

The Risk of Strategy Drift: Why Maintaining Discipline Matters in Private Credit

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McDonald's used to proudly track its "burger count" on the signs outside every restaurant, although they eventually stopped updating the number once it hit 99 billion.¹ As Jerry Seinfeld once quipped in an act, "Look, we all get it – you've sold a lot of hamburgers, whatever the hell the number is. Just put up a sign: McDonald's. We're doing very well." So why would the dominant player in the hamburger market decide it needed to start selling . . . pizza?

In the mid-1980s, McDonald's introduced the McPizza in an attempt to capture dinner-time market share from Domino's and Pizza Hut. However, the experiment was short-lived. The pizza took too long to cook, the large pizza box didn't fit through the drive-thru window . . . and it was off-brand. Ultimately, the strategy drifted too far from McDonald's operating model and core competencies – speed, consistency, and drive-thru efficiency.²

Strategy drift often arises as organizations seek new avenues for growth. That same pattern can appear in private credit, where this dynamic is commonly triggered by the need to quickly deploy large amounts of newly raised capital. In addition to the desire for rapid deployment, factors such as heightened competition, muted deal flow, or the pursuit of enhanced economics can push managers into areas beyond their original investment mandate.

In practice, strategy drift in private credit frequently emerges in the following ways:

- **Market Segment Drift.** One efficient way for lenders to deploy additional capital is simply to pursue larger deals. Conversely, when large transactions become scarcer, bigger players may temporarily act as "tourists" in the smaller end of the market. However, these market segments often differ substantially – in their documentation, deal structure, access to diligence, secondary market liquidity, economic terms, and market participants. Assuming that familiarity in one segment will automatically translate to another is risky – for example, just because someone has successfully run a local coffee shop, it doesn't mean they are qualified to be the CEO of Starbucks.
- **Industry Drift.** Lenders may opt to aggressively expand into new industries – ones they have historically avoided or where they lack sector-specific expertise. A notable example occurred when a bank relocated its headquarters from a mature industrial market to a high-growth energy region, aiming to diversify and expand its presence to the "Oil Patch."

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By early 2016, after oil prices collapsed, a material portion of the bank's energy loans were marked as "criticized," meaning they were at higher risk of default. This left the bank uniquely vulnerable to the downturn in the energy sector. More recently, lenders have moved into evolving niche sectors like Data Centers and Sports Lending, which can pose similar risks for those lacking sector-specific expertise or appropriate underwriting standards.

- **Origination Drift.** Lenders without established private equity relationships may try to expand their origination efforts by entering the sponsor-backed segment of the market. However, in our opinion, most sponsors already maintain long-standing relationships with a select group of lenders. As a result, new entrants may often face adverse selection (being offered only weaker credit opportunities that existing relationship lenders have already declined) or encounter limited control in the transaction (due to receiving a small allocation that results in minimal influence). On the flip side, lenders focused on financing private equity-backed businesses may seek to broaden their market reach by financing "non-sponsored" transactions or by working with private equity firms that do not have a dedicated fund. While this shift in strategy may seem benign on the surface, it can lead to complications during a restructuring, particularly when additional capital is required to support the business and there is no committed sponsor to step in.
- **Structural Drift.** To secure mandates in an elevated competitive environment, lenders may offer more creative financing solutions, such as ARR-based loans, PIK-toggle features, or covenant-lite terms. While providing such structures can deliver "wins" in the short term, doing so often dilutes lender protections and masks underlying credit risks until problems become acute. As Warren Buffett once noted, "You only find out who is swimming naked when the tide goes out."

Each of these forms of strategy drift can quietly introduce new and sometimes hidden risks into a lender's portfolio – a dynamic that's become especially relevant amid today's shifting market landscape.

With growing uncertainty in the software sector driven by AI-related fears, lenders will likely encounter a dearth of activity in what has historically been a key market. For some, software has accounted for as much as 20% of total deal volume in recent years³ – by comparison, NXT Capital is closer to 7%.⁴ As this void emerges, the temptation for strategy drift may increase, making it even more important to understand each lender's underlying investment approach and the consistency of its application over time. Ultimately, actively monitoring adherence to investment mandates, ensuring strong governance, and maintaining a clear sense of organizational core competencies can help guard against unintentional drift.

Since its inception in 2010, NXT Capital has maintained a disciplined investment strategy – providing senior secured financing to lower middle market businesses backed by established private equity firms with dedicated funds. Importantly, these borrowers operate in stable industries where NXT Capital has deep historical experience. Moreover, NXT Capital requires a financial covenant in every deal, avoids PIK features in new issuances, and does not offer ARR-based loans. By adhering to these principles, NXT Capital seeks to maintain a consistent risk profile rooted in disciplined underwriting. Bottom line: when the market shifts, our principles don't.

¹ John Weeks, "McDonald's Stopped Officially Announcing Burgers Sold in 1993," *The San Bernardino Sun*, May 3, 2011, <https://www.sbsun.com/2011/05/03/mcdonalds-stopped-officially-announcing-burgers-sold-in-1993/>.

² Lucas Reilly, "The Short, Strange Life of McDonald's Pizza," *Mental Floss*, June 26, 2015, <https://www.mentalfloss.com/food/pizza/short-strange-life-mcdonalds-pizza>.

³ Matt Wirz, "AI Fears Sink Shares of Private-Credit Fund Managers," *Wall Street Journal*, February 3, 2026, <https://www.wsj.com/livecoverage/stock-market-today-dow-sp-500-nasdaq-02-03-2026/card/ai-fears-sink-shares-of-private-credit-fund-managers-M0z50h17IAxP3zqXimxv>.

⁴ NXT Capital's Portfolio as of March 20, 2026.

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