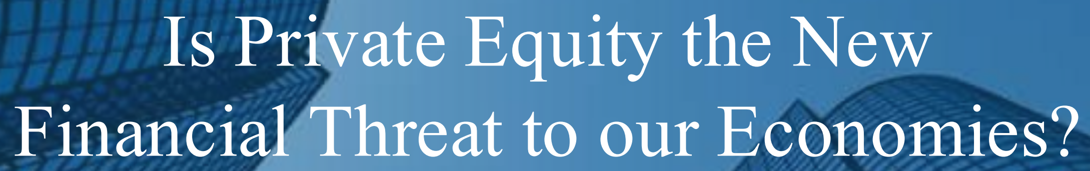

Is Private Equity the New Financial Threat to our Economies?

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Executive Summary

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Private equity has become a significant contributor to economic growth in developed countries, particularly in the US and, to a lesser extent in Europe. Indeed, in 2023 private equity investments in the United Kingdom reached 1.1 % of its GDP, placing the country as the leader among European countries. In 2022, in the US, Private equity accounted for 6.5% of US GDP.

Private equity is getting larger every year, representing multiple trillions of dollars in 2023 This growing allocation of capital to this financial activity is undoubtedly due to its better performance than public equity. Indeed, on average PE funds have delivered an average annual return of 13.1% over the previous 25 years, well ahead of the 8.6% average return posted by the S&P 500 during the same period, although this trend is currently weakening (Nasdaq, 2024).

But the question remains: do these very high returns hide potential financial risks driven by overleveraging and bankruptcies?

Indeed, LBO private equity funds face controversy for reducing employment and increasing debt burdens of their companies.

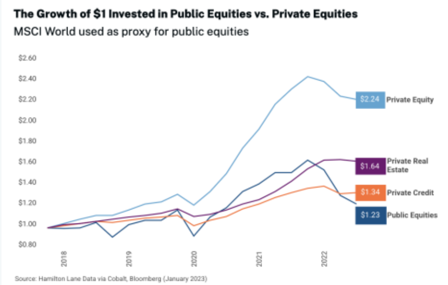
While overall, LBO PE funds have been beneficial to small and medium-sized businesses, which benefit from the funds' governance expertise and capital to grow organically, they tend to be riskier when they deal with already mature companies with low prospects of growth.

In some cases, it has been proven that LBO private equity was responsible for bankruptcy due to high levels of debt, this still represents a very small proportion of the companies backed by these funds. However, this pattern tends to happen more in the US due to a laxer legal environment and a deeper capital market (shadow banking) compared to Europe, which sees its funds being less leveraged.

Moreover, the more relaxed legal environment in the US has allowed large deals involving firms in sectors such as healthcare, education, and even prisons affecting their services which on average degraded after being taken over by a PE fund.

Private equity is, however, unlikely to be a systemic risk. As has been shown during the 2008 financial crisis, private equity neither contributed nor caused the recent financial crisis, and there was no widespread failure of private equity-backed companies (Alexandros Seretakis, 2013). Indeed, by being illiquid (capital is locked on average between 5 to 7 years), they don't have to face panic runs and are not subject to financial contagion as they are not linked to each other like Banks are with interbank lending.

Hence, it is acknowledged that Private Equity doesn't pose a systemic risk to our economies. It raises the question of stricter regulation on transparency and whether we should regulate some very sensitive sectors that require a minimum level of operational cost and R&D, incompatible with profit maximization strategies, such as in the health care or education sector.



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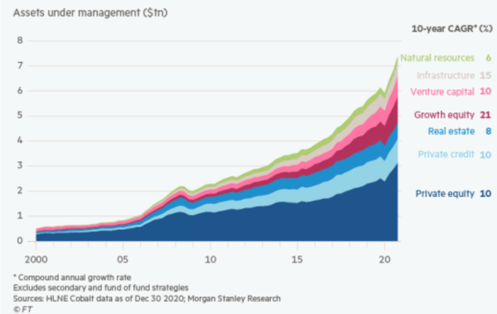

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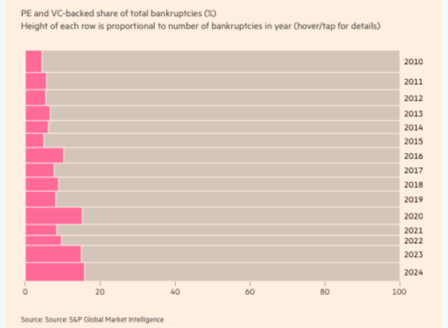

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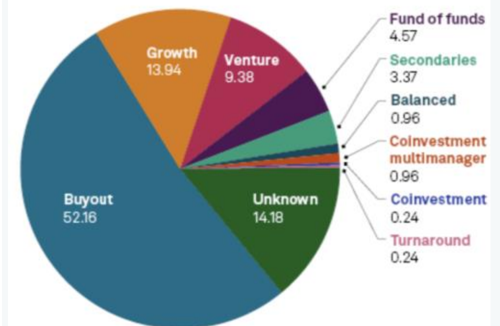
Prelude

The 2008 global financial crisis exposed the devastating consequences of excessive risk-taking in the financial sector. The collapse of major financial institutions triggered widespread economic hardship, leading to mass unemployment, business closures, and a prolonged recession that continued until not so long ago. In response, governments intervened with large-scale bailouts and regulatory reforms aimed at preventing a similar catastrophe.

One of the most significant regulatory measures introduced was Basel III, a comprehensive framework designed to strengthen the resilience, supervision and risk management of the banking system. It was developed by the Basel Committee on Banking Supervision (BCBS), who designed it to prevent another financial collapse by ensuring that banks hold sufficient capital and liquidity to absorb economic shocks. It is supposed a major shift since the previous regulation framework, Basel II, which was way less rigorous. Its key components include the introduction of stricter capital adequacy requirements, as before the implementation, banks were often undercapitalized, not having enough financial 'safeguards or buffers' in case of crisis. As a result, the Minimum Common Equity Tier 1 Ratio and Total Capital Requirement increased, as well as the Capital Conservation Buffer was modified to hold an extra 2.5% in good times

Moreover, it introduces a higher leverage ratio to prevent excessive borrowing, which was considered one of the main reasons for the 2008 crisis, especially for housing and mortgages.



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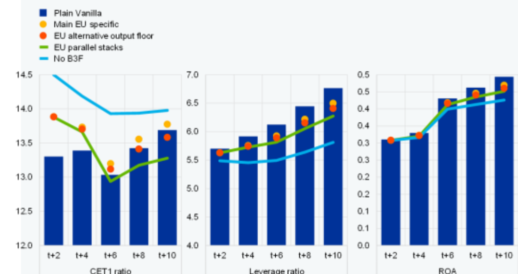
Furthermore, higher liquidity requirements (short and long-term) to survive financial stress were enforced in the shape of a higher Liquidity coverage ratio by which banks should have enough high-quality liquid assets to cover 30 days of cash outflows. Also, a Net stable funding ratio ensures having stable funding sources for long-term obligations, not only short-term.



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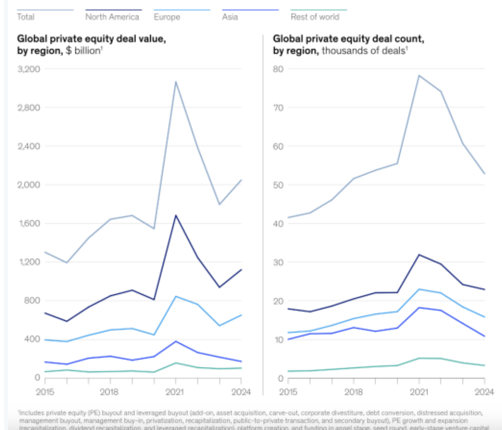
Finally, the application of a countercyclical capital buffer, that is making it compulsory to gather up reserves during 'good times' to be prepared for future turndowns.

These measures have significantly improved the transparency and stability of traditional banks while mitigating the risk and protecting consumers. Nonetheless, they have also led to the growth of the shadow banking system; a less regulated network of financial intermediaries operating outside the traditional banking sector and regulations. Among these entities, private equity (PE) firms have emerged as particularly influential players.

Introduction

Unlike banks, private equity firms are not subject to Basel III regulations. As they are not classified as depository institutions, they operate with significantly less regulatory scrutiny. This allows them to engage in high-risk financial activities, particularly through leveraged buyouts (LBOs), where acquisitions are primarily financed with borrowed capital. In such cases, the debt burden is transferred to the acquired company, rather than the PE firm itself, creating hidden financial risks for the broader economy.

The lack of supervision allows PE firms to accumulate significant influence without maintaining the capital reserves and liquidity required of banks. This unregulated environment can exacerbate systemic risks, as the interconnectedness of PE investments often extends to pension funds, sovereign wealth funds, and other institutional investors. The lack of a standardized public disclosure requirements further complicates the ability of regulators to assess and mitigate emerging threats.



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Private equity has expanded rapidly, becoming a major force in global finance. After two years of decline, global PE deals rebooted by 14% in 2024, reaching $2 trillion. (McKinsey 2025). This boost reflects a growing appetite among sponsors to pursue larger tickets, led by stronger conviction in their ability to realize higher returns and renewed confidence in the industry's growth outlook. Today, PE firms collectively manage over $10 trillion in assets, their onsiderable economic footprint. (McKinsey 2025) This influence extends across various sectors, including healthcare, energy, infrastructure, and real estate. In some cases, PE ownership has been linked to cost-cutting measures, reduced service quality, and even financial instability.

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This report will explore various aspects including how PE operates outside traditional regulations and in high-risk activities. The main operation covered are LBOs, however, PE executes many more variants of capital transactions, such as those related to growth, venture capital and many more. In addition its potential negative economic effects, and the reason why they remain unregulated will be discussed as well. To finalize it will delve into each of the mentioned elements to evaluate whether private equity is a financial threat or, by the contrary, doesn't pose a significant risk for the moment.

WSO

A Balance of Risk and Reward

PE thrives by improving company management through governance and using debt smartly (leverage) to boost profits. For 30+ years, this mix of expertise and financial tactics has helped small and mid-sized businesses (SMEs) grow faster than they could on their own.

The main difference between public and private firms is that while PE firms typically exit investment in 3-7 years, their strategies focus on long-term improvements to maximize the company's value at sale (long-term IRR - a measure of the annualized return on the PE firm's equity investment). Public companies often prioritize short-term metrics (quarterly earnings, share price) to satisfy shareholders.

PE operates in a blurry financial system with minimal oversight. Unlike banks, which must hold a minimum amount of capital as security to absorb potential losses (8% under Basel II rules (Chen, 2023)). PE firms can borrow wildly, load companies with debt, and tend to not be found legally responsible. For instance, in 2023, the collapse of PE-owned Revlon left creditors with $3.7 billion in losses, losses banks would have been forced to prepare for (Strugatz, 2024). Philippe Latorre's insights complemented our article with the two different financial philosophies in Europe and the US PE markets. These differences are reflected in legal frameworks discussed in the article, particularly the AIFM Directive in Europe and the Dodd-Frank Act in the US.

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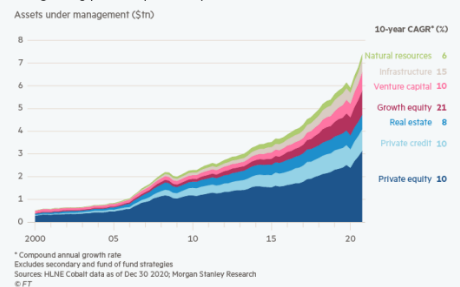
In Europe, slower economic growth, stricter rules (ex: AIFM Directive), and robust labor protections, force PE firms to prioritize being "closer to their clients" since bankruptcy or any misleading conduct would impact their reputation, leading to a decrease in banks and wealthy investors' trust, but mostly a legal liability and creditor lawsuits. On the other side, the US market has higher growth prospects, deeper capital markets and lighter oversight. For instance, the Dodd-Frank Act avoids the AIFM DIrective's structural constraints (ex: no depository requirements), which allows firms like Blackstone to pursue aggressive strategies such as dividend recapitalizations, which prioritize short-term returns. In addition to this, the American PE market benefits from a deeper capital market (robust high-yield bond market) enabling higher leverage. For example, US transactions often use 60-70% debt whereas EU deals face barriers like the financial assistance prohibition limiting their leverage options. This is why there is still a big fear about the PE industry and why back in 2022, SEC Chair Gary Gensler warned the world about PE's "lack of transparency and accountability".

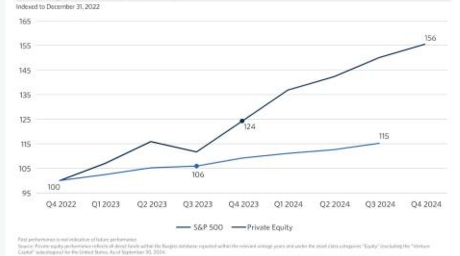
A Balance of Risk and Reward

However, the PE industry saw some regulatory changes in 2023, reshaping how these entities operate. In the US, under the new SEC rules, PE firms are subject to release quarterly financial statements outlining the performance metrics, fees, and expenses (this particularly targets illiquid funds holding hard-to-sell assets like real estate). Furthermore, annual audits made by third parties are now required for funds managing over $150 million, and practices such as utilizing "side letters" to give particular investors special treatment are now prohibited. In the EU, the AIFM Directive was updated and became stricter: funds must now disclose leverage ratios, liquidity risks and environmental impacts. In addition, there are stricter limits on side agreements and mandatory stress tests for funds with illiquid holdings and new sustainable benchmarks.

Despite these steps, oversight remains lighter than for banks, hence allowing the PE industry to reach $11.7 trillion in assets in 2022. (Segal, 2024)

PE's aggressive tactics are fueled by its record of outperforming public markets. Over the past three decades, top PE firms have delivered annual returns of 13-15%, compared to the S&P 500's 10%. This attracts pension funds, endowments, and wealthy investors, enabling PE to deploy trillions despite higher levels of risk. Hence, until rules align with those governing banks, the tension between profit incentives and financial stability will persist.





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A Focus on Private Equity LBOs

While we are going to focus on LBO-driven PE, the industry includes other strategies like Growth Equity (which invests in mature companies typically with less debt) and Venture Capital (which fund startups prioritizing high growth over leverage).

A leveraged buyout (LBO) occurs when a PE firm acquires a company using a significant amount of borrowed money, with the debt transferred to the target company (Kenton, 2024). With this money, the PE firm aims to improve operations, expand markets, or streamline costs to increase the company's value before selling it or taking it public. This financial strategy can drive growth but also has risks. This is what we call the leverage effect: it magnifies returns because gains are calculated on the smaller equity portion. Therefore, we can see that high leverage boosts the IRR. In fact, we saw that debt reduces the equity spent so gains are concentrated on a smaller initial investment. Hence, interest payments on debt are tax-deductible increasing cash flows (Kagan, 2025). Leverage can be great, but only in successful LBOs: if a company sells for less than the debt it owes, the PE firm's equity is wiped out (IRR turns negative).

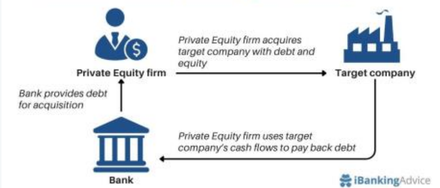
WSO

A Focus on PE LBOs

Throughout the years, we have seen so many successes, with LBOs helping struggling businesses grow so much. For example, Domino's Pizza modernized its operations and expanded globally after its 1998 LBO by Bain Capital. However, we have some huge risks as well: companies often allocate 20 to 30% of earnings to interest payments, meaning that they have fewer resources for employee wages, maintenance or innovation. So if the company underperforms or goes through layoffs, pension cuts, or bankruptcy, it certainly affects the whole company, thus the workers and the stakeholders, while the PE firm retains profits from management fees and dividends. For instance, Toys "R" Us filed for bankruptcy in 2018 after a $5 billion LBO in 2005 left it unable to manage its debt.

More recently, LBOs have been directly impacted by rising interest rates since they raise the cost of debt. Financial leverage has historically increased returns through tax-deductible interest and reduced equity costs, contributing about 30% to the profitability of LBOs. However, in order to prevent diminishing returns, investors are lowering their loan consumption as borrowing costs rise. Large LBOs, which historically relied on greater leverage ratios (more than 70% of capital structures before to 2008), are especially affected by this change. Post-2008 regulations, the US and EU caps limited leverage to 6 times EBITDA. Today, average debt levels in large LBOs are around 60% of capital structures. Regarding smaller-sized LBOs, higher rates have less of an impact because they usually use moderate leverage. They focused more on buy-and-build plans rather than aggressive debt stacking. (Cyril Demaria-Bengochea, 2024)

Hence, we cannot conclude that PE's LBOs are harmful, but we have to note that their impact can be significant and destructive in some cases. It depends on debt levels, industry dynamics, and the PE firm's long term strategy. Unlike traditional banks, as we previously noted, PE firms face fewer regulations, which to this day raises concerns about systemic economic fallout if multiple highly leveraged companies default. LBOs function like renovating a property with a loan. If the renovation increases the property's value, the investment pays off. If costs exceed returns, the debt becomes unsustainable. It all depends on planning, execution and market conditions.



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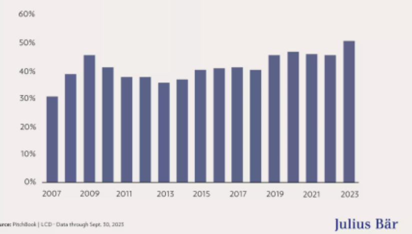

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LPAs, an incentive for risks?

Private Equity funds must not only convince shareholders to invest in their funds but must also convince investors that the Limited Partnership Agreement (LPA) is fair for both parties.

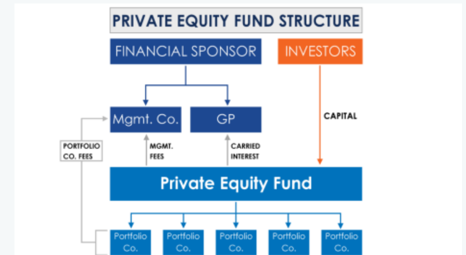
LPA's are the legal agreements between investors, as limited partners (LP) of the fund, and the general partner (GP), which is the main partner of the fund itself. The most important aspects of these agreements are; the duration of the new business and the commitments between the LP and the GP. (Model Limited Partnership Agreement | Institutional Limited Partners Association, 2024)

In terms of duration, the most common is to establish the duration of the Private Equity fund of 8 and 10 years. However, a fundraising period is usually agreed upon during the second year, in order to have the possibility of covering additional financing needs. Finally, a specific investment period - usually 5 years - is usually agreed upon. This limits the time in which the fund can make new investments.
The fundraising and investment period is usually at the request of the LPs, who want to ensure that the fund is efficient and does not make investments without being sure that they will add value to the project. (Expert, 2023)

Probably the most important part of the agreement is the commitment between LPs and GPs. The main aspects of this section are usually the GP's contribution, capital calls and the consequences of not meeting them, management fees, profit sharing, and LPA expenses.
As for the GP's commitment, it is a key clause in the agreement. It is usually between 1% and 5% of the fund size, and allows LPs to ensure that their interests are aligned with those of the GP.

Regarding "capital calls" they are also significant as they enable the GP to request funds from the LPs if needed for investment or fund assets. The ability to deploy capital flexibly can be essential to preventing the bankruptcies of portfolio companies. An oft-cited study by Hamilton Lane shows that the risk of 'catastrophic loss' (defined as a 70% or greater decline in peak value with minimal recovery) of a PE-backed company is 18%, which is half as high compared to a public company."

Researchers found that PE-backed companies, operating during GFC, could increase capex compared with peers lacking PE sponsorship. As a result, these companies were able to increase market share and experience higher asset growth during the crisis. Positive investment effects of PE were particularly large in companies more likely to be financially constrained at the time of the crisis, according to researchers from Stanford University and The Kellogg School of Management.



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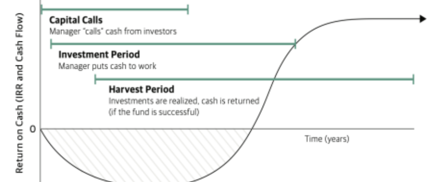

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LPAs, an incentive for risks?

Further demonstrating the resilience of private equity, a study of almost 500 PE-backed companies in the UK during the GFC found that these firm recovered faster from the crisis and captured more market share relative to comparable non-PE-backed competitors. (Private Equity During The Dot-com Crash And The Great Recession | Moonfare, 2023).

Thirdly, of great importance is the company's profit-sharing agreement, which is usually pro rata to the capital contributed by each LP.

Finally, it is particularly normal to include an agreement regarding exculpation and indemnification. This limits or even eliminates the liability of the General Partner, for the actions taken when managing the fund. It protects the GP as long as they act according to good faith and without gross negligence or misconduct.

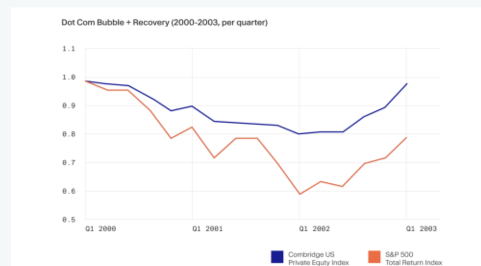
Taking into account the main characteristics of these agreements, we can see how they contribute to the risk associated with the activity carried out by Private Equity funds. The fact that they are limited in time and that they are normally between 8 and 10 years, means that the funds cannot operate within a certain flexibility. In case the market suffers drastic changes in certain periods, GPs may have to take very risky actions in order to obtain the desired return. On the other hand, the GP's freedom of action means that the funds contributed by the LPs are totally dependent on the management carried out by the GP. Also, the exculpation clause means that the GP may feel protected in the event of taking too risky actions in order to obtain high returns.

Apart from LPAs, the fee structure used by private equity is very important. Normally a hybrid system is established between Management Fees and Carried Interest. The most common is to use the model “2 and 20”, the 2 refers to a management fee of 2% and the 20 to a carried interest of 20%.

The rationale for setting Management Fees is to make sure to try to cover fixed and operating expenses, ensuring a minimum fee.

However, the most important part is the Carried Interest which is normally set at 20%. This interest acts as a performance incentive. Normally, before the carried interest can be activated, it is required that the LPs have recovered the initial investment together with a minimum yield called the hurdle rate. The hurdle rate is normally between 7% and 8%. From that point forward, the GP receives 20% of the benefit and the other 80% is distributed between the LPs.

In past downturns, private equity showed less volatility than public markets



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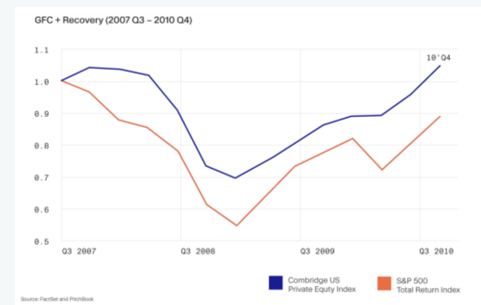

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The Unforeseen Effects

In recent years, private equity firms have aggressively expanded into critical industries such as public services, healthcare, pharmaceutical retail, and even prisons—sectors that directly affect millions of lives. PE firms often justify these investments by claiming they aim to improve the efficiency and profitability of the acquired companies; however, this sometimes comes at a cost. The constant pursuit of profits by PE firms can lead to aggressive cost-cutting measures, declining service quality, and financial instability—sometimes even resulting in bankruptcy.

This section of the research paper explores the unintended and unforeseen consequences of private equity, examining how its strategies impact employees, consumers, society, and the broader economy.

Link to the picture

I. Short Term Profit Strategies to Maximize Returns

Private equity firms focus on maximizing returns by pursuing long-term value creation and high-growth opportunities. However, the strategies they employ to restructure companies often rely on aggressive short-term tactics—such as mass layoffs, cost-cutting, benefit reductions, and asset stripping.

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A study from the University of Chicago found that, on average, employment falls by 4.4% within two years of a PE acquisition, while worker wages drop by 1.7% Stewart, 2020). This suggests that short-term financial gains often come at the direct expense of workers.

In particular, Healthcare is one of the sectors where the impact of private equity strategies has become most evident. Over the past decade, PE firms have invested over $1 trillion into U.S. healthcare, acquiring hospitals, nursing homes, and physician practices (McCluskey, 2025). However, recent research has highlighted concerning effects of PE ownership on hospital service quality and patient outcomes.

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In 2023, Harvard Business School conducted a study analyzing the impact of private equity acquisitions on hospital care. The study examined 600,000 Medicare hospitalizations across 51 PE-acquired hospitals from 2009 to 2019, comparing them to 4 million hospitalizations at similar hospitals not owned by PE. Researchers found that, following a PE acquisition, hospitals experienced a 25% increase in patient complications, with 27% more falls and 38% more bloodstream infections—largely due to understaffing and cost-cutting measures (Miller, 2024).

The Unforeseen Effects

This research highlights how the effects of PE ownership now extend far beyond rising prices for products and services. Experts warn that it is increasingly affecting critical aspects of society: "Now, we're learning that there are also downstream concerns for the clinical quality of care delivered to hospital patients," said Zirui Song, a Harvard Medical School (HMS) professor.

In response to the findings, different states in the US and countries around the world are seeking to regulate private equity's involvement in healthcare transactions. However, little progress has been made allowing PE firms to continue to make billions in profits with little accountability.

However, it is important to mention that these systemic issues cannot be blamed solely on private equity. While private equity's role in healthcare is alarming, many people and experts also argue that it is a consequence of a much broader issue in our society: the commercialization of healthcare.

In addition to healthcare, private equity has also recently started to influence an unexpected sector: the prison system. By privatizing core services such as food, healthcare, communication, and commissary, PE firms have worsened the living conditions of prisoners, increasing financial burdens not only for inmates but also their families, and even compromised basic human rights.

An example of this can be seen in Michigan's prison food crisis. Aramark, a US company owned by a private equity firm, slashed meal costs to $1.29 per inmate, which led to rotten food, maggot infestations, and nutritional deficiencies. At one facility even 30 inmates fell ill after consuming contaminated food (Requarth, 2019).

Furthermore, PE backed prison service companies are said to have turned incarceration of people into a multi-billion-dollar industry, charging prisoners and their families excessive fees for basic necessities. For instance, in some facilities in the US phone calls cost up to $25 for 15 minutes, putting many families in financial stress. In Alabama, a single PE backed healthcare provider had only 15 doctors for 25,000 prisoners, leaving countless inmates without critical medical attention (Requarth, 2019).

Finally, private equity firms can take out additional loans through the companies they own to pay dividends to themselves and their investors—a practice known as dividend recapitalization. This leaves the companies responsible for repaying the debt. Additionally, the share of profits earned by private equity managers, known as carried interest, receives special tax treatment and is taxed at a lower rate than ordinary income.

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The Unforeseen Effects

Overall, these cost-cutting, profit-driven strategies have turned basic services for humans into financial opportunities for investors, but at an expense. This raises an important ethical question: Should private equity firms be subject to stricter safeguards or regulations when investing in critical sectors like healthcare, where lives and well-being are directly at stake?

II. Bankruptcy

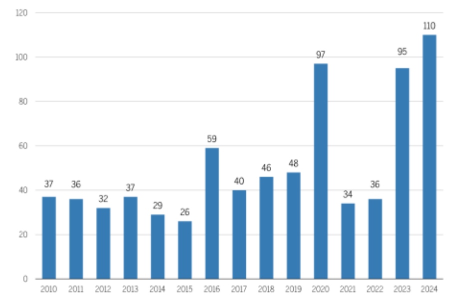
In recent years, a large number of companies acquired by private equity firms have declared bankruptcy years later, further highlighting the unintended and undesirable consequences of PE strategies. The use of Leveraged Buyouts (LBOs) in order to buy companies often leaves them with unsustainable levels of debt, making them highly vulnerable to financial distress.

Recapping briefly, the LBO model allows PE firms to acquire companies using minimal capital, relying instead on large amounts of debt financing. In addition, changes in interest rates place an even greater burden on acquired companies. As rates rise, borrowing costs increase, further straining these already overleveraged businesses. This has raised concerns, as PE firms often target financially unstable companies, transferring the debt burden onto them and leaving many unable to survive—ultimately leading to bankruptcy. Also, this leverage effect leads to a higher IRR and ROE.

Bankruptcy filings made by US companies backed by private equity and venture capital climbed more than 15% to 110 in 2024, the highest annual total on record, according to S&P Global Market Intelligence data (Vidal and Sabanter, 2024).

A well-known example of PE driven bankruptcy is the collapse of Toys "R" Us. The once dominant toy retailer was acquired in 2005 by KKR, Bain Capital, and Vornado Realty Trust through a $6.6 billion leveraged buyout (LBO). While the deal allowed the PE firms to take control of the company with minimal upfront capital, it left Toys "R" Us saddled with $5 billion in debt, forcing it to pay over $400 million in debt interest each year (Dinapoli and Rucinski, 2017).

As a result, Toys "R" Us struggled to reinvest in its business, falling behind competitors like Amazon, which were rapidly adapting and adopting new e-commerce strategies. The company also attempted aggressive cost-cutting measures, including store closures and staff reductions, but these measures failed to reduce the burden of high debt. By 2017, rising interest rates further increased borrowing costs, worsening the company's financial distress even more. Finally, Toys "R" Us filed for bankruptcy in September 2017, leading to the layoff of over 30,000 workers and the closure of many stores (Stewart, 2020).



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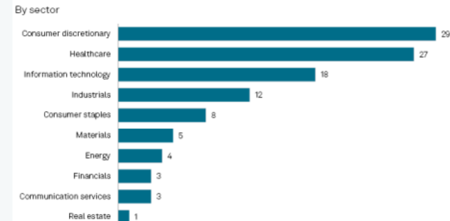

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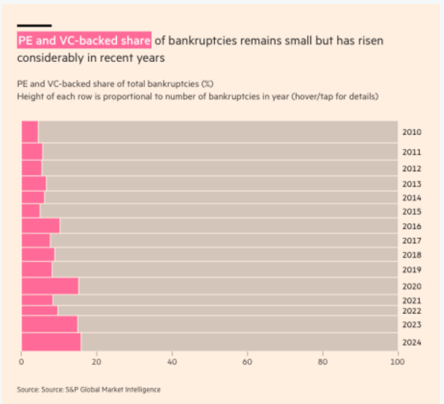
The Unforeseen Effects

Cases of PE-driven bankruptcies extend beyond just retail, and certain industries tend to be more fragile than others—for example, the consumer discretionary sector accounted for the highest number of bankruptcies among private equity portfolio companies in 2024. This sector racked up the most bankruptcies between January 1 2024 and and December 31 2024 with 29 filings, followed by healthcare with 27 filings.

However, it is important to consider the bankruptcy of Pe-backed companies although rising still represents a very low share of total bankruptcies. Moody's found that after the financial crisis, from 2008 to 2013, companies owned by top private equity firms defaulted on their loans at about the same rate as other companies. However, in megadeals where more than $10 billion of debt was involved, private equity-backed companies performed much worse (Stewart, 2020).

Therefore, while PE firms promise efficiency and value creation, their reliance on leveraged acquisitions is proving challenging for many companies and industries.



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III. Higher Market Concentration

PE firms often acquire companies, restructure them, and sell them within five to seven years—an approach designed to maximize investor returns. However, this strategy many times leads to market consolidation, reducing the number of independent players and limiting competition. When companies are sold to competitors or other PE firms, the resulting mergers increase the market share of acquiring entities, giving them greater control over pricing and weakening consumer choice. These dynamics also risk hindering innovation across sectors.

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A clear example of this trend is the U.S. housing market, where PE firms have aggressively acquired rental properties—thereby influencing rent prices. The single-family rental industry began with government support following the 2008 financial crisis. Since then, Wall Street investors and PE giants like Blackstone and KKR have spent billions buying homes, further tightening an already limited housing supply. More recently, historically low interest rates during the pandemic made borrowing cheaper, accelerating this wave of consolidation.

Link to the picture

As PE firms acquire and consolidate large portfolios of single-family homes, ownership is shifting away from millions of individual homeowners to a small number of institutional investors. This concentration increases their market share and reduces the number of independent suppliers in the housing market.

The Unforeseen Effects

According to the article published by the WallStreet Journal, private equity-backed firms have been reported to own approximately 1% of single-family homes and 4% of rental properties in the United States, with significant ownership in certain regions. With greater control over a significant portion of rental housing, these firms gain market power, enabling them to influence rental prices more easily and reduce competitive pressure.

In November 2021, rents in the US soared by over 18 percent annually — the highest increase on record, and in August 2022, the average rental price reached an all-time high of over 1,440 U.S. dollars (Statista, 2025). And although these figures and increase in rent prices can not be blamed solely on PE, they are definitely one of the main drivers.

"KKR is just the latest private equity firm using the housing crisis to rake in profits while squeezing families," Warren said in a statement to NBC News. "I'm sounding the alarm because we can't solve the housing crisis unless we crack down on predatory practices by Wall Street investors."

In addition, CivicScience data carried a survey and the results showed that more than 50% of U.S. adults believe that private equity companies have had a significant effect on housing prices in their area.

This is an example that clearly illustrates how private equity strategies, while profitable for investors, can lead to market consolidation that reduces competition, limits consumer choices, and potentially harms service quality across various sectors.

Overall, while private equity investments can bring capital and potential efficiencies to various sectors, the main concern lies in the privatization and commercialization of essential public services—such as prisons, the healthcare system, and critical industries like housing. Although PE ownership can sometimes lead to bankruptcies, these represent a relatively small (though growing) share of total bankruptcies in the U.S. Poor financial decisions are not uncommon, even among private equity firms, but they have generally managed to mitigate their risks effectively. These dynamics highlight the need for greater scrutiny and potential regulation of private equity activity to reduce its negative impacts on society and the broader economy.

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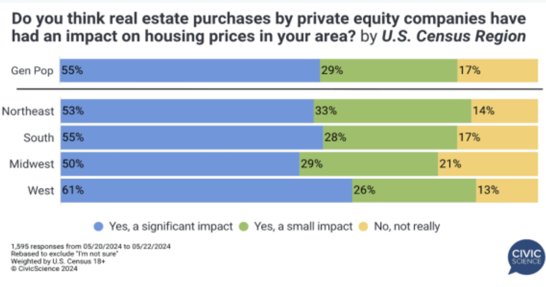

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But why the lack of regulatory oversight?

PE firms operate with a notable degree of freedom from stringent regulatory frameworks that govern traditional financial institutions. This can be attributed to several factors, including robust lobbying efforts, strategic political appointments, and their perceived role as catalysts for economic growth. However, it should also be noted whether it remains, or not, a financial hazard in itself.

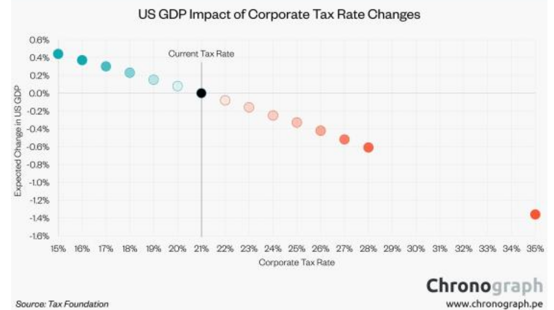
1. Lobbying Efforts and Influence on Tax Policies

A significant factor contributing to the minimal regulation of PE firms is their lobbying activities aimed at influencing policies, especially tax or regulation ones, to their advantage. An illustrative example is the preservation of the "carried interest" tax reduction. Carried interest refers to the share of profits that PE managers receive from their funds' investments, traditionally taxed at the lower capital gains rate rather than as ordinary income. This results in substantial tax savings for PE professionals.

In the United States, the Inflation Reduction Act of 2022 initially included provisions to close this loophole by extending the required holding period for preferential tax treatment from three to five years. However, intense lobbying by the private equity industry led to the removal of this provision from the final bill. Industry groups, such as the American Investment Council (AIC), launched campaigns emphasizing the economic contributions of PE firms, effectively persuading policymakers to maintain the existing tax treatment.

Similarly, in the United Kingdom, PE firms have actively lobbied to influence tax policy. CVC Capital Partners, a leading private equity firm, expressed concerns over proposed increases in the taxation of carried interest. Their lobbying efforts contributed to the government's decision to set the tax rate at 32%, rather than the initially proposed 45%.

One of the key reasons why that lobbying can be executed is the strategic designations for PE roles. Politics and private equity seem to be inevitably intertwined, even in the hiring appointments. Former politicians and government officials often transition into roles within PE firms, leveraging their networks and insights to influence policy decisions. For instance, former UK Prime Minister David Cameron joined Jeb Bush's (former Florida governor) private equity firm, strengthening PE's ties with policymakers. While such appointments can provide PE firms with valuable expertise, they also raise questions about potential conflicts of interest and the impartiality of policy-making processes.



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But why the lack of regulatory oversight?

Furthermore, research indicates that companies acquired by private equity firms often escalate their lobbying efforts, particularly in heavily regulated sectors such as healthcare and finance. A study titled "The Political Consequences of Private Equity: Evidence from U.S. Leveraged Buyouts" found that post-acquisition firms tend to increase political contributions and lobbying activities. This strategy aims to create a more favorable regulatory environment, potentially enhancing profitability.

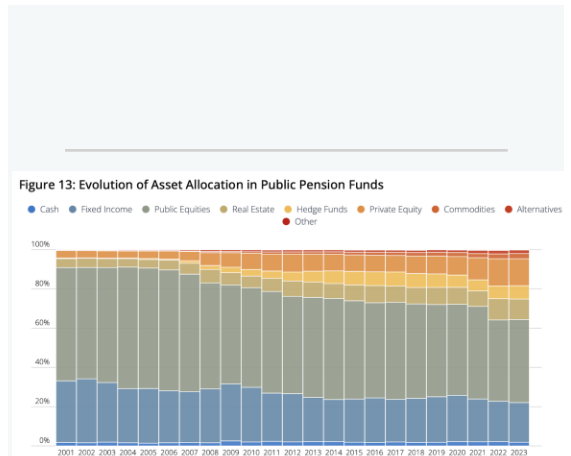

Figure 13: Evolution of Asset Allocation in Public Pension Funds

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Lastly, PE is increasingly fusioning with everyday life of regular consumers, specifically in retirement plans. In recent years, pension funds have significantly increased their allocations to PE, seeking higher returns that are more difficult to reach through regular banking products. This shift is particularly evident in the US, where public pension funds have raised their average allocation to private equity from 8% to 11% over recent years. (Financial Times January 2025)

Global pension funds with largest allocation in private equity

Pension fund name	Actual allocation in private equity ($B)	Actual allocation in private equity (%)[1]	Most invested fund manager[2]	Number of funds[2]
Canada Pension Plan Investment Board	143.86	24.6	CVC Capital Partners PLC	14
California Public Employees' Retirement System	83.50	16.0	Apollo Global Management Inc.	12
California State Teachers' Retirement System	53.70	15.5	Blackstone Inc.	28
Washington State Investment Board	47.89	29.0	TPG Capital LP	22
New York State Common Retirement Fund	39.08	14.6	Vista Equity Partners Management LLC	13
Teacher Retirement System of Texas	33.67	15.4	TPG Capital LP	18
Aware Super Pty Ltd.	32.15	26.5	Blackbird Ventures Pty. Ltd.	8
Hassana Investment Co.	32.00	10.0	Ardian	4
Public Sector Pension Investment Board	29.35	15.3	Radical Ventures Investments Inc.	3
Kaiser Permanente Pension Plan	28.61	49.9	Sequoia Capital Operations LLC	15
State of Wisconsin Investment Board	24.92	13.3	Blackstone Inc.	11
Stichting Pensioenfonds Zorg & Welzijn	23.40	8.8	Abingworth LLP	2
Virginia Retirement System	20.39	18.1	Apax Partners LLP	9
British Columbia Investment Management Corp.	19.68	11.8	HarbourVest Partners LLC	13
Pension Reserves Investment Management Board	17.99	16.5	Thoma Bravo LP	18
State Board of Administration of Florida	17.71	9.3	Lexington Partners LP	18
Minnesota State Board of Investment	16.35	17.5	Blackstone Inc.	15
Healthcare of Ontario Pension Plan	14.74	10.0	17Capital LLP	3
Ohio Public Employees Retirement System	14.57	13.0	HgCapital LLP	12
New York State Teachers' Retirement System	13.95	9.7	HarbourVest Partners LLC	20

Location Australia Canada Netherlands Saudi Arabia US

Data compiled Oct. 24, 2024.
Analysis includes the top 20 union, government, or corporate pension plan sponsors with largest actual allocation in private equity as of Oct. 22, 2024. Excludes pension funds with unavailable data on actual private equity allocation.
[1] Assets allocated to private equity as a percent of total assets.
[2] Includes current investments only as of Oct. 22, 2024.
Source: S&P Global Market Intelligence.
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Link to the picture

The growing reliance on private equity has led to increased engagement between PE firms and policymakers. During the Trump administration, private equity groups lobbied for regulatory changes to allow tax-deferred retirement plans, such as 401(k)s, to invest in a broader range of unlisted investments, including leveraged buyouts. This advocacy aimed to democratize access to private markets, traditionally reserved for institutional and high-net-worth investors, bringing them closer to the middle class. This is one more of the reasons why the lack of regulatory oversight is in the spotlight, as this rapprochement to the actual consumers could potentially endanger stability. Moreover, the complexity and opacity of some private equity investments have prompted calls for enhanced transparency and governance to protect beneficiaries' interests.

This interplay between political influence and private interests reveals the need for a balanced understanding of private equity's role. While lobbying and strategic appointments can be viewed critically, it's essential to consider whether the benefits PE firms bring to the economy justify their current regulatory treatment. This prompts a broader debate: Is the private equity industry adequately regulated, or are there areas where improvements are warranted to ensure transparency and fairness?

But why the lack of regulatory oversight?

2. An engine for economic growth

Governments are reluctant to impose strict regulations because PE firms play a major role in economic growth, innovation, infrastructure investment, and job creation.

In 2022, private equity contributed $1.7 trillion to the U.S. economy, accounting for 6.5% of U.S. GDP. (Statista, October 2024) That means substantial economic contributions, especially in the US, where 8 of the 10 biggest PE firms are established. PE firms manage over $10 trillion in assets worldwide, with nearly $4 trillion in "dry powder" (uninvested capital).

Private equity plays a crucial role in fostering innovation by providing capital and strategic guidance to companies leading technological advancement. Over the past decade, PE firms have invested nearly $300 billion in information technology service providers, supporting the development of innovative solutions and services. Additionally, they invested more than $40 billion in over 200 cybersecurity providers, enhancing protections for various sectors, including government organizations, financial institutions, and healthcare providers. (AIC, December 2024)

The influence of private equity is most pronounced in the United States and Europe. In the U.S., eight of the ten largest PE firms are headquartered, managing a substantial portion of the industry's global assets. These firms have been instrumental in supporting small businesses, with approximately 85% of private equity-backed businesses in 2022 being small enterprises employing fewer than 500 workers. In Europe, private equity-backed companies employed over 10 million people at the end of 2019, accounting for 4.3% of the continent's active workforce.

Beyond their influence on tax and regulatory policies, PE firms play a significant role in financing infrastructure projects and supporting government initiatives. Through Public-Private Partnerships (PPPs), they invest in critical sectors such as transportation, energy, and utilities. For instance, private equity-backed firms have invested substantial amounts in defense startups focusing on autonomous drones and cybersecurity solutions, contributing to national security advancements. They have injected $31 billion dollars in essential projects that wouldn't have found a private investor otherwise.

A notable case is Thames Water, the UK's largest water utility. Facing financial challenges, Thames Water attracted interest from several PE firms, including KKR, which reportedly submitted a £4 billion bid for a majority stake. Such investments highlight how PE firms can provide essential capital to infrastructure providers, potentially aiding in the stabilization and improvement of vital public services and most importantly avoiding financial collapse.

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But why the lack of regulatory oversight?

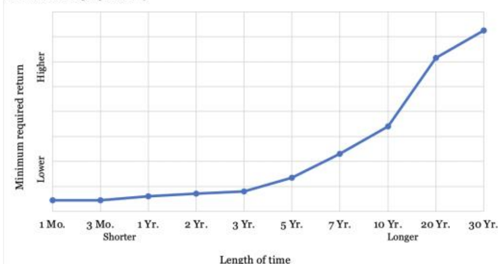
In terms of employment, private equity-backed companies have demonstrated remarkable growth. In 2022, these firms directly employed 12 million workers in the United States, an increase from 11.7 million in 2020. Notably, in Europe, private equity-backed companies added over 254,000 jobs in 2019, reflecting a 5.5% employment growth rate significantly outpacing the average job growth of 0.9% for the continent. (AIC, December 2024) This trend remarks how private equity's role in job creation and economic revitalization, particularly in sectors poised for future growth, is truly relevant and a reason for its dominancy, apart from lobbying.

3. Not an Institutional Risk Per Se

Structurally, private equity firms are less exposed to sudden liquidity shocks compared to traditional banks, which partially explains the lighter regulatory oversight. Banks typically face liquidity mismatches, holding long-term assets like loans and mortgages while accommodating short-term liabilities such as customer deposits. This structure can lead to bank runs during periods of financial instability, which calls for rigorous capital and reserve requirements.

In contrast, PE firms operate through General Partner Agreements (GPAs) and closed-end fund structures, securing capital commitments from investors for extended periods. Limited Partners (LPs) commit funds for the long term (7 to 10 years) allowing PE firms to manage investments without the immediate pressure of redemption demands. This model insulates them from the panic runs that can afflict banks. Moreover, PE firms typically lack the interbank lending connections that can propagate financial contagion. Notably, in the banking system, when panic spreads through society, it affects directly to the deposits, and consequently, to the funds banks move between themselves, a phenomenon that is not extrapolable to PE funds. The interconnectedness between the economy and the PT is not as evident as with traditional banks. Therefore, there are no significant precedents of large PE firms failing in a manner that poses systemic risks to the broader financial system.

Whatismore, as mentioned previously, they manage nearly $4 trillion in “dry powder”. That is a copious amount, that not only demonstrates their great economic power, but also their prudence and cautiousness over investment decisions. The last few years haven’t been smooth, conditions weren’t friendly in the market: high inflation, interest rates scaling up, uncertainty… Despite reaching out for profits, firms are reluctant to invest if they are not sure and will not spend that number of capital without being completely sure about its potential and security.



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Global private equity investors with largest private equity dry powder

Private equity investor	Geography	LTM investments	Private equity dry powder ($M)*
KKR & Co. Inc.	NY,US	47	43,864.6
Apollo Global Management Inc.	NY,US	22	41,623.9
CVC Capital Partners Ltd.	UK	27	29,498.6
Ardian	France	32	28,947.7
TPG Capital LP	TX,US	24	27,167.8
Blackstone Inc.	NY,US	19	26,184.7
EQT AB (publ)	Sweden	18	25,648.8
Clayton, Dubilier & Rice LLC	NY,US	8	25,400.0
HarbourVest Partners LLC	MA,US	10	24,879.9
Hellman & Friedman LLC	CA,US	4	23,600.4
Bain Capital Private Equity LP	MA,US	30	21,738.1
Carlyle Group Inc.	DC,US	23	21,428.7
Bain Capital LP	MA,US	7	19,950.8
Andreessen Horowitz LLC	CA,US	161	19,869.9
China Reform Holdings Corp. Ltd.	China	3	19,626.3
Silver Lake Technology Management LLC	CA,US	17	18,402.7
Advent International LP	MA,US	23	17,853.9
Francisco Partners Management LP	CA,US	6	16,495.9
Leonard Green & Partners LP	CA,US	10	16,408.6
Warburg Pincus LLC	NY,US	35	16,353.6
TA Associates Management LP	MA,US	27	15,638.6
GTCR LLC	IL,US	13	15,423.1
HgCapital LLP	UK	14	13,893.7
Apax Partners LLP	UK	15	13,769.2
New Mountain Capital LLC	NY,US	9	12,520.8

Data compiled July 1, 2024.
* Dry powder value as of the latest period reported by the company.
Analysis limited to the top 25 global private equity investors by dry powder with investments announced or completed between Jan. 1, 2024, and June 30, 2024.
Dry powder data is supplemented by Preqin.
Source: S&P Global Market Intelligence.
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But why the lack of regulatory oversight?

However, it's crucial to maintain a balanced perspective. While PE firms aim to maximize investment returns and manage risks to attract investors, they are at the same character with a positive function in the economy.

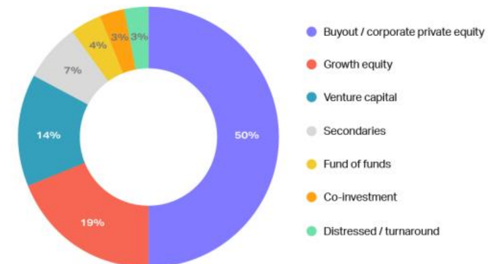
Nonetheless, their growing influence and the scale of assets under management necessitate ongoing scrutiny. The question remains: Is the current regulatory framework sufficient to address potential risks associated with private equity, or are there areas where enhancements could bolster transparency and stability?

Synthesis

Private equity firms operate within a regulatory environment that remains considerably lenient compared to traditional financial institutions. Through extensive lobbying, strategic political appointments, and perceived economic contributions, their structure has resulted in less direct regulatory scrutiny compared to Banks. While their reduced exposure to liquidity shocks and systemic contagion may justify some degree of regulatory leniency, the growing scale and influence of the PE industry suggest a need for more balanced oversight.

Moving forward, policymakers must carefully evaluate whether existing regulations are sufficient to mitigate the potential risks posed by PE firms. The most significant claim lies in ensuring transparency is granted for all stakeholders, as it is imperative to get a good knowledge of the activity of these agents, even more now, due to the way they are getting closer to the regular investor.

Striking the right balance between encouraging investment and protecting financial stability will be crucial in ensuring that the financial system remains resilient in the face of future challenges.



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Conclusion

It is unlikely that Private Equity (PE) has become a new financial threat to our economies. Undeniably, it has served as an engine of economic growth in developed countries. As a result, imposing stricter regulations on the industry could potentially weaken the already fragile economic growth in these regions. This may partly explain the difference in PE's economic weight between the U.S. and Europe. As discussed in the paper, Private Equity plays a larger role in the U.S. economy relative to its GDP compared to the EU, where heavier regulation may limit the industry's contribution to economic expansion.

However, when looking beyond economic growth and considering other factors such as the safety and stability of the broader financial ecosystem regulations appear to provide important safeguards. Stakeholders at risk from PE activity include not only the funds themselves, but also consumers, employees, and banks. These groups arguably ebenefit from a more regulated environment. For instance, European consumers are less exposed to market concentration and inflated prices in critical sectors such as housing, thanks to stronger regulatory frameworks. Similarly, EU employees benefit from more robust labor protection laws than their American counterparts.

Moreover, the privatization of essential public sectors such as healthcare is less prevalent in Europe, reducing the risk of PE-driven cost-cutting and profit-maximizing behaviors that may harm public welfare.

From a broader welfare perspective, sectors involving essential services in the U.S. should face greater scrutiny and regulation, especially concerning privatization practices and the manipulation of operational costs or R&D investments for short-term gain. Additionally, introducing transparency requirements for Private Equity could be beneficial for all market participants. Increased transparency would reduce speculation, uncertainty, and information asymmetries, ultimately contributing to more stable and predictable markets.

In short, Private Equity is not an imminent financial threat to our economies, but some of its residual effects, such as layoffs, bankruptcies, and fewer access to basic needs like education and healthcare, could be avoided at a certain extent.

Private equity is much more important in the US than anywhere else

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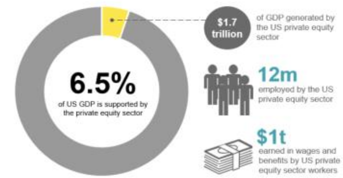
Figure E-1. Economic contribution of the US private equity sector, 2022



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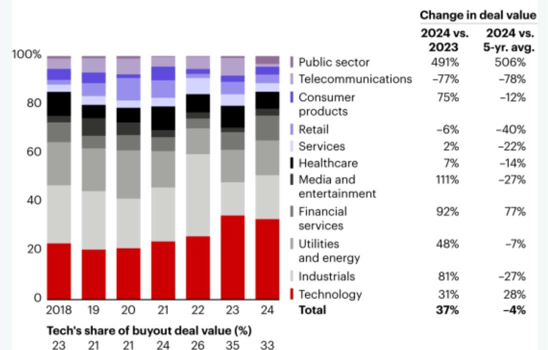
Share of global buyout deal value ($B), by sector



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