THE GATHERING STORM

Why Private Equity's Next Decade Demands an Operations-First Model

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Executive Summary

Private equity is navigating its most consequential inflection point in two decades. The confluence of compressed distributions, record portfolio backlogs, underperforming vintage cohorts, and a fundamental repricing of debt has exposed a structural fault line running through the industry's recent history: a decade-long dependence on financial engineering, multiple expansion, and cheap leverage rather than genuine operational value creation as the primary engine of returns.

This paper sets out the full scale of the challenge. It is not a cyclical adjustment. It is a structural regime change. The easy-money era that defined 2010 to 2022 has ended, and the firms that thrived within it are now confronting the consequences.

The data is unambiguous. Since 2022, PE funds have delivered annualised returns of just 5.8% against the S&P 500's 11.6% over the same period. Top-quartile global buyout returns averaged 8% in 2025. More than 16,000 companies globally have been held for more than four years, representing 52% of all buyout-backed inventory. Distributions as a percentage of AUM have collapsed to approximately 6%, against a ten-year average of 14%. Capital calls have exceeded distributions by roughly $1.5 trillion since 2018.

There is a clear path forward. Firms that adopt an operations-first model are generating specialist buyout IRRs of 17% against 13% for generalist peers. The dispersion between top and bottom quartile funds now exceeds 25 percentage points. This is no longer an asset class where a rising tide lifts all boats.

SECTION 1

The Anatomy of a Crisis

The private equity industry has been in structural difficulty since the interest rate reset of 2022, but the scale of the challenge has been obscured by optimistic mark-to-market valuations, the rise of continuation vehicles as a proxy for liquidity, and narratives of cyclical recovery. Strip away those artefacts and the underlying picture is stark.

1.1 The Return Collapse

Between January 2022 and September 2025, US private equity funds generated average annualised returns of approximately 5.8%, less than half the S&P 500's 11.6% over the same period, according to MSCI. In 2025 specifically, top-quartile global buyout returns averaged just 8%, compared to 18% for the S&P 500 and 22% for the MSCI World index. This marks a historic reversal from a decade in which PE commanded a meaningful premium over public markets.

The rot runs deeper across vintage cohorts. Funds that acquired assets between 2015 and 2017 have generated approximately 2% annualised IRR since January 2022, according to McKinsey. Newer vintages (2022 to 2024) show double-digit IRRs of approximately 15%, but the majority of that performance remains unrealised. The top-quartile buyout IRR has itself been in structural decline: from approximately 25% for 2010 to 2014 vintages, falling to approximately 23% for 2018 to 2022 vintages.

1.2 The Liquidity Drought

Distributions, the mechanism through which investors actually receive cash, have collapsed. Distributions as a percentage of AUM fell to approximately 6% in the six months to June 2025, against a ten-year average of 14%. Five-year rolling DPI as a share of AUM for buyout funds hit its lowest recorded level in 2025, according to MSCI.

For US and Western European funds raised in 2018, historical cash flow patterns would predict a DPI ratio of approximately 0.8x at this stage of the fund lifecycle. The current ratio barely exceeds 0.6x. Limited partners that rely on distributions to fund liabilities are feeling this acutely. The share of institutional portfolio allocations to alternatives has risen from 10% in 2000 to approximately 30% in 2025. The liquidity shortfall is not a fringe problem; it is directly impairing the ability of institutions to meet their obligations.

The response from many GPs has been to engineer liquidity rather than generate it. The ratio of contributions to continuation funds relative to distributions from mature PE funds averaged just 6% between 2016 and 2020. By 2021 to 2025, that ratio had jumped to 20%, according to MSCI data. More than 60% of LPs explicitly prefer conventional exits over synthetic alternatives such as dividend recapitalisations.

> "McKinsey's 2025 LP survey found that 2.5 times as many LPs now rank DPI as a "most critical" performance metric compared to three years ago."

1.3 The Inventory Overhang

The backlog of assets awaiting exit has never been larger. McKinsey's 2026 Global Private Markets Report estimates that more than 16,000 companies globally are currently held by private equity sponsors for more than four years, equivalent to 52% of total buyout-backed inventory, ten percentage points higher than the five-year average. The typical portfolio company is now held for an average of more than 6.5 years, the longest average holding period since 2005.

Exit volumes, while recovering from 2023 lows, remain substantially below the pre-2021 era. IPOs accounted for just 6% of exit value in recent periods. The value of PE exits peaked at $527.8 billion in 2021, collapsed to $100.8 billion in 2023, and recovered only partially to $243.9 billion in 2025.

1.4 The Fundraising Freeze

Global private equity fundraising declined in 2022, 2023, and 2024, and hoped-for recovery in 2025 has not materialised. Total PE fundraising is expected to fall below $600 billion in 2025, against a peak of $840.9 billion in 2023. US buyout fundraising declined by 20% in 2024 versus 2023, with fund count falling nearly 50%.

Capital concentration is accelerating sharply. In 2024, just five managers captured almost three-quarters of the $115 billion raised in the secondaries sector. Entry multiples offer no relief. The median PE purchase multiple rose from 11.3x EBITDA in 2024 to 11.8x in 2025. Without multiple expansion and cheap leverage, which together accounted for 59% of returns between 2010 and 2022 according to McKinsey, the arithmetic of returns at these entry prices depends entirely on operational performance.

SECTION 2

Bonfire of the Equities

The current crisis did not emerge from nowhere. It is the predictable consequence of a model that was never built to last, one that mistook favourable macro conditions for genuine skill. For the better part of a decade, private equity burned through one of the most accommodating financial environments in history, extracted enormous fees, and called it alpha.

2.1 How Returns Were Actually Made

Between 2010 and 2021, approximately 66% of private equity value creation came from leverage and multiple expansion, factors entirely outside the control of the manager, and therefore beta rather than alpha. McKinsey's data on fully exited deals from this period is unambiguous: the asset class was riding a macro tailwind and calling it strategy.

This era rewarded a simple playbook: acquire assets at high multiples with cheap debt, hold through a period of market appreciation, and sell at even higher multiples. Operational improvements were often cosmetic, sufficient to justify the investment thesis in presentations to LPs, but rarely the primary driver of the return achieved.

The MSCI value bridge for buyout holdings exited in the 2020 to 2021 window captures this precisely: over half of the incremental gain came from EBITDA multiple expansion alone. For deals exited in 2022 through Q3 2025, the picture has materially changed. Revenue growth now accounts for approximately two-thirds of value generated above invested capital. According to Gain.pro's 2025 Value Creation Report, multiple expansion's contribution has declined from 40–45% in 2019–2021, falling to approximately 15% in the current environment, while revenue growth has risen to 65–70% of value creation.

2.2 The Leverage Trap

Leverage was the fulcrum of the easy-money model. At near-zero interest rates, the mathematics were compelling: debt was essentially free, coverage ratios were manageable at very high loan-to-value levels, and sponsors routinely entered transactions with debt-to-EBITDA ratios of 6 to 7x or above.

The rate normalisation of 2022 shattered that model. At today's financing costs, sponsors must generate approximately 4.2% annual EBITDA growth to achieve a 20% IRR with a seven-year holding period, more than double the equivalent requirement under a 3% rate environment. Many assets acquired in 2019 to 2021 simply cannot deliver that growth. They are trapped: holding periods lengthen, IRRs decay with time, and the bid-ask gap between seller expectations anchored to peak-cycle valuations and buyer underwriting calibrated to higher rates makes exits impossible at acceptable multiples.

2.3 The Operational Capability Gap

The most damaging consequence of the financial engineering era is what it did not build: genuine operational capability within portfolio companies. A 2025 Accenture study found that only 8% of mid-sized companies have achieved operational maturity. Across the remaining 92%, there are substantial unaddressed opportunities in digital infrastructure, commercial efficiency, pricing sophistication, and data utilisation.

Since 2010, 47% of private equity value creation has come from operations, up from just 18% in the 1980s, according to PwC. Meanwhile, financial engineering's contribution has fallen to 25% from 51% in the same period. Yet the operating partner function that should be delivering this shift remains underdeveloped at most firms. Ten years ago, a sophisticated operating team with genuine technology transformation capability was a niche advantage. Today, according to PwC, it is table stakes.

> "Specialist funds with genuine operational capability generated 17% pooled IRR versus 13% for generalist peers across 2010–2022 vintages."

SECTION 3

The Structural Reckoning

The crisis is not limited to underperforming vintage cohorts or constrained exit markets. It is reshaping the competitive structure of the industry itself, and creating conditions that will permanently separate firms with genuine operational capability from those without.

3.1 The LP Patience Problem

Institutional LP portfolios that increased alternative allocations through the 2010s are now experiencing a structural squeeze. Ten of the fifteen largest US public pension funds are currently attempting to trim private equity positions, collectively needing to reduce exposure by more than $30 billion over time.

LPs that committed capital in 2018 to 2021 expected meaningful distributions by 2024 to 2026. Instead, they are sitting on assets held beyond stated fund lives, receiving continuation vehicle transfer notices, and watching DPI ratios stagnate. PwC's 2025 industry survey found that 28% of LPs now say that investment performance has fallen below their expectations.

3.2 The Concentration of Survival

Capital is consolidating around a shrinking number of credible performers. The top managers, those characterised by genuine operational track records, consistent DPI, and transparent reporting, are raising capital successfully. The rest are facing a structural freeze. US buyout fund count fell nearly 50% in 2024, even as dollar volumes held up somewhat due to mega-fund closings.

The mid-market, historically the most fertile ground for operational value creation, is experiencing the most acute capital contraction. According to With Intelligence's 2025 PE Trends data, sponsors that achieved successful fundraises in the last 18 months showed both higher net IRR and stronger DPI in prior vintages; some firms with solid performance but weak DPI failed to raise a new fund altogether.

3.3 The Multiple Compression Trap

Even as the industry struggles to exit assets acquired at peak multiples, entry multiples for new acquisitions have continued to rise, reaching a median of 11.8x EBITDA in 2025, according to McKinsey. This is the product of a perverse dynamic: global dry powder of approximately $2.1 trillion, with 24% aged over four years, competing for a limited supply of quality assets in a constrained deal market.

Apollo's analysis of 397 buyout deals demonstrates that cheapest-quartile entrants generated 2.5 times as much in exit proceeds as the most expensive quartile in the 2020 to 2022 cohort. The Gain.pro dataset reinforces this: the median MOIC for portfolio companies growing at more than 30% CAGR is 4.0x, nearly halving to 2.3x for companies growing at 0 to 10%. Paying 11.8x for assets in today's environment requires operational improvements of a magnitude that most funds have never systematically delivered.

SECTION 4

The Operations-First Imperative

The evidence is unambiguous: the firms that will survive and outperform the coming decade are those that embed genuine operational transformation capability as a core competence, not a peripheral service, not an after-the-fact intervention, but a systematic, front-loaded, data-driven engine of value creation integrated into every stage of the investment lifecycle.

4.1 What Operations-First Means in Practice

An operations-first model is not a rebranding exercise. It represents a fundamental rearchitecting of how a private equity firm creates value. It means operational diligence as rigorous as financial diligence at the point of acquisition; detailed, credible value creation plans built before completion and validated against realistic EBITDA uplift targets; embedded transformation capability within portfolio companies from day one; and a clear, measurable linkage between operational improvement and exit readiness.

Accenture's research quantifies the available opportunity: PE firms themselves now believe financial engineering should account for just 25% of value creation efforts, with the remaining 75% focused on operational improvement. Revenue growth now drives 54 to 71% of total PE value creation in the current environment, with top-quartile operational improvements delivering 5 to 18% EBITDA uplift.

4.2 The Digital Transformation Premium

Digital capability is the single most important structural differentiator between portfolio companies that achieve premium exit valuations and those that do not. EY's Q4 2025 PE Pulse found that 88% of respondents identify digital infrastructure as one of the most promising sources of growth in 2026. Strategic acquirers and secondary sponsors are increasingly paying demonstrable premiums for businesses with proven digital revenue engines, scalable data infrastructure, and measurable commercial automation.

Fast-growing companies typically command 30 to 50% higher exit multiples, according to Gain.pro's analysis of PE exit data. The research found that 78% of deals with negative EBITDA margins at entry achieved margin expansion during the hold period, but only 44% of companies with negative revenue growth achieved the same. The implication is that margin improvement follows revenue growth rather than preceding it.

Yet the current state of digital maturity across PE-backed companies is, by any objective measure, poor. Only 8% of mid-sized businesses have reached operational maturity. For the PE firms holding 16,000+ assets in extended hold positions, digital transformation is not merely an opportunity. It may be the only credible mechanism for generating sufficient EBITDA growth to support an exit at an acceptable multiple.

4.3 Why Execution Fails

PE firms understand the operational imperative better than they execute against it. Simon-Kucher's 2025 Value Creation Study found that 78% of respondents expect operational improvements to grow in importance over the next 12 months. The same study identified the top reasons why value creation plans fail: unrealistic business cases (37%), portfolio company resistance and lack of buy-in (35%), and insufficient execution capability within the GP's operating team.

Three structural deficiencies prevent PE firms from capturing the operational premium they aspire to:

— Diligence is financial, not operational. Assessment of realistic improvement potential, management team change capacity, and digital infrastructure gaps is typically superficial relative to financial modelling.

— Value creation plans are written for investment committees, not operators. Plans are often conceptual frameworks produced to justify acquisition rationale rather than detailed execution blueprints with clear owners, milestones, and EBITDA linkage.

— The 100-day period is wasted. The highest-leverage moment for structural change, immediately post-completion, is routinely consumed by reporting setup and relationship building rather than operational quick wins that build momentum and credibility.

4.4 The AI Readiness Gap

The deployment of AI and automation represents the most significant near-term opportunity within portfolio company transformation, and the area where the gap between aspiration and reality is widest. EY notes that 2024 was about AI experimentation within PE; 2025 was supposed to be about AI execution. In practice, AI thrives only when built on a strong digital foundation, and across the PE mid-market, that foundation does not widely exist.

Since 2010, 342 PE firms have invested in AI and machine learning companies, making 650 platform investments, according to Private Equity Info. Yet deploying AI as an investment is categorically different from deploying AI as an operational tool within portfolio companies. Documented AI implementations in PE portfolio contexts are generating individual savings of more than $2 million annually per customer. For a mid-market portfolio company with $5 million of EBITDA, a single well-executed AI deployment can meaningfully re-rate the business for exit.

SECTION 5

What Good Looks Like

The operational transformation model is not theoretical. The firms generating genuinely superior returns in the current environment have systematically rebuilt how they operate, before acquisition, during the hold period, and in preparation for exit. Their playbooks, while proprietary in detail, share common structural features that are observable from the outside.

5.1 Diligence That Reflects the New Reality

The firms generating operational alpha begin before completion. They assess acquisition targets not merely on historical financials and market position, but on a structured evaluation of operational improvement potential: where is revenue leaking, where is pricing unsophisticated, where is the commercial infrastructure inadequate, where is the management team's change capacity insufficient? This assessment is conducted with the same rigour as financial modelling, and in top-performing firms, it directly shapes the price paid and the structure of the investment.

This pre-completion work feeds directly into a credible, sequenced value creation plan that is built before day one rather than assembled in the first quarter post-acquisition. The plan is benchmarked against realistic EBITDA uplift ranges, calibrated to the specific operational gaps identified, and structured with clear ownership and milestones.

5.2 Execution Infrastructure That Matches Ambition

Blackstone's appointment of Rodney Zemmel, former global leader of McKinsey Digital, as Global Head of Portfolio Operations in February 2025 was not an accident. It signalled that the world's largest alternative asset manager views operational transformation capability as a primary competitive advantage. Bain Capital's Portfolio Group employs more than 115 dedicated operating professionals organised by functional specialisation. Apollo Portfolio Performance Solutions has expanded substantially to approximately 35 full-time professionals, blending generalist operating partners with specialists in data, digital, and AI.

These firms represent the upper end of the capability spectrum. But the strategic signal is clear: PE operating models are being fundamentally restructured around transformation capability. The industry is moving away from external advisors and towards full-time dedicated operating partners with board seats, hiring authority, and decision-making rights. The firms that are still treating operational improvement as a consulting engagement to be initiated post-close are structurally disadvantaged.

5.3 Exit Readiness as a Discipline, Not an Event

In a constrained exit environment, liquidity is a strategic capability rather than a transactional outcome. The firms generating strong DPI are distinguished not by perfect market timing but by having prepared their portfolio companies for multiple exit pathways from the point of acquisition. That means building the financial reporting infrastructure that strategic buyers and secondary sponsors expect, developing the commercial and operational transformation narrative that justifies a premium multiple, and ensuring the management team is oriented towards exit readiness well before a process begins.

Gain.pro's data on exit outcomes by deal type is instructive: family-to-sponsor deals generate the highest median MOIC (2.9x) in part because they offer the greatest operational improvement headroom. Carve-outs deliver lower median MOICs (2.3x) but represent the fastest-growing deal type as corporates rationalise portfolios under pressure. Each entry type demands a different operational playbook, and the firms that have built the capability to execute across all three are structurally better positioned for the decade ahead.

CONCLUSION

Storm Preparedness is a Strategic Imperative

Private equity is not in decline. But the version of private equity that dominated 2010 to 2022, one built on cheap leverage, multiple expansion, and passive financial sponsorship, is. The firms that recognise this and rebuild their model around genuine operational capability will be the industry's next generation of outperformers. Those that do not will be progressively crowded out by an LP community that is, for the first time in a generation, demanding evidence of real value creation rather than accepting its promise.

The gathering storm has been building for three years. The distressed DPI ratios, the record inventory overhang, the collapsing distributions, the fundraising freeze outside the mega-funds: these are not transient conditions. They are the structural residue of a model that worked until it did not. The question for every sponsor, every LP, and every portfolio company board is not whether change is necessary. It is whether the capability exists, in people, processes, tools, and mindset, to execute the transformation that change demands.

The answer begins with an honest operational assessment, a credible value creation plan built before acquisition rather than after it, and an execution infrastructure designed for this environment rather than the last one. The firms building that infrastructure now will find, when the storm clears, that they have not merely survived it. They have used it to separate themselves permanently from the competition.

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ABOUT CLAYMORE PARTNERS

Claymore Partners is a growth execution firm for private equity sponsors and their portfolio companies. We install revenue clarity, operating cadence, and execution ownership inside businesses where the gap between strategy and outcome is costing multiple points of EBITDA. This paper draws on Claymore's proprietary analysis alongside publicly available research from McKinsey, MSCI, Bain & Company, Accenture, PwC, EY, Preqin, Gain.pro, and other tier-1 sources cited throughout. The views expressed represent Claymore Partners' analysis as of March 2026.

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