Cash in hand eclipses paper gains

More leaders are using DPI—not IRR—to build resilience and generate cash without waiting for full exits

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Introduction

Private equity's (PE) traditional value-creation arc—buy, build, and exit—was designed on the assumption that capital markets reliably convert portfolio value into liquidity. That no longer holds. Exit markets have reopened unevenly, deal volumes remain constrained outside of select large transactions, and holding periods are longer. As a result, distributions have fallen even as reported net asset values remain elevated.

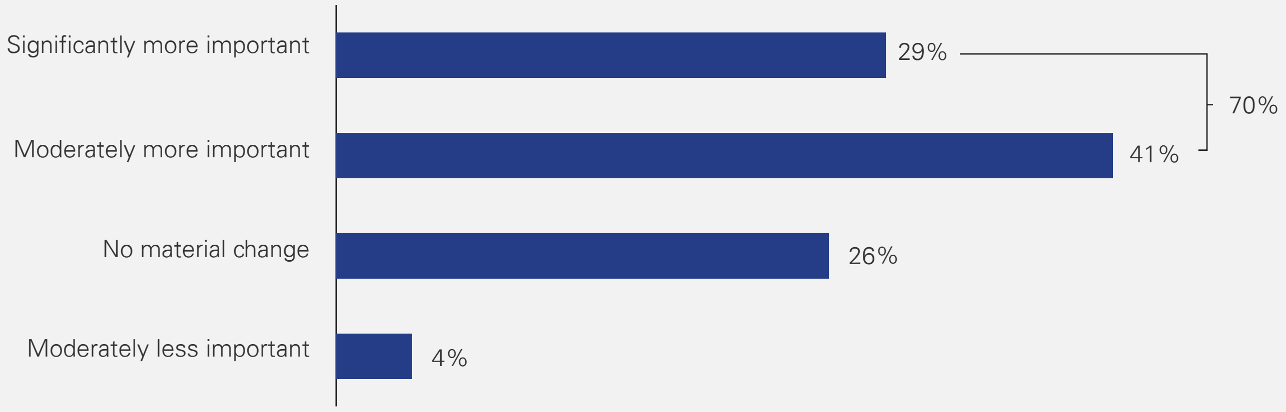
PE cash returns in the US have been broadly flat in recent years, with distributions hovering around $300 billion since 2022. Annual reported exit values have shifted markedly in the last three years but remain heavily influenced by a small number of outsized transactions: the five largest exits each year have accounted for 10 percent to 24 percent of total value while representing only about 0.3 percent of total exit count.[1]

Cash, not valuation, has become the scarce resource. The implication is that value creation itself must become less dependent on new capital. Sponsors are increasingly seeking initiatives that generate cash quickly enough to fund transformation internally, reduce leverage, and create earlier distribution capacity. Working capital optimization is uniquely positioned to achieve all three, often releasing meaningful cash within months rather than years.

Many sophisticated limited partners (LPs), recognizing these changes as structural and enduring rather than cyclical, are now assessing performance differently. In the KPMG M&A Survey—Mid-year 2026 of 150 PE dealmakers, 70 percent of respondents said distributions to paid-in capital (DPI) has become more important, while only 26 percent report no material change (Exhibit 1).

Exhibit 1: Seven in ten PE respondents say DPI has become more important

Q: Compared with prior cycles, how has today's PE deal environment (e.g., longer hold periods, softer exit markets, and valuation disconnects) changed the importance of distributed to paid-in capital (DPI) in how your firm evaluates performance?



Notes: a) Percentages may not add to 100 due to rounding; (b) We omitted a few options due to low responses.
Source: KPMG M&A Survey – Mid-year 2026

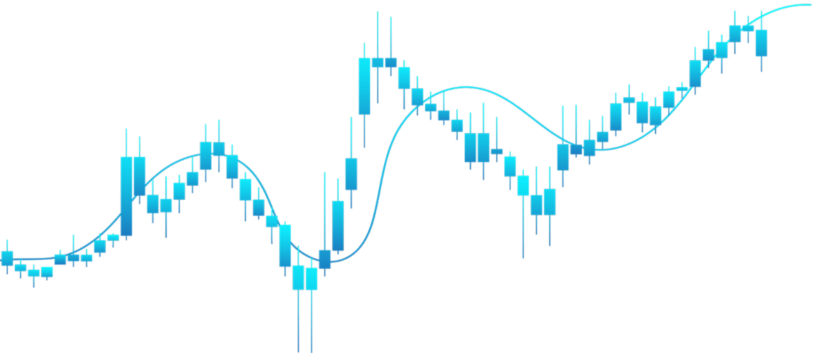
[1] Exit figures from Pitchbook as of December 21, 2025, refined and analyzed by KPMG LLP. The reported values and volumes encompass inbound, domestic, and outbound US exits announced over the period. Analysis includes public investments, acquisitions, and PE-backed exits. Exit values are based on publicly available information and are not exhaustive.

Given the combination of maturing private equity markets, persistent exit bottlenecks, and asset-allocation discipline, pension funds, insurers, and other large allocators are not expanding their private market buckets. Instead, they are recycling capital. In practice, this means sponsors who return cash are invited to redeploy it, and those who cannot are faced with capital rationing. The growing retailization of private markets may further reinforce this dynamic, as investors place greater emphasis on liquidity and timely access to cash.

In this environment, more than one in five LPs evaluating managers' performance now say the DPI metric is the most critical metric, up from just 8 percent three years ago , according to Allianz Research.[2] To these investors, cash in hand is more important than the paper gains reflected in internal rates of return (IRRs). Many also see DPI as a real-time test of liquidity, operating discipline, and sponsor credibility. Increasingly, it is also becoming a differentiator in fundraising, as investors favor managers with a demonstrated ability to return capital rather than simply report unrealized value. While IRRs are still the dominant measure, they are increasingly discounted as theoretical in the absence of realizations.

This shift is reshaping PE behavior across the full investment lifecycle. Diligence is more focused on downside protection and cash flow. Our survey results show that rather than a single terminal exit, more PE leaders now see interim liquidity mechanisms—partial exits, continuation vehicles, and dividend recapitalizations—as core elements of portfolio strategies.

In this paper, we address the issue head-on by introducing a DPI-aligned value-creation operating system: a practical blueprint for translating today's liquidity reality into decisions at entry, during ownership, and at exit.



[2] "Private equity in transition: from distribution drought to selective recovery," Allianz Research, February 20, 2026

> **Some of the most successful PE leaders** have elevated DPI not in response to a market cycle but to guide their redesign of value creation models, reshaping how assets are selected, managed, and monetized.

GenAI was utilized in the creation of this image

How we got here: From exits to uncertainty

A broken path to exit:

The once predictable sequence from value creation to scaled exits has weakened and become unreliable.

Selective recovery, broad stagnation:

A narrow set of large deals is clearing, but most portfolios remain locked by thin exit volumes and longer holds.

Capital went in—but hasn't come back:

Continued deployment widened the gap between capital called and capital returned.

LPs under liquidity pressure:

Persistent negative cash flows are forcing stricter allocation discipline and delaying new commitments.

Cash over claims:

With IRRs holding but distributions lagging, LPs are prioritizing DPI as the clearest test of performance.

How DPI pressure is reshaping PE behavior

Much of the PE industry remains overly focused on exit mechanics, in our view. More fundamental shifts are occurring earlier in the lifecycle: in how investments are underwritten, how risk and cash resilience are evaluated, and how portfolios are managed to generate distributable cash earlier and more consistently. DPI ultimately reflects these decisions as much as the eventual exit path.

With IPO and M&A markets constrained, sponsors are expanding their use of interim liquidity tools, including continuation vehicles, partial exits, and dividend recapitalizations. Increasingly, firms are managing toward a deliberate "liquidity mix"—balancing full realizations with transitional structures and engineered distributions—recognizing that the quality, sustainability, and signaling of DPI differ across pathways.

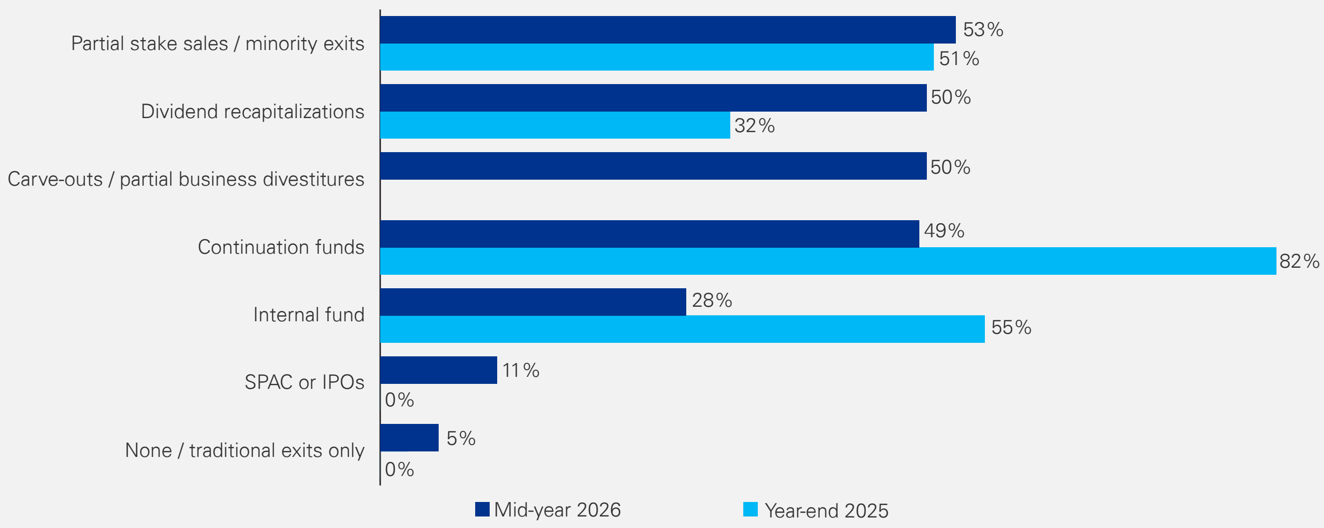
For many PE leaders, exit optionality has become a design principle rather than a contingency. Assets are being built to support multiple liquidity paths, allowing sponsors to generate distributions without forcing suboptimal exits while giving LPs flexibility to take cash or maintain exposure.

This shift is reinforced by changes at entry. Investment committees are placing greater emphasis on downside protection and near-term cash realization, underwriting base-case performance and resilience with greater rigor. Across the lifecycle, the model is evolving from dependence on a single exit event to a more deliberate system for generating cash.

Survey respondents reported being more likely to consider dividend recapitalizations and partial stake sales, followed by carve-outs and partial divestitures, among their preferred alternative exit strategies (Exhibit 2).

Exhibit 2: Partial stake sales and dividend recapitalizations emerge as the two most preferred alternative exit strategies

Q: What alternative exit strategies is your firm considering or using in 2026?



Notes: Percentages may not add to 100 since this is a multi-select question; Options that are blank in 2025 are newly added options in the Mid-year 2026 survey
Sources: KPMG M&A Survey – Year-end 2025 and KPMG M&A Survey – Mid-year 2026

The implications for value-creation strategies

This new environment is not simply shifting what PE firms do—it is changing how they make decisions and execute across the investment lifecycle. The most meaningful changes are visible in three areas: diligence, operating cadence, and cash visibility.

1. Diligence reframed:

From upside underwriting to cash resilience and liquidity readiness

Diligence is shifting from a predominantly valuation-led exercise ("How much can EBITDA grow?") to a cash-conversion and realization exercise ("How reliably and how quickly can this business generate distributable cash across scenarios?"). This is an evolution rather than a new concept. EBITDA was intended to approximate cash-generating potential by adjusting for non-cash items, but investors are increasingly focused on actual cash realization rather than cash-flow proxies.

Leading sponsors are now systematically underwriting cash conversion explicitly: translating EBITDA cases into free cash flow under base, downside, and delayed-exit scenarios, including working capital swings, capex intensity, and refinancing risk.
This also changes the questions asked at entry:

- What portion of the value-creation thesis is anchored in durable, reliable cash flow rather than multiple expansion?
- What working capital opportunity exists that can be realized within the first 100 to 180 days to self-fund the broader value-creation plan?
- Which liquidity pathways could remain viable if a full exit is unavailable in typical timeframes?
- Which capabilities inside the business—often one or two layers below the C-suite—can actually execute the required changes fast enough to matter?

Rather than treating working capital as a post-close optimization exercise, leading sponsors increasingly underwrite it as a tangible source of investment capital. Early improvements in cash management processes across order to cash, procure to pay, inventory management, and cash forecasting can finance AI transformations, commercial initiatives, procurement programs, and/or manufacturing improvements without requiring incremental equity.

2. Operating cadence:
From linear value-creation plans to short-cycle execution tied to liquidity windows

Traditional five-year value creation plans are being replaced or supplemented by a more dynamic model built around short-cycle value creation aligned to liquidity windows.

In practice, this can mean breaking value creation into sequenced "cash cycles" such as six- to 18-month initiatives designed to generate discrete, realizable cash outcomes, not just earnings growth. We recommend aligning initiatives to potential liquidity events, planning operating milestones around windows where partial exits, recaps, or CVs are viable.

This does not mean abandoning longer-term transformation. It requires balancing foundational investments with high-conviction actions that improve liquidity trajectory sooner. One emerging practice is sequencing value creation so that rapid cash-generation initiatives precede larger transformational investments. Working capital programs frequently become the first workstream after acquisition because they can release liquidity within three to six months. This can create an internal funding source for ERP modernization, AI deployment, procurement transformation, commercial investments, or bolt-on acquisitions while simultaneously increasing dividend capacity.

Continuous transaction readiness is part of this shift. Financials, KPIs, and narratives need to be maintained in a state that can support rapid execution of a liquidity event when conditions allow. This approach differs materially from traditional models: value creation is no longer optimized for a single exit but for multiple opportunities to extract cash along the way.

3. Cash visibility and control:
From retrospective metrics to forward-looking distribution capacity

If DPI is becoming a governing constraint, cash must become a more explicit operating signal. More sponsors are redesigning how they measure and manage performance, moving from backward-looking valuation metrics to forward-looking insights on what it can actually distribute under different scenarios.

This is where operating discipline matters. Many businesses focus on initiatives that enhance revenue and EBITDA, while treating operational cash flow as an outcome rather than a KPI. However, cash resilience does not simply happen on its own. It requires deliberate process change: better collections, smarter payables discipline, tighter inventory management, stronger forecasting, and clearer visibility into how operating decisions affect distributable cash. When done right, sponsors will have a more credible view of when an asset can support distributions.

Blueprint for action: Building a DPI-aligned value-creation operating system

To embed a DPI-first mindset into every aspect of operations, firms need an operating system that connects diligence, value creation, and governance into a continuous loop. The goal is not to replace the traditional PE model entirely, but to adapt it to a market where realization timing is less dependable and LP expectations around cash are more explicit.

A DPI-aligned operating system has six core components:

Six pillars of a DPI-aligned operating system

1. **Reframing value creation with a cash-centric performance scorecard**
2. **Redesigning diligence to validate cash resilience**
3. **Designing value-creation plans for multiple liquidity events**
4. **Aligning governance and incentives to DPI outcomes**
5. **Creating a liquidity event playbook for standardized execution**
6. **Moving from "mark-to-market" to "cash-to-LP" storytelling**

1. Reframing value creation with a cash-centric performance scorecard

The operating system's foundation is a standardized cash-centric performance scorecard used across all portfolio companies. This replaces valuation-only KPIs with metrics directly tied to realizable cash, including free cash flow (FCF) conversion, cash conversion cycle, working capital as a percentage of revenue, forecast accuracy, distribution capacity, cash available for reinvestment, and cash leakage.

In contrast to the traditional model that prioritizes earning growth and a theoretical exit multiple, this system elevates FCF as a primary measure of success. Operating reviews and capital allocation decisions center on cash, not just mark-to-market valuations. Leading firms are elevating the treasury function within portfolio companies and implementing sophisticated cash-flow forecasting tools. Some recast the "Office of the CFO" as a strategic driver of liquidity, not just a reporting function.

2. Redesigning diligence to validate cash resilience

A formal cash-resilience diligence module can be layered onto traditional commercial and financial diligence. This aim is to move beyond underwriting for upside and rigorously stress-test the durability of cash flows and margin protection in downside scenarios.

While traditional diligence validates the base case and upside potential, this system institutionalizes downside analysis as a core, nonnegotiable part of the Investment Committee process, focusing on cash behavior under pressure. Some sponsors now use advanced analytics and simulations to model a business's cash-flow behavior during macroeconomic shocks such as interest rate spikes or supply-chain disruptions. The question shifts from "How high can this go?" to "Will it still generate cash if everything goes wrong?"

3. Design value-creation plans for multiple liquidity events

The traditional five-year value creation plan aimed at a single, transformative exit should be replaced with a series of sprints targeting specific, high-conviction levers that can generate demonstrable results and cash within 12 to 24 months. Operating partners should maintain active scenario plans that identify triggers for potential liquidity events, shifting from an opportunistic to a deliberate approach to monetization.

To accomplish this, teams can run annual diagnostics that identify and prioritize the removal of blockers to cash realization. They can then build a roadmap of the most promising liquidity events from day one. Value-creation plans can be redirected toward initiatives that create natural windows for partial exits, dividend recaps, or other liquidity events.

4. Aligning governance and incentives to DPI outcomes

The operating system hardwires DPI into governance architecture by redesigning incentive structures for deal teams, operating partners, and portfolio company management. Moving beyond traditional fund-level carried interest, this approach to compensation is more variable and is more closely tied to realized profits and cash distributions throughout the hold period, not just upon a final exit.

Some firms are implementing multi-stage incentive plans where bonuses are tied to achieving specific cash-return milestones (e.g., a 0.5x DPI). This ensures that deal teams and operators are aligned with LPs' need for interim liquidity, especially during longer holding periods. New "realized profit-sharing" models can be integrated into compensation frameworks to align decision-making on multi-stage exits, keeping the GP, operating partners, and management coordinated over a longer and more complex ownership journey.

5. Create a liquidity event playbook for standardized execution

With a repeatable playbook, a firm can standardize its approach to partial exits, continuation vehicles, and other structured liquidity solutions across the portfolio, ensuring consistent and disciplined execution. Instead of treating each liquidity event as a bespoke, reactive transaction, the playbook establishes a proactive and systematic capability, helping to prevent inconsistent or panicked responses to LP or market pressure.

Many leading sponsors have established dedicated capital markets teams or centers of excellence that specialize in structuring and executing these alternative liquidity solutions, codifying best practices from each transaction to refine the playbook for future use. Indeed, according to the KPMG M&A Survey—Mid-year 2026, the most common primary objective for using alternative exit strategies is now to provide LP liquidity and improve DPI (25 percent), ahead of extending hold periods or bringing in new capital (22 percent each).

The playbook contains pre-defined decision trees and execution checklists for different scenarios. It establishes clear rules, approval pathways, and communication protocols in advance, turning a complex process into a manageable, repeatable discipline.

6. Move from "mark-to-market" to "cash-to-LP" storytelling

The final component of the system is a standardized LP Narrative Framework that complements statutory reporting and NAV disclosures so that all communications with investors lead with a clear story about realized cash returns.

This marks a fundamental shift in investor relations. Theoretical IRR figures and unrealized gains are de-emphasized in favor of a clear, credible narrative about realized DPI and the concrete steps being taken to generate future distributions.

Some of the most effective communicators use quarterly LP updates to connect operational improvements directly to distribution visibility, "telling the story of cash," reinforcing their credibility and building trust.

That framework provides templates for translating operating performance into a compelling cash narrative. Done well, it reinforces fundraising momentum and strengthens LP confidence through consistent, transparent storytelling, proving that the firm is a reliable steward of capital in all market conditions.

Conclusion

No longer a trailing indicator of success, DPI is now a defining constraint on PE strategy. Firms that continue to optimize primarily for IRR risk misalignment with LP expectations and capital availability. Those that adapt—by redesigning diligence, value creation, governance, and communication around realized cash—will be best positioned to restore momentum and credibility.

In a market where liquidity is scarce and patience is limited, cash in hand has eclipsed paper gains. The next cycle's winners will not simply wait for exits to return; they will build operating models that intentionally prioritize delivering distributions despite uncertainty.

How KPMG can help

KPMG professionals work with PE sponsors and portfolio companies to develop and execute value-creation programs that strengthen operating performance, improve cash conversion, and enhance strategic flexibility. Our multidisciplinary teams combine deep sector experience, data-driven insights, deal knowledge, and value-creation capabilities to help organizations identify opportunities, execute performance-improvement initiatives, and position assets for a range of potential liquidity outcomes. The KPMG Cash & Working Capital Advisory practice has unlocked more than $1B in cash for global PE sponsors, which has helped self-fund transformations and support earlier distribution capacity.

As PE firms place greater emphasis on translating performance into realized value, KPMG helps sponsors identify and unlock trapped cash across their portfolio through rapid working capital value-creation programs that generate liquidity within 3 to 6 months. These programs can self-fund transformation initiatives, reduce leverage, improve dividend capacity, and strengthen DPI, all while building more resilient operating models. In today's environment, working capital is no longer an operational metric; it has become a strategic source of investment capital and one of the fastest paths to realized value in elevated portfolio company holding periods.

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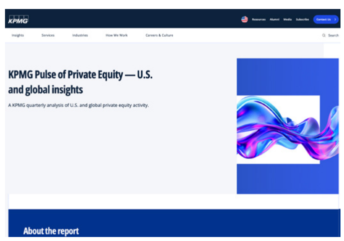

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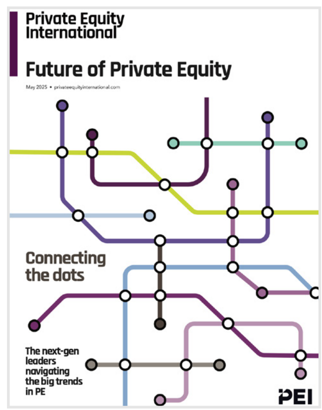

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