

# How has the Debt Financing for Private Equity Deals Evolved in the Past Few Years to Fund Acquisitions, Specifically Acquisitions in High-Growth Industries?

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## ABSTRACT

Over the last decade, private equity financing has undergone a significant structural transformation as firms increasingly shifted from traditional syndicated bank lending to private credit and hybrid debt structures. This transition accelerated following rising interest rates, tighter post crisis banking regulations, and growing constraints within leveraged lending markets. This shift became significant in high-growth industries such as technology, healthcare, AI infrastructure, and renewable energy, where companies often possess volatile cash flows, intangible assets, and elevated reinvestment demands that conflict with conventional bank underwriting standards. This paper argues that alternate financing methods, flexible debt instruments, and specifically private credit emerged not merely as an alternative financing source but a structural response to the expanding incompatibility between traditional leveraged lending models and the financing requirements of modern high-growth acquisitions. The paper further demonstrates how this transition is reshaping capital intermediation, redistributing systemic financial risk, and transforming modern private markets.

## INTRODUCTION

Recently, in January 2026, one of the most significant private equity structural transitions took place in modern capital markets by a middle-market industrial acquisition. While headlines were directly focused towards mega cap AI deals a more telling shift was quietly occurring in private equity. Berkshire Partners acquired United Flow Technologies (“UTF”), which serves municipal, industrial water, and wastewater infrastructure markets. While from afar, the deal appears as a conventional private equity platform investment, just a sponsor acquiring a company in a fragmented sector that was scalable and had consistent demand, it was much more. The significant shift was not the target itself, but its financing, signaling a broader shift in leveraged finance. Instead of depending on a syndicated bank loan this transaction was financed by a private unitranche facility from primarily Oak Hill Advisors then BMO Capital Markets. By its financing provided by private credit lenders, then unitranche debt combining senior and subordinated debt as one instrument, it completely discarded the need for multiple debt

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tranches, decreased the immediate exposure of syndicated loan market volatility, and no ratings market cycle. The capital was privately committed, had flexible structure, and held largely of lender balance sheets. In this deal private credit took the role of primary lenders which demonstrated the expanding role in sponsor backed acquisitions with customizable convenient packages and tailed structures which make it easier to align with sponsors long term growth strategies.

This shift is particularly significant in the middle market today as middle-market companies have mainly had to hinge on sponsor relationships and negotiable debt solutions. Where now, private credit has shaped itself as a preferable financing method in certain transactions, like this case where the private credit capital and unitranche structure allowed a simplified adaptable capital stack, supporting Berkshire's strategy to scale UFT and reflects how innovative capital structures can be a strategic tool.

Historically, middle market leveraged buyouts depended on syndicated bank lending structures that prioritized predictable cash flows, stable collateral bases, and wider lending participation. However, rising interest rates, tighter post crisis banking regulations and increasing volatility within high-growth industries exposed growing structural limitations. As a result private equality sponsors searched for financing solutions which were capable of offering flexibility, faster execution, and tolerance for operational uncertainty.

This transformation raises a broader question, why did traditional leveraged lending become increasingly insufficient for financing modern private equity acquisitions particularly with high-growth industries, and why did private credit emerge as the dominant alternative?

Private Equity, which was once a niche financing method, has transformed into a powerhouse of global industries in the past four decades (Morgan Stanley Wealth Management). Long term success increasingly depends on firms' ability to integrate flexible capital structures with innovative financing tools, beyond private credit alone, to sustain growth and manage risk (McKinsey & Company). This paper argues that PE firms increasingly moved away from traditional syndicated bank lending toward private credit and hybrid debt structures because of rising interest rates, tighter banking regulations, and the financing demands of high-growth industries made conventional leveraged loans less effective. This transition implies a broader restructuring of capital intermediation and risk allocation across modern private markets. While current research often examines leveraged lending, private credit growth, or high-growth acquisitions as two separate parts, this paper argues that these developments are interconnected. Specifically this paper demonstrates how financing methods and characteristics of high-growth industries accelerated the transition from the traditional bank financing toward flexible structures, such as private credit, altering capital allocation and risk distribution across private markets.

By 2026 private credit overtook banks as the dominant financing source for leveraged buyouts (S&P Global Market Intelligence). S&P Global Market intelligence found private debt financed 77% of global leveraged buyout in 2024 compared to less than 23% by banks, the banks lowest share since 2015. By early 2025 private debt's share increased to 83% of announced LBOs. McKinsey reported that private lenders financed a record 59% of leveraged buyouts at the end of 2023 while globally private credit assets grew to almost \$3 t, while over 40% of large U.S. buyout loans utilized flexible debt instruments as May 2026

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private credit, unitranche, or hybrid co-lending structures compared to less than 10% in 2015.. Together these reports reflected the same trend, a structural breakdown in traditional bank-led leveraged lending as tightened regulation, rising rates, and the financing demands of high-growth industries increasingly pushed PE sponsors to private credit.

The following pages examine the evolution of PE financing and its impact on high-growth sectors, by integrating historical analytics with emerging and timely market trends (McKinsey & Company). Part I describes how private equity financings occur and the fundamentals. Part II examines how PE firms have historically financed deals. Part III examines the industry's turn to private credit and innovative financing trends. Part IV mainly covers the unique challenges of high-growth firms, addressing opportunities and complexities within financing. Finally, Part V looks at the upcoming trajectory of PE as a whole and new strategies. Ultimately, this paper concludes that private credit and alternate financing methods emerged as a structural replacement for constrained traditional leveraged lending, reflecting a broader structural transformation in modern capital markets, where traditional leveraged lending became increasingly incompatible with the financing requirements of high-growth private equity acquisitions (McKinsey & Company).

## **I. How does Private Equity Financing Work**

### **A. What is Private Equity**

Private Equity (“PE”) is the accumulation of equity-like investments made into privately held assets (Morgan Stanley Wealth Management). PE is financed by firms raising a high capital fund from investors to buy, then improve, with the ultimate goal of selling the private companies for a profit or taking them public (Morgan Stanley Investment Management). PE deals are long-term deals that can last multiple years (Duane Morris LLP). There are three main ways investors can access PE: Investing in a Private company, Private Equity funds, or Multi-Manager Funds (J.P. Morgan Asset Management). Private Equity funds are pools of capital raised from investors and wealthy individuals who are limited Partners (“LPs”) (Mergers & Inquisitions). The LP entities provide the initial capital, and the GP entity is controlled by the private equity firm (Mergers & Inquisitions). There is typically one general partner. The LPs do not participate in day-to-day operations; rather, the investment professionals at the PE firm manage the funds’ investments and supervise the acquired companies (Morgan Stanley Investment Management).

### **B. History of Private Equity**

While the term ‘Private Equity’ was born in the 1980s, the invention of PE types of deals started right before the 1940s (Harvard Law School Library). Before the 1940s, there were a few cases of private investing that began in the 1900s. The first example occurred in 1901, when J.P. Morgan acquired Carnegie Steel, marking the first buyout (Harvard Law School Library). The main private investors of the time were families such as the Vanderbilts, Warburgs, Rockefellers, Wallenbergs, and Whitneys, who expanded the businesses they bought or restructured (Harvard Law School Library). One known example is in 1938. In 1938, Laurence Rockefeller founded Eastern Airlines and Douglas Aircraft. Although there was a lack of formal structure, this period saw the development of family-led venture financing and early partnerships. This marked the beginning of buyouts, the introduction of debt usage, and acquisitions, even if they were not explicitly referred to as such.

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The term "private equity" became more apparent after World War II, when new businesses and infrastructure were on the rise (Harvard Law School Library). While many count the McLean Industries purchase of Waterman Steamship as the first real leveraged buyout in 1955, making it the first PE deal (Hurduzeu & Popescu), the term was not used until the 1960s. Starting in the 1960s, media and financial corporations, such as KKR, Thomas H. Lee, and Forstmann Little, began using the term. As a whole, while PE-like investments date back to 1901, it is estimated that the modern PE structure began in 1946 with the American Research and Development Corporation (Harvard Law School Library).

### **C. Typical Deal Structure**

PE firms are constantly on the hunt for potential investments with thorough research and financial analysis, which help conclude if the investment has the potential to perform well and improve while aligning with the company's investment criteria (Mergers & Inquisitions). However, before this, capital is always raised first through equity and debt. The firm almost always acquires control of the company by owning over 50% (Morgan Stanley Investment Management). By acquiring a controlling stake, typically at or over 51%, PE firms gain authority over all major decisions and can implement their own board members and change management direction as they wish, including the management strategy as aggressively as they wish. The deal process starts with deal sourcing through proprietary networks, banks, and intermediaries (Mergers & Inquisitions). Once the target is identified, an initial screening is conducted to assess potential value creation and fit (Mergers & Inquisitions).

After conducting preliminary due diligence and an intensive review of the target company, firms identify potential strategies for the project, outline market-wide opportunities, and assess potential EBITDA. Preliminary findings are then brought to the PE firm's investment committee, which assesses a preliminary investment memo (Duane Morris LLP). This ensures an alignment between the firm's investment mandate and the proposal before creation. After proper preparation, an investment proposal is made. After an investment proposal is reviewed, the PE firm's deal team will typically submit a non-binding offer to express interest. The non-binding offers are written as an indication of interest ("IOI") or a letter of intent ("LOI") (Duane Morris LLP). These are just an expression of interest, allowing the firm to proceed without an immediate commitment to financing the deal. If the targeted company accepts the non-binding bid, it moves to the next round. When moved, the final investment proposal is made. The PE firm reviews every detail of the company, including financial statements, all legal documents, commercial position, taxes, and employee numbers. When finalising the review of final details, a team edits the leveraged buyout ("LBO") model and tests different scenarios and different capital structures (Mergers & Inquisitions). The final investment committee memo can be over a hundred pages long and is followed by any and all questions and answers.

After a definitive agreement is reached, the firm submits a final, binding bid that includes the purchase price. Then, suppose the PE firm is selected as the winning bidder. In that case, lawyers negotiate the Definitive Purchase Agreement ("DPA"), which is based on the final purchase price, warranties, indemnities, and closing conditions (Duane Morris LLP). Subsequently, capital is called before closing to fund the equity part of the transaction (Duane Morris LLP). While this is the deal structure after getting the company, the PE firm manages it, improving margins and changing the company as a whole to be

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more efficient and drive growth. The end goal is to exit through an initial public offering (“IPO”) (Morgan Stanley Investment Management).

#### **D. Value Creation**

PE firms scale companies with two main growth strategies. To create value, PE firms use platform roll-ups or organic growth (Vickey et al.). Platform roll-ups are a strategy in which PE firms consolidate various smaller companies within an industry to create a more competitive firm (Forbes Finance Council). By consolidating fragmented markets, PE firms can achieve economies of scale, improve operational efficiency, reduce competition, gain scale, and enhance competitive positioning (United States Private Equity Council). By combining entities, they gain greater influence, creating market leaders. Exploiting fragmented sectors is usually the best path to merge. Sectors such as healthcare, consumer and home services, transportation, and technology are ripe for consolidation. However, the use of the roll-up strategy can come with risks as the merging of many smaller companies is no small feat, given the operational complexities involved. The endgame of the roll-up strategy is to create larger companies that trade at higher multiples, as the market typically views these companies as lower-risk investments, and the companies themselves are better capitalized.

Organic growth is a much different strategy than a rollup and occurs when a company expands without mergers or acquisitions (“M&A”) (McKinsey & Company). While organic growth may be slower, the risk is much lower. Additionally, margins may initially be better as it doesn't have the cost associated with mergers or acquisitions. Organic growth strategies include geographic expansion, digital marketing, product development, customer service improvements, technology infrastructure enhancements, and overall operational improvements (McKinsey & Company). As organic growth allows one entity to maintain complete control, there is less space for risk and mistakes with multiple entities working together. Consequently, the strategies used may be changed at any moment without having to deal with the complexities of merging. An overview indicates that while the organic growth process may be gradual, the result may be much more significant, with a much better early return on invested capital (“ROIC”). In 2022, McKinsey & Company published research doing a broad study on 550 public firms over the span of 15 years, finding that firms that would pinpoint a focus on organic growth would average 7% annual revenue growth and then accumulate 6% higher in total shareholder returns, in contrast to competitors, which were heavily reliant on acquisitions (McKinsey & Company). The companies using capital to build up the internal structure rather than high-cost external acquisitions achieved steady growth, allowing steady returns. A similar result was published by Bain & Company in 2023 on consumer packaged goods, with the conclusion that firms made almost twice the long-term shareholder returns through exclusively internal processes from margin expansion and revenue growth (Bain & Company).

## **II. How have Private Equity Firms Typically Financed Deals**

### **A. History of LBO Financing**

Through the availability of different types of credit, innovations, and regulatory environments, leveraged buyouts (“LBO”) have evolved throughout the past century (Hurduzeu & Popescu). While the term “LBO” did not come into existence until the 1960s, the concept started in 1955 with the purpose of the Waterman Steamship Corporation and the Pan Atlantic Steamship Company by McLean Industries

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(Hurduzeu & Popescu). McLean Industries, owned by Malcolm McLean, the investor of containerized shipping, raised \$7 mm through preferred stock and borrowed \$42 mm for this LBO (Hurduzeu & Popescu). He then applied the assets from the Waterman Steam Corporation to pay the \$20 mm down payment on the \$42 mm loan.

However, it didn't have formal PE sponsors or institutional LPs (Hurduzeu & Popescu). This was groundbreaking for its time, as before then, the majority of acquisitions relied heavily on equity or cash (Hurduzeu & Popescu). LBOs were not widely used until the 1960s, when barriers of limited debt financing, high regulatory constraints, and the absence of PE sponsors all came down (Hurduzeu & Popescu). PE sponsors entered the market strategically, and it was identified how to use leverage efficiently (Hurduzeu & Popescu). An example is the formalized PE model of multiple funds from investors' pooled capital, allowing the sponsorship of LBOs (Hurduzeu & Popescu). Some main entrepreneurs were Henry Kravis, George Roberts, and Jerome Kohlberg (Hurduzeu & Popescu). The market conditions became better for the possibility of LBOs as antitrust regulations became less tight and more flexible, allowing holding company structures. As new debt instruments were introduced to the market, new opportunities arose rapidly (Hurduzeu & Popescu).

In the 1980s, it was mainly junk bonds and takeovers of companies with minimal equity (Hurduzeu & Popescu). The junk bond market was when high-yield bonds allowed PE firms access to large amounts of debt financing, so it was possible to buy bigger companies (Hurduzeu & Popescu). KKR made the biggest junk bond deal of its time with a \$31 bn RJR Nabisco deal in 1989 (Hurduzeu & Popescu). This financing innovation turned junk bonds into LBOs from niche deals to the typical force in acquisitions. In the 1990s, LBOs were financed by more conservative bank debt (Hurduzeu & Popescu). Following the 1990s, the 2000s saw regulatory tightening, and the type of debt utilized was mainly Covenant lite and PIK (Hurduzeu & Popescu).

## **B. History of Debt Products**

PE deals are commonly funded through a combination of different types of equity and debt through a capital stack, each having different risk and return strategic purposes (Mergers & Inquisitions). Private Equity firms have typically financed deals through two types of financing: equity and debt financing. In a typical PE deal, 30-40% of the capital stack is equity from the PE firms themselves or their LPs (American Investment Council). In certain situations, co-investors also participate. Recently, co-investments seem to be on the rise; one example is how Morgan Stanley collected \$2.3 bn in PE co-investments. By using co-investments, they rely more on growth and less on leverage, mainly to co-underwrite deals. Firms utilize debt along with equity, such as senior debt, subordinate debt, unitranche debt, and other financing tools as seller financing, secured equity, and earnouts.

Senior Debt, which is also known as senior note, is debt that a company has to pay first when it goes out of business. This has the first claim on assets and is the lowest risk in case of bankruptcy (Mergers & Inquisitions). Because senior debt is the highest priority, it carries the lowest risk and usually offers lower interest rates. Senior debt is generally funded by banks. The difference between senior and subordinate debt is that subordinates are paid only after senior debt is fully repaid. Senior Debt is the backbone of LBO financing and usually accounts for at least 40% of the total company value.

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Mezzanine Debt is a complicated form of debt that acts like a customizable financing tool with equity-like features. I.e., equity kickers, participation in value appreciation, PIK interest, and subordination. This form of debt is riskier as it is paid after senior debt and is lower in the capital stack, as it offers higher returns in exchange for higher risk. Companies use mezzanine debt when they do not have enough cash and don't want to sell more equity and if the loan defaults, debt may be converted into equity. Some risk with mezzanine debt is that it is not backed by strong collateral, and if the company fails, then the mezzanine debt lenders could lose their money.

It is a high-risk, high-reward loan used when a company needs cash but doesn't want to give up partial ownership. It also includes equity kickers to increase lenders' returns. PE firms mainly use this when they need more capital than the banks are willing to provide and don't want to dilute their ownership

Unitranche Debt is putting two different types of loans into one; it blends senior and subordinated loans into one with a single interest rate (Mergers & Acquisitions). The difference between Unitranche and Mezzanine is that Unitranche is a mix of two loans, while Mezzanine is just subordinated, and Unitranche is paid before Mezzanine. Unitranche debt interest rates are lower than Mezzanine.

This makes it have one interest rate and one set of rules, and it's used because it simplifies things and is more flexible, as it can be changed to a company's needs. The interest rate on Unitranche debt is higher than that of a regular senior loan, and the company/person lending the money gets more control, with stricter terms. Unitranche debt is usually provided by private credit funds and not banks. It's used to speed up leveraged buyouts. It speeds up the process because when there's one lender to deal with, it's simpler than multiple lenders, when there's one agreement, it's simpler than multiple contracts, and private lenders are faster as bank approvals take longer. Some also used NAV-based loans, which are often used for distributions and collateralized by the value of the entire PE fund's portfolio (Harvard Law School Forum on Corporate Governance).

Flexible Holdco Debt: Flexible Holdco Debt is a loan made to holding companies. Holdco Debt is a loan made to the parent company. It is risky for the lenders because they don't have direct access to the cash flow of operating companies; the HoldCo borrows money to buy another company, usually. Flexible HoldCo Debt is risky because lenders are the last in line to be paid. It's risky as lenders don't have a claim on the revenue from the operating companies. Its main revenue is from its subsidiaries.

Currently, a commonly used tool for this type of lending is Payment-in-kind options (also referred to as PIK). What this means is instead of paying the cash now, the person borrowing the money pays later, but with more debt (Mergers & Acquisitions). People who lend money do this because they earn more interest. After all, it's interest on interest, and it's useful in risky PE deals. People borrow because it helps save cash early on and leaves some slack in tough times or while growing. It's risky because for lenders, there's no steady cash flow, and there's a chance they never get paid if the company fails.

While many of these traditional syndicated loans and conventional leveraged lending have historically dominated PE acquisition, these methods become less effective in high-growth environments as deals grew riskier, more complex, and dependent on long-term growth. Traditional bank lending was designed

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with traditional companies with stable cash flows, predictable earnings, and mainly physical collateral to support strict covenants and large syndicated debt issuances. However, many modern high-growth companies particularly in sectors such as technology, AI infrastructure, and digital services, operate with volatile cash flows, heavy reinvestment needs, and mainly intangible asset business models that may fail to fit traditional underwriting standards. At the same time, the rising interest rates increased borrowing costs and reduced debt capacity, while post 2008 banking regulations made highly leveraged deals more difficult for banks to underwrite. Syndicated loan markets increasingly became more vulnerable to pricing swings and execution risk especially during periods of high market volatility. Whereas now as a result PE sponsors are not trying to fit in the traditional method but instead branch off and make their own custom structures, increasingly shifting to unitranche financing, hybrid debt structures, and private credit solutions.

### **III. The Pivot to Private Credit and Other Forms of Financing**

#### **A. What is Private Credit?**

The 2008 financial crisis led to regulatory changes and increased scrutiny of lending criteria (McKinsey & Company). The crisis was due to the U.S. housing bubble collapse. This included widespread failures in mortgage underwriting and excessive leverage in the banking system. The amount of defaults increased at a rapid level, and financial institutions all around the US faced liquidity shortages, leading to the failure or near-failure of firms, freezing interbank lending markets. This breakdown prompted government intervention through programs such as the Troubled Asset Relief Program (“TARP”) and regulations (McKinsey & Company). These regulations and increased scrutiny meant that leveraged-based lending became more capital-intensive, so banks stopped lending in deals that required risky leverage (McKinsey & Company). As leveraged lending became more capital intensive and exposed to heavy regulatory scrutiny, traditional banks faced growing limitations in underwriting highly leveraged acquisitions, especially in industries which were asset light and characterized by uncertain cash flows and heightened operational risk. Subsequently this created a financing gap which private credit lenders rapidly expanded to fill. Private credit lenders exist outside of the banking context and lend money directly to companies or funds (McKinsey & Company). Private credit loans have higher interest rates due to the increased lending risk. Private credit offers lenders higher yield than public bonds, predictable cash flows, and reduced mark-to-market volatility due to its private, non traded structure. The growth in the private credit sector is driven by banks’ retreat from large lending, refinancing of corporate debt, and PE firms seeking greater flexibility in deals (McKinsey & Company).

#### **B. Private Credit Growth Impact**

The use of Private Credit has skyrocketed, not just impacting PE financing but also banks and investors, giving rise to new regulatory concerns (McKinsey & Company). The utilization of Private Credit has grown at an annualized rate of 14.5%, significantly outpacing traditional borrowing, which has grown 5.5% (McKinsey & Company). Most of the growth can be attributed to firms with limited financing options or countries with stringent banking regulations (McKinsey & Company). The numbers from Q2 2024 showed how drastic the shift in lending from banks to private lenders had become, with private credit lending in the US totaling \$1.34 t and globally reaching \$2 t (McKinsey & Company). The impact on the credit market has changed the way traditional banks view private credit, trying to work with it

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instead of against it (McKinsey & Company). Banks are providing credit lines as a way to collaborate rather than compete. Banks are providing revolving lines of credit to private credit funds that lend money to companies. The revolving lines of credit help manage overall cash flow by providing flexibility for private credit funds and generating profits for banks .

The private credit funds gain flexibility as they don't need to wait for investors' money, letting them make loans quickly. According to the Federal Reserve, in US banks, lending to private credit vehicles increased from \$8 bn in 2013 to \$95 bn at the end of 2024. Some other ways banks have worked with private credit are through unitranche and mezzanine loans, so they share risk, but both earn fees (McKinsey & Company). They practice syndication, and the bank and private credit fund take different levels of return and risk (McKinsey & Company). With the Unitranche loans, the bank is on the lower risk and lower return side, while the private credit firm takes the high risk and return portion (McKinsey & Company). For those who are borrowing, this is liked because it provides a single source and allows them to secure larger loans faster (McKinsey & Company). Because the banks are only a portion of the loan, they keep the regulatory capital requirements lower and still earn interest and the structuring fees (McKinsey & Company).

In 2024, according to PitchBook, over 40% of large midmarket buyout loans in the U.S. utilized unitranche or hybrid co-lending in between banks and private credit funds. This was a huge gap from the 10% in 2015. Some banks also provide operational services as a way to profit from the increase in private credit. They offer services such as settlement, treasury, or just advisory services. The main reason banks collaborate with private credit firms instead of competing is because they can make a profit off them and it's a risk mitigation. As private credit mainly lends to more risky borrowers, banks lend to private credit funds and transfer some risk off. So while they are involved, they are not the direct lenders and gain profit from interest fees. By the end of 2023, 14% of total bank lending to non-bank financial institutions was commitments to private equity and private credit funds totaling \$300 bn.

Private credit lenders grew rapidly because of the unique financing structures which banks struggle to offer. Opposed to syndicated bank loans with broad market participation and vulnerability towards pricing volatility, private credit transactions could be directly negotiated between sponsors and lenders. This let PE firms obtain faster execution, customized covenant packaged, and greater certainty of closing, all which are increasingly valuable in volatile market conditions.

Recently, policymakers and regulators have given attention to private credit structures and have raised concerns about the lack of transparency and systemic risk with the interconnectedness of banks (McKinsey & Company). As private credit increasingly replaced traditional syndicated lending and is becoming more interconnected with banks and investors, major concerns are expanded beyond acquisition financing itself towards broader issues involving market transparency, liquidity exposure, and systemic financial risk. While banks and private credit operate separately, the way banks have been providing lines of credit makes them indirectly impacted if the loans default. Although banks bear less direct exposure than private credit lenders, risk is not eliminated but rather redistributed across the financial system. For example, in the case of an economic downturn where the vast majority of credit funds revoke their bank credit lines, this would strain liquidity across banks as they would all be drawing back simultaneously.

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The expansion of private credit reflects a broader shift in modern financial intermediations, where financial risk and leverage are moving outside of many traditional banking institutions and into less transparent private markets. Moreover, while these structures improve financing flexibility and execution certainty for sponsors, they also increase concerns with liquidity stress, valuation, and the concentration of systemic financial risk during periods of downturn.

Where banks are required to be fully transparent with reports on every detail occurring, private credit firms are their own entity, where they don't need to disclose any information about their credit quality, internal leverage, borrowers, or anything about their loan portfolios (McKinsey & Company). Where risks are concentrated, regulators and investors don't have insight into posing future challenges. As private credit firms don't need to perform detailed risk metrics, regulators can't measure the potential of spillover into other sectors. Even while these funds usually are long-term they still have liquidity pressures in many cases where borrowers default, especially in private credit with the higher risk. In addition, the valuation tied to transparency is another gap that can't be filled. As internal models are used to find the fair value instead of market prices, it incorporates bias and a conflict in interests across the board. In 2023, research from the University of Oxford came to the conclusion through intricate research that the private credit funds seem to lag and the valuations are behind by a gap somewhere in a range between 6 and 7 months, leading to the recognition of losses much more slowly. As private credit is looked at as a blind spot, it's been hard for regulators to accurately price the risk and gauge its longevity (McKinsey & Company).

**C. Trends in financing besides Private Credit**

The development of financing is constantly evolving through new innovative financing methods and trends (McKinsey & Company). Current trends in PE financing include Environmental, Social, and Governance (“ESG”) financing, cross-border financing, and asset-backed lending (“ABL”) (McKinsey & Company). ESG financing aims to promote more responsible investing, with the goal of achieving both financial performance and sustainability objectives (McKinsey & Company). Most lenders offering ESG-linked debt products align the interest rates and terms with the company's ESG performance (McKinsey & Company). When a company meets or surpasses a specific ESG target, lower borrowing costs. Cross-border finding is on the rise as PE firms globalize across the world and are increasingly becoming more common (McKinsey & Company). PE firms are gaining access to cheaper capital and funding sources where deals involve multiple currencies, international banks, international private credit funds, and local debt markets. Cross-border financing arrangements introduce added complexity to deals, bringing the additional risks of tax considerations, differing regulatory laws, currency risk, and varying market volatility (McKinsey & Company). The use of ABL has increased among PE firms, where borrower assets or receivables can secure the loan in accounts receivable-based loans (“AAR”) (Mergers & Inquisitions). ABL debt products are used by middle-market companies that do not have large cash flows or a steady credit history, providing them with a more flexible borrowing limit (Mergers & Inquisitions). By financing the assets instead of just the future estimated cash flow, ABLs have become significantly popular in LBOs (Mergers & Inquisitions).

#### **IV. How Private Equity Deal Financing Differs for High-Growth Industries**

##### **A. High-Growth Companies and Related Industries**

Typically, a high-growth company is one that grows at an average annual rate of 20% or higher over at least a 3 year period (McKinsey & Company). High-growth industries became a catalyst behind the growth of private credit because the financing characteristics increasingly conflicted with many traditional bank underwriting standards. Companies within sectors in AI infrastructure, software, healthcare, and renewable energy often have volatile cash flows, and are asset light, extending the scaling timeline which makes them less compatible with conventional structures. Now many rely on private credit lenders who can provide flexible financing arrangements aligning with their specific needs. High-growth companies often start operational scaling between 18 and 36 months. As technology becomes increasingly embedded across many sectors of business, there is a strong correlation between scaling speed and a company's continuous integration of new technologies (McKinsey & Company). For instance, the OECD reported that digitally intensive companies (i.e., companies that incorporate technological innovations such as data analytics, automation, software, digital platforms, and similar services in daily operations) grew twice as fast as non-digital-intensive companies. Companies with a high degree of digital intensity are very attractive investments for PE because of the significant potential for value creation through higher margins, data-driven decision making, and quick scaling through digital intensity (McKinsey & Company). Companies that exhibit high growth will also have a 20% growth rate over a three year time frame and also have an average employee growth rate of 20%. As a whole, the key traits are their digital intensity, revenue growth, employee growth, economic innovation and growth, and finally, the capital reinvestment. Because of high-growth companies' innate characteristics, high-growth companies often have higher valuation multiples (McKinsey & Company).

The technology industry is one of the most rapidly growing sectors, even by surpassing the global GDP rate, through its capital intensity and ability to shape the global economy (McKinsey & Company). Specifically, PE firms of many sizes around the globe are evolving from scalable software, AI productivity tools, and subscription-based infrastructure (McKinsey & Company). It is forecasted from Gartner that globally spending will reach \$5.43 t by 2025. This was a large increase of 7.9% from 2024. In the sector, there's been a huge shift from on site-systems to cloud environments and data centers (McKinsey & Company). Whereas in 2024, spending on data center systems was at \$333.4 bn, it has now jumped to \$474.9 bn. Similarly, specifically public cloud end user spending was \$595.7 bn in 2024 and now, at the end of 2025, it is projected to be \$723.4 bn. Software as a service (SaaS) is forecasted in 2025 to be up 19.2% at \$299.1 bn and by 2034 up to \$1,251 bn.

The healthcare industry is one of the biggest sectors, generating over \$12.8 t in 2024 and is estimated to pass \$22 t in 2033 (Morgan Stanley Wealth Management). Morgan Stanley categorized healthcare as a good long-term investment through the consistent demand, supply, and funding environment (Morgan Stanley Wealth Management). Morgan Stanley argued that healthcare delivered the highest EPS growth rates consistently all the way from the last 20 years (Morgan Stanley Wealth Management). In specific PE, according to Bain & Company in 2024, healthcare reached over \$115 bn, one of the top earning years (Bain & Company). Not just major PE firms but small specialty PE firms have raised \$59 bn since May 2026

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2020 in specifically Healthcare IT, carve-out assets, and biopharma, with biopharma being the leading sector. While deal value increased, there was a 41% decrease in exit volume compared to the peak in 2021 (Bain & Company). Bain notes this to the heightened interest rates and the difficult buyer and seller alignments. In addition, PE in India, South Korea, and Japan are being more active within PE healthcare (Bain & Company).

**B. Challenges of financing high-growth companies**

While high-growth companies are the idolized goal, these companies come with challenges and unique issues related to financing. Common challenges and risks which are encountered are exit risk, constraints within capital structures, market and macroeconomic volatility, and inaccuracies in monitoring costs/projections (McKinsey & Company).

High-growth entity financing specifically in PE comes with high risk from the reliance on external capital, rapid expansion, and unsystematic risk (McKinsey & Company). As PE incorporates a highly leveraged structure, it was found that the default rate for loans in PE companies was at 6.6% in comparison to 4.2% for high yield bonds (McKinsey & Company). External methods of financing were noted by the OECD as an imperative method to financing high-growth companies; however, they may not meet the traditional lenders' criteria for collateral or covenants (McKinsey & Company). In addition, borrowing has become more expensive as global debt levels are at a record high, as structural macro risk intensifies the sensitivity (McKinsey & Company). Investor downside risk is amplified when aggressive structures such as PIK interest are utilized, deferring cash obligations and obscuring underlying financial weakness, making the risk of downstream distress or write downs (Mergers & Inquisitions).

Firms aiming to be high-growth usually don't follow the traditional capital structures, specifically in financing using a mix of venture capital and growth equity (Harvard Law School Library). However, their debt has restrictive covenants. However, when the firm needs capital to scale, it may be detrimental as it requires deleveraging. In addition, the covenants will also limit the reinvestment ability. In addition, rapidly growing SMEs are having difficulties accessing equity (Mergers & Inquisitions). In 2024, the OECD showed a plummet in equity financing, which was correlated to the rise of rates and smaller risk appetite.

Before major liquidity, these high-growth firms need numerous rounds of financing, and when markets are uncertain, the time for exits shrinks, and the period of opportunity may completely close (McKinsey & Company). McKinsey stated that in lower multiple environments, many sponsors are holding on to assets longer and are very reluctant to sell. These extended holding periods are inflating risk for both ends of investors and founders (McKinsey & Company). The overall exit routes are additionally under pressure. A recent Financial Times commentary section emphasized the record number of unsold companies in PE with over \$3 t in value locked up, causing LPs to delay future commitments, leading to fewer paths to liquidity for high-growth firms.

Specifically in the high-growth companies, under these conditions, potential backers may be much less incentivized to commit capital as the risk expected increases, where growth funding may never materialize. In addition, direct lenders in private credit are under intense pressure, even though in 2023

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they financed 64% of the buyout loan volume. In these higher-rate markets, managers are facing an increase in default risk. Companies that rely on credit to scale, specifically high growth, the tighter market lending increases the effective cost of constrained available financing options and capital.

The systematic risk that PE investors and the entirety of the financial system face goes hand in hand with rising interest rates (McKinsey & Company). While the Federal Reserve has cut interest rates twice already in 2025 at 4%, this is still a high marginal increase from the many earlier years. These rates are continuously creating pressure in PE, specifically in leveraged financing, refinancing risks, and valuation discounting.

The borrowing costs for PE LBOs increased aggressively during the high in 2024 at 5.50%. McKinsey found that during this time, the higher rates, which therefore lead to lower debt capacity and more pressure, lowered the equity IRR during the deal period (McKinsey & Company). In the next 5 years, over trillions of middle market and PE loans are due to be repaid (or refinanced). Where a large tranche of loans are maturing at the same time, these sudden or changing rates are creating rising stress throughout funds and companies simultaneously. The increased chance of unfavorable outcomes may result in issues not just in the private market but banks, insurers, and the public credit market. Just in 2024, the entirety of the industry performance was under the long run median average, even though the deal volume rebounded to \$1.7 t. The higher rates lowered returns and heightened the increase in systematic risk (McKinsey & Company).

**V. What does the future of Private Equity Financing look like?**

The expansion of private credit demonstrates more than a temporary financing trend within PE markets. It reflects the broader shift in modern financial intermediation where leverage and financial risk are increasingly migrated outside traditional banking institutions and into less transparent private markets. As PE continues to evolve, the future of a new era within PE involves deeper integration of private credit, extended holding periods, and a more imperative focus on long-term value growth, driven by capital structures and dynamic changes in investment strategies (McKinsey & Company). The private markets universe, including private debt, related infrastructure, and PE real estate, is projected to grow from \$13t currently to over \$20t over the next five years (McKinsey & Company). The driving factor for the increase in private market funds is increased allocations from pensions, illiquid investments by wealth investors, and insurance firms (McKinsey & Company). Currently, private debt represents \$1.6 t in assets under management and is expected to remain a core financing tool in the near future. While private credit financing slowed globally in 2024 and early 2025, private credit is expected to gain traction in the future as deal structures evolve, requiring more flexible and non-traditional strategies (McKinsey & Company).

An up-and-coming trend is sector conversion and operation transformation in PE (McKinsey & Company). PE firms appear to increasingly engage in industry-transcending decisions in energy, technology, and infrastructure, with a primary focus on AI-powered data centers (McKinsey & Company). The line is blurring as typically dominated sectors by venture capital (“VC”) have gained a growing presence from PE (Harvard Law School Library). While historically, VC is concerned with high risk and early stage investment, and PE focuses on the latter, being mature companies with already established cash flows, the increasing convergence arising is apparent, specifically in the AI industry

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(Harvard Law School Library). Recently, a VC-dominated process, financing the creation of data centers, has been increasingly overtaken by PE, private credit, and asset management firms such as Blackstone, Pimco, Magnetar Capital, Apollo, BlueOwl Capital, Carlyle, and BlackRock (McKinsey & Company). There has been a surge in digital infrastructure investment pre-maturity, mainly towards AI infrastructure (McKinsey & Company). Where in 2020 capital allocation to data centers was at \$11 bn, it expanded to over \$50 bn just by the end of 2024. Energy access has become strategic as the incentive to invest in energy with grid capacity. The heightened PE presence in AI, data centers, and energy pre-maturity is due to alignment of scalable demand and long-duration capital under active ownership models (McKinsey & Company).

In parallel, digital-intensive technologies are a key to value growth (McKinsey & Company). Currently, 88% of PE firms use AI for deal appraisal, and 72% plan to continue investing in emerging technologies (McKinsey & Company). The digital shift and support for operational improvements will drive returns, not just financial leverage (McKinsey & Company).

Deloitte noted that 86% of corporate and PE leaders already have integrated generative AI into their M&A and deal-making workflows, with 65% of those firms adopting it within the past year (McKinsey & Company). With a majority deciding to invest significantly in millions of these technologies and expect returns within the next year or two. Not only do a substantial percentage plan to increase the amount invested in AI for strategy within the next year. In addition, in PE, 83% use AI for deal sourcing and over 81% for due diligence (McKinsey & Company). As a whole, AI has become the norm, a common tool which has become a strategic tool in analytical and efficiency in PE (McKinsey & Company).

The usage of these tools has not just been limited to due diligence back office but now directly assessing the transaction cycle with market assessment and target identification. The deal sourcing which has historically depended on manual overview of proprietary databases, personal networks, and industry reports has completely shifted with AI analytical programs which can rapidly scan large datasets, identify opportunities off market, and flag strategic flexible fits. Now with predictive models the need for manual overlook has been replaced with something more efficient allowing sponsors to prioritize higher probability targets swifter. AI investment decisions have doubled in the last year from 13% to 28% in 2026, reflecting that AI is not just supportive but is becoming a central core analytic player. Financial documents have been increasingly written and reviewed by AI, now accelerated through natural language processing tools which can take a deep insight from data sources which are unstructured in a fraction of the time it took in comparison to manual review.

While AI has a large part in front and back office deal functions the industry has highlighted that AI's value stands in augmentation rather than replacement. The adoption of AI has reshaped operations in deal teams more than automating tasks but allowing firms to address more client and people centric challenges such as aligning incentives and up-skilling the talent to extensively capture AI's potential while preserving the human oversight. Today firms are positioning AI into core workflows and a type of institutional infrastructure instead of a side tool, changing how the firm operates, becoming a fundamental for PE firms to analyze, execute, and operate.

## CONCLUSION

Collectively this paper finds that private credit and flexible debt instruments emerged as a structural replacement for increasingly constrained traditional leveraged lending. As rising rates, tighter banking regulations, and the financing demands of high-growth industries reduced the effectiveness of syndicated bank lending, private credit became the dominant financing mechanism for modern PE acquisitions.

Industries operating in technology, AI infrastructure, healthcare, and digital services heavily relied on financing structures which could support volatile cash flows, aggressive reinvestment, and intangible asset heavy business models that conflict with traditional bank underwriting standards. As a result, many private equity sponsors turned toward flexible private credit structures better aligned with operational uncertainty and long term growth strategies.

Now consequently the rapid growth of private credit reflects the broader shift where leverage and financial risk are increasingly shifting outside traditional banking systems and into less transparent private markets. While these structures improve execution certainty and flexibility, they also create growing concerns with liquidity exposure, valuation, and systemic financial vulnerability during periods of market stress.

The evolution of PE financing is no longer simply reshaping acquisition frameworks, but refining how capital, leverage, and systemic financial risk are distributed across modern private markets.

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amounts of capital needed to finance multi-billion-dollar deals. The history of these two instruments goes hand in hand, as for example, the conjunction between the U.S. recession of the early 1990s along with the junk bond market crash following the fall of the investment bank Drexel Burnham Lambert, brought the first LBO wave (the one that started in 1980) to an end. This is not the only example that shows a true connection between LBOs and junk bonds. This paper aims to bring into light the liaison that exists between these two instruments and the history that was created by the financing of LBOs with junk bonds. The present article will bring into focus the speculations that rests on the idea that the junk bonds has proven to be a life saver to big leveraged buyout groups as companies are able to get access to funding as investors look to invest in companies with high yields. Apart from this subject, this paper will try to figure out the role that the junk bond market plays in new LBO's, especially the ones created after 2012 (there was a slowdown in the LBOs activity after the financial turnover from 2008, and only after 2012 we can observe an improvement in the leveraged buyout market). This research paper will try to stimulate thinking about the effects that are generated on a market by a LBO, the power that exists behind a leveraged buyout (e.g. the junk bonds) and the connection that makes them prevail and become powerful, mainly together. Keywords: Leveraged Buyouts; Junk Bonds; High Yield Bonds; Mergers and Acquisitions

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