THE LEAD
https://theleadpc.com/why-private-equity-matters-part-three/

Why Private Equity Matters (Part Three)

THE LEAD | January 27, 2026

The notion of private equity as anything but constructive for shareholder value is of recent vintage. The real story of PE is the story of commerce itself. The first enterprising person to buy a company instead of starting one engaged in a private equity transaction.

Before World War II, most "private equity" transactions were funded and financed by wealthy families. The lack of a sophisticated lending infrastructure and regulatory framework for what we call leveraged buyouts today left most corporate investments to the Vanderbilts, Rockefellers and Whitneys who were expanding their family empires. Returning vets with entrepreneurial instincts began many small and medium-size companies in the post-war period.

Another boost came from the conglomerate era in the 1960s and '70s (remember ITT?). Public markets discounted holding companies of unrelated industries. Private buyers looked to unlock their hidden value. As founders aged, many faced a succession problem. With few younger generation members carrying on the family business, and not wanting to sell to competitors, they turned to private financial buyers such as Jerome Kohlberg and Henry Kravis. Coining the term, "bootstrapping," they used borrowed funds in pioneering the leveraged buyout.

Two key pieces of legislation helped launch what we know as the PE boom of the 1980s. In 1978, restrictions of the Employee Retirement Income Security Act (ERISA) were relaxed to allow investments in private companies by corporate pension funds. Then the Economic Recovery Tax Act of 1981 lowered the top capital gains tax from 28% to 20%. These resulted in a dramatic surge of private equity fundraising and deployment, including the buyout of RJR Nabisco made famous in *Barbarians at the Gate*.

After the S&L crisis and junk bond pullback, the private equity industry tracked economic cycles. Activity and performance slowed during the 1990 recession and tech bust of 2001, grinding to halt during the GFC. A common thread over these three decades was the use of increased leverage as a primary driver (vs. operating improvements) of returns.

But too much debt can be a drag on cash flows. And some firms became careless about over-leveraging cyclical industries. Instead of earnings growth as the gold standard for multiple improvement, paying lower purchase prices coupled with debt pay downs became the norm. So private equity developed a bit of a boom-or-bust reputation.

High rates make it tough to generate alpha with leverage alone. Purchase price multiples are double-digit for top companies, and sponsors' investors balk at the strategy. Successful managers are sophisticated business builders, not just financial engineers. Those with proven skills – industry specialties, for example, and differentiated deal sourcing – lead the pack.

Finally, operating partners drive growth and best business practices for PE firms. Today's leveraged buyout needs to stay true to its "hands-on" roots. Leverage built the industry, but operational excellence will sustain it.