

Designing Management Incentives For An Uncertain PE Exit

By **Gemma Roberts and Andrew Callaghan** (October 16, 2026, 4:16 PM BST)

In a report this summer, McKinsey & Co. highlighted the increasing practice among private equity sponsors of reunderwriting investments during the holding period, revisiting the investment thesis and returning their exit options and equity stories as circumstances evolve.[1]

Management teams are increasingly being asked to stay invested for longer as private equity holding periods extend and routes to exit all become less predictable. Globally, average holding periods have reached 6.6 years.

This is evident in the U.K., where only 96 private equity exits were completed in the first half of 2026, nearly 30% fewer than a year earlier, while holding periods continued to extend.[2] Against that backdrop management incentive plans, or MIPs, need to be designed with sufficient flexibility to remain effective as the investment strategy, business and management team evolve.

Longer holds can test the incentive; acquisitions can alter the composition of the management team and individual responsibilities; and alternative liquidity routes can affect when, and how, management realizes value.

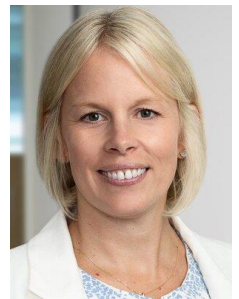
This article considers how MIPs can cater for broader participation, longer holds, alternative liquidity routes, buy-and-build strategies and, where circumstances change, address reincentivization or the need to reset.

Structuring Participation

A key trend in MIP design is broader participation, using equity to foster ownership and alignment with investors across a wider cross-section of the management team. While broader participation can support recruitment and retention, it also creates commercial and practical trade-offs.

Sponsors should prioritize attracting and retaining the principal value drivers, while recognizing that different populations and jurisdictions may require different forms of participation.

A tailored approach is therefore important from the outset. Company administration, including managing ownership records, transfers, leavers and exit processes, become more complex as participant numbers and jurisdictional diversity increase.



Gemma Roberts



Andrew Callaghan

Spreading the equity pool too widely risks diluting the incentive for those with the greatest influence on enterprise value. Sponsors should distinguish between those who need genuine equity economics and those for whom alternative incentives are more appropriate, while ensuring each group can be administered effectively.

Early identification of the jurisdictions in which participants are based and the applicable legal, tax and regulatory considerations is fundamental. Identical instruments may produce materially different outcomes depending on jurisdiction, making careful tax structuring essential.

Timing also matters. Bringing senior hires into an equity MIP once significant value has been created can be harder to achieve in a tax and cost-efficient way. Where future senior hires are foreseeable, including through acquisitions, considering how they might be accommodated at inception can preserve flexibility and protect the incentive for existing MIP participants.

Tailoring equity terms to seniority can become important in broadly held MIPs. Senior members are likely to hold sweet equity, i.e., an equity interest issued to management and structured to provide participation in future growth, subject to three-quarters of a year vesting and graduated leaver provisions as well as investing personal funds alongside the sponsor.

More junior equity participants may warrant different vesting or simpler leaver framework on their sweet equity, including benefiting from value only in genuine, good leaver circumstances. This type of differentiation can help to maximize the incentive for the core team while keeping the MIP administratively manageable.

Alternative incentive structures may be more appropriate for mid-and lower-level executives, including options, phantom or cash-settled awards whose value tracks equity without issuing shares and exit-related bonuses.

These can be implemented quickly with minimal or no upfront funding and avoid complex leaver and buyback mechanics. While these schemes may not replicate equity economics, and are generally subject to income tax treatment, rather than typically lower capital gains tax, together with applicable employment-related social security charges, they can still offer meaningful incentives and provide a practical solution for the company administering the MIP.

Whatever the structure, each participant should understand the incentive offered, how it works and the economic outcome it is designed to deliver.

Coinvestment Schemes

Coinvestment schemes, where employees and sponsors hold the same equity, have developed as a valuable incentive mechanism, particularly in people-intensive businesses with large global employee footprints. Typically operated alongside the senior management MIP, they can be a powerful cultural tool, helping to foster a broader sense of ownership and alignment by allowing employees to invest personal capital, on an opt-in basis, alongside sponsors and senior management and participate in future value creation.

Their popularity can create administrative complexity, so clear guardrails are needed at inception: minimum subscription levels accessible to an all-employee population; maximum individual and

aggregate subscription caps; defined annual participation windows; clear treatment of invested capital for leavers; and robust mechanics to facilitate a clean exit.

Participation should generally be funded from personal savings. If company loans or bonus offsets are used any additional tax, regulatory and administrative complexity needs to be factored in. Recognizing the potential investment inexperience of participants in these schemes, documentation should clearly explain the investment terms and risks, encourage personal tax advice and undergo legal and regulatory review.

Anticipating Liquidity

The default path to liquidity is no longer a straightforward third-party sale. McKinsey estimates that globally more than 16,000 buyout-backed companies have been held for more than four years, representing 52% of buyout-backed inventory.[3]

An incentive calibrated around a shorter horizon may therefore need to remain meaningful for several years longer, and sponsor liquidity, management liquidity and the original timetable cannot be assumed to coincide.

MIPs should contemplate partial sales, minority or co-control deals, fund-to-fund transfers and continuation vehicles alongside a conventional full exit; ambiguity on treatment risks debate, negotiation and mismatched expectations between management and the sponsor during the hold or pre-transaction.

Sponsors and advisers should therefore scenario-test potential paths to exit and liquidity when designing the MIP, and clearly address them in documentation, including matters such as whether minority or co-control deals accelerate vesting or provide liquidity and whether drag/tag mechanics apply in continuation scenarios.

Linking management participation/liquidity to fund-level liquidity or carried interest distributions is becoming an increasingly established approach in continuation transfers.

In continuation or minority liquidity scenarios where management are required to roll over rather than realize value, providing additional upside through a refreshed ratchet, adjusted vesting or additional incentive may be appropriate, subject to tax structuring.

During longer holds, management may have delivered significant enterprise value without an opportunity to realize it, while new recruits may be asked to invest against an uncertain liquidity horizon.

One response is to offer selected executives limited liquidity after a defined period, potentially coupled with partial reinvestment obligation to preserve alignment. Once largely reserved for funds with known lengthy hold periods, these arrangements which provide management with an opportunity to realize some value without a full exit are becoming more mainstream and are generally documented by side letter with key management.

Such rights must remain subject to the company's financial position to avoid creating a guaranteed return or unfunded obligation. Flexibility need not always be specifically written into the MIP.

Sponsors may instead respond at appropriate points with confidential offers of partial synthetic liquidity, retention or exit-related bonuses, or targeted top-up as additional incentives for key value drivers.

Tax treatment is important: Cash bonuses and other employment-related awards will generally attract income tax and social security liabilities, meaning a higher gross award may need to be considered, and the aim on any reinvestment should be to defer taxes until a sale of the new incentive equity.

Integrating Buy-and-Build Strategies

Buy-and-build remains central to private equity value creation: In the UK, bolt-ons represented 61.8% of mid-market private equity deals in the first half of 2026, up from 56.1% a year earlier.[4]

Buy-and-build can transform scale and value, but its prevalence makes acquisition strategy a core MIP design consideration: Acquisitions can reshape the management team, alter duties of the original members and dilute existing holdings. If acquisitions are contemplated from day one, the MIP should reflect that at the outset.

Key design questions include:

- How much MIP pool capacity is reserved for managers joining through future acquisitions;
- Whether the existing pool receives antidilution protection for issuances to acquired team members; and
- Treatment of inherited plans.

The approach to dilution will differ depending on whether acquisitions are core strategy from day one, in which case antidilution to an agreed threshold may be negotiated; where M&A is merely opportunistic, meaningful antidilution protection is harder to achieve.

In holding company structures, leaving existing equity or other incentive arrangements for employees of an acquired business at operating company level is often more practical, with only selected key personnel joining the top company MIP.

Diligence should establish the acquisition's impact on those arrangements, including tax, and whether a future exit can be cleanly delivered with the same economics envisaged at the inception of the historic MIP. Moving participants or replacing incentives requires care because tax consequences can materially affect participant value.

Where incentives sit at different levels, cultural work to reinforce one team with shared success can matter as much as legal integration; phantom or other incentives can help bridge those levels.

Economics are only part of the picture. Repeated acquisitions can strain culture and increase demands on the original management team.

Time spent sourcing, executing and integrating acquisitions may detract from running the underlying business and affect the performance against which MIP economics are measured. Sponsors can support alignment by providing practical deal execution and integration support, such as access to dedicated

personnel in mergers and acquisitions.

A ratchet, which increases the value the MIP shares where agreed acquisition-driven performance thresholds are met, can reinforce alignment. In certain European jurisdictions, tax efficiency for tiered growth through future acquisitions can be difficult to achieve, as such early structuring is critical for success.

When Circumstances Change

However well designed, a MIP cannot cater for every scenario, so sponsors should monitor its economic health throughout the life cycle of the investment. A longer hold, changed business plan, acquisitions, financing changes or a different liquidity route can affect the economics expected at entry.

If the MIP is under water or materially depleted, or changed circumstances mean it is no longer operating as intended, a considered adjustment or reset can preserve alignment, reduce the risk of key managers leaving and keep the team focused on future value creation.

Depending on circumstances, mechanics can include:

- Amending the existing MIP;
- Issuing new sweet equity;
- Waiving or amending shareholder debt;
- Transferring sponsor-held loan notes to management; and/or
- Retention or performance-linked bonuses.

Careful tax analysis is needed to avoid unintended adverse consequences; changes to equity rights can trigger "dry" tax charges (i.e., tax liabilities that arise before participants receive the proceeds on which tax is assessed) before a full exit. The objective should be to identify early when the original structure is no longer delivering the intended incentive and curating a structured response capable of restoring alignment.

Practical Takeaways

Management incentives should be treated as part of the ongoing investment strategy. No MIP can predict every exit or eventuality. The priority is to build sufficient flexibility at inception to attract, retain and align key management talent as the business and ownership strategy evolve.

That requires scenario-testing the MIP against longer holds, partial disposals, continuation transactions, acquisitions and material changes to the management team, ensuring the documents cater for those scenarios. Cross-border participation and future recruitment should also be considered early.

Good design should be coupled with proportionate monitoring as the business plan, management population and likely exit path evolve. This does not mean continually reopening the MIP but identifying when changed circumstances weaken its effectiveness and responding appropriately through targeted liquidity, a top-up or, where necessary, a reset.

Conclusion

As investment periods lengthen and liquidity becomes less predictable, the strongest MIPs will combine

certainty for management with sufficient flexibility for sponsors to preserve alignment throughout the investment.

Gemma Roberts is a partner and the leader of the European private equity practice at Morgan Lewis & Bockius LLP.

Andrew Callaghan is a partner at the firm.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] McKinsey & Company, The second look: An adaptive approach to reunderwriting, 21 July 2026, <https://www.mckinsey.com/industries/private-capital/our-insights/the-second-look-an-adaptive-approach-to-reunderwriting>.

[2] KPMG, UK Private Equity Snapshot – H1 2026, <https://kpmg.com/uk/en/insights/advisory/kpmg-uk-private-equity-snapshot.html>.

[3] McKinsey & Company, Private equity: Clearer view, tougher terrain, Global Private Markets Report 2026, <https://www.mckinsey.com/industries/private-capital/our-insights/global-private-markets-report/private-equity>.