to financial distress, particularly during economic crises, especially when credit markets become tighter and interest payments play a bigger role (Tykvova and Borell, 2012). While the risk of financial distress increases after a company is acquired by PE investors, bankruptcy rates remain at a comparable level to non-PE-backed

companies (Tykvova and Borell, 2012). During Financial crises PE firms adjust their strategies by focusing on operational improvements, liquidity management and financial restructuring shifting away from their growth focused strategies. During GFC and Covid-19 firms with PE backing displayed greater resilience than those with no PE backing. PE investors focused on working capital management, making sure their portfolio companies remained stable through these crises (Lavery et al., 2024). These shifts in strategy demonstrate that while leverage generates greater profits in stable economic conditions, it is necessary to actively manage these investments during economic downturns, showing the evolution of PE investment models.

This thesis aims to understand the mechanics of PE funds and their investment strategies and how they differ during financial crises. There is also a focus on the role that PE plays in financial distress on the financial markets.

1.1 Hypotheses and the purpose of the thesis

Over the course of several years Private Equity has become a significant force in modern financial markets, with total assets under management projected to surpass 9 trillion USD by 2025 (Borysoff et al., 2024). With PE funds' central role in capital raising and their rising importance in the financial markets makes it crucial to understand the behavior of PE during financial crises, given PEs significant reliance on leverage and heavy involvement in corporate governance and structure.

According to Gompers et al. (2016), PE firms have traditionally generated value through financial engineering, operational improvements and governance changes. PE firms use of leverage to increase profitability is considered one of the main characteristics of PE (De Silva et al., 2024). While operating in stable markets, this leverage can boost profitability but, it can also increase risk of financial distress when credit markets become more restrictive, as seen during crises like Global Financial Crisis and Covid-19 pandemic (De Silva et al., 2024). However empirical evidence reveals conflicting results: while some

companies with PE-backing showed superior performance and greater resilience during crises (Lavery et al., 2024), others struggled under heavy debt burdens (Lavery and Wilson, 2024).

Additionally, there is an ongoing debate regarding PE funds' performance in comparison to public markets. Buyout funds outperform public markets by 20-27% over the funds life (Harris et al., 2014). Others question whether this superior performance holds across crisis contexts (Kallenos and Nishiotis, 2023). Furthermore, there is limited research on how PE firms adjust their strategies during financial crises, especially when it comes to switching from growth to a more defensive strategy like restructuring and liquidity management (Gompers et al., 2016; Lavery et al., 2024).

The purpose of this thesis is to study the role and behavior of PE during financial crises, focusing on short-term resilience and long-term risks carried by PE-backed companies. The study also intends to investigate how PE funds adjust their management and investment strategies during economic downturns.

H1: PE-backed companies show greater short-term resilience during financial crises compared to non-PE-backed companies.

H2: Despite the short-term resilience, PE-backed companies face higher long-term risks of financial distress compared to non-PE-backed companies.

H3: PE funds adjust their strategies during crises by shifting focus from growth to operational improvements, liquidity management and financial restructuring.

This thesis will add to the existing body of research by systematically evaluating and synthesizing academic literature on Private Equity and its role in financial crises. Given PE increasing importance in the global capital markets, knowing how PE firms and their portfolio companies operate during economic downturns is crucial. While numerous

studies have researched PE performance and value creation in normal market conditions, the research in PE's role and function in financial crises remains fragmented and inconclusive.

This thesis aims to clarify what is presently known about the resilience and vulnerability of PE-backed companies during economic downturns as well as how PE firms adjust their investment and management strategies in response to crises, by performing assessments of previous research. This thesis will compare crises such as the 2008 Global Financial Crisis (GFC) and the Covid-19 pandemic, to explore whether PEs behavior varies in crises of different nature.

Furthermore, this thesis will draw attention to current academic debates regarding whether PEs heavy use of leverage contributes or mitigates financial stability during economic crises. This thesis systematically examines the existing research on PE performance and resilience during financial crises. This thesis will also examine the effects of different theoretical frameworks, such as agency theory and financial distress theory and how they have been applied to understand PEs crisis-time operations.

Additionally, this thesis will aim to identify existing gaps in current literature regarding Private Equity during financial crises, such as: Lack of comparative studies across different countries PEs performance during financial crises. Limited evidence of long-term performance of PE firms during financial crises. Limited research on how different types of PE firms respond to financial downturns.

1.2 Structure of the study

The thesis is structured as follows

Chapter 1: Introduction

Introduces the topic of research, motivations, relevance and highlights the research problem, purpose and hypotheses

Chapter 2: Theoretical framework

Presents the core theories relevant to the thesis. This includes Trade-off theory, Pecking Order Theory of Capital Structure, Agency Theory and capital market models like CAPM and EMH. These theories aim to provide a basis to understand the decisions of PE.

Chapter 3: Literature Review

This chapter analyzes the empirical literature on PE, covering its definition, fund types, value creation strategies and performance in both stable and unstable conditions

Chapter 4: Synthesis and Conclusion

Synthesizes the core themes and empirical insights, revisits the hypotheses and draws overall conclusions from literature. It evaluates theoretical alignment, identifies gaps in research and research limitations.

References

2 Theoretical framework

In this chapter, the thesis will present the key theoretical concepts and components to understand the behavior of Private Equity (PE) during financial crises. PE as a financial field operates through mechanisms such as leverage, governance and operational improvements. These mechanisms are all influenced by financial and economic conditions (Gompers et al., 2016). These mechanisms are designed to improve performance and grow the value of portfolio companies, they can also introduce risks that become significantly more major during economic downturns and during market instability (Lavery and Wilson, 2024).

A crucial element of PE transactions is the use of heavy leverage, which can increase profitability in favorable market conditions but also increases the risk of financial distress when cash flow and access to credit may be limited (De Silva et al., 2024; Tykvova and Borell, 2012). Furthermore, while PE funds typically apply strong strategic oversight to their portfolio companies, the effectiveness of these strategic changes may vary depending on the severity and the nature of the crisis (Gompers et al., 2016). Therefore, understanding how PE-backed companies behave in times of crisis and how they adjust their strategies to preserve value and control risks requires understanding of the theoretical framework of leverage, governance and financial distress.

This chapter will focus on four core theoretical areas which are highly relevant to the field of PE and its behavior during financial crises. Firstly, the Leverage and Capital Structure Theories, which demonstrate PEs reliance on debt financing and the risks associated with heavy leverage, especially during unstable market conditions (Kraus and Litzenberger, 1973; Tykvova and Borell, 2012). Secondly, Agency Theory, which addresses how PE funds influence management, governance and reduce agency costs to push operational improvements (Gompers et al., 2016). Thirdly, Financial Distress and Bankruptcy theories, which especially during financial downturns when the capacity to pay off debt is limited, help to identify the costs and risks of financial distress (De Silva et al., 2024).

Finaly, Private Equity Value Creation Theories, which explain how PE funds generate returns through operational and strategic changes and how these methods are adjusted during crisis conditions. The following section begins with an examination of Leverage and Capital Structure Theory, as this is a fundamental financial framework supporting the PE funds business models and its value creation.

Financial crises are periods where there is widespread distruption in the financial markets, often triggered by asset bubbles, credit collapses and failures in banking. Reactions to these periods of time typically include tightened credit markets, decline of asset prices and an increased risk aversion amongst investors. The 2008 Global financial crisis was started by the collapse of the U.S. housing market, which resulted into the halting of interbank lending, while the COvid-19 pandemic caused sector wide operational halting and shocks in demand (Lavery & Wilson, 2024; De Silva et al., 2024). Financial crises create challenging environments and conditions for all firms to operate, especially for PE firms with their typically heavily leveraged structures (Tykvova & Borell, 2012; Demiroglu & James, 2010).

These conditions serve as an active real-world stress test for different financial theories, such as Trade-off theory, Pecking order theory and agency theory. The trade-off theory becomes critical in these conditions as credit markets tighten, and the advantages and disadvantages of debt must be carefully assessed (Kraus & Litzenberger, 1973; Frank & Goyal, 2008). Pecking order theory helps explain the avoidance of firms to release new equity during financial crises, this reinforces the notion that PE preferences debt over equity (Myers, 1984; Frank & Goyal, 2008). Agency theory offers essential insights on the behavior of managers during crises, when incentives are more prone to be misaligned, due to the heightened liquidity restrictions. The PE ownership structure typically characterized by performance-based incentives and active management, are theorized to mitigate these risks posed by financial crises (Jensen & Meckling, 1984; Acharya et al., 2013). In essence these crises are not only financial turning points but also offer significant empirical data for analysis.

2.1 Trade-off Theory of Capital Structure

The Trade-off Theory of Capital Structure, originally developed by Kraus and Litzenberger (1973), offers a fundamental framework for understanding how companies balance debt and equity funding. This theory states that companies aim to achieve an optimal level of leverage by balancing the tax benefits of debt financing against the anticipated expenses of bankruptcy and financial distress. The basic concept is that interest tax shields offered by debt financing lower a company's taxable income, thereby reducing its overall tax burden. However, as companies deal with heavier leverage, they also face an increased likelihood of default and expensive financial distress, including bankruptcy, legal fees and agency disputes between debt and equity holders. Firms must operate on between these two opposing ends to determine an optimal capital structure. PE-backed firms often operate with levels of leverage that may exceed optimal trade-off thresholds, especially during times when obtaining debt is relatively cheap. When distress costs become apparent, this can lead to considerable value destruction (Axelson et al., 2013).

Highly leveraged PE-backed companies are often subjected to strict debt covenants, which are contracts placed by lenders to limit borrower behavior. These covenants include limitations on additional borrowing, capital expenditure and requirements to uphold certain financial ratios. These covenants are designed to reduce the risks of creditors and mitigate the risk of default. Covenants are an essential risk control mechanism that prevents risk-shifting and limits managerial excess. This comes with a cost of limited operational flexibility, and potentially intensifying distress risks during downturns (Demiroglu & James, 2010). During times of financial downturn, covenant breaches may trigger expensive renegotiations, forced asset sales or in most extreme cases bankruptcy. Demiroglu and James (2010) documented that while traditionally Leveraged buyouts (LBOs) relied on loans with heavy covenants, the trend is towards more light covenant loans in recent years. This reflects the loosening of lending regulations which could increase financial risks during economic downturns.

According to Kaplan and Strömberg (2009) that although high leverage can improve management efficiency, it may cause vulnerability under financial downturns, increasing the need for debt refinancing. The cost of financial distress, as explained in the trade-off framework, are especially relevant in heavily leveraged transactions, showing the fragility of PE-backed firms during economic downturns (Lavery & Wilson, 2024). Covenants serve as an example of how the expenses linked to high debt levels, which are highlighted in Trade-off theory, can limit PE-backed businesses and increase the risk of distress when those businesses operate close to their debt capacity (Kaplan & Strömberg, 2009; Axelson et al., 2013).

Kaplan and Strömberg (2009) note that although heavy leverage may improve management efficiency, it can lead to increased vulnerability under financial downturns, increasing the need for restructuring or renegotiations. The cost of financial distress, as conceptualized in the trade-off theory, are especially relevant in such leveraged transactions, highlighting the frailty of PE-backed businesses during financial crises (Lavery & Wilson, 2024).

The application of trade-off theory to Private Equity and leveraged buyouts is strongly supported by empirical evidence, while also identifying deviations from the theoretical optimal leverage. According to Kaplan and Strömberg (2009), Private Equity firms use high leverage to obtain tax benefits and discipline management, but these strategies inherently expose them to an increased risk of financial distress. Guo, Hotchkiss, and Song (2011), research on Leverages buyout transactions between 1990 and 2006 highlight that while tax shield provided by interest payments significantly increase PE returns, operational improvements seem to be lesser than in previous decades. This highlights PE heavy reliance on financial engineering to boost profits. The findings also highlight an increased risk of distress as financial conditions decline.

Axelson et al. (2013) research on PE provide evidence that PEs levels of leverage are substantially influenced by the conditions of credit markets rather than company-specific factors. This implies that PE companies are systematically over-leveraged during periods of cheap credit, pushing these companies towards capital structures often beyond the ratios highlighted in Trade-off Theory. During times of tighter credit markets these capital structures significantly increase the risk of value destruction.

Lavery and Wilson (2024) find that to avoid insolvency during Covid-19 pandemic PE companies were forced to shift from growth focused strategies to a defensive strategy, with a significant focus on liquidity management and restructuring of debt. These cases highlight that, while leverage can increase profits in stable economic conditions, it increases risks in downturns. This aligns with the concepts explained in Trade-off Theory about an optimal level of leverage, where the benefits of debt are balanced against the costs. The relationship can be described as an upside-down U-shape, where at first, the increasing leverage enhances value due to tax benefits and managerial discipline. At a certain point increasing leverage starts to reduce company value as risks of costs associated with financial distress begin to outweigh the benefits (Frank & Goyal, 2008; Kraus & Litzenberger, 1973). Furthermore, according to Bernstein et al. (2019) PE-firms with high debt show higher probabilities of distress and sharper declines in revenue, when faced with crises. This validates the notion that leverage can become a financial liability under certain economic conditions.

In summary, Trade-off theory provides a crucial understanding of the role debt plays in PE transactions. The theory offers insight on both how debt offers value creation through tax benefits and how it plays into financial distress. The theory offers explanation on why PE firms frequently use debt to improve returns but also highlights the risks associated with excessive leverage. Although leverage is an essential part of the PE business model, excessive reliance on debt particularly during times of financial instability, can undermine value. The theory explains the optimal level of debt as an upside-down U-shape, where firm value initially grows with additional debt. At a certain point the value starts

to diminish as the costs associated with financial distress start to outweigh the benefits gained from the leverage (Frank & Goyal, 2008; Kraus & Litzenberger, 1973). In The Private Equity context this dynamic is highly relevant, where the pursuit of high returns is often associated with heavy debt, pushing companies beyond the optimal leverage point. This increases the vulnerability of portfolio companies especially during financial downturns (Axelson et al., 2013; Lavery & Wilson, 2024). Thus, trade-off theory provides a crucial framework for understanding both the strategic use of leverage and the risks to portfolio firms during economic downturns.

2.2 Pecking order theory

According to the Pecking Order Theory of Capital Structure, which was first introduced by Myers in 1984 and further developed by Myers and Majluf in 1984, companies rank their sources of funding in order of least effort, expense and information asymmetry. The theory suggests that companies would rather finance operation with internal capital first, followed by debt and equity as a last choice. The existence of information asymmetries between management and external investors, which can make issuing fresh equity expensive due to adverse selection concerns, is what motivates the desire for internal financing (Myers & Majluf, 1984).

According to Pecking Order Theory managers of a company are better informed about the true value of a company than external investors. As a result, the issuing of new equity may be interpreted as a negative signal by the markets. This is caused by the markets intercepting the new issuing of equity as a sign of the company being overvalued. This leads to debt having a lower cost relative to equity, encouraging companies to avoid issuing new equity if possible (Myers, 1984).

Even though Pecking Order Theory was developed to understand the financing policies of public companies, it still offers valuable understanding of the strategies of Private Equity companies. PE funds are not typically as concerned with the negatives of signaling

issues, they still inhibit preferences which align with Pecking Order theory when raising new capital at the fund and deal levels. PE firms usually prefer to use debt rather than equity on acquisitions, maximizing profits on their equity investments. Following the preferences introduced by Pecking Order Theory allows PE firms to avoid dilution and maintain control over the fund (Kaplan & Strömberg, 2009).

Especially during financial crises these behaviors introduced by Pecking Order Theory become extremely relevant. During crises when access to external financing becomes more expensive and uncertain, the role of internal funds becomes more crucial. PE funds typically during times of economic uncertainty tend to avoid the issuance of new equity and shift their focus on debt restructuring and internal capital reallocation, as a response to tightening credit markets (Lavery & Wilson, 2024). This demonstrates a preference of the pecking order for the least costly and externally less visible source of capital. The universality of Pecking Order Theory has been challenged by empirical studies. Frank and Goyal (2003) find that even though there is evidence of Pecking Order behavior, it is not always consistent. In the PE context where transactions are heavily funded with leverage and reliant on credit market conditions, the theory struggles to fully explain the financing decisions. PE funds use of leverage is often motivated by debt enhanced profitability rather than the financial preferences introduced by The Pecking Order Theory (Axelson et la., 2013).

The financial preferences introduced by Pecking Order theory, during economic uncertainty can help to understand why PE funds might shift to restructuring and internal capital over issuing new equity. Companies seeking to minimize cost associated with financing aligns with the insights of the theory, especially when economic uncertainty is presented (Myers & Majluf, 1984). While Pecking Order theory during normal market conditions does not fully explain the behaviors of PE companies, it still offers understanding on how PE fund behave during uncertain market conditions. It helps understand how and why PE funds navigate challenging market conditions and manage their financing operations during uncertainty. The dynamics of PE operations and capitals structures are

given insightful explanations by Pecking Order Theory, especially during times when traditional financing options are challenged.

2.3 Agency Theory

The conflicts arising between managers and investors rising from misaligned interest were first researched by Jensen and Meckling (1976) in their work on agency theory. Personal benefits such as empire-building may be prioritized by managers over shareholder value creation. The effects created by these misalignments are the agency costs, which can lead to inefficient capital allocation and reduced company value (Jensen & Meckling, 1976).

PE firms impose high leverage and strict governance oversight, thus reducing agency costs during leveraged buyouts (LBOs). Significant debt burdens force managers to focus on operational efficiency and cash flows (Jensen, 1986). The reduced free cashflow caused by heavy leverage prevents managers from excess spending and helps reduce unprofitable investments (Jensen, 1986; Kaplan & Strömberg, 2009). According to empirical evidence PE firms financial discipline allows them to operate with greater efficiency than most of their equivalent public companies (Acharya et al., 2013). During stable economic conditions leverage helps align these incentives, but when faced with economic downturns it can elevate the risk of financial distress. During these times leverage is transformed from a form of governance into a financial burden, especially when facing rising interest rates and liquidity shortages (Tykova & Borell, 2012; Axelson et al., 2013). During the Covid-19 pandemic companies with PE-backing shifted from aggressive growth to defensive strategies like liquidity management. This aligns with the notion of leverage having two sides with its effect of increasing governance and profits and the risks it can pose (Lavery & Wilson, 2024).

Governance restructuring to reduce agency costs is actively driven by PE companies. By taking the majority or close to the majority stakes in a company PE firms are allowed to

strongly enforce governance mechanics and reduce managerial incentives. PE firms appoint industry experts and optimize capital structures, improving performance and reducing risks (Acharya et al., 2013). To ensure that the managers incentives remain aligned with those of investors, debt covenants are placed. These covenants serve as an enforcement mechanism by restricting additional debt or mandating performance targets (Demiroglu & James, 2010). During crises PE firms to prevent insolvency had to shift to liquidity management and restructuring (Lavery & Wilson, 2024). This highlights the crucial role of balancing financial flexibility and governance. PE companies' performance during financial instability is dependent on this balance (Kaplan & Strömberg, 2009).

2.4 Capital Asset Pricing Model (CAPM)

The Capital Asset Pricing model (CAPM), developed by Sharpe (1964), is a financial theory that provides an understanding for pricing risk in normal-functioning public markets. According to the model when operating in efficient markets, investors are rewarded for taking on non-diversifiable risks. According to the model, returns of an asset should align with their exposure to the overall market risk.

Private equity assets are not frequently traded and often are held for long periods of time, unlike public stocks. This makes it challenging to apply CAPMs assumptions directly or calculate betas. PE transactions often involve complex deal structures and financing, which introduce complexity over the model's scope. Even so the concepts of CAPM are still useful. Kaplan and Schoar (2005) Public Market Equivalent (PME) allows the performance of PE funds to be compared to those of public assets like the S&P 500. Even though not a direct application of CAPM, PME reflects its logic of comparing risk-adjusted returns. A PME greater than one suggests outperformance, while numbers less than one underperformance. PME seeks to answer the question of would investors have earned more by passively investing in public markets.

Kaplan and Schoar (2005) study show that while on average PE funds might not outperform public market benchmarks after fees, they find that there is significant dispersion across fund performance. Some general partners consistently outperform public market benchmarks, implying that skill and strategic execution might drive value. These factors are not accounted for in the CAPM.

2.5 Efficient Market Hypothesis (EMH)

The Efficient Market Hypothesis (EMH), developed by Fama in 1970, argues that market prices reflect all available information. EMH argues that it is impossible to consistently achieve abnormal returns above the market average, since the information is almost instantly included in prices. The theory assumes broad access to information and that decisions are made rationally. However private equity strays significantly from these conditions. These private equity deals are executed privately and often involve undervalued or distressed companies. These deals also depend heavily on negotiations and inside information. EMH is challenged by lack of liquidity, pricing and public disclosure in private markets.

According to Lerner, Schoar and Wongsunwai (2007) there is significant evidence against EMH in private equity settings. According to their research there are persisting differences in fund performance across different types of institutional investors. University endowments outperform commercial banks and pension funds, not only due to better access, but also due to better fund selection and choices in reinvestments. This outperformance is consistent over time, suggesting that skill and informational advantages play a part. This contradicts EMHs claim that it is impossible to consistently outperform.

According to these insights the private equity environment is operated on incomplete information and is strategically complex. While EMH offers useful theoretical baselines the complex improvements and financial restructuring are not accounted for. In private markets these inefficiencies are often attributed as a base for investment opportunities.

3 Literature Review

This chapter of the thesis will take a closer look at the existing literature about private equity (PE) and its behavior during financial downturns. It starts with covering what PE is and how it operates, continuing to explore PE firms' behavior during financial downturns and the strategies used during these times. This chapter utilizes theory and empirical studies to find patterns and understand how PE adapts its operations under unfavorable economic conditions.

3.1 Definition and Characteristics of Private Equity

Private equity is an investment type where investments are made into an unlisted private company. The goal of these investments is typically to acquire ownership stakes in companies and to improve their performance before making an exit and turning profit. These investment firms usually gather capital for these deals from different institutional investors such as pension funds and endowments. PE firms typically seek to invest in companies they view as undervalued, inhibit some operational inefficiencies or have strategic misalignments. PE funds believe that by actively managing these companies they can produce significant value gains (Kaplan & Strömberg, 2009; Borysoff et al., 2024).

Private equity can be classified by three different key characteristics, these being long investment horizons, illiquidity and active management. These private investments do not allow daily trading like their public counterparts, which means PE investors are usually forced to commit capital for long periods. During these investment periods the PE firms have very limited liquidity in the capital invested. The long investment horizon allows PE firms to implement operational, financial and strategic changes to increase profitability, this is critical for the PE model (Kaplan & Schoar, 2005; Gompers et al., 2016).

In PE general partners (GPs) are the managers of the fund, these GPs have an active role in the governance of portfolio companies. Often after an acquisition GPs redesign business incentive, appoint new management and explore new strategic directions for the portfolio company. This active management is often the base of PEs aim to generate returns exceeding the public markets (Acharya et al., 2013). PE returns are largely based on this active management and direct value creation, whereas their public counterparts' profits are often dictated by market betas.

The use of leverage is also a critical component in the PE model, especially in leveraged buyouts (LBOs). In LBOs a substantial amount of capital needed for the deal is financed with debt. This increases the potential returns on equity generated on the deal but also increases the financial risk carried. The incentive behind these LBOs is that the use of heavy leverage offers managerial discipline by limiting cash flow and forcing operational efficiency (Jensen, 1986). When cash flows might decline in unfavorable economic conditions, this leverage introduces risks and highly leveraged firms face increased distress (Tykvova & Borell, 2012; Lavery & Wilson, 2024).

Due to the private nature of PE investments, it is challenging to valuate these investments, this is attributed to the lack of standard valuation methods and real time market data. These challenges can offer potential for investors to exploit informational inefficiencies and possible arbitrage opportunities. In these less efficient capital markets, where PE operates, it is possible to strategically exploit these inefficiencies and generate abnormal returns (Lerner et al., 2007).

During recent years, PE has become a mainstream part of institutional portfolios. The assets under management have seen a rapid expansion (Borysoff et al., 2024). This growth signals expanding trust in PE ability to generate abnormal growth and outperform the public markets.

3.2 Types and Structures of Private Equity Funds

Private equity (PE) funds are usually limited partnerships, where the General Partner oversees the fund and the investment decisions, while Limited Partners (LP) provide capital to the fund but have a more inactive role. This structure creates a separation between the management and capital and lines up incentives. GPs are traditionally compensated through management fees and carried interest, which is a percentage of the fund's profits. This compensation structure encourages GPs to prioritize profits and keeps the incentives in line with those of the LPs (Kaplan & Strömberg, 2009; Borysoff et al., 2024).

A typical PE fund moves through various stages during its lifetime of around ten years. When the funds are done with raising capital the GP starts investing in selected companies. During this time the focus is on the management of these portfolio companies. This typically involves operational improvements and growth. When the time is up the fund exits these positions, usually through private sales or public offerings. After the exit returns are distributed among the LPs. This strategy of focusing on long-term returns helps eliminate risk by reducing the pressure for short-term returns (Kaplan & Schoar, 2005).

There are different types of PE funds that focus on individual investment strategies. Buyout funds, which are the major focus of this thesis, aim to acquire established companies with stable profits. These transactions are usually leveraged buyouts (LBOs) which involve both debt and equity. Debt in these deals is used to increase profits and the need to maintain payments increases financial discipline in the companies. These strategies allow the funds to create value and enable exits to be profitable (Jensen, 1986; Tykvova & Borell, 2012; Lavery & Wilson, 2024).

Growth equity funds invest in companies that are generating value but lack the extra capital needed for expansion. In these investments the fund typically takes a minority stake in the company and little to no debt is used. The focus on these investments is to

support the companys growth efforts, usually by helping the company expand on new markets or increase production. These growth funds are typically between buyout and venture capital funds in terms of their risk and reward (Kaplan & Schoar, 2005).

Venture Capital (VC) funds take a focus on investing in companies that are in the early stages, especially in sectors like technology and healthcare, which are classified as relatively high-growth areas of business. These investments made by VC funds are considered risky due to the high failure rate associated with companies in the early stages of business. The limited historical data and unproven business models of startup companies also add to the risk profile of these investments. It is important to note that in the case of even a small portion of these venture capital portfolio companies' success, the upside can be significant. VC funds often provide capital, strategic mentorship and network possibilities. Even though these VC funds do not typically acquire control of the company it can still be considered very influential to the companys formative stage. VC investors typically search for potential exits through either IPOs or acquisitions, the investment period can last anywhere from five to ten years (Gompers et al., 2016).

There are funds which focus on distressed and turnaround investments. These funds focus on companies that are facing financial difficulties, inefficiencies in operations or external market shocks. These distressed investment strategies can often be classified as counter-cyclical, meaning they become especially appealing during times of unfavorable economic conditions, when prices are low and there might be opportunities to acquire undervalued companies. After acquiring companies at a lowered price these PE companies typically take aggressive steps to stabilize the businesses, often through managerial changes, debt restructuring and cost-cutting. The high level of difficulty involved in these deals demands more than just capital but also deep operational experience. According to Acharya et al. (2013), companies with expertise in distress scenarios can often outperform others by leveraging their skillsets.

Secondary funds allow investors to purchase stakes from an already existing fund from LPs that are a part of the older fund. This allows LPs to exit their positions at an earlier stage, adding liquidity to an often-illiquid market. Fund-of-funds invest in a range of different PE funds, allowing diversification for investors.

Recently PE funds have started to create multi-strategy platforms which include buyouts, growth investments and private credit. There is an increasing demand for permanent capital vehicles that offer long-term capital. Despite these changes this industry is still characterized by long-term capital commitments, and active portfolio management (Borysoff et al., 2024; Borysoff et al., 2024).

3.3 Types of Investments and Value Creation Strategies

The previous section defined the different organization types of PE funds, this section focuses on the investment strategies employed at the company level. Private equity (PE) investment strategies can vary in their goals and structure, but they typically fall under recurring strategies which aim to increase the value of portfolio companies over the holding period. These strategies are not only defined by financial engineering but also focus on operational improvements, governance and market timing. These strategic tools have been identified by researchers like Kaplan and Strömberg (2009), Acharya et al. (2013) as the core fundamentals that PE investors use to achieve returns beyond the ones explained by sheer market risk. The typical investments in the PE field include leveraged buyouts (LBOs), add-on acquisitions, recapitalization and growth financing. Each strategy includes its own balance of risks, control and how value is created and is often dependent on the firms' capabilities, sector dynamics and economic conditions (Kaplan & Strömberg, 2009; Acharya et al., 2013; Gombers et al., 2016).

One of the most utilized forms of PE investments is leveraged buyouts. In a leveraged buyout a PE firm acquires a controlling stake in a cash-flow positive company, with a significant portion of the purchase price financed with debt. In these deals the acquired

companys own assets and projected cash-flows are often used as collateral for the loan. This model increases returns on equity when the performance targets are achieved but exposes the company to financial distress during times of economic uncertainty (Kaplan & Strömberg, 2009; Tykvova & Borell, 2012). LBOs play a central role in the PE markets by combining financial discipline with achievable operational improvements. Historically LBOs have been associated with strong performance post buyout, but the performance of these deals have become more unsteady after the 2008 global financial crisis, due to tightening credit markets and decreased operational flexibility (Guo, Hotchkiss and Song, 2011).

PE firms employ platform and add-on strategies, these strategies often start with an acquisition of a platform company that operates in a desired industry, The PE firm uses this company to acquire smaller, often operationally supportive companies. The objective of these deals is to increase market share and increase competitive positioning. These deals are common in markets that have fragmented structures, such as healthcare, IT services and manufacturing. Add-on deals allow PE firms to distribute capital evenly and reduce the requirements needed for market entry (Gompers et al., 2016).

Another typical strategy in PE investments is recapitalization. These deals involve restructuring of a company's financials, often achieved through additional debt. With these deals the company can distribute dividends to shareholders or refinance older debt with more favorable terms. Recapitalization can increase levels of leverage and expose companies to financial strain, but they can be useful in extracting early value in the holding period. These deals must be timed carefully, during a downturn they can significantly increase distress risks (Demiroglu & James, 2010).

According to Kaplan and Strömberg (2009) successfully employed operational improvements can have an often more lasting impact on a company's value than financial restructuring. Operational improvements have become an increasingly important tool in PE especially in fields with high competition. These actions can range from cost cutting

and supply chain management to rebranding. It is also common for PE investors to bring in external advisors to drive these actions through, in the portfolio company. Governance transformation is another significant aspect of the private equity business model. After a company is acquired, PE firms often reconstitute the board and closely link management compensation with the performance of the company. These actions help to reduce agency problems faced by the company by closely aligning the incentives of managers with those of the PE fund (Acharya et al., 2013). PE Funds also benefit from ease of decision making and freedom to drive different strategies because the GPs lack the constraints that public shareholders face.

During unfavorable economic conditions, such as financial crises, PE funds typically shift their strategies from aggressive growth to a more defensive stance. The focus during economic turmoil is on the stabilization of the portfolio companies rather than on growth or aggressive acquisitions. These stabilizing actions might include improving liquidity, reducing overhead costs, renegotiating debt and pausing projects that require large amounts of capital. According to Lavery & Wilson (2024) during the Covid-19 pandemic PE firms actively pursued these defensive strategies, by reallocating resources, securing credit lines and focusing on short-term financial health. These shifts highlight the importance of flexibility and the role of PE firms as adaptive investors who adjust their actions according to the market conditions.

In conclusion, the PE investment model is a multidimensional value creation framework, which needs to be flexible to adapt with market conditions, sector-specific factors and deal attributes. While the use of leverage is a defining characteristic of PE, long-term value is created with operational expertise, governance and strategic adaptation. This flexibility allows PE funds to consistently shape portfolio companies and create value across different scenarios.

3.4 Returns in Private Equity

To understand and assess the role of PE in the financial markets, it is important to understand the return profiles of these investments. Unlike their public counterparts PE investments are often described as illiquid, hazily valuated, making measuring performance challenging and prone to biases. As a result, researchers have developed tools for benchmarking and to estimate if PE delivers abnormal returns.

One of the most used tools to measure PE performance is Public Market Equivalent (PME), which is used to compare PE funds and public equity indexes performance. This is done by estimating how the cash flows would have performed if invested into a public index (Kaplan & Schoar, 2005). Evidence using PME suggested that the average net-of-fee returns generated by buyout funds were roughly comparable to those of public markets, while venture capital funds were considerably more volatile. Kaplan and Schoar (2005) identified performance persistence as a key feature in the PE industry. In PE top-performing GPs often outperform on multiple fund periods, unlike mutual funds where past performance does not help to predict future returns. This performance persistence has made seeking access to top-tier GPs a significant goal for many limited partners (LPs).

However, some research has highlighted some methodological issues regarding the performance of PE investments. According to Phalippou (2009,2020) the use of internal rate of return as a metric to measure performance has left the industry data vulnerable to manipulation. Through strategic timings of cash flows and unrealistic reinvestment assumptions the performance data might be biased. He highlighted that with more reliable methods of measurement, such as Total Value Paid-in Capital (TVPI) and PME, the performance of PE funds after fees is often matching to those of public investments. In some cases, PE investments underperform the public markets when evaluated through these more reliable methods. While general partners have earned substantial compensation through carried interest and fees, the net earnings for LPs have been modest, suggesting that the value is transferred from LPs to the GPs (Phalippou, 2020). This debate

underscores the significant role of different fees and incentives in PE field. Management fees are typically around 1,5-2%, combined with the carried interest of approximately 20%. These fees create a structure which can significantly lessen the gross returns. Gompers et al. (2016) find that even though operational improvements and active governance can contribute substantially to value creation, the multiple different fees further complicate the assessment of net returns to investors.

Cyclicality is a highly influential factor in PE returns. According to Lerner, Schoar and Wongsunwai (2007) PE returns may vary substantially across different periods of funds depending on the economic climate at the time. Funds raised in unfavorable economic conditions often benefit from the lowered entry prices and stronger subsequent performance, while funds raised during favorable economic conditions often face lower future returns. Cyclicality highlights the importance of market timing and the effect of credit availability on leveraged buyout strategies (Axelson et al., 2013). In favorable markets multiple expansion is a substantial driver of returns and in less favorable markets the operational improvements and cost cutting are more apparent sources of value creation.

In conclusion, private equity has shown potential for attractive returns, these profits are not automatic or evenly distributed between funds, managers, or periods in time. Fund selection, fee structure, market timing and strategic emphasis on operational transformation significantly shape the returns. The understanding of PE returns requires attention to the flexibility of value creation, alignment of incentives and the economic conditions.

3.5 Private Equity Returns During Financial Crises

The effects of financial crises, such as the 2008 Global Financial Crisis and Covid-19 pandemic have been significant to both the public and private markets (De Silva et al., 2024; Lavery & Wilson, 2024). During these times of economic volatility opportunities to test the PE investment models performance have risen. As portfolio companies face tighter

availability of credit and reduced revenues, PE investors are forced to preserve value under unfavorable conditions. This section analyzes the research on PE returns and performance during financial crises.

During leveraged buyouts heavy leverage is often used to finance the acquisitions, which can increase returns but can also magnify risks, especially when economic crises emerge and cash flows decrease and access to credit is limited (Tykvova & Borell, 2012). The empirical evidence on whether PE ownership contributes to the ability of firms to weather crises remains mixed. According to Tykvova and Borell (2012) PE ownership makes companies more prone to financial distress caused by leverage, the companies do not show significantly higher bankruptcy rate compared to non-PE backed companies. Demiroglu & James (2010) find that PE sponsors with good reputation and expertise often negotiate covenant-lite loans, these loans provide flexibility and reduce default risk in the companies.

During crises PE firms typically shift from offensive strategies to a more defensive stance, focusing on operational improvements, liquidity management and debt negotiations (Lavery & Wilson, 2024; Gompers et al., 2016). Aggressive actions are often taken by sponsors, such as cost cutting and limiting cash spending. Lavery and Wilson (2024) find that during the Covid-19 pandemic, PE firms actively adjusted their strategies, with significant attention to financial restructuring and working capital management.

Evidence from the 2008 Global Financial Crises highlights this flexibility. According to Guo, Hotchkiss and Song (2011) in the sample of buyouts researched, companies with PE-backing generated positive operational improvements post-buyout, even as market conditions declined. Exit opportunities remained limited during the crisis, several PE companies extended their holding periods and worked actively with management to stabilize the performance of portfolio companies. This resulted in more favorable outcomes when compared to the broader markets (Guo et al., 2011).

Research on the Covid-19 pandemic shows that firms with PE-backing showed greater resilience than their counterparts. Lavery and Wilson (2024) find that in the UK companies with PE-ownership outperformed non-PE owned companies during the pandemic, being able to maintain a higher degree of growth and employment rates. They credit this to active liquidity management and stronger support from sponsors. The advantages of PE-backing were seen to be more minor than in later crises, this was attributed to the widespread government support that helped all companies.

Liquidity management served as a critical tool during both the 2008 Global Financial Crisis and the Covid-19 pandemic. According to De Silva et al. (2024) PE firms utilized revolving credit facilities, equity injections and strategic cost cutting to help stabilize cash flows. Demiroglu and James (2010) find that the existence of covenant-lite loans in buyouts, negotiated before the 2008 Global Financial Crisis allowed the companies to operate with greater flexibility and reduced the risk of defaults and distressed restructuring.

Even though PE-backed companies often exhibit a highly leveraged structure they showed resilience during crises. The financial risk associated with this leverage is often balanced by the active governance and support offered by PE sponsors (Tykova and Borell, 2012; Lavery & Wilson, 2024). According to findings by Lavery and Wilson (2024) PE firms are more likely to successfully negotiate debt terms and less likely to enter liquidation, compared to those companies with no PE-backing that face similar unfavorable conditions.

In conclusion, the research shows a mixed picture of PE performance during financial crises. At a portfolio company level, PE backing seems to provide the companies with a stabilizing effect. Targets of leveraged buyouts have had comparable or lower failure rates compared to other companies, despite the high level of debt. This has been attributed to active interventions by the PE sponsors (Tykova & Borell, 2012; Lavery & Wilson, 2024). This greater resilience is often contributed to PE-backed firms benefitting from more aggressive cost management, better access to funding, and greater

willingness of owners to restructure, these together create an edge for PE firms to show greater resilience during financial crises (Lavery & Wilson, 2024; De Silva et al., 2024). However, from the investor's perspective, the returns on average generated by private equity funds during crises have been similar to those of public markets once the fees have been deducted (Phalippou, 2009; Phalippou, 2020). The high fees and often competitive nature of private equity cause the created value to erode and leaves the LPs with often non-superior returns. While financial crises highlight the ability of PE firms to protect and even increase profits of their portfolio companies, they also show the rewards to investors might not supersede those of simply owning a diversified public portfolio. The research highlights the importance of efficient risk management and the cautious use of leverage in PE and raises important considerations about the risk-returns for investors allocating money to private equity during financial crises.

While many studies highlight the stabilizing role of PE during crises, according to Bernstein et al. (2019) PE-backed companies might experience heightened financial fragility during crises. They suggest that PE-firms create rapid growth with the use of leverage and operational growth, their model could expose firms to greater decline in financial health during downturns, especially in vulnerable sectors.

3.6 Synthesis of the literature on PE During Financial Crises

The discussed literature gives a complex but also interesting picture of how PE works across economic cycles, especially during financial crises. By combining empirical findings from the 2008 global financial crisis and the Covid-19 pandemic, several patterns and points of interest were visible, especially regarding the resilience on firm level, fund-level returns and theoretical alignment.

At the portfolio company level, it is widely agreed that firms with PE-backing are more resilient during financial downturns when compared to firms with no PE-backing. Research from both the 2008 Global financial crisis and the Covid-19 pandemic show that

PE sponsors actively engage in financial restructuring, operational guidance and liquidity management to cover their portfolio companies from crises (Tykvova & Borell,2012; Lavery & Wilson, 2024). While the heavily leveraged capital structures of these firms do increase the risk of financial distress, these risks are often mitigated by interventions done by sponsors and governance improvements. This is in line with the notion of Trade-off theory, which highlights the importance of balancing between tax benefits and debt and the costs of financial distress. The exact point in which leverage becomes a burden still varies between companies, industries, timing of acquisition and the experience of the fund managers.

The fund-level performance shows a more complex outcome. While the top performing PE funds might often outperform the public markets, the average net-of fees performance is similar to those of public equities (Kaplan & Schoar, 2005; Phalippou, 2020). Financial crises widen the gap between the top and bottom performing funds, this variability highlights the importance of manager selection for limited partners. Furthermore, the ultimate benefit of the investors is often being narrowed down by the management fees and carried interest fees. These issues show the limitations of traditional benchmarking like CAPM, suggesting that these returns cant be explained by market risk alone. There is a need for more complex models to estimate these returns, like the Public Market Equivalent (PME).

The research suggests that in PE strategies there is a general pattern of adaptation. During the 2008 Global Financial Crisis there was a focus on debt renegotiations and cost-reducing, while during the Covid-19 pandemic even faster liquidity interventions were required due to the sudden nature and the widespread impact of the crisis. According to Lavery and Wilson (2024) the outperformance during Covid was narrower than in previous crises, firms with PE-backing were still able to outperform those with no PE-backing. This narrowing of the outperformance is widely attributed to the level of government support companies received, regardless of ownership and the unique nature of the Covid-19 pandemic.

The literature highlights the relevance of Agency Theory in explaining the governance structures in PE. PE sponsors often employ tools like active ownership, board replacement and performance-based incentives are placed. These tools guarantee that the management behavior is aligned with those of the investors. (Acharya et al., 2013; Jensen, 1986). Even under the stress induced by unfavorable economic conditions, these frameworks appear to function effectively. This helps explain the lower bankruptcy rates faced by PE-backed firms despite their often highly leveraged structures. These governance tools become even more essential during times of crisis as management discipline is essential for survival.

Another point of interest is whether PE contributes to systematic financial risk. PE ownership often stabilizes firm-level performance, the heavy reliance on leverage across the field might create vulnerabilities in the broader credit industry during crises. The combination of heavy leverage, aggressive growth and exit pressure might create shocks in the financial markets (Acharya et al., 2013). In essence, while PE stabilizes its own companies the use of leverage might increase risk elsewhere and destabilize the financial markets, this still remains largely an unexplored area of research.

The effects of PE ownership during financial crises on job related outcomes is a topic of increasing interest. According to Lavery and Wilson (2024) PE-backed firms in the UK were more successful in retaining employees and wages during the Covid-19 pandemic. This research challenges the typical narrative of PE being purely extractive and supports the view of PE helping to maintain human capital. However, this research was limited to the UK and the evidence outside the UK remains unexplored.

4 Conclusion

This thesis aimed to explore how private equity operates during financial crises keeping a specific focus on the performance of PE-backed firms, PE firms strategies, and the implications for investors. This thesis covered evidence from both normal and crisis conditions, taking data from empirical studies across major financial crises, including the 2008 Global Financial Crisis and The Covid-19 pandemic. These findings confirm that while there are several consistent patterns in terms of portfolio company outcomes, fund returns and strategic flexibility, the performance during economic downturns varies across context.

At a portfolio company level, firms with PE-backing often outperformed their non-backed counterparts during both the 2008 Global Financial crisis and the Covid-19 pandemic. This was credited to dynamic financial and operational management by the PE sponsors, including restructuring, cost reducing and liquidity support (Lavery & Wilson, 2024; De Silva et al., 2024). Despite the heavily leveraged structure, Pe-backed firms showed no systematically heightened rate of bankruptcy compared to firms with no-backing, this result is in line with the notions of Trade-off Theory regarding the benefits of debt outweighing the negatives up to a certain point (Tykvova & Borell, 2012).

At the fund level the evidence suggests that private equity returns might not always exceed those of public markets, once fees and risk adjustments are considered. While the top-performing funds might deliver strong returns, average fund returns during crises tend to be similar to those of public equities, especially when measured with tools like PME (Kaplan & Schoar, 2005; Phalippou, 2020). This suggests that portfolio company performance does not automatically translate into superior returns at the investor level, especially for limited partners, who are subject to high fees.

4.1 Revisiting the Hypotheses

H1: PE-backed companies show greater short-term resilience during financial crises compared to non-PE-backed companies.
Multiple studies find that companies with PE-backing show stronger short-term performance and resilience during crises like the GFC and Covid-19 pandemic. Sponsors provided support, allowing the firms to pull through crises better than their non-backed counterparts (Lavery & Wilson, 2024; Guo et al., 2011).

H2: Despite the short-term resilience, PE-backed companies face higher long-term risks of financial distress compared to non-PE-backed companies.
The literature shows that, while PE-backed companies carry higher leverage, which increases risk to long-term financial distress, bankruptcy rates are not consistently heightened, largely because of the ability of PE firms to manage their portfolio companies (Tykvova & Borell, 2012; Demiroglu & James, 2010).

H3: PE funds adjust their strategies during crises by shifting focus from growth to operational improvements, liquidity management and financial restructuring.
Both during the GFC and the Covid-19 pandemic there were visible changes in PE strategy. Sponsors focused on stabilizing cash flows, preserving capital and maintaining solvency. These changes align with crisis time priorities and demonstrate the flexibility of the PE model (Lavery & Wilson, 2024; Gompers et al., 2016).

4.2 Theoretical Implications and limitations

The findings of this thesis reinforce the relevance of traditional financial theories when applied to the PE model. The Trade-off theory explains the balance between the benefits and risks of leverage, especially during unfavorable economic conditions. The Pecking Order theory helps explain the preference of debt over equity in the PE model when

raising new capital. Lastly, the Agency theory is critical to understanding the PE value creation, showing the role of concentrated ownership, performance-based incentives and active management in reducing inefficiencies in portfolio companies.

This thesis was limited by the availability of prior research, especially when most empirical studies focused on U.S. and UK markets, with less data available from Europe, Asia and emerging markets. Most of the Covid-19 literature is still evolving and post-crisis data is still incomplete due to delayed realizations. Also there has been a clear focus on buyout research, leaving a gap in the research on other PE strategies, such as venture capital and Growth equity.

Private equity shows significant strengths in preserving and increasing the firm value during crises, mostly through active governance and financial adaptability. However, at fund level these advantages do not always translate to outperformance, especially when fees are accounted for.

4.3 Practical Implications and Suggestions for Future Research

This thesis provides insights for institutional investors, fund managers and policymakers on how to navigate the private equity field during financial crises. While multiple studies show that while PE-backed companies often exhibit greater resilience during financial crises, this performance does not automatically transform into abnormal returns for limited partners (Phalippou, 2020; Kaplan & Schoar, 2005). Investors should be careful not to be lured in by the portfolio company level stability without considering the importance of fund selection and heavy fees involved.

The ability of PE sponsors to be able to restructure debt, impose strong management and maintain liquidity shows the value of active management during crises (Acharya et al., 2013; Lavery & Wilson, 2024). To practitioners, this highlights the importance of creating internal risk management strategies and upholding financial flexibility. For

regulators these findings raise questions about the systematic risks associated with the heavy use of leverage and highly concentrated management structure of PE, especially as the private equity market continues to evolve and grow.

Future research could focus on how these patterns behave in different fund structures, such as venture capital and growth equity and compare them to buyout funds. There is also a need for research into different geographic zones, such as Europe, Asia and developing markets and the behavior of PE in these markets. Deeper research into long-term performance of companies post PE exit and the labor effects of PE ownership are also needed. There would also be a benefit of post-covid research as the exit data for that period starts to become available.

In conclusion, this thesis explores the duality of private equity operations during financial crises, highlighting both its strengths and its limitations. While private equity offers useful tools for operating in unfavorable economic conditions, it is not immune to the risks faced by the whole financial markets. As the private equity field grows globally it is increasingly important to understand the implications of these crises and their effects.

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