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Exit Strategies in Private Equity

Factors Influencing the Choice of IPOs, Secondary Buyouts, and Trade Sales

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Pääomasijoitusmarkkinat ovat kasvaneet merkittävästi viime vuosikymmeninä. Yksi syy kasvuun on tutkimuksissa havaittu ylituotto suhteessa julkisen markkinan tuottoihin. Pääomasijoitukset ovat lähtökohtaisesti epälikvidejä, sillä ne eivät ole julkisesti kaupankäynnin kohteena ja niiden sijoitushorisontti on usein 3–10 vuotta. Pääomasijoituksen menestyksen mittari on irtautumisen (engl. exit) yhteydessä saavutettu tuotto, joka pyritään maksimoimaan luomalla arvoa sijoitusjakson aikana. Pääomasijoitusyhtiöt optimoivat irtautumisesta saatavan tuoton valitsemalla sijoitukselleen sopivimman irtautumisstrategian ja ajoittamalla irtautumisen suotuisaan markkinaympäristöön.

Tämä kandidaatintutkielma käsittelee pääomasijoittamisen irtautumisstrategioita ja niihin vaikuttavia tekijöitä. Tutkielman tavoitteena on ymmärtää, miten markkinaolosuhteet, arvonluontistrategiat ja informaation epäsymmetria vaikuttavat pääomasijoitusrahastojen irtautumis päätöksiin. Tutkielman teoreettinen viitekehys käsittelee pääomasijoittamisen rakennetta, rahastojen toimintamallia ja arvonluontimekanismeja. Viitekehyksessä tarkastellaan informaation epäsymmetrian roolia muun muassa arvon maksimoimisen näkökulmasta sekä markkinaolosuhteiden vaikutusta irtautumisstrategian valintaan.

Tutkielma keskittyy kolmeen keskeisimpään irtautumisstrategiaan: strateginen myynti, toissijainen myynti sekä listautumisanti. Näiden strategioiden etuja ja haasteita tarkastellaan tutkielmassa yksi kerrallaan. Useiden tutkimusten tulokset osoittavat, että suotuisat markkinaolosuhteet lisäävät listautumisantien todennäköisyyttä, kun taas heikommat olosuhteet voivat tehdä strategisesta myynnistä tai toissijaisesta myynnistä kannattavamman vaihtoehdon. Lisäksi tutkimukset osoittavat, että arvonluontistrategiat voivat lisätä yrityksen houkuttelevuutta strategisille ostajille. Tutkimuksista käy myös ilmi, että informaation epäsymmetria vaikuttaa irtautumisstrategian valintaa ja ajoitukseen sekä irtautumisen arvoon.

Avainsanat: Private equity, Private equity exits, Investment exits, Buyout strategies, Initial public offering, Secondary buyout, Trade sale, Information asymmetry, Market conditions

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1 Introduction

The private equity (PE) industry has grown markedly since the mid-1990s (Gompers et al., 2016). The global value of private equity buyouts bigger than \$1 billion grew from \$28 billion in 2000 to \$502 billion in 2006, according to Dealogic, a firm that tracks acquisitions (Barber & Goold, 2007). Additionally, the global buyout-backed exit value has increased from \$233 billion in 2006 to \$855 billion in 2021, reaching a record value (Burrack et al., 2025). Barber and Goold (2017) state that PE firms' reputation for dramatically increasing the value of their investments has helped fuel this growth. Harris et al. (2014) find that PE buyout funds have outperformed public markets at least 3.7 % per year for a long period of time, contributing to the industry's sustained growth.

The private equity investment process begins with selecting portfolio companies. Investors seek businesses with strong competitive positions and scalable business models, while also considering factors such as the strength of the management team, the investor's ability to add value, and financial valuation (Gompers et al., 2016). Once an acquisition is made, PE firms actively enhance the company's performance through operational improvements, strategic repositioning, and financial restructuring. Their goal is to drive revenue growth, optimize costs, and implement governance structures that align management incentives with long-term value creation (Gompers et al., 2016).

The final and most decisive stage of the PE investment cycle is the exit strategy—the point at which investors realize the value they have created. The exit strategy is crucial, as it ultimately determines the financial success of the investment and enables PE firms to deliver returns to their investors (Uddin & Chowdhury, 2021). The most common exit routes include initial public offerings (IPOs), trade sales, and secondary buyouts (SBOs) (Gompers et al., 2016; Uddin & Chowdhury, 2021). According to Uddin and Chowdhury (2021), the choice of exit strategy is influenced by factors such as market conditions, company performance, and investor objectives. Each exit route presents its own advantages and challenges, and selecting the most suitable option requires careful consideration of these factors.

1.1 Purpose of the Study

Exit strategy is important for PE investors because well-planned and effective strategy can lead to higher profits at exit. However, there is little documented evidence as to what the buyout fund managers' decisions for a certain exit strategy are driven by, how capital markets react to these strategies, and what determines the capital markets' reactions (Fürth & Rauch, 2015). Understanding these factors is essential for investors to enhance market efficiency and optimize PE investment outcomes. Strong historical performance of PE funds makes private equity an attractive investment strategy and an interesting topic to study.

The purpose of this study is to examine the private equity investment process, with a particular focus on the exit phase. This literature review discusses the structure of private equity, seeks to identify the factors that influence successful exits and the role of value creation during the holding period. Additionally, this study investigates the impact of asymmetric information on valuation and the selection of exit routes. Understanding how value creation strategies and minimizing information asymmetry contribute to a successful exit is essential for evaluating the effectiveness of private equity investments.

This study examines the three most common exit routes, with a focus on understanding their prevalence and the factors that influence their selection. According to Gompers et al. (2016), approximately half of all PE exits occur through strategic sales, 30% through SBOs, and less than 20% through IPOs. Similar trends are found by Uddin and Chowdhury (2021). The purpose of the study is to explore the reasons behind the relatively lower frequency of IPOs compared to other strategies, considering factors such as market conditions, company performance and value creation, and information asymmetry. By analyzing these factors, the study will provide insights into how PE firms can improve their exit strategies to achieve optimal returns.

1.2 Hypotheses

The first hypothesis of the study concentrates that the choice of exit strategy by PE firms is significantly influenced by prevailing market conditions. Market conditions, including economic cycles, stock market performance, and investor sentiment, play a crucial role in determining the optimal timing and method of exit. For example, Uddin and Chowdhury (2021) find that the choice of exit strategy of a PE fund varies across different market periods. Moreover, Jenkinson and Sousa (2015) state that private equity firms aim to achieve the best exit price possible, and capital market conditions may create different 'windows of opportunity'. They argue that for example a cold IPO market may make SBOs the most profitable exit route. Therefore, the first hypothesis of the thesis can be expressed as follows:

H₁: Favorable market conditions increase the likelihood of IPO exits, while adverse conditions create a preference for SBOs or trade sales.

Value creation strategies, such as operational improvements, strategic repositioning, and financial restructuring, are essential for enhancing the performance and attractiveness of portfolio companies (Gompers et al., 2016). PE firms leverage their expertise and deep market knowledge to develop effective value creation strategies for their portfolio companies. This also enhances their ability to attract strategic buyers, who typically seek to integrate the acquired company's technology or products into their existing operations to achieve synergies (Cefis et al., 2016). This leads us to the second hypothesis which is as follows:

H₂: Effective value creation strategies increase the probability of attracting strategic buyers and achieving higher exit valuations.

The third hypothesis is focusing on the information asymmetry between PE firms (sellers) and potential buyers or investors and timing of exit strategy. Information asymmetry refers to the unequal distribution of information, where PE firms possess more detailed

knowledge about the portfolio company's performance and prospects than external parties (Uddin & Chowdhury, 2021). Previous literature has found evidence that information about firm quality accumulates over time (Cumming & Macintosh, 2003; Uddin & Chowdhury, 2021). Additionally, Cumming & MacIntosh (2003) argue that information asymmetry is highest in case of IPOs, as public market investors have limited access to private firm data compared to strategic buyers or other financial sponsors. Given that secondary buyouts and trade sales allow for more private negotiations and due diligence, PE firms may prefer these exit routes to minimize information asymmetry. Hence, the third hypothesis of this thesis is the following:

H₃: Information asymmetry delays exit timing and increases the likelihood of secondary buyouts or trade sales.

These hypotheses aim to provide a structured framework for examining the factors that influence the choice and success of exit strategies in the private equity industry. By testing these hypotheses, the study seeks to contribute to a deeper understanding of PE exits and the role of market conditions, value creation, and information asymmetry.

1.3 Structure of the Thesis

The structure of the thesis is as follows. Chapter two provides the theoretical framework for understanding private equity and its key components. It begins with an overview of private equity, defining its characteristics and structure PE investment fund. After that, the chapter examines the ways in which the PE investors attempt to create value for their investments, what is information asymmetry and how it affects to PE exits. Finally, the chapter concludes with an analysis of market conditions and their impact on private equity investments, particularly in terms of valuation and exit strategies.

Chapter three examines PE firm exits, focusing on three main exit strategies and the factors influencing their selection. It explores how market conditions, information asymmetry, and strategic considerations impact exit outcomes. Additionally, the chapter

reviews previous studies and their data findings, linking them to the theoretical framework and assessing their implications for PE firms' decision-making.

Finally, chapter four concludes the study by summarizing key findings and discussing their implications. It reflects on the significance of the results in the context of private equity investments and exit strategies, emphasizing the practical applications of the research in real-world decision-making. Furthermore, the study highlights potential areas for future research, considering its limitations.

2 Theoretical Framework

2.1 Private Equity

Private equity is a form of investment that involves the acquisition of equity ownership in private companies, as opposed to publicly traded companies. This type of investment is typically characterized by its long-term horizon, active management, and the goal of achieving substantial returns through various value-creation strategies. Private equity plays a significant role in the global financial landscape, providing capital to businesses that may not have access to traditional financing methods such as bank loans or stock exchange (Demaria, 2013).

Metrick and Yasuda (2011) provide a definition of private equity funds by listing the following four main characteristics: First, a PE fund is a financial intermediary. PE funds raise capital from several institutional investors, for example pension funds, universities, insurance companies, foundations, and high-net-worth individuals (Cefis et al., 2016). PE firms use this raised capital to make investments to target portfolio companies.

Second, a PE fund invest only in unlisted companies. This means that once the investments are made, the companies cannot be immediately traded on a public exchange (Metrick & Yasuda, 2011). Previous literature shows that private equity investments often involve long-term commitments, typically ranging from three to ten years (Gompers et al., 2016; Uddin & Chowdhury, 2021), or even up to ten to fifteen years (Buchner, 2016). Therefore, PE investments are quite illiquid. As mentioned in the introduction section, PE investments have outperformed public markets even over the long term. Harris et al. (2014) suggest that since PE investments are illiquid, it is unsurprising that they offer investors a premium compared to public market investments. Additionally, Buchner (2016) states that investors assign lower valuations to assets that are illiquid not frequently traded, such as PE investments.

Third point is that a PE fund takes role and supports the companies in its portfolio. this means that the investors' purpose is to create value in their portfolio company. This third point is closely linked to the fourth, and the final point. The fourth point according to Metrick and Yasuda (2011) is that PE fund's primary goal is to maximize its financial return by exiting investments. The link between point three and four is that PE fund is assumed to only sell a company once it has realized all potential for operational improvements and will use market timing and negotiation skills to achieve the best possible value at exit (Achleitner & Figge, 2014). The success of an equity investment is measured by the return received at exit, which is directly impacted by the value created during the ownership period. We will discuss more about value creation in section 2.3.

2.2 Structure of Private Equity Fund

PE funds are usually structured as limited partnerships. In this structure, PE firm acts as a general partner (GP), investment advisor and fund manager (Cefis et al., 2016). The capital for these funds comes from institutional investors, who are known as limited partners (LPs) (Cefis et al., 2016). However, it is normal for the GP to provide at least 1% of the total capital (Kaplan & Strömberg, 2009). Kaplan and Strömberg (2009) continue that LPs have minimal influence over how GPs invests the funds if the basic covenants of the fund agreement are followed. Thus, GP is responsible for managing the fund, making investment decisions, and overseeing the portfolio companies, while the LPs provide the capital and have limited liability. Figure 1 illustrates the structure of a private equity fund, and the roles of GPs and LPs.

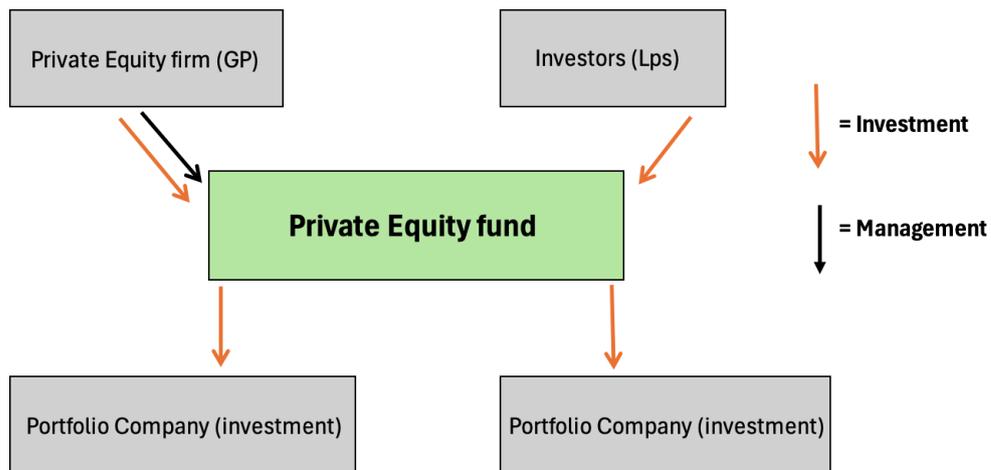


Figure 1. Structure of private equity fund.

GPs is compensated in couple of main ways. GP earns an annual management fee, usually a percentage of capital committed, and then, as investments are realized, a percentage of capital employed (Kaplan & Strömberg, 2009). Second, the GP earns a share of the profits of the fund, referred to as “carried interest,” that is around 20 percent. For example, if PE firm makes one-billion-dollar profit in successful exit, and carried interest is 20%, PE firm gets 200 million. Figure 2 illustrates the capital flow of a private equity fund at the time of exit.

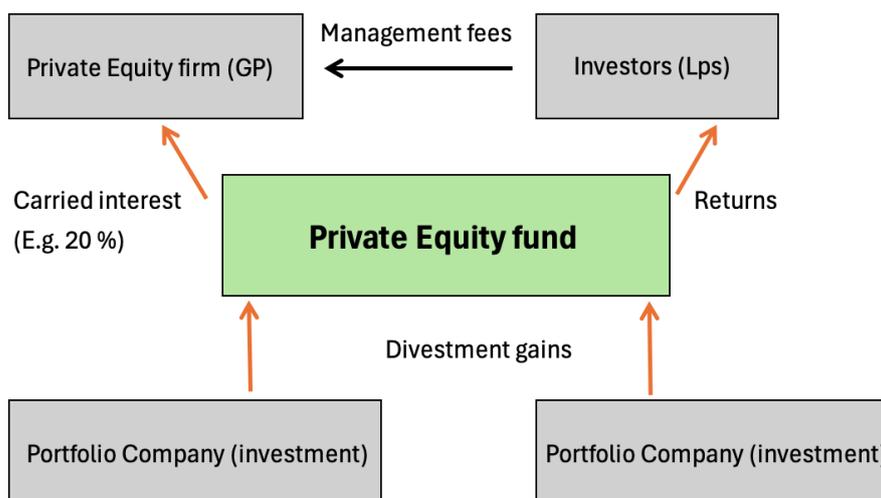


Figure 2. Capital flow of a private equity fund at the time of exit.

2.3 Value Creation

In recent years, value creation has become more relevant to all parts of the private equity lifecycle (Jauch-Degenkolb et al., 2023). One reason for this is the rapid growth of the private equity sector over the past few decades. PE investors use a lot of resources to deal sourcing in pre-investment phase. Gompers et al. (2016) find that PE investors claim an important determinant of value creation is the ability to identify or source deals that are proprietary in some sense. They find in their survey that PE investors on average deeply investigates 15 possible firms for every hundred opportunities but closes on fewer than four.

Previous literature indicates that value creation in private equity is a multifaceted process, with PE investors relying on several sources of value creation. According to Gompers et al. (2016) private equity investors actively create value in their portfolio companies through three main mechanisms: financial engineering, governance engineering, and operational engineering. Operational engineering focuses on improving business performance by increasing sales and reducing costs. Governance engineering involves enhancing corporate oversight, which may include restructuring management teams to improve decision-making and accountability. Financial engineering refers to the strategic management of capital structure and investment valuation to optimize financial performance.

Gompers et al. (2016) find in their survey that the most frequently mentioned source of value is increasing revenue, identified by PE investors as being important in over 70% of their investment deals. The survey finds that improving incentives is important in over 60% of cases and follow on acquisitions in over 50% of cases. It is interesting to note that the improvement of incentives plays a key role in value creation, suggesting that properly aligned incentives contribute to the success of private equity investments. Another interesting observation from the table is that reducing costs from a value creation perspective is important in only 35.6% of deals. Table 1 shows the survey's expected sources of value creation in pre-investment phase.

Table 1. Pre-investment expected sources of value creation (adapted from Gompers et al., 2016).

Sources of value	Percentage of deals
Increase revenue or improve demand factors	70.3
Improve incentives	61.1
Follow-on acquisitions	51.1
Facilitate a high-value exit	50
Improve corporate governance	47
Purchase at an attractive price relative to the industry	46.6
Purchase at an attractive price (buy low)	44.3
Reduce costs in general	35.6
Redefine the current business model	33.8
Change senior management team other than CEO or CFO	33.4
Change CEO or CFO	30.6
Improve IT or information systems	26.1
Introduce shared services	15.6
Strategic investor	15.6
Other	9.8

An interesting aspect of value creation is the specialization of the PE firms. Cressy et al. (2007) argue in their paper that specialized PE firms can select potentially superior performers, they have deeper knowledge of the competitive environment of acquired companies and of their companies' strengths and weaknesses. Cefis et al. (2016), in turn, state that specialized PE firms can provide experienced management and consultants who collaborate with the portfolio company's management, further enhancing performance and increasing the likelihood of a successful exit. Also, Gompers et al. (2016) state that PE firms often have particular industry experience and focus, and a successful track record in a particular industry is likely to lead to greater investment concentration in that

sector. On this basis, it can be concluded that a portfolio company held by a specialized private equity firm is more valuable than one held by a non-specialized firm. This indicates that specialized private equity firms create value through their expertise and focused approach.

2.4 Information Asymmetry

Information asymmetry is a situation where one party has more or better information than the other. This is usually the case in the sale of item, and the case in private equity exits. Information asymmetry can lead to inefficiencies in markets or distorted decision-making. Two common problems can arise from asymmetric information: moral hazard and adverse selection (Bloomenthal, 2024). For example, adverse selection occurs when one party to a transaction seeks to benefit from asymmetric information.

Cumming and MacIntosh (2003) argue that information asymmetry between sellers and buyers plays a crucial role in the choice of exit routes and exit duration. Uddin and Chowdhury (2021) further emphasize that sellers typically possess comprehensive knowledge about the company, whereas buyers often have limited information, which can result in buyers assigning a lower valuation to the company. Additionally, Ritter and Welch (2002) explore theories related to information asymmetry and find that all theories of underpricing based on asymmetric information share the prediction that underpricing is positively related to the degree of asymmetric information. When the asymmetric information uncertainty approaches zero in these models, underpricing disappears entirely. Private equity firms need to take this into account when choosing an exit route.

Cumming and MacIntosh (2003) present a theory of private equity exits, suggesting that information asymmetry influences both the selection of the exit vehicle and the timing of the exit decision. The theory further argues that, as the sellers (PE firms) want to maximize their return, they would select the exit vehicle that would help to improve the value of the investment by minimizing the information asymmetry (Uddin & Chowdhury, 2021). Cumming and MacIntosh (2003) assume that a longer investment duration would

reduce asymmetric information and thus increase the exit value of PE firm. As a result, reducing information asymmetry contributes to maximizing the exit value. We will discuss information asymmetry in relation to each exit strategy individually in Section 3.

2.4.1 The Role of PE Firms' Specialization in Information Asymmetry

The specialization, whether at the industry or stage level, is a crucial strategic dimension for a PE firm (Cefis et al., 2016). Cressy et al. (2007) suggest that PE firms with specialization have theoretical reasons to focus on a specific area or stage of private companies. A potential competitive advantage can be gained, for example, by reducing asymmetric information through specialization. The lower the information asymmetries, the higher the interest of the new owner in purchasing the company (Cumming et al., 2006). This implies that specialized PE firm has more knowledge and information about the investee companies' competitive environment and the market in which the companies operate compared to non-specialized PE firms. These findings suggest that specialized PE firms themselves reduce the asymmetric information between the buyer (PE firm) and the seller (investee company), as the buyer already has better than average information about the environment of the company to be acquired.

2.5 The Impact of Market Conditions

As we assume in the Hypothesis 1, market conditions influence to the choice of exit strategy. Ewelt-Knauer et al. (2014) examine the impact of the economic environment on exit decisions and find that factors such as overall economic conditions, debt financing availability, and stock market performance play a significant role in shaping a private equity firm's exit strategy.

Additionally, Uddin and Chowdhury (2021) emphasize that external shocks, such as sudden economic downturns, changes in market sentiment, or financial crises, can compel private equity firms to adjust their exit strategies. A decline in economic environment may limit the ability to achieve an attractive exit price allowing the duration of the exit

strategy to be adjusted to maximize the value of the investments. The impact of such external shocks is evident in historical exit data. Burack et al. (2025) analyze exit data over the past twenty years, showing how economic turbulence has influenced PE exits. The data reveals that global buyout-backed exit value dropped sharply from \$358 billion in 2007 to \$73 billion in 2009 during the financial crisis. In contrast, the decline during COVID-19 was more moderate, with exit value decreasing from \$508 billion in 2019 to \$434 billion in 2020. One possible reason for this is that COVID-19 crash was fast and it recovered just in couple of months. This highlights the importance of market timing and adjusting the exit strategy to maximize exit value.

Moreover, Schmidt et al. (2010) study market characteristics influence to exit decisions and choice of exit vehicles. They find that exit decisions are driven by the market sentiment and thus seem to be cyclical like other investments. Despite the cyclical nature of exit decisions, the study did not find evidence that specific market characteristics directly influence the choice of exit vehicles. This suggests that while the overall market sentiment affects the timing of exits, the choice of how to exit is not determined by these market characteristics. The findings contradict many other studies, such as Uddin and Chowdhury (2021), who found that PE firms prefer trade sales during periods of exogenous shock. Also, Ewelt-Knauer et al. (2014) present differing findings, suggesting that IPOs typically occur during periods of strong economic growth, whereas secondary buyouts are more common in weaker economic conditions and less developed capital markets. Additionally, they observe that debt financing and stock market conditions influence the choice of exit strategy.

In conclusion, market conditions, including economic growth, sentiment, and external shocks, may impact private equity firms' exit strategies. Differing findings underscore the complexity of market influences. The next chapters will explore specific exit strategies in more detail, illustrating how these market conditions may affect the decision-making process for each strategy.

3 Exits and Choice of Exit Strategy

In this section the study focuses on exit strategies. There are three primary exit strategies in private equity: initial public offerings, secondary buyouts, and trade sales. Each of these methods presents advantages and challenges. An IPO allows the PE firm to offer shares to the public, often yielding high returns but requiring favorable market conditions (Uddin & Chowdhury, 2021) and substantial regulatory compliance. An SBO involves selling the portfolio company to another PE firm, providing a structured and relatively predictable exit while maintaining the company within the private investment sphere. Trade sales, where the company is sold to a strategic buyer, are the most common exit route (Gompers et al., 2016; Uddin & Chowdhury, 2021), and it offers synergistic benefits for the acquiring firm.

Table 2. Exit types and their count (adapted from Uddin & Chowdhury, 2021).

Exit type	Count	Percentage	Cumulative count	Cumulative percentage
Trade Sales	39 160	55.89	39 160	55.89
SBO	15 397	21.98	54 557	77.87
IPO	12 189	17.40	66 746	95.27
Write-off	2 478	3.54	69 224	98.81
Reverse takeover	455	0.65	69 679	99.46
Buyback	383	0.55	70 062	100
Total	70 062	100	70 062	100

Table 2 presents the frequency and percentage distributions of Uddin and Chowdhury's (2021) findings on different exit types, illustrating the relative prevalence of each strategy. Trade sales emerge as the most common exit route, accounting for 55.89% of all exits. SBOs constitute the second most frequent exit strategy, making up 21.98% of total exits. The cumulative count shows that by including SBOs, 77.87% of exits are covered,

further emphasizing the reliance on private transactions over public offerings. IPOs account for 17.40% of exits, making them the third most common strategy. The three leading exit strategies – trade sales, SBOs, and IPOs – account for 95.27% of the total. This shows how dominant these exit methods are, which further cements their importance in the lifecycle of investments. Only 1.2% of exits are made through reverse takeover or buyback.

The remaining 3.54% were write-offs. The Write-off exit channel has to be regarded as a last option (Schmidt et al., 2010). Write-offs occur when an investment is deemed unrecoverable, resulting in a total loss. While a write-off often involves the failure of the company, a VC (or PE) may continue to hold shares in an enterprise that is marginally profitable (Cumming & MacIntosh, 2003). Thus, while write-offs are a last option and signify loss, they underscore the inherent risks in private equity investments.

PE funds have a limited contractual term, which requires all positions to be closed by the fund's maturity date. Typically, PE firms aim to hold their investments for approximately five years (Gompers et al., 2016). However, the actual holding period can vary depending on the chosen exit route. Ewelt-Knauer et al. (2014) find that both holding periods and exit strategies differ across investments. Their study reveals that companies exiting through an IPO tend to have the shortest holding period. In contrast, portfolio companies exited through an SBO are held for, on average, more than a year longer than those exited via an IPO.

Schmidt et al. (2010) focus on holding periods and probabilities of exit routes. Their study finds that probability to write-offs is highest in the beginning of the holding period, because underperforming investments are identified quickly and non-profitable investments are rather written off soon, instead of being held as living-dead investments. The study also finds that the probability for an exit via IPO or sale increases during the holding period. While the likelihood of a sale rises sharply in the early years before stabilizing,

the probability of an IPO exit grows more slowly. These findings are illustrated in figure 3.

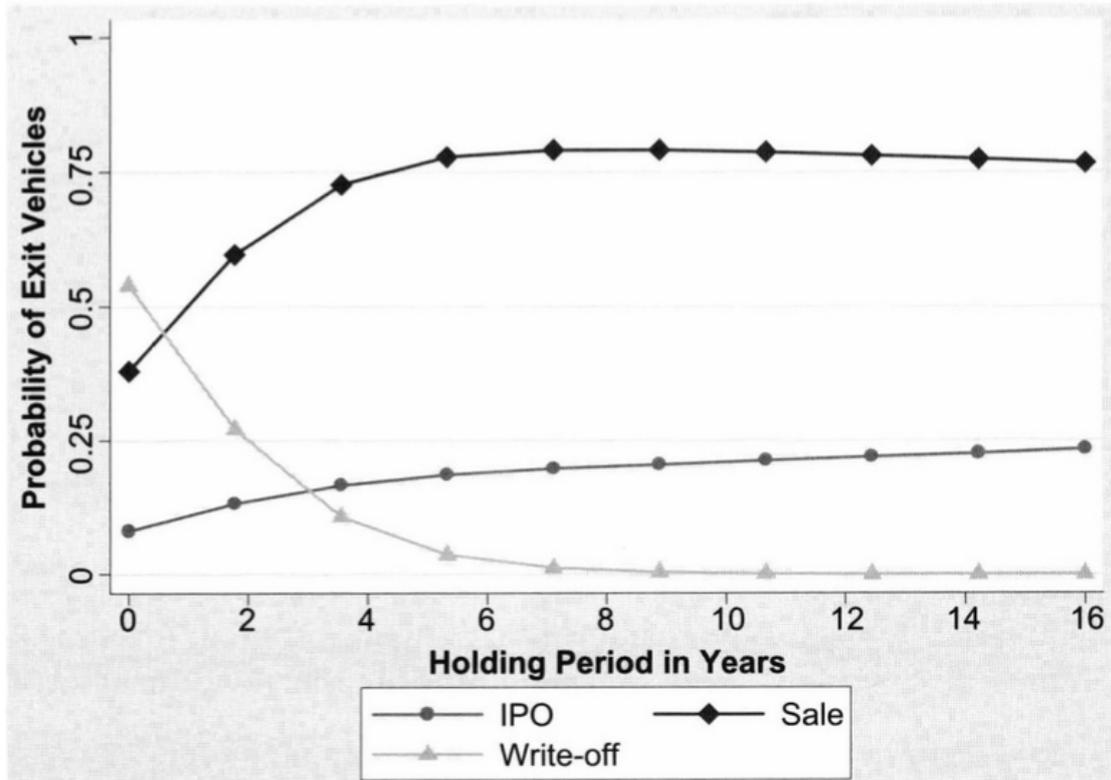


Figure 3. Probability of exit vehicles during holding period (Schmidt et al., 2010).

Ewelt-Knauer et al. (2014) find in their analysis that the reputation of the selling investment company, syndicate size, quality of the transaction object, as well as partial exit are associated with exit channel type. Their findings suggest that well-established investment firms with strong track records may have greater flexibility in selecting their preferred exit route, while smaller or less reputable firms may face constraints in their options.

To further explore the exit phase, this study continues by examining each exit strategy individually, considering different scenarios to determine the most suitable option in various situations. The goal is to provide insights into the key factors influencing exit decisions.

3.1 Trade Sale

A trade sale, also known as a strategic sale, is the most common exit strategy for private equity firms. This method involves selling the portfolio company to third non-financial company. It is typically a strategic acquirer, i.e., a large company operating in a business sector that is the same or very closely related to the object of the acquisition (Cefis et al., 2016). In this situation, the buyer is often looking for synergistic benefits and strategic advantages from the acquisition.

Trade sales are driven by the strategic interests of the acquiring company. Unlike financial buyers, strategic buyers are typically operating companies that seek to integrate the acquired business into their existing operations (Cumming & MacIntosh, 2003). A major motivation for the transaction is to meld the targets products and/or technology with its own, in order to produce synergistic gains (Cumming & MacIntosh, 2003), which can result in cost savings, increased market share, and enhanced competitive positioning.

3.1.1 Advantages of Trade Sale

One of the primary advantages of a trade sale as an exit strategy is its ability to reduce information asymmetry (Uddin & Chowdhury, 2021), a common issue in private equity transactions. Cumming and MacIntosh (2003) point that greater information risk leads to a larger discount on a company's expected future cash flows because risk is a cost. Buyers who struggle to assess the company's true value due to information gaps will pay less, while those with better knowledge and understanding can offer a higher price. In the case of a trade sale, this asymmetry is often reduced because of the nature of strategic buyers and their deeper knowledge of the industry and market in which the portfolio company operates. Therefore, when using a trade sale as an exit route, a PE firm should seek a buyer with strong industry knowledge to minimize information asymmetry and maximize the exit value. This finding underscores the strategic importance of trade sales in maximizing returns for private equity investors. These results support Hypothesis 3, reinforcing the notion that information asymmetry affects the choice of exit strategy.

Schmidt et al. (2010, as cited in Ewelt-Knauer et al., 2014) state that another benefit is that strategic investors take into account potential synergies and strategic advantages in the valuation of their businesses, so the returns from the deal may be higher than in a stand-alone valuation. Similarly, Cefis et al. (2016) argue that industry-specialized private equity firms, leveraging their skills and expertise, can build networks within a given sector and identify acquirers that align with the target's characteristics. The higher the PE firm's industry specialization, the easier it is to match the interests and needs of potential strategic buyers, further increasing the likelihood of a successful exit. On the other hand, PE firms' specialization and value creation can also enhance the attractiveness of their portfolio companies to strategic buyers (Cefis et al., 2016). In a trade sale, the buyer can more accurately evaluate the value created during the PE firm's holding period, making the acquisition more compelling, supporting Hypothesis 2.

As we noted in section 2.5, studies have found diverging results on the impact of market conditions on exit choices. As discussed before, Uddin and Chowdhury (2021), found that PE firms prefer trade sales during periods of exogenous shock. They justify their finding by the fact that trade sales offer certain proceeds, which is important for PE investors in a time of uncertainty such as COVID-19 or financial crisis. Another point is that on market downturns information asymmetry increases, and that is why trade sale would be used as exit route more often than SBOs or IPOs. Schmidt et al. (2010) find that IPO market was down 61% during financial crisis but the number of buyouts in Europe fell by only 20%. They also find that PE investors sell only when necessary, aiming to avoid sales at heavily discounted prices. These findings indicate that during periods of market uncertainty, private equity firms prioritize exit strategies that offer greater financial stability and predictability. In such conditions, trade sales emerge as a more favorable option than IPOs, supporting the Hypothesis 1.

Trade sale also offers quick exit route for a PE firm compared for example to IPO (Ewelt-Knauer et al., 2014; Uddin & Chowdhury, 2021). This is primarily because a trade sale

typically involves fewer regulatory requirements and restrictions. Additionally, the due diligence process in a trade sale is often less complex than in other exit routes, such as SBOs. This is largely due to the strategic position of the acquiring company, which is already operating in the same market as the target company. Ewelt-Knauer et al. (2014) further note that additional advantages of trade sales include relatively low transaction costs and a short transaction phase. Moreover, Cumming and MacIntosh (2002, as cited in Schmidt et al., 2010) show that trade sale is the most pre-relevant exit vehicle and also the most profitable of the sale types

3.1.2 Challenges

Overall, there is quite few challenges in trade sale for the seller PE firm. Main challenges focus on finding the right buyer to maximize the value at the time of exit. As discussed in previous chapter, the specialized and strategic buyer can pay more than non-strategic buyer. This suggests that in a trade sale the challenge is to find the best possible strategic and specialized buyer to maximize the exit value. To overcome this challenge, identifying potential strategic buyers who have a clear synergy with the business is crucial.

3.2 Secondary Buyout

From the perspective of the selling PE firm, an SBO represents an exit strategy (secondary sale), while for the acquiring PE firm, it serves as a new investment opportunity. An SBO involves the sale of a portfolio company, but unlike a trade sale, where the buyer is typically a strategic firm from the same industry, the buyer in an SBO is another PE firm or financial investor. SBOs have become an increasingly common exit route in private equity markets, particularly in cases where other exit options, such as IPOs or trade sales, are less attractive (Cefis et al., 2016).

During the 2000s, SBO deals have become very popular, attracting the interest of both scholars and practitioners (Cefis et al., 2016). The trend toward SBOs has been met with skepticism among researchers and practitioners alike, who doubt that the follow-on

financial sponsor can still create value (Achleitner & Figge, 2012). Achleitner and Figge (2012) argue in their paper that a primary PE firm typically sells a company only after maximizing its operational improvements, using market timing and negotiation skills to achieve the highest possible value at exit. Consequently, a financial buyout is expected to have lower equity returns. However, they cannot find empirical evidence that financial buyouts have lower equity returns than other buyouts or offer less potential for operational performance improvements.

The continued operational performance improvements in SBOs suggest that follow-on sponsors possess the skills necessary to enhance the target company's value, even after the primary PE sponsor has already made significant changes. As such, this highlights that the value created during the holding period is not just relevant for the first sponsor but also contributes to the exit success in the SBO context. These findings support Hypothesis 2, illustrating that the value generated in the holding period has a profound impact on the exit success in SBOs, and underscores the idea that both primary and follow-on private equity firms have an equal chance of a successful exit through value creation.

3.2.1 Advantages of SBOs

Since an SBO, or secondary sale, is similar to a trade sale—differing only in the type of buyer—it shares many of the same advantages. Cefis et al. (2016) find some studies that highlight the SBO as an optimal solution to those PEs whose fund life is close to maturity. As a fund approaches the end of its investment horizon, PE firm faces time-sensitive liquidity needs. Ewelt-Knauer et al. (2014) further emphasize that SBOs offer the advantage of prompt realization and a short transaction period, making them a practical choice when a quick and seamless exit is required to meet liquidity demands. As discussed in trade sale, also secondary sale typically involves fewer regulatory requirements and restrictions, making transaction period shorter.

Such as trade sale, secondary sale can help mitigate information asymmetry compared to IPOs. Both the strategic private buyers, and the financial buyers in the case of an SBO, although being different in nature and interests, are active actors capable of carrying out due diligence and of understanding the strengths, weaknesses and potential of the firm (Cefis et al., 2016). This thorough due diligence process reduces the information gap between the buyer and the seller, leading to more informed decision-making and fairer valuations. However, Cumming and MacIntosh (2003, as cited in Uddin & Chowdhury, 2021) mention that trade sales are superior to secondary sales in resolving the information asymmetry problem due to the limited bargaining power of new buyers in the case of secondary sales. While reducing information asymmetry in SBOs may not be as effective as in a trade sale, it still promotes distribution of information, benefiting not only the buyer but the seller, by securing a better price at exit. This support Hypothesis 3.

One advantage of SBOs, as identified by Cefis et al. (2016), is that PE firms often collaborate to facilitate exits and enhance their returns. This collaboration can lead to smoother transactions, as both parties often have a shared understanding of operational improvements implemented during the holding period. Furthermore, Cefis et al. (2016) argue that SBOs are particularly advantageous when the initial PE firm lacks specialization either at the industry level or in LBO-stage restructuring. In such cases, the follow-on PE firm brings the necessary expertise to continue supporting the target company's growth and expansion, making an SBO a more suitable exit option. The advantage is that the follow-on private equity firm will be able to see the value of the company being sold, whereas an unspecialized PE firm may find it difficult to reach a strategic acquirer. These findings align with Hypothesis 2, which suggests that effective value creation strategies increase the probability of attracting strategic buyers and achieving higher exit valuations. Thus, non-specialized PE firm cannot maximize value creation, an SBO may be the optimal exit strategy.

3.2.2 Challenges

While SBOs present several advantages, they also come with challenges that may limit their suitability in certain situations. Ewelt-Knauer et al. (2014) find evidence that one of the main disadvantages of SBOs is the time pressure imposed by the maturity of private equity funds, which often results in the need to sell quickly in the end of funds lifetime. This can lead to below-average returns, as buyers typically have high return expectations and there is often a lack of synergy potential.

The second challenge relates to the reputation of PE firms. Ewelt-Knauer et al. (2014) state that many studies have found that SBOs are regarded as harmful to an investment company's reputation. Further, they find that SBOs become less likely if the reputation of an investment company is high, whereas SBOs are more likely for low quality firms. On this basis, PE firms may want to avoid SBOs for reputational reasons.

Metrick and Yasuda (2011) find that credit market conditions have a strong effect on prices paid in buyouts. Similarly, Achleitner and Figge (2012) highlight that follow-on financial sponsor exercise on market timing skills, with the price paid depending on market conditions. Their study concludes that favorable prices for PE firms are largely driven by greater debt availability. Conversely, in weaker credit market conditions, SBOs may become less attractive to sellers. Ewelt-Knauer et al. (2014) also find that illiquid capital markets significantly decrease the likelihood of SBOs. However, as discussed earlier, they observe that SBOs are more common during periods of low economic growth and less developed capital markets. These findings support Hypothesis 1, even though unfavorable market conditions prevent SBOs from achieving the best possible exit value.

3.3 Initial Public Offering

An Initial Public Offering is the process through which a private company offers its shares to the public for the first time. An IPO marks the transition from private ownership to public ownership, allowing a company to raise capital from a broader investor base. As

discussed in the beginning of chapter three, IPO is third most used exit strategy for PE firms, accounting for less than one fifth of all exits.

IPOs differ in many respects from the exit strategies discussed earlier, the main difference being that in a trade sale or secondary sale strategy the company remains private. IPOs do not always offer an immediate and complete exit, unlike commercial sales or SBOs, as lock-up periods restrict private equity firms from selling their shares immediately after an IPO (Cefis et al., 2016).

Another key difference between IPOs and other exit strategies is the regulatory and administrative complexity involved. Going public requires extensive disclosure, regulatory compliance, and significant costs related to underwriting (Cumming & MacIntosh, 2003; Ewelt-Knauer et al., 2014). While an IPO can provide access to capital and increased visibility for the company, it also introduces risks, such as public market scrutiny and pressure to meet shareholder expectations.

For PE firms, the decision to pursue an IPO as an exit strategy involves several strategic considerations. One of the primary motivations is the potential for higher returns in the public market compared to private sales (Ewelt-Knauer et al., 2014). However, the timing of the IPO is crucial. Market conditions, investor sentiment, and the overall economic environment significantly impact the success of the offering (Cefis et al., 2016). PE firms must carefully assess these factors to determine the optimal timing for the IPO to maximize returns.

3.3.1 Advantages of IPOs

Since IPO differs from the two main exit strategies, trade sale and secondary sale, it also offers different advantages compared to those strategies. For example, Ewelt-Knauer et al. (2014) study focuses on reputation of investment company. The study finds evidence that the reputation-building potential of an IPO is one factor influencing its use. Investment companies with a lower reputation may choose an IPO to enhance their credibility

and market standing (Ewelt-Knauer et al., 2014). By successfully taking a company public, PE firms can demonstrate their ability to create value and manage high-quality investments, improving their prospects for future fundraising and deal-making. At the same time, high-quality firms are more likely to be sold via an IPO, as a successful listing of a high-quality company is more likely, and thus raises the reputation of the investment company (Ewelt-Knauer et al., 2014).

One key advantage of an IPO is its ability to yield higher financial returns compared to other exit strategies. Ewelt-Knauer et al. (2014) highlight that above-average returns are one of the primary benefits of an IPO exit. When market conditions are favorable, companies can achieve high valuations, leading to substantial gains for PE investors. Cefis et al. (2016) support this by stating that firms are more likely to go public during periods of strong stock market performance and high investor confidence. Furthermore, Ritter and Welch (2002) state that large variation in the number of IPOs suggests that market conditions are the most important factor in the decision to go public. This suggests that IPOs are closely linked to stock market conditions, with firms strategically timing their public offerings to maximize value.

Economic conditions, closely linked to market conditions, play a crucial role in determining the suitability of an IPO as an exit strategy. According to Ewelt-Knauer et al. (2014), IPOs are more likely to occur during periods of high economic growth. Their research identifies significant differences between variables gross domestic product (GDP) growth and the total market capitalization of all listed firms relative to GDP in the exit year. Additionally, the study finds that high long-term interest rates enhance the attractiveness of IPOs compared to trade sales and secondary sales. These findings on market and economic conditions provide strong support for the Hypothesis 1.

As discussed earlier, high-quality firms are more likely to be sold via an IPO, with strong evidence suggesting that top-performing and highly profitable companies often choose this exit route (Schmidt et al., 2010). They highlight that such companies are

characterized by a convincing equity story as well as high growth prospects, and they are not in mature development stage.

Cumming and MacIntosh (2002, as cited in Schmidt et al., 2010) support that adding value is only possible over time. They argued that private equity investors, due to their sophistication, private equity investors can clearly distinguish between good and bad investments, adding value only to good ones. That is why the duration of an investment can be interpreted as a signal of the firm's quality, and therefore they suggested that the longer holding period increases the probability of an IPO. As shown in Figure 3, Schmidt et al. (2010) found support for this in their study, indicating that the probability of IPOs gradually increases over time. These findings support Hypothesis 3, because information about firm quality cumulates over time (Cumming & MacIntosh, 2003).

3.3.2 Challenges

Like other exit strategies, the IPO strategy has its own challenges and limitations. One of the main challenges with IPOs is information asymmetry. Cumming and MacIntosh (2003) argue that information asymmetry is highest in the case of IPOs compared to other exit strategies. As discussed in previous section, information about firm's quality cumulates over time. Consequently, private equity firms may prefer to hold their investments longer, reducing information asymmetry and allowing better valuation at the time of exit (Uddin & Chowdhury, 2021). This often leads to longer holding periods for exits from IPOs compared to other exit strategies with less information asymmetry. Compared to IPOs, trade sales or secondary sales are much more effective in mitigating information asymmetry (Uddin & Chowdhury, 2021), giving strong support to the Hypothesis 3.

As discussed in chapter 3.1.1, greater information risk leads to larger discounts on expected future cash flows, as buyers with limited knowledge offer less while informed buyers can pay more. In an IPO, the public buyer is typically composed of dispersed investors that have access only to public information about the firm (Cefis et al., 2016), making information asymmetry more pronounced. Since these public investors lack

comprehensive knowledge of the firm's operations and competitive environment, it can result in underpricing and lower valuations. Additionally, Ritter and Welch (2002) find that information asymmetry contributes to underpricing in exits made through IPOs. Cefis et al. (2016) state that to mitigate this asymmetry and to gain the public market attention, the PE firm needs to provide certification about the quality of the firm being sold. These findings suggest that the IPO process is challenging from the perspective of information equalization and maximizing exit value.

Other major disadvantage of an IPO exit is the high cost associated with the listing process. Ritter (1987, as cited in Ewelt-Knauer et al. 2014) assume that IPOs involve significant expenses, including cost of issue and stock exchange listing fees. Additionally, the IPO process is time-consuming, often requiring extensive preparation and a relatively long transaction phase. These factors make IPO exits less attractive compared to trade sales or secondary sales, where the process is typically faster and less costly.

Additionally, partial exits in IPOs can make this exit strategy challenging. Ewelt-Knauer et al. (2014) generate evidence that investment companies are more likely to only partially sell their portfolio companies in IPOs. Ball and Gefter (2016) state that sponsor's holdings are typically too large to sell in the market at one time. A sponsor selling its entire holdings may signal to the market that it believes the company has limited upside. However, in cases where a PE fund is nearing the end of its maturity, a partial exit may not be a viable option.

As discussed in chapter 3.3.1 IPO exit achieve high valuations when stock market performs well. Ewelt-Knauer et al. (2014) find that the IPO market is cyclical in nature. Korajczyk, Lucas and McDonald (1992, as cited in Uddin & Chowdhury, 2021) show that firms abandon IPO during bad economic conditions and wait for a good time to go for IPO. This reliance on market conditions and sentiment can result in extended holding periods, as firms wait for more favorable conditions to maximize returns. This also supports Hypothesis 1.

4 Conclusion and Discussion

4.1 Conclusion

This study has examined the factors influencing private equity exit strategies, focusing on the role of market conditions, information asymmetry, and value creation during the holding period. The findings suggest that exit strategy selection is driven by both market and economic factors and firm-specific capabilities, such as PE firms' specialization.

First, market conditions are crucial in determining the optimal exit route. Favorable credit and stock market environments increase the likelihood of IPO exits, whereas SBOs and trade sales become more attractive during periods of economic downturn or constrained capital availability. This aligns with Hypothesis 1, confirming that market dynamics significantly shape exit decisions.

The study finds that information asymmetry remains a key challenge in exit transactions. IPOs are particularly sensitive to information asymmetry, as public investors often lack detailed insights into the company, which can lead to lower valuations at the time of exit. In contrast, trade sales mitigate these risks by leveraging strategic buyers' industry expertise, making them a preferred option to minimize information gaps and maximize exit value. These findings strongly support Hypothesis 3, reinforcing that information asymmetry influences exit strategy selection.

Finally, the specialization of PE firms affects their ability to create value and successfully exit investments. Specialized PE firms with industry expertise are better positioned to maximize portfolio company performance and attract strategic buyers. In contrast, non-specialized PE firms may prefer SBOs as an exit route, where the acquiring PE firm has the necessary expertise to continue value creation. This supports Hypothesis 2, highlighting that specialization enhances exit outcomes.

4.2 Discussion

The findings suggest that reducing information asymmetry should be a priority in PE transactions to maximize exit value. This can be achieved through enhanced due diligence, increased transparency, and selecting exit routes like trade sale or secondary sale. PE firms aiming for an IPO exit should consider longer holding periods to allow more information to accumulate, thereby improving valuation outcomes.

For private equity professionals, these findings emphasize the need for strategic exit planning. Firms should develop a clear exit strategy early in the investment cycle, considering market timing, industry conditions, and potential buyers. Moreover, PE firms can improve their exit outcomes by focusing on specialization—those with deep industry expertise tend to achieve better valuations and attract more buyers.

One key practical implication is the necessity for PE firms to closely monitor macroeconomic trends and capital market conditions to optimize exit timing. Economic downturns can significantly limit exit opportunities, making flexibility and contingency planning essential. External shocks can rapidly alter market conditions, often making it difficult for PE firms to anticipate the best exit timing. If a firm's liquidity needs coincide with unfavorable market conditions, the potential returns from an exit may be suboptimal. Furthermore, the study finds that fund maturity and liquidity need influence exit route selection, though this aspect is not explored in depth. These findings raise an important question for future research: To what extent does fund maturity pressure PE firms into suboptimal exit decisions?

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