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The Effect of Leverage on Exit Valuation in Private Equity Buyouts

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ABSTRACT:

This thesis investigates the relationship between leverage and exit values in private equity acquisitions. The aim is to clarify whether higher leverage is always associated with higher exit values, whether other factors are involved, and, if so, which ones. The thesis uses traditional capital structure theories to analyze leverage decisions. Still, these theories alone are not sufficient to explain all decisions made by private equity investors in acquisitions and the related financing structures. Much of the prior literature indicates that leverage is largely determined by credit markets rather than by changes in company operations alone. In private equity acquisitions, deals are largely debt-financed, and leverage ratios tend to increase when cheap, readily available credit is abundant. For this reason, the thesis focuses on the impact of credit market conditions on private equity investors' debt decisions and exit outcomes. This study looks at earlier research on capital structures, value creation, and leverage in corporate acquisitions. Past studies have found that high leverage can increase exit values when credit markets are strong. On the other hand, high leverage also raises financial risk if credit becomes less available or uncertainty grows. Exit values are shaped by several factors, including refinancing risk, valuation cycles, and exit timing. Research shows that leverage alone does not determine exit value. Instead, its impact depends on the surrounding conditions. Credit market conditions, financing regulations, and other transaction-specific factors, together with the level of debt, determine the final exit value of a leveraged buyout. Therefore, successful LBOs require in addition to debt, favorable credit markets and the right timing.

KEYWORDS: Leveraged buyouts, Leverage, Exit valuation, Private equity, Credit market conditions, Fund-level performance, Multiple expansion

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1 Introduction

Private equity (PE) has grown into a major part of global financial markets by providing an alternative to traditional financing methods such as bank loans and public equity issues. Private equity firms mainly operate by acquiring companies to increase their value through restructuring, improving operations, and ultimately realizing value in exit. Buyouts are one of the most significant strategies in private equity. In a buyout, private equity firms look for a target company that is already mature and generating stable cash flow and finance the transaction mainly with debt (Siegel et al., 2011). This kind of transaction is known as a leveraged buyout (LBO) and has become one of the cornerstones of modern private equity.

PE buyouts became a recognized part of corporate finance in the 1980s, when innovations in the debt market made it possible for investors to acquire stable, cash-generating companies with relatively little equity. The buyout model that emerged during that period began to evolve into its current form, as larger acquisitions were financed with increasing amounts of debt rather than internal financing or equity issuance (Kaplan & Strömberg, 2009). Today, buyouts form a core element of the private equity industry and are increasingly used in ownership changes and corporate restructurings.

Figure 1. shows how LBOs have grown to become a more significant part of global corporate finance since 1985. Both the number of transactions and their value increased sharply by the mid-2000s. This reflects the rapid expansion of the private equity industry worldwide. More recent data also support the conclusion that PE has continued to expand globally (McGrath, 2023).

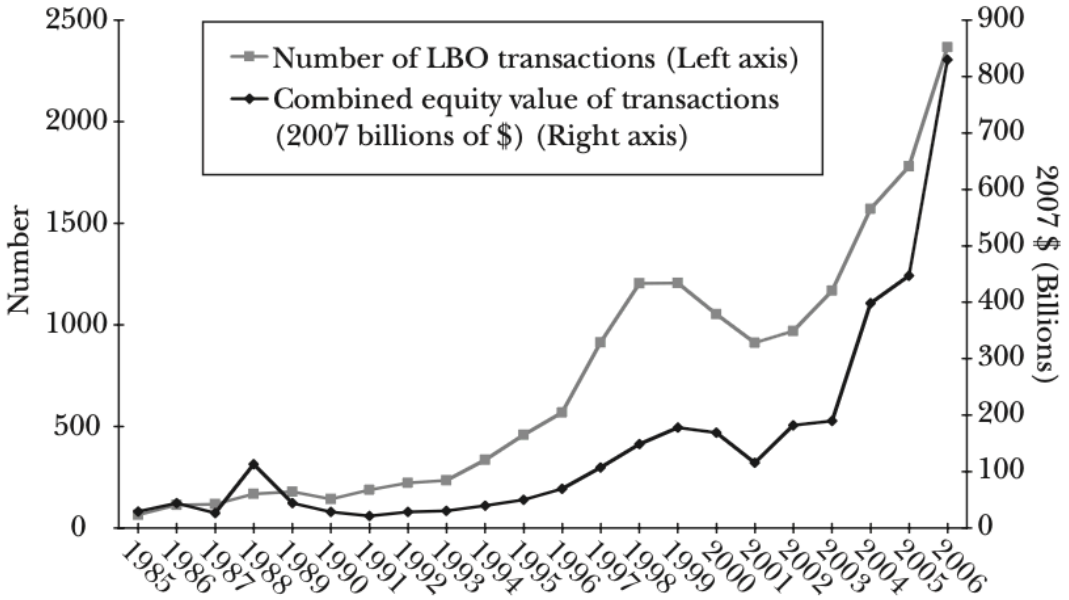

Figure 1. Global Private Equity Transaction Volume, 1985-2006

Based on Kaplan & Strömberg, (2009, pp. 126); updated discussion in McGrath, (2023)

1.1 Purpose of Study

This thesis aims to study the relationship between leverage and exit valuation since they lie at the intersection of theory and practice in corporate finance. Private equity buyouts provide a clear setting in which capital structure decisions play a central role and the consequences are directly visible in exit valuations. The literature has previously examined whether high leverage is uniquely behind value creation or whether it increases exit value due to favorable credit markets. This thesis is therefore timely and relevant, as the importance of private equity investments continues to grow in global financial markets (McGrath, 2023).

Most of the existing studies emphasize the role of credit market cycles in shaping leverage decisions in PE buyouts. But less attention is given to how differences in leverage intensity transform into value at exit especially when considering both deal-level and fund-level outcomes. Based on that, this thesis focuses on examining how leverage

relates to exit valuation in PE buyouts while also noting the influence of credit market conditions.

The analysis is guided by two research questions. The first question examines the relationship between leverage intensity and exit valuation in private equity buyouts:

Q1: How does high versus low leverage affect exit valuation in private equity buyouts?

This research question is central to discussions of value creation, as leverage represents one of the key features of buyout transactions. Based on this arguments and prior studies the hypothesis will be the following:

H1: Highly leveraged buyouts are associated with higher exit valuations than low-leverage buyouts.

In addition to leverage intensity, there is no doubt that financing conditions are likely to influence exit outcomes. Credit market conditions affect both the availability and the cost of debt financing and may therefore strengthen or weaken the effects of leverage on performance. This leads to the second research question:

Q2: How do credit market conditions moderate the relationship between leverage and exit valuation in PE buyouts?

To better understand how leverage affects exit valuation in private equity buyouts, it is also necessary to consider the role of credit market conditions. Leverage decisions in buyouts are closely tied to the availability and cost of debt financing and that is why the second hypothesis is:

H2: The positive effect of leverage on fund-level performance is stronger when credit market conditions are favorable.

The thesis results are limited by its focus on traditional leveraged buyouts. It ignores areas such as venture capital, crisis acquisitions, mezzanine financing and tax-related aspects. The research focuses on theoretical and empirical studies on leveraged buyouts and fund-level performance discussed in peer-reviewed articles and studies. This thesis does not include new empirical studies on the topic.

1.2 Structure of Study

The motivation for the study is presented in the first chapter along with the research questions and hypotheses. The second chapter investigates the theoretical foundations of capital structure and introduces the key theories explaining leverage decisions, including Modigliani & Miller propositions, trade-off theory, market timing theory and agency theory.

The third chapter provides a review of prior empirical literature on leverage in PE buyouts and examines how credit market conditions and leverage intensity influence exit outcomes. The fourth chapter reviews prior literature on value creation and exit valuation in leveraged buyouts.

The fifth chapter focuses on the empirical findings. And the last, sixth, chapter concludes the thesis by summarizing the main results, limitations and highlighting the implications for theory and practice.

2 Theoretical Foundations of Capital Structure

This chapter examines the main theories that explain how companies determine their capital structures and how leverage decisions affect their value. This discussion begins with Modigliani & Miller (1958, 1963) propositions, which form the basis of modern capital structure theory. Discussion continues with more developed perspectives such as the trade-off theory, market-timing theory and agency theory. Together, these frameworks provide the conceptual tools for understanding how leverage can both create and destroy value in PE transactions.

This chapter provides the theoretical and conceptual foundation upon which the subsequent analysis of the relationship between the leveraged buyouts and exit valuation is built. Traditional capital structure theories support the relationship between leverage and exit value and the hypotheses of this study. This theoretical foundation and its implications for leveraged buyouts guide the analysis and synthesis of empirical evidence as the study progresses.

2.1 Modigliani & Miller, Trade-Off and Agency Theories

Franco Modigliani and Merton H. Miller shaped today's view of capital structure with their research. Their theories show that in a perfect capital market, a firm's value does not depend on how it is financed. Instead, the value comes from its assets and operations, not by the proportion of debt and equity in its capital structure (Modigliani & Miller, 1958). This framework acts as a benchmark for later theories in which leverage has no effect on the firm's value.

Modigliani & Miller later modified their theory by introducing corporate taxes. They proposed that interest payments on debt create a tax shield, which increases a firm's value because interest is tax-deductible, debt reduces taxable income and thereby raises the after-tax value. The recognition of tax advantages implies that in the presence of taxes, a higher level of leverage can enhance firm value. In buyouts, this is one reason leverage

can boost exit valuation. It increases with leverage until the tax benefits of debt are offset by the expected cost of financial distress (Modigliani & Miller, 1963). This laid the foundation for the later developed trade-off theory, which allows the analysis to be extended to the optimal tax level, balancing the tax benefits against the expected costs of bankruptcy and the agency problem (Abel, 2018).

The trade-off theory is based on the idea of an optimal level of debt, beyond which increasing debt increases risk faster than the tax benefits (Kraus & Litzenberger, 1973). This theory shows that moderate debt can increase the value of a firm through tax benefits, but beyond a certain level, risk starts to increase faster than tax benefits and, as a result, the risk of default and loss of flexibility start to reduce the value created by debt (Axelson et al., 2009).

Graham's (2000) empirical studies show that the marginal tax benefit of debt declines after a moderate level of debt, corresponding to a debt-to-value ratio of about 30-40%. This research supports the view of a range of optimal debt levels and the idea that there is no single, absolute, universal optimum for all firms.

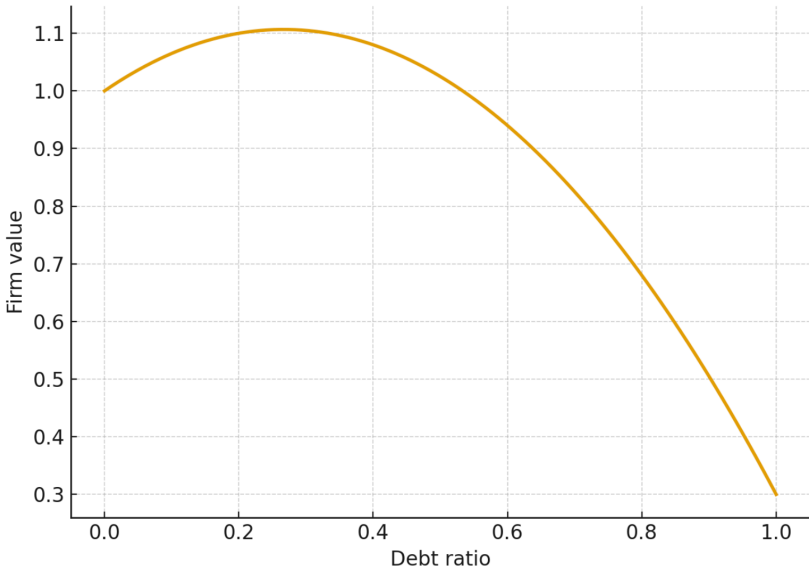

Figure 2. Trade-off Theory: Leverage and Firm Value

Based on Graham (2000) & Abel (2018)

Agency theory focuses on behavioral effects and adds to the existing theoretical base. Debt brings responsibilities that limit management's freedom, since more cash flow must go toward paying off debt. Creditors' requirements for interest and principal payments help cut down on inefficient investments and wasteful spending, aligning the interests of management and shareholders (Jensen, 1986). However, agency conflicts can still happen between shareholders and debt holders if too much leverage encourages risky behavior or causes underinvestment (Axelson et al., 2013).

These theories explain how leverage can both enhance and destroy value. It depends on the balance between tax benefits, bankruptcy risk and agency costs. In the context of PE buyouts, these mechanisms are particularly pronounced as high leverage levels and active ownership structures make capital-structure decisions central to value creation.

2.2 Pecking-Order and Market-Timing Perspectives

The extension of the traditional trade-off theory to a more diverse and contemporary perspective can be done based on the following theories. Pecking-order theory and market-timing perspective bring new approaches to the idea of the optimal level of debt. According to these theories, the traditional trade-off theory should include information and behavioral factors that shape financing choices.

According to the pecking-order theory (Myers & Majluf, 1984), companies follow a kind of hierarchy when they choose suitable financing sources. This perspective emphasizes the asymmetry of information between managers and investors. Managers think carefully about their financing sources, because each choice sends a signal to investors. Managers first favor internal funds, then debt, and only as a last resort, equity issuance. This is because equity issuance can be transmitted to investors as a signal of market overvaluation.

Baker & Wurgler (2002) suggest that managers utilize capital market conditions when considering financing sources. The idea is to issue shares when valuations are high and

resort to debt when interest rates or credit spreads are low. Both perspectives, pecking order and market timing, refer to financial behavior that conforms to the environment rather than a journey towards a goal that is a fixed point independent of the environment.

These theories are important in the private equity industry. People in this field closely study their environment, including debt markets and valuation levels. The way information asymmetry, market timing, and debt leverage interact helps explain why leverage changes during different credit cycles and valuation periods.

2.3 Capital Structure Theories and LBOs

Leveraged buyouts (LBOs) illustrate how capital structure theories work in practice in the real world. Private equity sponsors acquire mature companies and complete the transaction using very large amounts of debt, often exceeding 60-70% of the total transaction value (Kaplan & Strömberg, 2009). The target company is required to have stable cash flows, as they are used to repay the debt used in the transaction. When cash flow covers the repayments, private equity investors aim to improve the company's operations and thus increase the value of the company and at the same time their chances of higher exit rates. Such an arrangement challenges capital structure theories, as debt financing is carefully designed to maximize exit value (Baldi, 2015; Brinkhuis & De Maeseneire, 2012).

According to the trade-off theory, acquisitions operate as transactions that are guided by a conscious pursuit of an optimal capital structure. The aim is to increase the value of the firm in two ways: through tax benefits resulting from interest deductions and through close governance and active monitoring resulting from ownership by private equity investors (Jensen, 1986; Axelson et al., 2013). However, previous empirical research shows that excessive debt can reduce the value of the firm, as operating performance deteriorates and refinancing conditions may become tighter (Korteweg, 2010; Brinkhuis & De Maeseneire, 2012). The idea of the agency theory complements this perspective. It suggests that the debt taken disciplines the management by limiting free cash

flow and thus improving efficiency. On the other hand, high debt can also cause conflicts of interest between owners and management, especially when management is encouraged to take higher risks (Acharya et al., 2013).

In addition to traditional theories, market-based theories explain changes in leverage during different acquisitions. According to market timing theory, when credit is cheap and readily available, financiers use it more. Conversely, when interest rates rise and its terms become tighter (Baker & Wurgler, 2002; Ljungqvist et al., 2008). Such a cycle suggests that credit market conditions would be more important than inflexible adherence to planned targets. In debt-financed acquisitions by private equity investors, factors such as the availability of debt, investor expectations, and the financing environment are central to the actual impact of leverage (IPC-PERC, 2021).

LBOs show that traditional equity theories, combined with modern perspectives, help explain leverage decisions. They combine the tax and agency ideas of traditional theories with behavioral and timing factors from more recent research. It is precisely because of this combination that debt-financed acquisitions are an interesting way to study how debt levels and leverage can increase and limit a company's value.

3 Credit Market Dynamics and Determinants of Leverage

Determinants like investor reputation, credit market conditions and company characteristics shape financing structures. Knowing how these factors affect leverage is important for PE investors when making buyout decisions. Previous research shows that financing decisions for LBO also take into account the financing environment, such as interest rate markets and the uncertainty of the economy in which the transactions take place (Axelson et al., 2013). Syndicated loans and combinations of high-yield debt are the most important financing instruments used by private equity investors in their transactions. Therefore, the availability of credit and its pricing are among the most crucial factors when considering the amount of debt.

3.1 Credit Market Conditions and Financing Environment

In PE buyouts, credit market conditions are among the most important factors that determine how much debt is used. When credit is easy to get and lenders are willing to take more risk, they give out bigger loans with fewer restrictions. This allows investors to have greater leverage. On the other hand, as interest rates rise and credit becomes tighter, debt-financed acquisitions require a different financing structure, as lenders demand higher risk premiums. The debt-equity ratio should therefore be adjusted to support the financing environment (Axelson et al., 2013). They also highlighted the determining effect of credit market liquidity on the amount of debt. This suggests that leverage interacts more actively with loan terms than with firm-specific fundamentals.

The expansion of structured loan products such as collateralized loan obligations (CLOs) by lenders increases the prices of acquisitions during credit booms, as investors obtain larger loans (Shivdasani & Wang, 2011). High prices are associated with higher yields and increased borrowing, all of which indicate that debt follows the credit market cycle and not just the risk profile of individual deals (Ljungqvist et al., 2008).

When credit markets are favorable, the effects extend to exit values and not just the possibility of higher leverage in buyouts. In such a favorable financing environment, private equity firms have the opportunity to achieve higher valuation multiples, which are due to cheap debt financing. From an investor's perspective, increased valuation multiples can lead to higher realized returns in buyouts. The cyclical behavior of debt and valuations reflects the market-timing model described by Baker and Wurgler (2002). In the model, acquisition promoters actively employ debt to take advantage of loose credit market conditions. Their empirical research provides the basis for the second hypothesis of this thesis, according to which the positive effect of debt on returns is stronger in favorable credit market conditions (Jenkinson et al., 2022; Axelson et al., 2013).

A long-term view of market data supports the market-timing model, as the movement of leverage and valuation multiples followed the pace of credit availability. During periods of cheap debt, when credit spreads narrow, the debt-to-EBITDA ratio rises. This rise in the ratio is reflected in a higher value-to-EBITDA ratio, indicating investors' willingness to pay higher prices for buyouts (Axelson et al., 2013). Conversely, during periods of tightening financing conditions, both leverage and pricing decline. Figure 3. Illustrates these cyclical fluctuations and shows how changes in liquidity in credit markets affect leverage intensity and subsequently exit valuations.

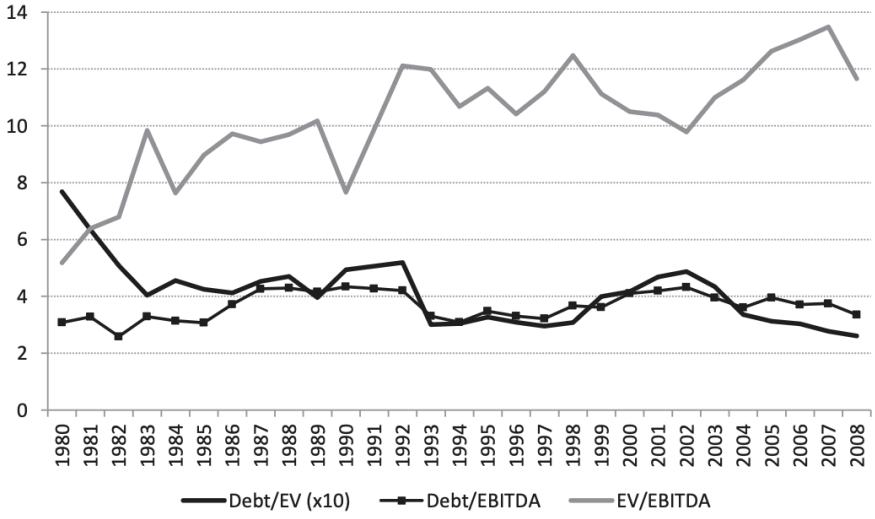

Figure 3. Market Trends in Leverage and Pricing

NB: The figure was created using AI, with the prompt: “Create a conceptual time-series diagram showing long-term trends in leverage and pricing in private equity buyouts, including Debt/EBITDA, Debt/EV and EV/EBITDA ratios for the period 1980–2008.” (OpenAI, 2025).

Adapted from Axelson et al., (2013)

3.2 Sponsor Reputation and Relationship Banking

In addition to the financial environment, the reputation and banking relationships of private equity investors are important factors in leverage decisions, as they directly affect the cost of debt and, through it, the level of leverage in buyouts. Lenders’ knowledge and experience of the private equity fund’s credibility, experience, and supervisory ability affect credit terms and financing structure, alongside the liquidity of the credit market (Ivashina & Kovner, 2011). Established investors with a history of successful deals enjoy looser loan terms than new and unknown investors (Demiroglu & James, 2010). Their model showed that lenders expect reputable investors to intervene more strongly in operational matters if the portfolio company’s performance deteriorates and are therefore perceived as safer loan applicants than new market entrants.

Faverzani (2024) proves that the reputation of sponsors is a significant factor in both covenant structure and pricing. Demiroglu & James (2010) study confirms that sponsors with a successful track record of buyouts are considered to be lower credit risk. In addition to reputation, loyal customer relationships reduce the information asymmetry between private equity firms and banks. This improves access to credit during the ups and downs of the credit cycle (Ivashina & Kovner, 2011). According to them, such relationships are often created through continuous interaction over time. This allows lenders to more easily rely on the sponsor’s discipline assessment criteria and performance monitoring rather than just financial ratios alone.

Relationship banking has been found to have an impact on the cost of debt. For example, when a financier combines investment and lending activities to gain a more aligned interest in the customer and put both parties on an equal footing. When incentives are

aligned, the customer can obtain a loan on better terms. Fang et al. (2013) found that the financier's own investment in the customer, for example, through fund investment or co-investment, can reduce moral hazard and improve information quality. The established customer relationships resulting from integration allow PE investors to use greater leverage and more favorable loan terms.

The agency theory provides theoretical support for the financier perspective. Debt is known to constrain management decisions, as the principal and interest payments on a loan must be repaid regularly (Jensen, 1986). Lenders grant more loans to reputable PE investors on better terms because they are seen as less risky. Successful investors are perceived as safer because they actively monitor and guide the company and dare to intervene if it no longer supports value creation. This allows the sponsor's good reputation to become a kind of economic capital. This explains why loan terms vary both across credit cycles and across sponsors.

3.3 Firm and Deal Characteristics

The financing environment for transactions is mainly determined by the credit market, the macroeconomic situation and the reputation of the investor. However, before applying for credit, it is necessary to know the fundamentals of the company, such as the nature of its assets, the stability and predictability of its cash flow and the profitability of the company. These factors ultimately determine how much debt the company can carry. Solid and profitable companies can carry more debt because their costs are more predictable. On the other hand, companies operating in cyclical or asset-light industries often do not have stable cash flow and collateral, so their loan terms are stricter (Brinkhuis & De Maeseneire, 2012).

The size and financial strength of the company have also been studied as significant determinants of the level of debt. Private equity firms plan the financing structures of a company acquisition very carefully from the outset. The financing structure is designed to support the target company's repayment capacity and operational improvements.

This is evident from the fact that private equity firms tend to reduce debt levels after the transaction (Cohn et al., 2014). Guo et al. (2011) state that the value created in an LBO is largely explained by increased profitability. This means that performance expectations need to be included in the design of the financing structure from the very beginning. Furthermore, Axelson et al. (2013) emphasize that large and stable companies with diversified operations typically enjoy better loan terms. This allows the amount of equity in such a private equity firm to remain low in merger situations, as it is possible to take on more debt.

The structure of the deal and its ownership interests also explain the variation in the gearing ratio. When lenders make a risk assessment, the size of the transaction, the proportion of equity and competition affect the final result of the risk assessment, on which the loan terms are based. In particular, if the investor has a large equity share in the financing structure, it creates trust and leads to better loan terms (Acharya et al., 2013). On the other hand, competitive auctions combined with aggressive pricing increase the reliance on optimistic cash flow forecasts (Kaplan & Strömberg, 2009). In addition, different exit routes affect the formation of the debt structure. For example, secondary acquisitions generally allow for higher leverage and a shorter holding period, while IPO exits typically require a more moderate level of debt to maintain flexibility after the exit (Jenkinson & Sousa, 2015). These findings show how the financing structure of a buyout is individualized according to the company's fundamentals and the timing and form of exit opportunities.

Macroeconomic credit conditions, investor reputation and banking relationships, and company-specific characteristics together determine the debt leverage of acquisitions. These shape the availability of debt, its terms, and the level of sustainable debt. Figure 4. below illustrates how each level affects the leverage of PE buyouts.

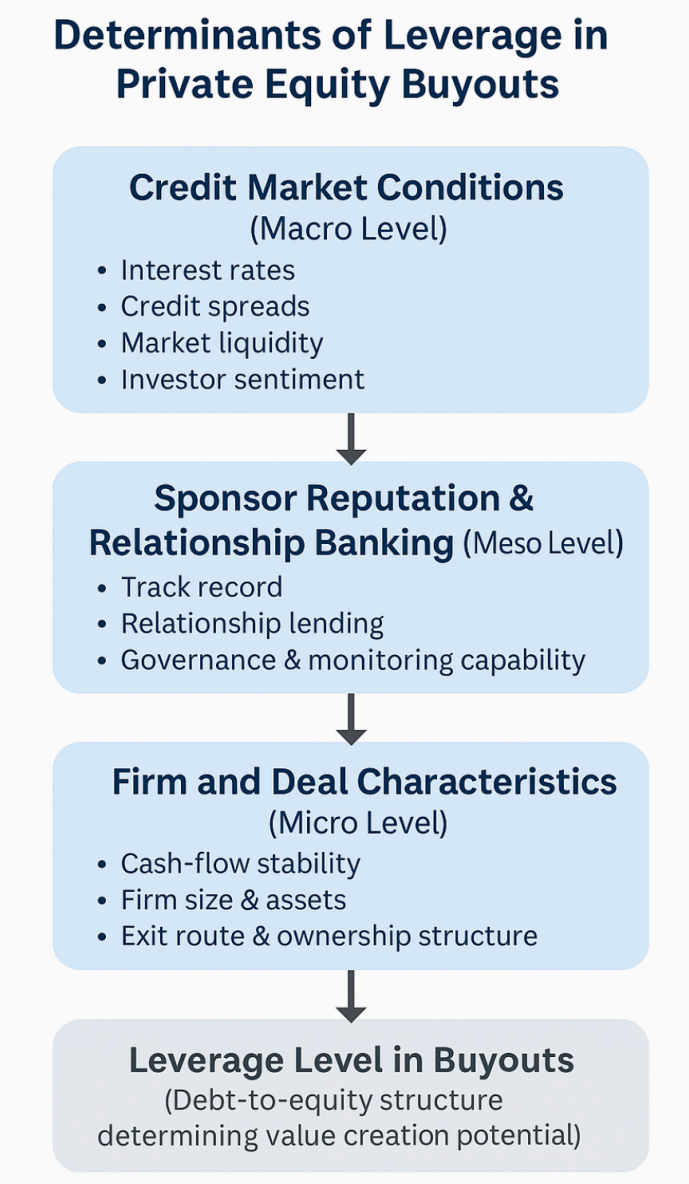

Figure 4. Determinants of Leverage in Private Equity Buyouts

Adapted from Axelson et al. (2013); Brinkhuis & De Maeseneire, (2012)

4 Value Creation and Exit Valuation in Buyouts

The previous chapters have justified the factors that determine the level of leverage used by private equity investors in corporate buyouts from a theoretical perspective. Now, we turn our attention to the results of leverage and examine how leverage intensity affects value creation and exit value.

Value creation in LBO occurs through several mechanisms. Improvements in financial, operational, and governance areas together increase exit values. For example, when considering debt financing and how it can enhance firm value through tax benefits, management discipline, and solutions to the agency problem. However, excessive levels of debt increase risks, limit flexibility, and weaken long-term sustainability. The balance and interaction of mechanisms determine what kind of exit values leverage intensity leads to in the endgame.

Prior research has taken a deeper look at the value creation process in LBOs. Kaplan & Strömberg (2009) consider operational efficiency improvements and restructuring as the most important ways to create value in a company, while Acharya et al. (2013) emphasize the importance of aligning incentives and improving governance. Axelson et al. (2013) and Shivdasani & Wang (2011) also emphasize credit market conditions and financing structure design from a timing perspective. According to them, the right timing and cheap debt can temporarily increase valuation multiples. Together, these findings suggest that leveraged value creation interacts with both firm-level fundamentals and market conditions.

First, Section 4.1 examines post-acquisition operational and financial performance and how improvements in them affect debt gearing. Section 4.2 examines multiple expansion and the valuation effects that occur during favorable market conditions. Section 4.3 explores governance mechanisms, agency effects, and tax advantages that connect leverage to value creation. And last, chapter 4.4 compares outcomes between highly and

lowly leveraged buyouts, highlighting the moderating role of credit market conditions in explaining fund-level performance.

Figure 5 below summarizes the main channels through which LBOs create value. It shows how credit market conditions influence leverage intensity, and how operational improvements, financial structure and governance mechanisms together shape exit valuation and overall performance.

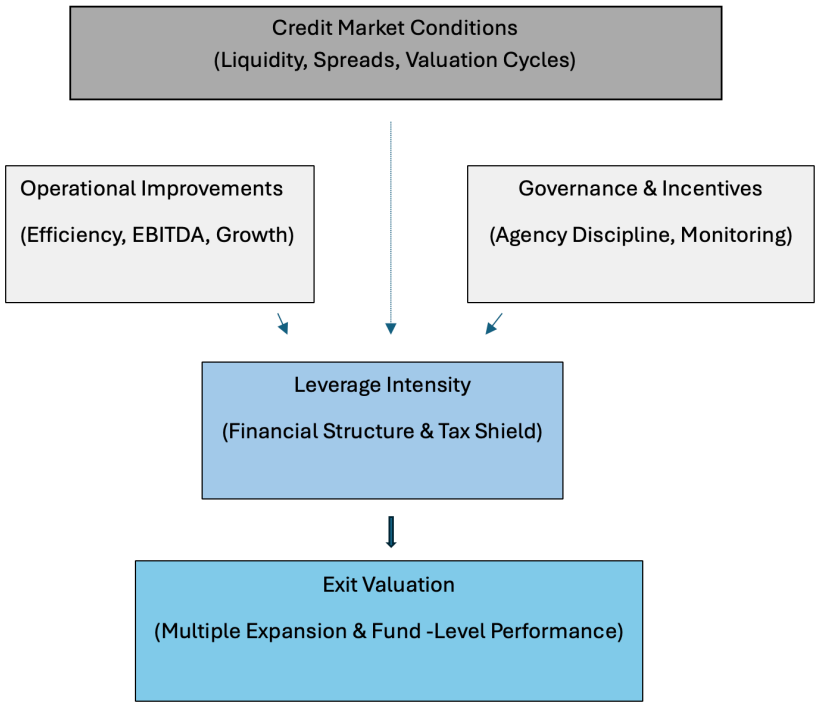

Figure 5. Channels of Value Creation in LBOs

Adapted from Kaplan & Strömberg, (2009); Jensen, (1986); Acharya et al., (2013); Axelson et al., (2013); Jenkinson et al., (2022).

4.1 Operating and Financial Performance After LBOs

The main question in research about LBOs is whether using a lot of debt in buyouts actually makes the company more valuable. Does taking on debt help the business perform better, or are the profits just a result of favorable market conditions? Using a lot of debt can force managers to be more careful, which can help the company make more

money and manage its cash flow better (Acharya et al., 2013). It can also expose companies to excessive distress risk and make management short-sighted (Korteweg, 2010). However, research has shown that the connection is more complex than it seems.

Why can debt improve firm performance? This can be justified by the free cash flow theory developed by Jensen (1986). Leveraged firms are constrained by the fact that the principal and interest payments arising from debt must be made regularly. This puts pressure on management to focus on productive activities so that payments can be made on time. Management discipline has been found to reduce risky or inefficient investments and prevent wasteful spending. In LBOs, sponsors are involved in the management of the firm and ensure that managers act in the best interests of the firm. They monitor and create rewards that encourage management to do their best (Acharya et al., 2013). As a result, many LBOs become more profitable after the sponsors are involved.

Empirical results support the claim that a company becomes more profitable when PE sponsors are involved. In particular, in highly leveraged buyouts, significant improvements in EBITDA and return on equity have been observed after the acquisition (Cohn et al., 2014). This proves that financial pressure and active monitoring enhance the company's operations in a more profitable direction. Studies have also confirmed that positive performance is not based solely on financial planning but is due to real operational improvements. This was observed by comparing the results with similar public companies (Guo et al., 2011). Achary et al. (2013) show that the involvement and ownership of private equity investors promote cash flow growth and productivity. This development is due to better monitoring and stronger incentives.

High debt levels can support value creation, but at the same time also increase the possibility of financial risks, which depend on firm-specific factors. Therefore, the effects of high debt on value creation are not universal. In buyouts where the amount of debt is proportional to the company's fundamentals and financial planning is done correctly, high debt can strengthen exit values. When debt exceeds a sustainable limit, especially

for companies in cyclical industries, the risk of bankruptcy has been observed to increase sharply in tightening credit markets (Ayash & Rastad, 2021). Especially in highly leveraged companies, the trade-off between tax benefits and distress costs is relevant, as even a small shock to earnings can critically change the value of equity (Korteweg, 2010).

At the fund level, financial development and performance are directly reflected in exit results. As debt enhances management and improves efficiency, it accelerates debt repayment. From an investor perspective, gradual debt deleveraging leads to a decrease in the debt ratio and an increase in equity (Kaplan & Strömberg, 2009). Even if the total value of the firm remains unchanged, the reduction in debt and the increase in equity can increase exit values, because lower debt during the exit period strengthens the return on equity. However, the value of equity can decrease when debt exceeds the firm's repayment capacity. In this case, refinancing challenges and covenant violations start to eat into value (Korteweg, 2010; Ayash & Rastad, 2021).

Recent research shows that having a high leverage intensity can be seen as a double-edged sword. Debt that stays within safe limits can help by improving companies' efficiency and governance and provide tax benefits. But if the level of debt gets too high, it increases vulnerability and limits their long-term success. Therefore, debt can be seen as a catalyst for improvements, but also as a risk escalator. These perspectives form the basis for the first hypothesis in this thesis, which says that buyouts with high leverage levels are associated with higher exit valuations.

4.2 Multiple Expansion and Valuation Effect

While financial and operational improvements explain some of the value created in LBOs, market-based factors explain more of this variation in exit value. PE sponsors generally achieve high returns by improving the performance of the target company, but also largely through timing and high valuation multiples. For example, private equity funds sell shares at higher valuation multiples than what was originally paid for the

acquisition. This phenomenon is called multiple expansion and is very dependent on credit market conditions and investor sentiment.

When credit markets are liquid and risk premiums are low, credit becomes easier to obtain, and its price falls. Such conditions are called favorable market conditions and usually allow PE sponsors to use greater leverage, which drives up buyout prices. Such favorable conditions and rising transaction prices, in turn, increase firm values and exit rates (Axelson et al., 2013; Shivdasani & Wang, 2011). The phenomenon also works in reverse: tighter credit markets reduce debt capacity and valuation rates, which, in turn, lead to a decrease in leverage intensity. Thus, leverage and pricing are correlated with cyclical credit market liquidity, reflecting market-timing behavior.

The model is supported by Axelson et al. (2013), who show that leverage is more strongly related to the credit market cycle than to firm-specific fundamentals. During periods of cheaper credit and higher prices, more heavily leveraged acquisitions occur than during periods of tighter lending. Certain types of loans, particularly CLOs, grew rapidly in the 2000s, enabling larger and riskier buyouts (Shivdasani & Wang, 2011). The results show that buyouts financed with this type of loan were more dependent on the price and availability of credit than on improving business performance.

Valuation multiples can improve LBO returns even if operating results remain the same. PE investors have been observed to exit their investments during periods of high valuations in strong credit markets, in order to obtain higher equity returns. This behavior is consistent with exit-timing theory, which states that PE sponsors carefully plan their entry and exit timing when valuations are at their peak (Jenkinson & Sousa, 2015). The same phenomenon has also been observed at the fund level. PE funds achieve their highest returns at the same time as credit expansion, suggesting that exit timing is a key factor in value realization (Harris et al., 2014). Research shows that PE fund managers have good market timing skills, as investment activity is executed when credit is cheap and exits are made when valuations are at their highest.

These valuation multiple effects do not last and can change throughout the credit market cycle. Leverage increases returns when markets rise, but it also increases losses when markets fall (Acharya et al., 2013). Timing exits to match credit market conditions is important because high leverage can quickly lower stock values. This cyclical pattern shows that using more leverage does not always lead to better exit results, since fund performance can differ a lot between different years.

Studies show that leverage and its growth depend on the credit cycle. High leverage is most helpful when markets are easy to access and valuations are high, but it can be harmful when it is harder to get financing. These trends support the second hypothesis of this thesis: leverage has a stronger positive effect on fund returns when credit market conditions are favorable.

4.3 Governance, Agency and Tax-Shield Mechanisms

Alignment of management incentives and other administrative improvements must be taken into account when considering the effects of leverage intensity on value creation in LBOs. In the agency theory developed by Jensen (1986), debt acts as a disciplinarian for management, as it limits the use of free capital. Management of a company operating at a high leverage level must allocate capital more efficiently so that regular principal and interest payments can be made. This reduces wasteful spending and empire-building. Discipline is central in the private equity environment, as concentration of ownership and active control amplify the effects of economic pressure (Acharya et al., 2013).

PE sponsors usually aim to align interests through the adaptation of governance structures. Such means include, for example, performance-based compensation or stock ownership, which tie management's personal wealth to the success of the acquisition. Such bonus schemes improve efficiency and profitability (Acharya et al., 2013; Guo et al., 2011). Equity-based incentives lead to long-term value creation, while the need to manage debt requires cost control.

However, high debt can also create conflicts between shareholders and debt holders. When there is too much debt, managers, under pressure to maintain returns, may take more risks and choose projects that have the potential for large profits but only small downside for equity (Axelson et al., 2013). This conflict of interest, known as the debt overhang problem, can lead to underinvestment in safer but more valuable projects (Myers, 1977). In this case, the benefits of debt are lost, and its financial position deteriorates.

According to Modigliani & Miller (1963), debt affects value creation through tax deductions. According to them, interest on debt can be deducted from taxes, which increases the value of the company compared to a company without debt. This theory is supported by Graham (2000) and Abel (2018), who show that moderate debt clearly improves the value of the company, as tax liability decreases with deductions. In LBO arrangements, a large initial debt brings significant tax savings during the ownership period and improves the company's cash flow and return to owners. However, these benefits are reduced if there is too much debt, as this increases the risk of financial distress and the possibility of bankruptcy.

Research based on real-world data shows that buyouts often balance these opposite forces. Better management and making sure everyone’s goals match explains much of the value created in successful LBOs (Acharya et al., 2013). Axelson et al. (2013) show, on the other hand, that taking on too much debt reduces value as it becomes harder to borrow. The overall effect of how people are motivated and of tax savings determines how debt affects a company’s value.

The research shows that moderate leverage increases value through governance discipline and tax benefits. If leverage rises too much, risks increase and flexibility decreases. This balance of benefits and costs constitutes a trade-off that supports the first hypothesis of this study: highly leveraged buyouts are associated with higher exit values than low-leveraged ones.

4.4 High vs. Low Leverage and Fund-Level Performance

The first hypothesis of this thesis is that highly leveraged acquisitions generate better exit values than less leveraged ones. According to theory, high leverage is associated with higher exit values, for example, through tax shelters and debt relief. In practice, buyout contract structures are highly variable and highly leveraged transactions are most commonly based on more complex financial instruments, layered debt tranches, and strict covenant packages. This complex contract structure makes them sensitive to cyclical fluctuations in credit markets (Pignataro, 2013).

Axelson et al. (2013) argue that the intensity of leverage does not in itself lead to higher exit values when credit markets are considered. Their research shows that leverage acts more as a conduit for market cycles than as an independent value creator. Brown et al. (2021) find more recent evidence that private equity firms actively adjust their financing structures to the current market cycle to manage the cost and risk of debt. During periods of abundant credit, debt and pricing expand and evolve hand in hand, but when markets tighten, these same structures can quickly weaken.

At the fund level, returns have been found to be highest during periods of credit expansion (Harris et al., 2014). This supports Jenkinson and Sousa's (2015) exit timing theory, which states that private equity firms actively monitor financing conditions and plan IPOs and divestments to take advantage of them. Cao's (2011) empirical study observes this theory in practice and substantiates it through valuation multiples. Exits through IPOs at favorable market times allow private equity firms to exploit the highest valuation multiples. Jenkinson et al. (2022) study results demonstrate the market timing ability of PE sponsors. During times of cheap credit, capital investment activity increases and exits are planned at times of high valuation multiples.

On the other hand, Ayash & Rastad (2021) find that in the U.S., excessive corporate debt increases financial risks and weakens exit outcomes, especially during times of

uncertainty. Similar results were also observed in Europe (Brinkhuis & De Maeseneire, 2012). They emphasize the level of sustainable leverage that determines macro-level liquidity and cash flow stability. However, leverage is only one of many factors that drive performance, as Hammer et al. (2022) prove in their study. According to them, in buy-and-build strategies, value creation occurs as a result of operational synergies and strategic integration rather than as a result of financial planning alone.

A fund-level analysis reveals that, in addition to the intensity of leverage, timing and capital are crucial elements in value creation. In fact, when examining successful funds, the strongest results have been achieved by exploiting market cycles and obtaining cheap debt (Kaplan & Schoar, 2005).

According to the literature and research, the pattern of the benefits of leverage is like throwing a ball into the air: it goes up, peaks and comes down. Moderate and high leverage improve exit values, other factors remaining favorable, but excessive debt leads to underperformance. Figure 6 below summarizes these comparative outcomes and illustrates how credit market conditions shape the relationship between leverage intensity and fund-level performance.

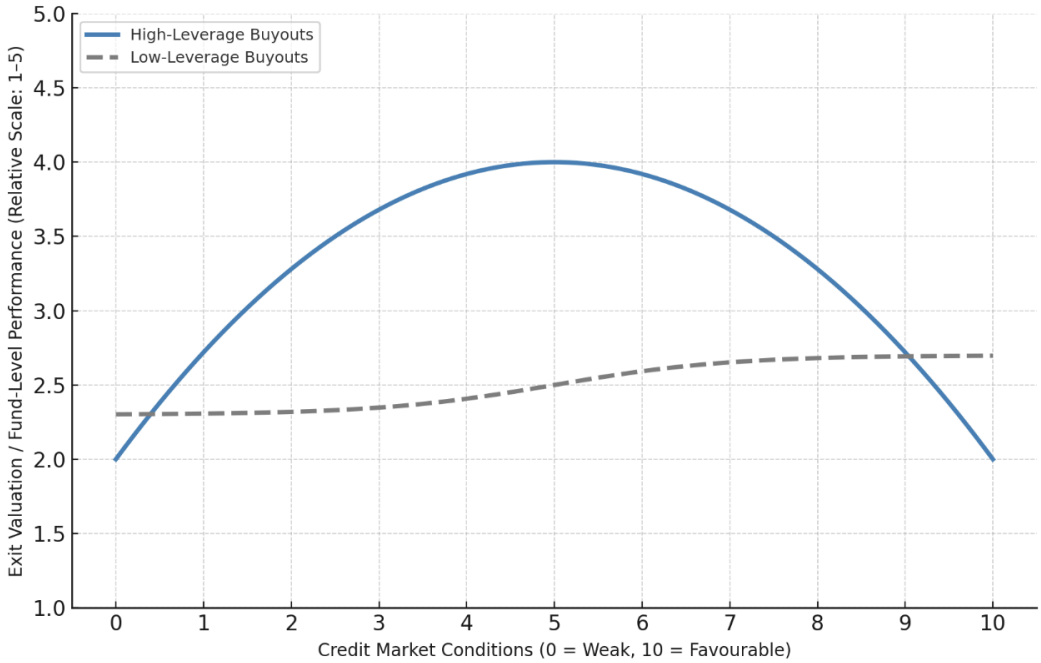

Figure 6. High vs. Low Leverage Buyouts

NB: The figure was created using AI, with the prompt: "Create a conceptual diagram comparing high-leverage and low-leverage buyouts, illustrating differences in risk, performance drivers and exit valuation effects." (OpenAI, 2025).

Adapted from Axelson et al., (2013); Harris et al., (2014); Brown et al., (2021); Jenkinson et al., (2022).

As credit markets become highly favorable, abundant and cheap debt allows sponsors to pay higher entry multiples. While this initially supports higher valuations, it also reduces long-term returns once market overheat (Axelson et al., 2013; Jenkinson et al., 2022). This dynamic explains the slight decline of the high-leverage curve at the most favorable end of credit conditions in Figure 6.

5 Synthesis and Critical Assessment

The preceding chapters showed that leverage, governance mechanisms and credit market conditions are closely interconnected. Leverage provides the financial structure that shapes incentives, governance determines how effectively this structure is translated into operational outcomes, and credit markets set the external environment in which these mechanisms function. Taken together, these elements help to explain why the value effects of leverage differ across buyouts, particularly across credit cycles and governance regimes.

Previous research provides partly contradictory explanations for the effects of leverage on exit valuations and why outcomes vary across transactions. Studies that focus on operational improvements, such as Guo et al. (2011) and Acharya et al. (2013), find that leverage can improve incentives and performance after a buyout. Axelson et al. (2013) show that leverage levels are influenced more by the credit market environment than by factors specific to each firm. This suggests that high leverage levels may be related to cheap and easily accessible debt rather than governance development. The perspectives across all studies are consistent when the context is considered: Credit-driven leverage booms weaken the disciplinary role of debt and increase the importance of appreciation in exit value. In contrast, in times of disciplined credit markets, the returns from operational improvements are more clearly visible. In addition, there are also differences in the reputation of the investor. Some studies argue that a good reputation allows for higher levels of leverage, as the risk is supposedly lower, while others find that strong governance compensates for the pressure of debt. Together, these contradictions show that leverage does not inherently create or destroy value. Its effect depends on the relationship between the quality of governance and the state of the credit market cycle.

Leverage intensity	Value creation mechanisms	Value destruction mechanisms	Typical credit-market conditions	Expected exit outcome
Low leverage	Lower distress risk; operational flexibility	Weak governance discipline; limited tax benefits	Tight credit markets; higher spreads; cautious lending	Stable but modest valuations
Moderate leverage (optimal range)	Tax shield improves cash flows; incentive alignment; governance discipline	Moderate refinancing exposure	Normal credit conditions; balanced spreads; stable liquidity	Strongest risk-adjusted valuations; sustainable performance
High leverage	Amplifies returns through deleveraging; potential multiple expansion	Elevated default risk; tight covenant constraints	Favorable markets; cheap debt; covenant-light lending	High upside OR high downside; timing critical
Very high leverage	(No marginal benefits beyond leverage)	Overheating; inflated entry multiples; severe refinancing & distress risk	Extremely favorable / overheated markets; excess liquidity	Short-term high valuations; long-term underperformance likely

Figure 7. Leverage Intensity and Value Outcomes

Adapted from Kaplan & Strömberg, (2009); Jensen, (1986); Acharya et al., (2013); Axelson et al., (2013); Jenkinson et al., (2022).

The first hypothesis of this thesis assumes that high leverage improves the exit valuation through tax efficiency, operational efficiency and management discipline, as long as the level of debt remains within reasonable limits. The evidence reviewed supports the hypothesis, although the strength of the positive effect depends on firm-specific factors, such as stable cash flow and management performance. The second hypothesis of the thesis posits that the positive effects of leverage on exit values are amplified under favorable credit market conditions. Findings from previous empirical research confirmed the positive correlation between leverage intensity and liquidity cycles, investor sentiment and credit spreads at both the transaction and fund levels.

The literature shows that leverage creates cyclical risks. It can help create value when credit is accessible, but it also puts firms and funds at greater risk during downturns or when markets become tighter. Most previous research looks at overall performance instead of long-term sustainability. As a result, it is still unclear whether the observed value increases are truly sustainable or just short-term market-driven changes.

This section brings together the results we have seen and examines their trustworthiness, scope, and limitations. The goal is to determine whether what is predicted in theory differs from empirical evidence. This section also looks at differences in regulatory regimes, the effects of dividend recapitalization and how macroeconomic risks and uncertainty affect exit valuations.

5.1 Regulatory and Market Context

The level of leverage is also strongly linked to what regulatory and market structures allow, and these structures vary significantly from region to region. The period following the subprime crisis in Europe has made lending standards stricter. The European Central Bank (ECB) assesses LBOs using leverage thresholds. It has been stated that when total debt exceeds six times EBITDA, the transaction will be subject to stricter supervision (ECB, 2017). The ECB has also set strict guidelines for banks, as they must maintain their repayment capacity even in stressful situations and are expected to bear a significant share of the credit risk. The ECB's requirements reduce the range of possible capital structures that a bank can offer. The guidelines particularly affect medium-sized transactions, where banks still act as primary lenders. In these transactions, particular care is taken to ensure that the amount of leverage remains within the limits set by the supervisory authorities.

At the same time, the regulatory environment in the United States is very different. Non-bank lenders, such as private credit funds and CLOs, which have become central to the financial sector, are focusing on financing riskier transactions as traditional banks are subject to stricter capital requirements (Irani & Meisenzahl, 2017). Such a shift allows

for the formation of deals with higher leverage and looser terms than would be possible in Europe. CLOs in particular have grown in importance as they are important buyers of syndicated loans and their involvement shapes financial planning in a less constrained way.

Research does not always clearly explain why leverage affects exit value differently across regions. Some studies point to lender incentives, rather than regulation, as the main reason. DeYong et al. (2013) found that U.S. bank managers are rewarded for taking on more marketable loans. These incentives, along with the U.S. banking environment, may encourage more risk-taking. In Europe, tighter supervisory rules restrict lenders' actions. If leveraged deals get close to the ECB's leverage limits, they must go through extra checks and paperwork (ECB, 2017). This helps curb incentive-driven behavior and makes the U.S. market different.

Other regional differences, such as investor reputation, also make a difference to the results. In the United States, the impact of investor reputation is greater than in Europe, due to regulatory restrictions in the European market on the amount of debt per transaction, which even reputable investors must comply with (ECB, 2017). This reduces the ability of lenders to adjust loan terms based on past performance. In the U.S., reputable private equity investors receive better loan terms and higher leverage, partly because institutional investors, such as hedge funds, buy covenant-light debt (Demiroglu & James, 2010).

In addition to regulation and investor reputation, securitization practices also differ between the U.S. and European markets. Acharya et al. (2013) show that certain U.S. channel structures allow for the sharing of credit risk without transferring it entirely. As lending banks maintain implicit support obligations, market discipline weakens, leading to an expansion of aggressive lending during favorable credit cycles. When banks keep implicit support obligations, market discipline becomes weaker, which encourages more aggressive lending during good credit cycles. Meanwhile, the European market focuses

more on balance sheet risk retention and expects lenders to have stable credit ratings and repayment ability (ECB, 2017). Such prudential practices reduce the cyclical nature of debt increases in corporate acquisitions.

Looking at the findings reviewed, the relationship between leverage and exit value can now also be seen to depend on the interaction of market architecture, supervisory regulations and lender incentives. The U.S. market is defined by institutional investors, the influence of investor reputation on lending, and securitization structures that support more aggressive leverage. In Europe, the focus is on regulations and managing risk. As a result, borrowing in U.S. buyouts changes more with shifts in lending and prices, while borrowing in Europe remains more limited. This difference helps explain the connection between borrowing and exit value, which will be discussed next.

5.2 Leverage, Recapitalizations and Exit Valuations (H1)

The first hypothesis of the thesis is that a higher debt share in the financing structure of a buyout leads to higher exit prices. It is based on the Agent theory, the trade-off theory and the Modigliani & Miller theory of tax incentives. According to these frameworks, debt can be used to achieve a higher exit value. Value creation occurs due to tax benefits, management discipline and more efficient use of free cash flow.

Other studies also support this hypothesis, but under certain conditions. The financing environment must be favorable and the level of debt must be sustainable. The sustainable amount of debt is shaped by company-specific factors. Under these conditions, debt, management ownership and active governance improve post-acquisition profitability and cash flow (Kaplan & Strömberg, 2009; Acharya et al., 2013). Also Guo et al. (2011) and Cohn et al. (2014) provide evidence supporting the value creation of debt, as long as it is used sustainably. According to them, value creation is based on management discipline and linking owner incentives to the long-term return of the firm.
Not all evidence supports this idea. Taking on too much debt increases the chance of not being able to pay it back and can lead to worse results when selling a business,

especially in cyclical industries. Axelson et al. (2013) find that how much debt a company uses depends more on credit availability than on the company itself. High prices in deals with high leverage may be due to market timing rather than genuine business success. Debt can increase profits or losses, depending on the circumstances. Dividend recapitalizations are a good example. Bhardwaj et al. (2025) report that investors often borrow more after buying a company to pay themselves dividends, thereby increasing their returns but not strengthening the company. Paying dividends before selling makes the company look better on paper, which makes it easier to get a loan. However, higher debt means less of a buffer against unexpected situations and also makes it harder to obtain new loans. Dividend recapitalizations indicate that using debt can give quick gains for investors but may reduce the likelihood of a successful exit later.

Based on the analysis, the literature can be stated to support the first hypothesis of the thesis, but with certain conditions. It can help increase the value of the company and strengthen the exit value if it improves the company's operations, brings tax benefits or makes management more efficient. However, the potential benefits quickly disappear if there is too much debt, it is used only for payments or if the macroeconomic situation changes. Debt is therefore not a means of creating value in itself, but it strengthens value creation through the influence of favorable markets for an already stable and profitable company.

5.3 Credit Conditions and Uncertainty (H2)

The second hypothesis of the thesis claims that the positive effect of leverage on exit value is stronger when credit market conditions are favorable. The hypothesis is based on market-timing theory (Baker & Wurgler, 2002) and exit timing theory (Jenkinson & Sousa, 2015). Both studies show that PE sponsors adjust the amount of leverage they use to suit their economic environment. The importance of planning is particularly emphasized in the exit strategy and its timing. In addition to exits, a good example of investors' timing planning is the acquisition phase, as high-leverage buyouts tend to occur during periods of loose credit markets and thus benefit from high valuation multiples.

The idea is also supported by empirical research. Axelson et al. (2013) found that credit market liquidity affects leverage more than firm-specific factors. In times of loose debt markets, when credit is cheap and readily available, lenders lend on more favorable terms. The same phenomenon is observed at the fund level. The fund achieves higher returns in years with credit expansion (Harris et al., 2014). These findings demonstrate the importance of favorable financing terms on debt and exit values.

In buyouts that are financed largely with debt, interest rates are of primary importance. In a favorable credit environment, low interest rates and the resulting lower cost of debt, together with increased transaction prices, allow the investor to utilize high leverage. LBOs have been shown to be very sensitive to movements in the cost of debt (Kaplan & Strömberg, 2009). Indebtedness sets limits on interest rate and liquidity changes. Debt-financed acquisitions made during very low interest rates have been shown to perform worse when the financing environment returns to normal levels (Axelson et al., 2013). In fact, the entire private equity industry is financially vulnerable when lending tightens (Bernstein et al., 2019). Again, when interest rates rise and lending tightens, the constraints that come with debt become more pronounced.

From a macroeconomic and political perspective, the risks of high debt only increase. In uncertain times, cash flow predictability deteriorates (Bernanke, 1983). This is due to the quantitative reduction in investments that an uncertain environment causes with high credit costs (Gulen & Ion, 2016). This increases the risk in LBO, because the stability and predictability of cash flow play a key role in determining the limit of sustainable debt. This perspective is also supported by Bloom (2009), who shows that uncertainty shocks reduce production and employment, causing difficulties for companies. Political uncertainty also raises return requirements and lowers company valuations (Pástor & Veronesi, 2012). These uncertainty factors are important to consider in leverage decisions, as they weaken the positive effects of debt leverage by raising interest rates and risk opportunities.

High debt limits the business operations of leveraged companies in uncertain times. Distress risk and default risk have been observed to increase, for example, in companies backed by private equity investors during a downturn (Ayash & Rastad, 2021; Hotchkiss et al., 2021). This shows that financial structures designed with a high debt ratio are highly vulnerable to economic shocks. In such times, high debt can become a potential source of risk.

From an empirical perspective, studies do not provide direct support for the second hypothesis of the thesis. According to some studies, the effects of leverage on exit value are mainly related to cheap financing (Axelson et al., 2013; Harris et al., 2014). On the other hand, in uncertain times, when liquidity decreases, PE's target companies become very vulnerable (Bernstein, 2019). Ayash & Rastad (2021) also find that high leverage sharply increases distress risk, even in mild downturns. The observed research findings have an explanation in the uncertainty literature. While stable and favorable financial environments allow investors to use falling discount rates to increase exit value, economic uncertainty can complicate the relationship. Uncertainty shocks raise risk premia, reduce investment, and lower valuations, which directly affects the way debt can create value (Bloom, 2009; Gulen & Ion, 2016; Pastor & Veronesi, 2012). These findings clarify that the value creation of debt is contingent. It critically depends on the impact of market and macroeconomic conditions on capital structure decisions.

The research results support the second hypothesis of the thesis, according to which the positive effects of leverage are stronger when credit markets are favorable, but only conditionally. For the hypothesis to be fully valid, in addition to favorable credit markets, macroeconomic stability in the operating environment must also be taken into account. The availability of credit, interest rates and uncertainty affect how effectively leverage affects exit value. The strongest results are obtained in times of low uncertainty and cheap financing, when high leverage can support increased valuations without causing additional risk. However, leverage also puts pressure on exit and causes downside risk.

The success of high-leverage buyouts depends on operational efficiency, but also on the timing and sustainability of financing decisions across credit and uncertainty cycles.

5.4 Integrated Interpretation

The analysis in sections 5.1–5.3 shows that debt in buyouts is not always a clear way to increase value, but its effects depend heavily on how the company is managed, the regulatory environment and the market situation. Debt has been found to support higher exit valuations if its actual effects are as desired. In this context, management behavior is a key factor. The discipline resulting from debt must enhance management performance, otherwise its effects may remain weak. Timing also plays an important role. Even if management acts effectively, overheating credit markets and rising interest rates negatively affect the effects of debt. These factors, combined with regional differences in regulation, strengthen the debt-equity interaction. For example, in the United States, where regulation is market-driven, companies can obtain higher debt leverage than in Europe due to stricter rules and supervision in the EU region. On the other hand, financial structures in the U.S. are also more sensitive to credit cycles than in Europe, so losses can also be higher. Therefore, the benefits of debt depend on the interaction of company-specific fundamentals and the financial environment.

6 Conclusions

This thesis examines the impact of leverage on exit value. The relationship between them is studied in different macroeconomic environments and during different credit cycles. The impact of the amount of debt on value creation, through which exit values increase, depends on many different mechanisms, such as regulation, uncertainty and interest rates. Based on these variables, the thesis tests two hypotheses:

H1: Highly leveraged buyouts are associated with higher exit valuations than low-leveraged buyouts

H2: The positive effect of leverage on fund-level performance is stronger when credit market conditions are favorable

Based on these results, debt can be seen as acting as an amplifier. It should not be confused with any universal rule that higher leverage guarantees higher exit value, but under favorable circumstances, when the leverage ratio is at a sustainable level, high debt can strengthen exit value through, among other things, tax benefits, governance changes and incentives. These elements help to increase efficiency and cash flow management. Together, the above factors improve the target company's business performance and can therefore lead to higher exit valuations, while maintaining a sustainable level of leverage. As leverage exceeds a firm-specific sustainable level, distress risk increases and financial flexibility decreases, reducing the impact of leverage on value creation.

There is strong evidence for the second idea in this thesis. The advantages of using leverage at the fund level are greater when credit markets are strong. This allows for bigger deals, cheaper loans and higher entry and exit multiples. Funds that start during times when credit is easy to get do better than those that start when credit is tight (Harris et al., 2014). The best funds use leverage more wisely, but as prices go up, using the same amount of leverage becomes riskier (Jenkinson et al., 2022). Due to this cyclicality, when

using leverage, the timing of the investment and the state of the credit markets must be carefully monitored.

The arguments presented in the thesis help to understand the importance of governance and the financial environment in leverage decisions. The micro-level company-specific characteristics and the different cycles at the macro level make the role of leverage an important part of the whole on which PE returns are based.

Leverage is a central element in the private equity industry. Its timing, sustainability and effectiveness, combined with favorable credit and macro environments and controlled governance, reinforce the importance of leverage to the exit value. However, debt must comply with a firm-specific sustainable limit, otherwise it reinforces vulnerability instead of value creation. Therefore, the strength of leverage can be seen as based on its management rather than its amount.

6.1 Limitations & Future Research

However, the findings and sources of the thesis are somewhat limited. Research on value creation and private equity lending differs significantly in terms of data availability, research methods and reporting practices. This makes it difficult to draw conclusions and make direct comparisons. Second, many sources are based on U.S. data, so differences in regulation and credit markets between countries may be overshadowed, although they are addressed somewhat in the work. A third limitation is related to the level of detail. For example, details of deals are obscured and at the fund level, returns are often calculated using combined data from different years, all of which makes it difficult to find clear connections between leverage and exit value. Future research could focus on more detailed data on transactions and harmonizing reporting across countries.

6.2 Practical Implications

The thesis provides important practical insights for PE investors, lenders and policymakers. For investors, the findings of the work prove that high debt in buyouts can strengthen exit value, but only if the right things are taken into account in leverage decisions. By correctly defining a company-specific sustainable debt ratio, monitoring the credit market conditions and the macroeconomic situation, an investor can benefit from the leverage. In addition to timing and the right amount, an exit strategy, governance guidance and planning of interest and debt repayment are important for the desired effects to occur.

For lenders and other credit providers, the findings of the thesis focus on the availability of credit, standards and covenant structures in LBO transactions. When credit markets are liquid, lending standards are relaxed, which allows companies to have both a higher level of leverage and a higher risk of default. In particular, in leveraged companies, long-term losses and the possibility of financial difficulties have been observed to decrease due to stricter rules and better supervision.

The thesis also provides evidence for regulators and policymakers on how the volatile nature of debt requires close monitoring at the economy-wide level. Debt has been found to adapt to macroeconomic cycles, such as credit cycles, and during their favorable times, debt is used in large quantities. High debt increases systemic vulnerabilities and therefore needs to be closely monitored. Rules that limit excessive risk-taking during credit booms, as well as transparency and effective supervision of loans with minimum terms, have been found to stabilize markets without restricting useful business activities.

In summary, debt can be seen as a very useful tool in private equity transactions. However, its effects depend on a number of micro and macro factors. If all of these factors are taken into account and aligned, it creates the conditions in which leverage can add

value to private equity investments. In general, however, debt should be seen as an amplifier, the impact of which depends more on its management than on its amount.

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Appendices

Appendix 1. Writing Notes

This thesis uses artificial intelligence tools in a limited and clearly explained way. Grammarly was used only to check grammar and make the writing clearer. OpenAI's ChatGPT 5 model was used to make a few simple figures, which are each labeled in the figure captions. All main arguments, explanations, and conclusions are based only on academic sources and were created by the author.