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Exploring Post-Exit Dynamics for Search Fund Entrepreneurs

The journey continues with a novel set of capital partners, and search fund entrepreneurs must understand this new relationship

Keith Burns[1]
A. J. Wasserstein[2]

The traditional search fund odyssey begins with aspiring entrepreneurs courting investors to fund their two-year search period and provide additional acquisition equity when a deal is sourced and passes the diligence examination. Search fund entrepreneurs might get to know their investors over one to two years while they are in MBA programs through endless coffee chat interactions, conferences, and a parade of investor visits to classes. It is a well-orchestrated dance that allows both parties, but especially the talent (the entrepreneurs), to truly get to know their soon-to-be partners.

After the entrepreneur selects investors, it is heads down for two years of searching and an average operating holding period of five to six years. According to the 2024 Stanford Graduate School of Business Search Fund Study, between 2018 and 2021, 58 companies exited with a mean holding period of 5.9 years, and in 2022 and 2023, 28 companies exited with an average operating duration of 4.8 years.[3]

Search fund entrepreneurs often dream of the day they sell their business. They regularly envision newfound riches, hard-earned free time, and investors celebrating their achievement and offering hearty congratulations. The exit represents the culmination of years of hard work and a final sprint through an investment-bank-led auction process. It is perceived as the crowning achievement and pinnacle of the entrepreneurship through acquisition (ETA) journey. There is only one problem with exit day in ETA land – the CEO rarely actually gets to exit.

At first glance, entrepreneurs might interpret the Stanford data cited above to mean that the entire search fund trek is approximately two years of searching and about five to six years of operating, for a total seven-to-eight-year commitment. This would be an inaccurate conclusion, not due to faulty data on Stanford's part, but because of a not entirely true understanding of what the holding period means and what the exit really is about. The five-to-six-year holding period is indeed true, but it is for *investors* and not necessarily *entrepreneurs*. This is because entrepreneurs often are required to roll equity into a fresh deal with new equity partners. Furthermore, entrepreneurs frequently must continue in their CEO role, leading the company for several more years.

This dynamic is interesting and demands attention. When entrepreneurs begin their ETA adventure, they probably do not contemplate the exit and what it means for them individually; instead, they are fixated on sourcing a company, closing a deal, and generating a sufficient internal rate of return (IRR) to win all of their potential equity. While we do not want to minimize this priority, we believe entrepreneurs need to understand what the exit actually means for them because it might not be exactly what they imagine. Of course, some entrepreneurs exit the business with their search fund investors and walk away from the company, which is fully liquid, with cash in hand. However, we suspect that most entrepreneurs do not leave the business physically or financially after the first exit (the one where the search fund investors depart). This is because many search fund deals are sold to financial firms like private equity funds or family offices. This is a very different dynamic than working with search fund investors, and entrepreneurs should not only think about this fact but also understand what it is like to operate with these new capital partners who are more institutional in nature.

To help entrepreneurs understand this new arrangement, we built a data set by surveying 151 traditional search fund CEOs who have exited. Of the 151 CEOs we queried, we received valid anonymous responses from 57. According to the 2024 Stanford Graduate School of Business Search Fund Study, 160 of all search fund companies have exited.[4] Our data set captures 35% of those exits. Of course, our data set is not perfect. There might be reporting biases, and we sourced the CEOs who exited from investors, so we might have concentrated exposure to some investors whom we contacted and who helped facilitate the building of the data set. Regardless, the data set we built tells a very interesting and not necessarily inspiring story, which we are eager to share with prospective and sitting entrepreneurs.

In this note, we will explore a handful of topics related to ETA CEO exits, which are detailed in **Figure 1**.

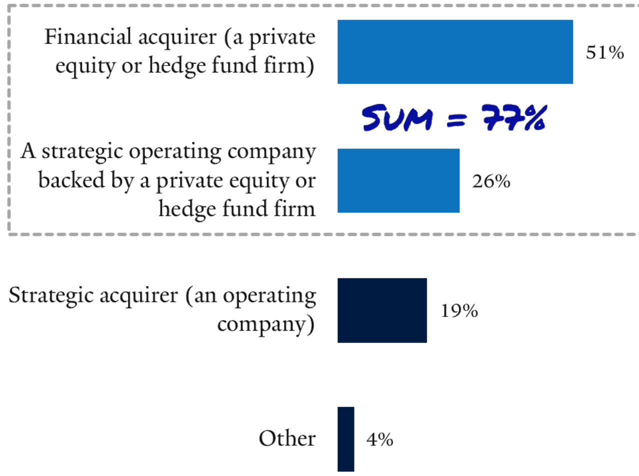
Figure 1: A pentad of topics we will explore in this note

- **01 The exit that wasn't**
- **02 How CEOs feel about working with new capital partners**
- **03 Why ETA CEOs do not like their new investor groups**
- **04 It's not all bad news**
- **05 How to avoid the new equity partner trap**

The exit that wasn't

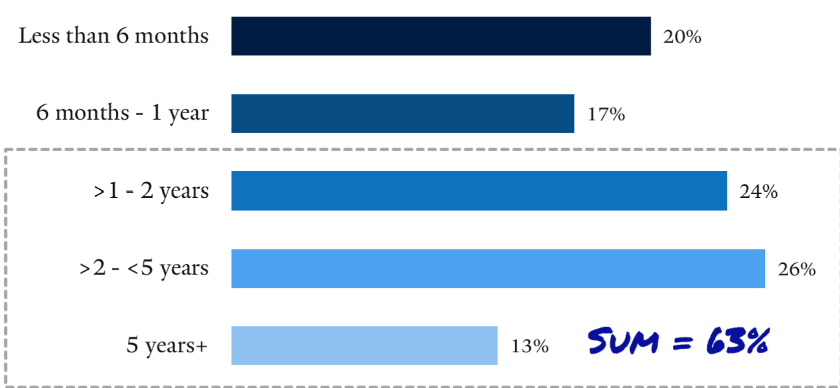
We think the exit is one of ETA's dirty secrets that is glossed over in classrooms and conferences. This is one of several junctures where there is a divergence of interests between capital (search investors) and talent (entrepreneurs). Entrepreneurs need to approach this moment with eyes wide open and a full understanding of what is happening. The vast majority of exits in our data set were to financial buyers – think private equity (PE) firms – or operating companies backed by PE firms. In **Figure 2,** we see that 51% of exits were explicitly to a PE acquirer, with an additional 26% to an operating company backed by a PE, a backdoor way of landing in a PE lap. This means that 77% of our exits were to PE or PE-linked entities. Only 19% of our respondents were purchased by strategic buyers, and 4% were other buyers. ETA exits are unequivocally about financial buyers and PE.

Figure 2: Distribution of ETA acquirers



Now that we have unambiguously established who buys search fund companies, we want to highlight what these transactions look like for CEOs. Specifically, we want to illuminate the results in **Figure 3**, which indicates the time frame in which ETA CEOs remain with the new equity sponsor group. In our data set, 80% of CEOs remained with the acquiring company for at least six months, with 63% staying more than one year. The most common window was more than two years but less than five years. The average and median time frame with the new capital partners was two years. As a point of comparison, the average and median ownership period for the new equity was four years. We acknowledge that some CEOs likely chose to remain with their new equity partners, but some likely did not and were compelled or coerced into extending their CEO tenure. In 2024, search fund investor Endurance Search Partners shared research which indicated that 67% of search CEOs stay full time with the company after the search investors exit; this corroborates our data.

Figure 3: Time frame in which ETA CEOs remain with the new sponsor group

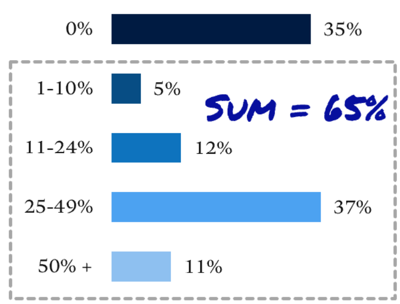


In **Figure 4**, we provide details of the rolled equity distribution. Rolled equity is when a seller, in this case, the CEO, does not monetize their whole equity position and instead rolls a portion of their current ownership into the newly configured deal. A complete 65% of CEOs rolled some equity into the new transaction, with most falling in the 25% to 49% range. The average and median roll was 20% (including the zeros for those that did not roll), but for those CEOs exiting to financial buyers, the median roll was

30%. When selling to an operating company backed by a PE, the median equity roll fell to just 5%. One CEO reported rolling 90%, and 35% of all CEOs did not roll any equity. If we exclude observations for those CEOs who did not roll anything, the average roll for CEOs who did roll was 31% and the median was 30%. This data implies that two-thirds of CEOs will not get all of their money out at the exit and will roll equity by choice, obligation, or arm-twisting. In 2018, the law firm Goodwin published a study examining rollover and incentive equity terms in middle-market private equity.[5] In the document, Goodwin reports that 81% of all buyout transactions examined involve some rollover equity by existing owners with an average minimum rollover of 20%. These results loosely align with the numbers we present. The Endurance Search Partners information is also congruent. In that report, 56% of CEOs rolled equity, with an average equity roll of 33% for those that did roll.

Although we did not explore whether rolled equity comes in pari passu to the fresh money, CEOs should understand this concept. If the rolled equity is junior or inferior to the new equity capital, this is obviously a very bad fact for the rolling CEO. Furthermore, CEOs should understand how and when they can extract their capital if they depart (under both good and bad leaver scenarios) before the second exit. Their equity position could be subject to a call at a low valuation or illiquid for the foreseeable future. Rolled equity also might not enjoy the same tag-along and drag-along rights as the sponsor's position. Finally, rolling CEOs are in the unique position of being both seller and buyer at the time of the first exit. They are selling part of their position and buying in with the rolled piece. This might mean that the roll is coming in at a high valuation – which is part of what prompted the search investors to exit. These factors should go into the CEO's calculus when evaluating what the financial exit was really worth. Rollers, caveat emptor.

Figure 4: Distribution of equity roll for exiting ETA CEOs



With 63% of CEOs staying with their new capital partners for more than one year and 65% rolling some equity, we have to question whether the exit is a mirage for CEOs and can be characterized as an exit that wasn't. To be clear, it is hard to call a transaction an exit for the CEO when the CEO must continue to provide labor and does not get all of their money out of the business. While investors applaud the CEO for excellent leadership and returns, they drift away with cash in hand, and the CEO remains at the company with most of their winnings out, but not all. A material chunk continues to be locked up in illiquid equity. Imagine when the deal closes: there are congratulatory phone calls and obligatory thank-yous from the investors, but the next day, the CEO wakes up early, returns to the office, and continues to fight the battle with new equity partners who start the IRR meter afresh.

Is this really an exit for the CEO? Maybe it is a partial one, but it certainly does not feel like the exit we expect most CEOs to fantasize about. We are not implying that buyers are acting unscrupulously by either requiring or coaxing CEOs into another leadership stint or rolling equity. That makes perfect sense; a leadership bridge reduces risk, and an equity roll signals belief in the deal. However, there is a clear fork in the road between the path taken by search investors and that followed by entrepreneurs at the exit. Entrepreneurs should understand what the exit means to them.

How CEOs feel about working with new capital partners

This is the data we were most curious to explore in this project: We wanted to know how CEOs experienced their new equity partners, whether they actively chose to stay with the company or sheepishly agreed to another tour of duty. Were these new post-exit investors better, worse, or the same as the original search fund investors? This is important to examine because the average search investor operating window is five to six years, and the typical time commitment with the new set of investors is two years; the new investors represent 25% to 30% of the entire operating runway, a material chunk of the expedition. While we think it is interesting to contemplate how the new investors perform financially, that is outside the scope of this note, and we want to zoom in on what the CEO experience is. After all, at some level, it does not matter what the returns are if the CEO is utterly miserable.

We will now discuss a septet of topics (**Figure 5**) related to how ETA CEOs feel and experience their new equity investors. We approach this theme from multiple vectors in an attempt to paint a complete picture without bias. The resulting mosaic is informative and worthwhile for any potential search fund entrepreneur to ponder and internalize. When we think of the new post-exit investors, we often think of a firm, but the firm is comprised of individuals. These personal interactions likely drive CEO perceptions of their new partners. A majority of CEOs (55%) report interacting with senior professionals, while 25% indicate collaborating with a mix of professional levels, and 21% interacted with mid-level professionals.

Figure 5: Seven topics we will discuss related to how ETA CEOs feel about second-round investors

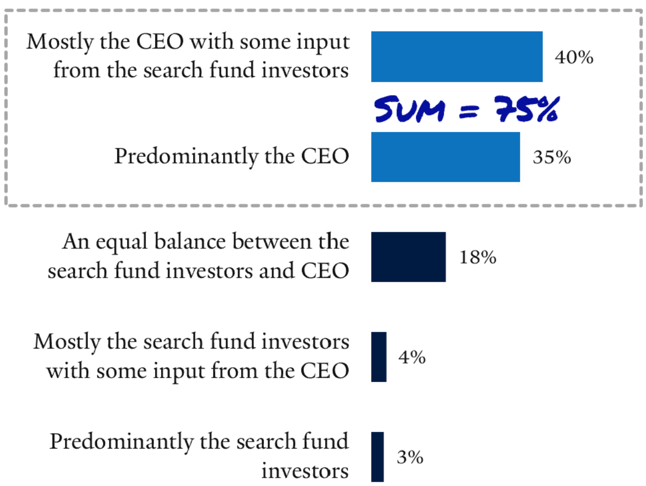
- **01** **Establishing who selects the buyer**
- **02** **Initial satisfaction with the new investors**
- **03** **CEOs' perception of investors over time**
- **04** **Unpacking the data by the initial assessment**
- **05** **Comparing perceptions amongst investor groups**
- **06** **Net promoter score**
- **07** **Qualitative dimensions**

01 *Establishing who selects the buyer*

Before we jump into the results of how CEOs perceive new investors, we want to establish who drove the buyer selection process. The data depicted in **Figure 6** clearly tells that story – CEOs pick their new equity partners. In 75% of the cases, CEOs predominantly or mostly drove the buyer selection process. In only 8% of situations, the search fund investors predominantly or mostly engineered the exit partner pick. The CEOs have their fingerprints all over the next equity partner choice. They own their decision and its implications.

This surprised us. We expected the search fund investors to be much more influential in the buyer selection process and to be primarily driven by the highest valuation. Maybe the CEO selected the winning bid based on the biggest number, too, but in our data set, CEOs claim to be the leading force behind the next equity partner selection. We will next explore how that worked out for them.

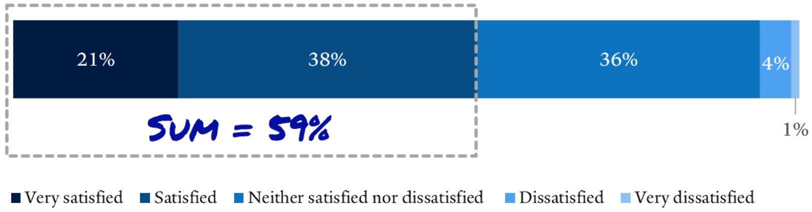
Figure 6: Examining who selects the buyer in an ETA exit



02 *Initial satisfaction with the new investors*

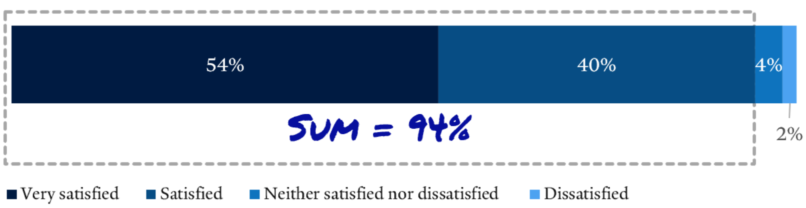
Since the search fund CEOs typically nominated or were deeply involved in the selection of the new equity investors, it should not surprise us that they were initially fairly satisfied with those fresh capital partners. Of course, our results might reflect the CEO's selection bias (I picked them, so now I like them). As depicted in **Figure 7**, a robust 59% of CEOs were either satisfied or very satisfied with the next round's equity ownership in the beginning. More specifically, 82% of the CEOs who drove the buyer selection process (predominantly or mostly) ranked the new partners with some degree of satisfaction. Not all CEOs were initially happy; 36% were neither satisfied nor dissatisfied, and a scant 5% were dissatisfied or very dissatisfied. These results reflect the dating phase of the relationship with the new equity courting the CEO. Usually, in a sale process, everybody is on their best behavior and in sales mode. Effusive compliments are the norm in order to win the deal. So, it makes sense that initial satisfaction scores are generally positive.

Figure 7: CEOs' initial perception of their second-round equity partners



Fortunately, we have a comparison point in how the search CEOs evaluated their first-round investors (the search fund capital providers). It is interesting to contrast those rankings with the new (second-round) investors. In **Figure 8,** we highlight how the CEOs initially felt about the search investors. A vigorous 94% of CEOs were initially satisfied or very satisfied with the search investors. This presents a resounding endorsement for search fund investors, at least initially. Once again, the search investors were selected by the CEOs often over an extended get-to-know-you window, so logically, the CEOs liked them at the inception. Additionally, the size of the funds raised during the upfront search phase were identical (typically $550,000)[6] regardless of the search investors. This drives a deeper focus on who the investors are (as compared to garnering the most dollars in an exit auction where financial factors can override non-financial dimensions like fit).

Figure 8: CEOs' initial perception of their search-round equity partners



While initial satisfaction levels are worthy of note, what interests us more is how the relationship fared over time – after the honeymoon. We will now examine those results.

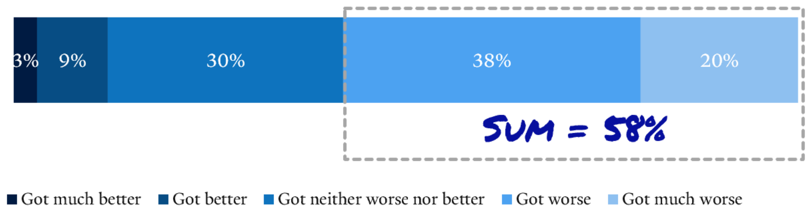
03 *CEOs' perception of investors over time*

When new investors pitch for a deal in an auction process, everybody is on their best behavior; it is like dating. Once the deal is consummated, it is time for marriage, and the new investors reveal their actual selves outside of sales mode. In this dimension, search CEOs' affinity for their new investors over time fell precipitously. In **Figure 9**, we see that 58% of CEOs evaluated their relationship with the new equity partners as getting worse or much worse. In comparison, 30% noted no change in the relationship dynamics, and just 13% rated the relationship as getting better or much better. These results indicate that after the initial bloom with the new investor group, things tarnished significantly. Furthermore, not a single CEO who remained with the new investors for more than one year but less than five years reported their relationship satisfaction levels increasing. As CEOs got to know their new partners, things declined.

We will highlight one exception here. CEOs' satisfaction with new equity investors increases based on the amount of equity rolled (with more equity rolled, satisfaction goes up). When the equity roll was greater than 25% and less than 50%, satisfaction was at 75%. Similarly, when the equity roll was more than 50%, satisfaction was 83%. This is in contrast to no equity roll having 45% satisfaction rates. Perhaps this reflects an attitude of being all in and needing to make the relationship work.

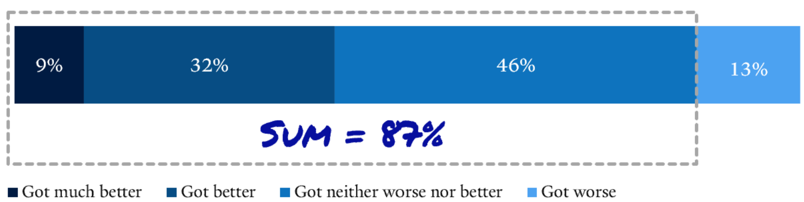
Our data proves that money cannot buy happiness (or satisfaction). There is no observable increase in satisfaction with more equity points granted, or cash compensation increases.

Figure 9: CEOs' perception of second-round investors over time



Once again, we have a comparison point for the search fund investors. Over time, 87% of CEOs assessed their relationship with the search investors as getting better, much better, or staying the same, while only 13% evaluated it as getting worse (**Figure 10**). Recall that in **Figure 8** above, 94% of CEOs ranked their initial satisfaction with their search investors as satisfied or very satisfied. So, the fact that 41% of CEOs reported that the relationship improved is noteworthy, and the fact that 46% indicated no change is not pejorative since the original assessment was already favorable.

Figure 10: CEOs' perception of search-round investors over time

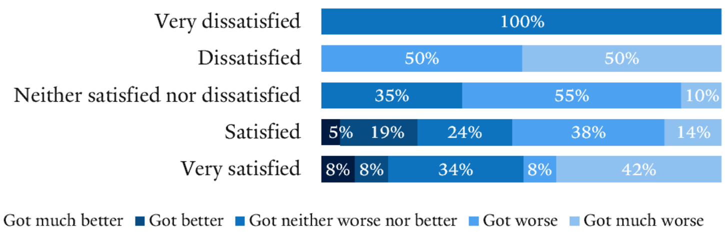


Figures 9 and **10** directionally tell us that ETA CEOs' perception of second-round investors got much worse over time, while their slant on search investors got better or remained constant over time. Despite CEOs selecting the next-round equity partners and initially thinking of them favorably, those feelings do not persist.

04 *Unpacking the data by the initial assessment*

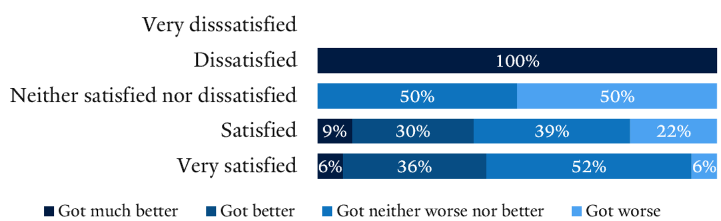
We next broke down the data to discover how CEOs' perceptions of investors changed over time based on their initial evaluation. For example, if a CEO was at first negative, did they swing to positive over time? We will first take a look at how new investors were scored in **Figure 11**. For CEOs who were initially very dissatisfied with their new investors, there was no change whatsoever – it did not get worse or better. For those who were dissatisfied at the get-go, it got worse or much worse for every respondent. CEOs who were initially on the fence with neither satisfied nor dissatisfied postures experienced a 65% regression rate. Initially satisfied CEOs thought the relationship got worse or much worse 50% of the time, as did those CEOs who were initially very satisfied.

Figure 11: CEOs' perception of new investors over time unpacked by their initial assessment



We performed the identical analysis for the original search fund investors, too, in **Figure 12**. For CEOs who were initially dissatisfied, the relationship got much better 100% of the time. For those who were initially neither satisfied nor dissatisfied, it remained the same 50% of the time and got worse 50% of the time. Those initially satisfied saw satisfaction increase 39% of the time and get worse 22% of the time. Finally, very satisfied CEOs at the beginning saw improvement 42% of the time and degradation 6% of the time.

Figure 12: CEOs' perception of search investors over time broken down by their initial assessment



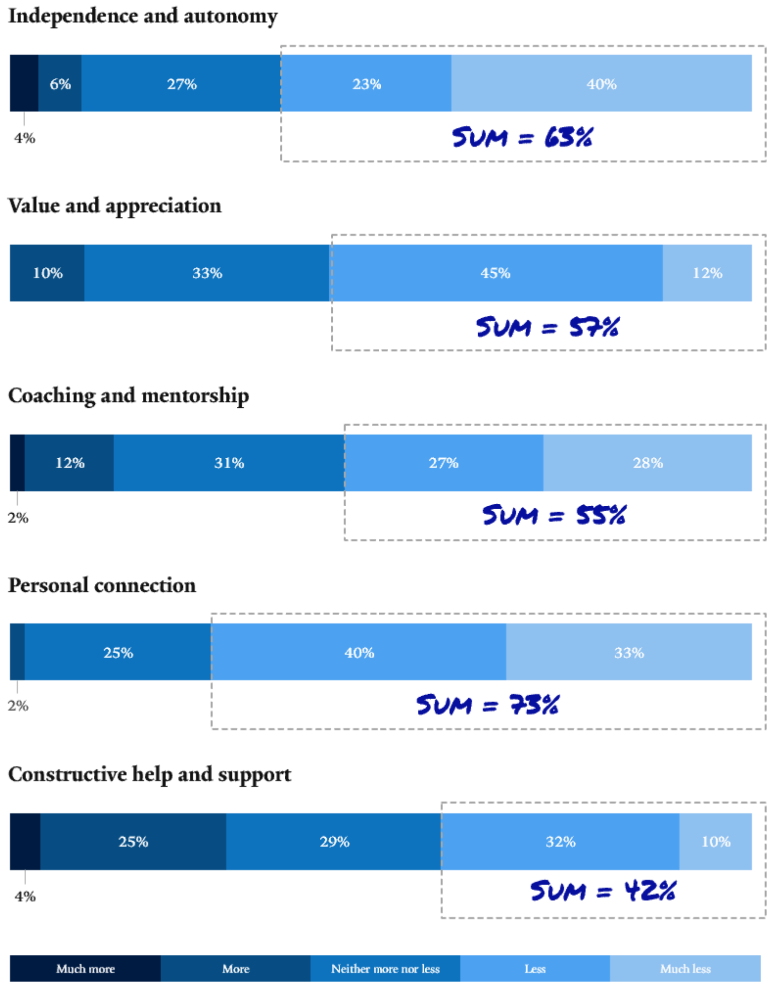
Figures 11 and **12** suggest that ETA CEOs' perception of second-round investors got much worse over time, regardless of their opening appraisal. This is in contrast to search investors, where the CEOs' evaluation over time improved or remained the same, irrespective of their primary position.

05 *Comparing perceptions amongst investor groups*

We asked our survey participants a handful of questions to further gauge how they felt about their relationship with their new post-exit investors. The questions and results are reflected in **Figure 13**, and the data are not encouraging for entrepreneurs or the next set of investors. The CEOs unequivocally faced strained relationships with their new partners. The questions were set up as a comparison point to the original investors. For example, "As it relates to your original search fund investors, do you feel that the new equity investors provided significantly more, more, neither more nor less, less, or significantly less fill in the blank."

For independence and autonomy, 63% of CEOs indicated they had less or significantly less; only 10% experienced more or significantly more. A full 58% of CEOs felt less or significantly less valued and appreciated, while 10% experienced more value and appreciation. On the coaching and mentorship question, 56% of respondents leaned toward less or significantly less, and 14% tilted toward more or significantly more. The question on personal connection provided the starkest insight. A full 73% of CEOs had less or significantly less personal connection, and 2% had a greater personal connection. Finally, a bit of relative positivity: 43% of CEOs had less or much less constructive help and support, but 29% reported more or much more.

Figure 13: How ETA CEOs feel about second-round investors on several dimensions relative to search-round equity providers



CEOs report feeling an increasing loss of independence and autonomy over time. Dissatisfaction grows from 43% for CEOs who remain with the new equity partner for under six months to 78% for those CEOs who stay in place more than two but less than five years. Dissatisfaction drops to 29% on this dimension for those CEOs who stay for more than five years. This hints at the notion that the longer a CEO stays with the new equity partner, the less independence and autonomy is felt.

Entrepreneurs who spend less than six months with new investors report neutral feelings about feeling valued and appreciated, likely due to insufficient time for the relationship to evolve. However, those staying between six months and five years report progressively negative experiences regarding feeling valued and appreciated. After the five-year mark, this trend reverses, likely due to relationship maturity, leading to a more balanced and positive perception.

CEOs who remain with new investors for less than five years generally experience a declining sense of personal connection compared to their original investors, with negative sentiment intensifying over time. An exception is those with tenures of less than six months, who lean towards neutrality—likely due to the limited time available to build meaningful connections. In contrast, entrepreneurs who stay for five years or longer are the only group to report any stronger personal connections (14%), indicating that trust and relationship maturity typically develop after an extended period.

Post-exit ETA CEOs appear to have disappointing and strained relationships with their new capital partners. They directionally perceive their relationships as disintegrating over time and on multiple data points, and they feel less connection, satisfaction, appreciation, and autonomy than with the original search fund investors. This is not a pretty picture. Keep in mind, despite the state of disrepair, CEOs mostly select or play a prominent role in determining their new partners. This leads us to believe that new capital providers might have a bait-and-switch approach to winning deals, CEOs are not very good at picking buyers of their companies, or search fund investors are superior equity partners than most second-round investors. Alternatively, CEOs might very well know what they are getting into and overly discount the bad aspects in the heat of the pending deal. Furthermore, CEOs might falsely believe that are the exception and will have a positive experience with the new equity partners – which might be accurate.

Perhaps the CEOs had unrealistically high expectations that were not met. Maybe search CEOs imagine an institutional PE firm that buys their company is a step up in sophistication and skills. This might be true for the most senior professionals at a firm, but is often invalid for junior professionals who are pre-MBA or greenhorn post-MBA associates or vice presidents. Alternatively, CEOs might harbor negative feelings because of their (the company's) performance. With search fund investors, CEOs reported performing below plan only 11% of the time as compared to 33% of the time with subsequent capital partners.

To be fair, our analysis in this note is unidirectional – we are examining how entrepreneurs feel about their new equity investors. We are not exploring how these new equity partners feel about ETA CEOs. The perceptions very well might be mutual, with the novel money feeling equally dismayed by the search fund CEOs. So, we are not implying that ETA CEOs are perfect or easy to work with and that second-round equity is the sole problem. Although that might be true, we do not know, and the alternative could be true, too – the new owners might not be happy with the legacy leadership. Disappointment on either side might reflect an absence of realistic expectations about decision rights and roles pre-closing.

06 *Net promoter score*

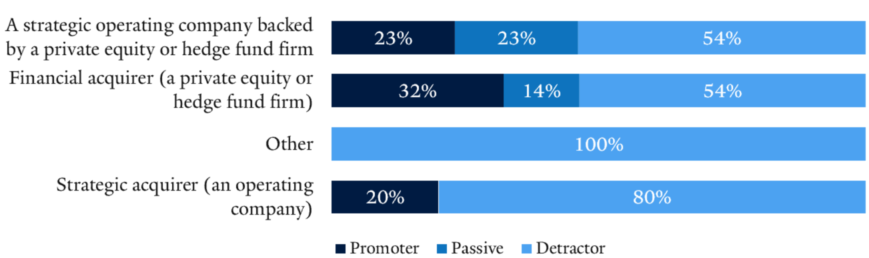
In an attempt to capture the general tone of the new equity investors, we asked survey participants a classic net promotor score (NPS) question, "Would you recommend your new investor to a friend or colleague?" **Figure 14** displays the results of that question, and once again, we see that ETA CEOs are not fond of their new investor groups.

Figure 14: ETA CEOs' net promoter scores for new investor groups

Detractors, those who would not recommend their new investors to friends or colleagues, make up the largest bucket at 60%; those who are passive, or on the fence, capture 13% of the group; and promoters, who are new-investor enthusiasts, are 27% of the population. This translates into an NPS score of *negative* 33 (promoters minus detractors). The lowest possible NPS score is negative 100 (everybody is a detractor) and the highest possible score is positive 100 (everybody is a promoter). Let's just say there is an opportunity for improvement here.

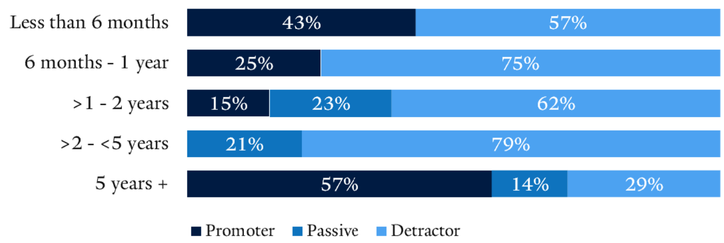
We can decompose the NPS scores further by the type of buyer and the amount of time the CEO remained with the new equity investors. We provide this data in **Figures 15** and **16** below. CEOs are more likely to be detractors (80%) when acquired by a pure strategic buyer. In contrast, they are detractors only 54% of the time when bought by a financial acquirer or a strategic company backed by a PE firm. Financial acquirers have the most promoters at 32%.

Figure 15: Net promoter score by buyer category



It appears that CEOs are more likely to shift from being detractors to being promoters the longer they remain in the CEO role with their new capital partners, but it gets worse before it gets better. CEOs who stay for less than six months are promoters 43% of the time; this drops to 25% when the CEO is in the position for more than six months but less than one year. It deteriorates more after one year, with CEOs taking a promoter stance only 15% of the time when remaining for more than one year but less than two, and there are zero promoters when CEOs are in the more than two and less than five years bucket. There is a rebound for CEOs who stick around for more than five years; they are promoters 57% of the time. Conversely, we could interpret the data to signify that CEOs who liked the subsequent equity partners remain in place the longest.

Figure 16: Net promoter score by CEO tenure



Financial performance strongly influences NPS outcomes. Entrepreneurs performing below or on plan are far more likely to be detractors (67%), with limited promoters (13%). In contrast, those performing above plan are much more likely to be promoters, with nearly half (47%) expressing strong support for their new investors. This suggests that financial success fosters a more positive perception of new equity investors and their contributions.

Additional equity points do not appear to influence NPS outcomes. CEOs who received no new equity points were detractors 70% of the time, while CEOs who received more than five but less than 15 new equity points were detractors 80% of the time. Conversely, cash compensation increases might impact NPS outcomes. When cash compensation increased by one to ten percent, there were no promoters and 78% detractors. A ten to 20 percent increase brought promoters up to 57% and dropped detractors to 43%. Yet, 20 to 30% increases yielded no promoters and 80% detractors. Finally, greater than 30% increases produced 54% promoters and 36% detractors.

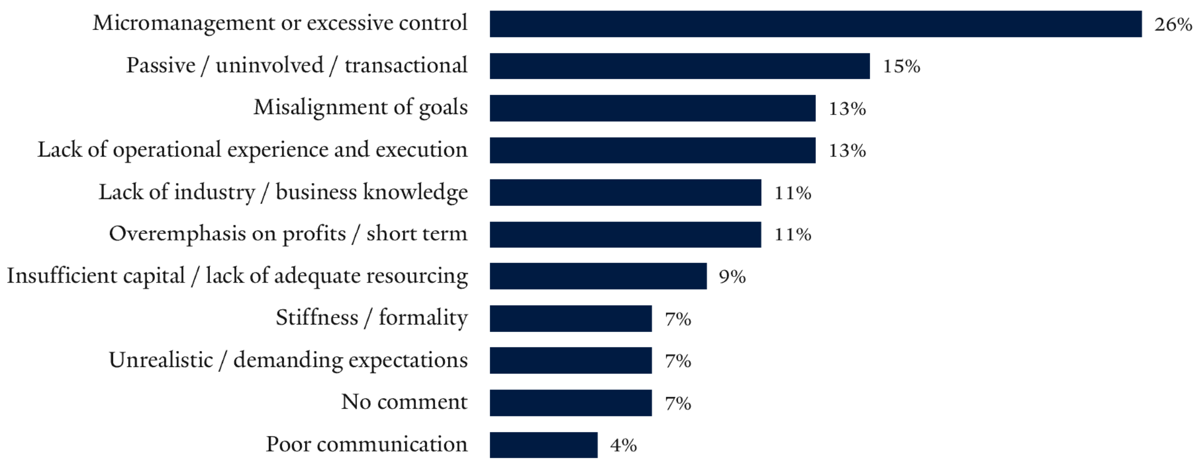
07 *Qualitative dimensions*

Qualitatively, we heard from many CEOs in our data collection in open-ended, free-form responses. This helped fill out the story and give the picture a bit more texture. First, we will share some illustrative quotes from CEOs in **Figure 17**. These quotes help illuminate how CEOs feel beyond the quantitative data above.

Figure 17: Illustrative quotes

Additionally, we categorized the qualitative responses into several buckets to tease out some general themes and highlight sources of disillusionment. We share those in **Figure 18**.

Figure 18: Qualitative categories with mention frequency



Micromanagement was the most popular source of angst – NPS promoters and detractors both saw micromanagement as unappealing, with 9% of promoters and 23% of detractors. Interestingly, the second most-cited reason for carping was the new equity investors being passive and uninvolved, which feels like the opposite of micromanagement. We guess ETA CEOs are looking for a Goldilocks amount of engagement, not too much and not too little.

Why ETA CEOs do not like their new investor groups

We believe that the data we present above unmistakably tells a story of ETA CEOs not enjoying their post-exit relationships with their next equity partners. This leads us to ask the next obvious question: Why is that the case? We have hypotheses, and we have had many conversations with ETA CEOs about this topic. We will distill those ideas and conversations into a handful of critical issues highlighted in **Figure 19**. While we are not asserting that these are the only catalysts for flagging relationships with new equity investors, they are some of the more frequent conversation points we hear from post-exit ETA CEOs. It is unlikely that any single point causes dismay or deterioration. However, when several of these items amplify, we think CEOs begin to check out mentally and turn against their next equity sponsors.

Figure 19: Predominant reasons why ETA CEOs do not like subsequent equity partners

- **01** **An effective demotion to a COO role**
- **02** **A significantly more transactional relationship**
- **03** **A single equity sponsor is in control**
- **04** **Less autonomy and independence**
- **05** **Feeling replaceable**

01 *An effective demotion to a COO role*

When a new equity partner, especially a PE firm, successfully acquires an ETA asset, the legacy CEO's role can subtly shift into a de facto COO role. Since the new equity firm built out the capital stack for the transaction, created the financial model, and has a strategic plan in place to drive the value-creation plan, the CEO tagging along in the acquisition can feel like they took an effective demotion to a COO role reporting to the new equity sponsor. This can be in sharp contrast to the search fund dynamics where the CEO was leading a group of investors and built out and owned the capital structure, financial plan, and strategic plan and spearheaded the incipient acquisition.

When a PE firm purchases an asset, it delivers the capital structure, including the amount of debt. This might immediately create a point of contention if the CEO would have levered less or more. Managing an over-levered company that was not the CEO's design is problematic. Furthermore, the buyer hands the CEO a model designed by the investors and tells them to make it happen, regardless of the assumptions and inputs. Operationalizing the plan is necessary to achieve the new acquirer's IRR targets, but it might not be the CEO's blueprint. This all makes the CEO feel like they are not growing into a more significant and more prominent role; instead, they are regressing into a line operations role with a new taskmaster.

02 *A significantly more transactional relationship*

Search fund investors and ETA entrepreneurs typically match up when the entrepreneur is just out of an MBA program and in their very late 20s or early 30s. These aspiring entrepreneurs are young, inexperienced, and trying to be first-time CEOs. They are green and full-on rookies. Search investors act as coaches and mentors who shepherd entrepreneurs through the search, CEO ascendency, and exit. They often build deep and meaningful relationships.

In contrast, the frequent PE buyers of ETA firms are far more transactional. They might admire the value that the CEO built for the last set of investors, but it did not accrue to their benefit, and the CEO must prove themselves all over again. The CEO might feel like one more leader and company hopping aboard the PE conveyor belt within a large portfolio. This is clearly a show-me-the-IRR game. One CEO described search investors as akin to a high school basketball coach. They ask and care about grades, how things are going at home, and how the boyfriend or girlfriend relationship is going. In contrast, new PE investors were described as Division 1 top ten basketball coaches – less relationship-oriented, more transactional. "Do your job and put points on the board. If you can't, I have someone else who will."

03 *A single equity sponsor is in control*

Search fund cap tables are often characterized by a dozen to twenty investors, each being a minority shareholder. They offer diverse opinions, experiences, and styles that the CEO can draw from as needed and synthesize into a cohesive direction. When a new investor takes over the ETA business, the CEO is now dealing with a single control entity. There is no longer a building of consensus and a merging of varied perspectives. There is one voice in charge. While managing search fund investors can feel like herding cats at times, there is a different tone and dynamic when everybody is a minority equity holder and incentivized to play nice and get along. When there is a single dominant equity owner, it is clear there is a new sheriff in town, and they need to be heeded.

This exacerbates the CEO's feeling of being a glorified employee with an inflated title, as compared to being a genuine CEO. Of course, this is reality, and the ideal situation should not be confused with what it actually is. However, that does not mean the CEO needs to like it despite having to accept it. There is a quick and profound switch in power from the CEO pre-close to the new equity investors post-close.

04 *Less autonomy and independence*

Building on the notion of a single equity sponsor, this results in CEOs feeling significantly less autonomy and independence, as reported in **Figure 13** above. There is a real dichotomy here. We believe most ETA CEOs choose their path precisely for the independence and autonomy they can flex as a young CEO – especially once they prove to the search fund investors that they can create equity value. That is one of the core selling propositions of the ETA model. With new equity sponsors, that autonomy and independence quickly atrophy, especially with increased reporting, micromanagement, and amplified formality structures. ETA CEOs perceive themselves first and foremost as entrepreneurs. They are company builders and value creators. They do not self-identify as professional CEOs who are hired guns. The desire for autonomy and decision rights is one of the most compelling reasons search fund entrepreneurs choose this path in the first place, so this change is the most disheartening for many of them.

This creates a conflict with new owners who *want* hired guns – with less autonomy and independence – who will adhere to marching orders. We do not dismiss what the new owners want or need – it is their business to handle as they choose. However, we understand entirely why ETA CEOs cringe and bristle. This might be a fundamental disconnect that the CEO needs to comprehend and accept, at least for the duration of the arrangement.

05 Feeling replaceable

Institutional investors are well served by having a network and a stable number of potential CEO candidates. After all, that is one of the ingredients necessary for their stew. However, when ETA CEOs feel less independent, like they are in a more transactional relationship, and generally marginalized, they start to feel like they are replaceable. And, of course, they are substitutable; we all are. But when a CEO feels like they are not fully needed after they were previously an integral part of the company's DNA, the resentment and misalignment seeds are planted and start to grow.

This dynamic is exacerbated for ETA CEOs who, in many ways, thought of themselves as being the company and the company being them. They often took the business from a kernel and multiplied it through several growth initiatives before selling it. They lived and breathed the company and thought of it as their baby. Feeling threatened by replaceability frays the relationship and dents the CEO's commitment and confidence in both the new equity partners and the company itself.

It's not all bad news

We apologize for painting a relatively grim picture of post-exit dynamics with new capital partners so far in this note. Although we are just sharing the data results about the negative, there is also some good news to share, too. The bad news appears to outweigh the good in our protagonists' eyes, but there is absolutely some positive mixed into the muck. We will now examine the upside of leaving search investors for new equity partners (**Figure 20**).

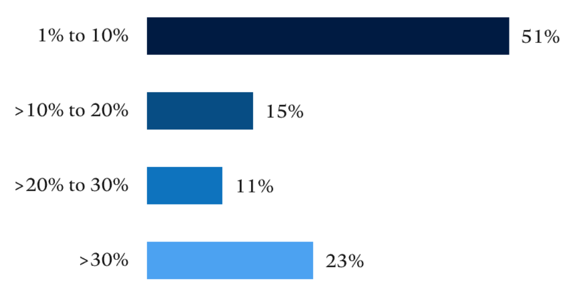
Figure 20: Four factors ETA CEOs enjoy about their new situation

- **01** **Cash compensation**
- **02** **An equity refresh**
- **03** **The opportunity to multiply the rolled equity**
- **04** **The qualitative assessment**

01 *Cash compensation*

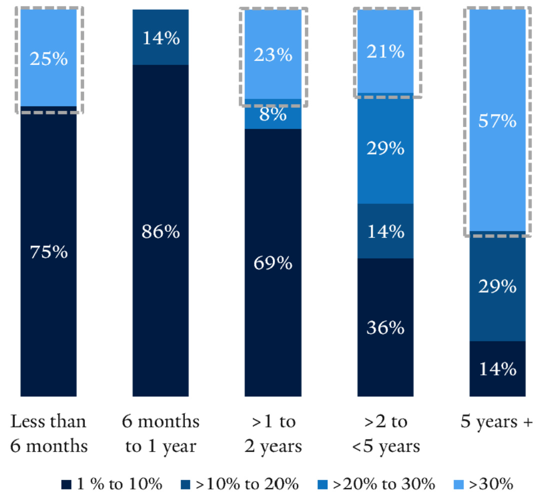
When the new equity partner comes in, the CEO has an opportunity to negotiate a new cash compensation package. In all instances, our surveyed CEOs received some bump in cash compensation (**Figure 21)**, with most (51%) falling in the 1% to 10% band. A complete 23% had greater than a 30% pick-up. Some CEOs, 17%, who only garnered a 1% to 10% increase in salary, also received zero new equity points; some buyers might pay a full price but are parsimonious with the CEO's overall remuneration.

Figure 21: Cash compensation increases for CEOs post-exit



It gets better when the CEO sticks around, too. Cash pay grows as the CEO builds tenure with the new equity partners. As we see in **Figure 22**, if CEOs hit the five-year mark with their new partner, 57% of those survivors are making over 30% more than they did with the search fund investor group.

Figure 22: CEO cash compensation over time with the new equity investor

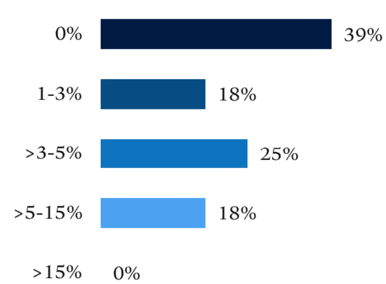


02 *An equity refresh*

Typically, when a CEO shifts gears to a new equity partner, there is a reset in the company. There is a new capital stack, strategy, and cap table, and this usually means a refresh on the CEO's equity compensation package. So, if a CEO rolls equity, that is treated as legacy ownership and is not compensatory in any way. On top of the rolled equity, CEOs are often granted compensatory equity that has various vesting and performance parameters. Regardless of the mountain the CEO must scale to earn the new ownership position fully, it is free equity. We are not implying that the CEO gains this equity without sweat and performance, but they do not take cash out of their pockets for the compensatory equity position.

According to our respondents, 61% of CEOs who continue to serve in an executive capacity in the recapped deal receive some equity, and 39% receive no equity at all. Financial partners grant a median 4.8% additional equity points. On average, all CEOs received 3.1 points and a median of 2.3%. This is far less than the 25% to 30% opportunity in a search fund transaction and might amplify CEO disillusionment since there is likely no grand payday. In the previously mentioned Goodwin report, management teams (as compared to individual CEOs) received an average 9% equity pool.[7] **Figure 23** displays the distribution of new equity points for CEOs.

Figure 23: Refreshed equity points for CEOs in the new deal



It is important to realize that it is highly likely that CEO incentive equity will be subordinate to preferred investor equity. Furthermore, there is probably a vesting and performance schedule to fully earn the equity. Additionally, the equity might evaporate under various separation circumstances including good and bad leaver situations. In other words, this is highly contingent compensation that should probably be discounted significantly in the CEO's math.

03 *The opportunity to multiply the rolled equity*

We estimate that most new equity partners, especially the midmarket private equity financial backers, are looking for approximately a 3x return on their investment over a handful of years. This means that if a CEO rolls 20% to 30% of their equity at the deal closing, and the equity does, in fact, grow by 3x, the ending result of the roll is equal to 60% to 90% of their initial equity value at the first exit. For example, if a CEO's nominal dollar value is $5 million at the close, and they roll $1.5 million, which grows by 3x, the CEO grabs $4.5 million at the second exit. A tidy sum if everything plays out as planned. Of course, some outcomes are not as intended, but plenty hit or exceed the objective.

This math has another attractive twist in that the CEO does not pay taxes on the rolled equity until the equity is converted to cash. This creates a very tax-efficient investment opportunity for the rolling CEO.

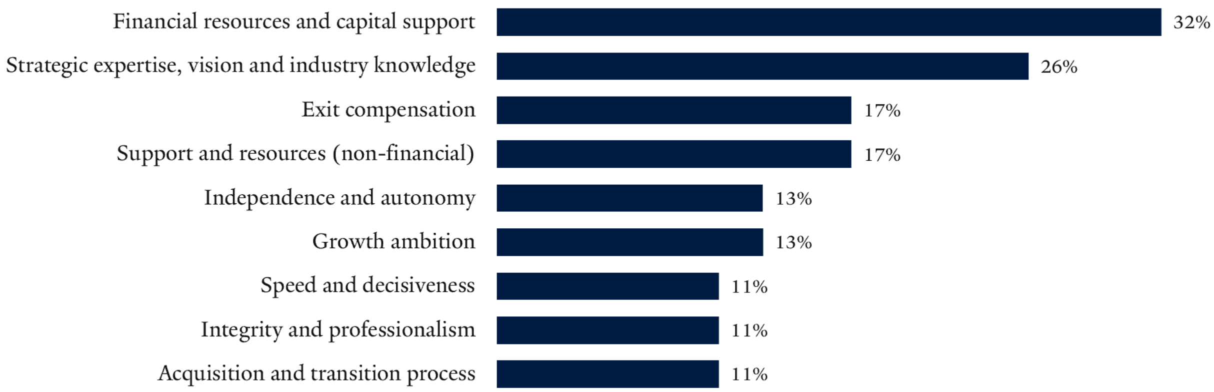
04 *The qualitative assessment*

In our open-ended questions, we did hear some nice things about new equity partners, as shown in **Figure 24**. Some of the qualitative data tend to cluster around the new investors who have robust capital resources that could be used to grow the business further organically and through acquisition. Recall that the equity funded at the exit close just takes out the legacy equity and does not stay in the company to fuel growth. However, these new capital players tend to have deep pockets and can augment the take-out equity with additional growth equity, especially if a programmatic acquisition strategy is in the offing. Furthermore, CEOs enjoyed the decisiveness and aggressive posture of their new partners when dealing with business-building issues.

Figure 24: Illustrative positive comments from post-exit ETA CEOs

We attempted to organize the qualitative responses on the positive side in **Figure 25**. Financial support and capital resources are the best parts of the new partners, followed by strategy expertise. So, as we mentioned in the introduction to this section, it is not all bad; there are some attractive elements, too.

Figure 25: Positive attributes of second-round investors



How to avoid the new equity partner trap

Based on the data we have presented so far in this note, ETA CEOs perceive working with new equity partners as mostly an unpleasant experience. Given that observation, we want to present six potential avenues search fund entrepreneurs can think about to either avoid or mitigate the post-exit phenomena we have documented. We do not assert that these approaches are easy to operationalize or without consequences, but they should at least be considered. If ETA CEOs are getting locked up financially, personally, and directionally, and the group is unhappy, it is worth contemplating how to eschew that situation.

In all new equity partnership circumstances, CEOs should work to build a positive relationship with their new investors. In the deal with the new owner, the most crucial dynamic is between the ETA CEO and the senior partner. If this is positive, the new money can spark new energy and ideas. If this is not positive, the ETA CEO will feel trapped, disillusioned, and unlike an entrepreneur. There can also be a tendency for the senior partner to delegate some oversight to a junior partner (or a junior person). The ETA CEO should insist on constant connectivity with the senior partner; they should be obstinate about this. Distance creates tension.

We will now detail six possible ways to blunt the post-exit malaise ETA CEOs encounter (**Figure 26**). We do not assert that they are the only potential ways to counter the post-exit doldrums; there very well might be additional tactics.

Figure 26: A sextet of ways to reduce post-exit frustrations for ETA CEOs

- **01** **Pursue a self-funded search**
- **02** **Become irrelevant**
- **03** **Roll equity and labor with a predefined time horizon**
- **04** **Only solicit acquirers who will not require an equity or labor roll**
- **05** **Make a market for search investors who want to exit**
- **06** **Seek premium compensation for an equity and labor roll from the search investors**

01 *Pursue a self-funded search*

Despite the fact that ETA CEOs are typically fully engaged in the exit buyer selection, they appear to be unhappy post-deal. Perhaps the best way to address the woes of new equity partners is to not be in a situation where a subsequent round of capital partners is necessary, thus avoiding the problem entirely. One way to do this is to pursue a self-funded search where entrepreneurs often hold the majority of the equity – frequently 70% to 80%. This puts them in a control position where they can choose not to sell the business and operate it for as long as they want and not encounter new investors. Alternatively, if they do want to sell, they can establish the terms and conditions of the sale and accept those consequences. For example, if a self-funded CEO is in control, they can market a business exclusively to buyers who do not require an equity roll or expect the CEO to remain with the company post-sale. This might have economic implications, but it is the CEO's choice to accept or reject the bids.

Pursuing a self-funded search has many positive and negative implications for an aspiring entrepreneur. We would never say it is a superior or inferior choice. We believe there is a best way for every searcher, but there is no best way for all searchers. One thing is for sure: Entrepreneurs who have control of the cap table have more independence in how, when, or if they exit the business. This freedom could help ETA CEOs avoid years of disharmony with new investors.

An adjacent strategy is to pursue the increasingly popular holding company vehicle. This is a model where the entrepreneur raises more capital than a traditional search (perhaps $15 to $25 million) with the intention of building a portfolio of businesses over a few decades – avoiding or deferring exits for the foreseeable future. Alternatively, the company can sell to a new consortium of search investors – if they can match the price of the next highest bidder.

02 *Become irrelevant*

When a company is going to market in a sale process, financial buyers typically want a CEO in place who is both backable and capable of leading the firm into the next chapter. The purchaser might plan on or choose to eliminate the CEO at some point, but they likely do not want to go into the game with a risk-amplifying hole at the top of the organizational chart. This implies that the CEO is tethered to the business and is a de facto asset that flows to the buyer.

A potential strategy to liberate the CEO while still meeting the acquirer's needs is for the CEO to make themselves irrelevant prior to an exit. This means that the CEO is not necessary to the new capital and implies either that there is another executive who can be promoted into the CEO role or that the CEO has already fully extracted themselves from daily operations and is only serving as an executive chair or board member. This requires pre-planning and investing in the people necessary to facilitate a smooth transition. It takes time and likely means additional human capital costs that might dilute current period earnings. However, if it is the CEO's goal to not be pushed into the new owner's hands, this is one approach to potentially make the argument to the buyer that "you do not need me; I am irrelevant."

03 *Roll equity and labor with a predefined time horizon*

If it is wholly unavoidable for the CEO not to roll equity and their labor, the next best thing is to establish, in advance, a timeline for the CEO to step out of their executive role and convert their rolled equity into cash. For example, during the sale process, the CEO can state that they will roll and remain as the CEO of the company for one year, but no longer. We all can endure hardships if we can see the finish line. What is especially painful is to be in a negative situation with no end in sight. With a time cap, the CEO sees an off-ramp and can muscle through.

Financially, the CEO can similarly ask for a market-making mechanism for the rolled equity at some future point. This might be contingent on achieving the plan, liquidity availability, or a prescribed valuation formula. That is all fine; at least there is some pathway out if that is the CEO's goal. Valuation can be a sticky point. The CEO can ask for the same protocol used in the exit, but that might be an optimistic framework because it involved a change of control premium. Even if the valuation formula is at some discount, it gracefully ends the journey and frees the CEO's capital. Having a plan to get out is better than no plan and an indefinite dissatisfying purgatory.

04 *Only solicit acquirers who will not require an equity or labor roll*

CEOs who are certain they no longer want to be the company leader or roll equity can push for an auction process that limits the buyer pool to candidates who will not require the CEO's labor or equity roll. This will likely rankle the search fund investors because a truncated auction with limitations on the CEO's participation could negatively impact valuations. However, this is the CEO's choice, and if they absolutely do not want to work for a new sponsor or provide an equity roll, they can ask for an exit process with limitations. This might also impact investment bank participation because this approach might result in lower banker fees.

This tactic would require a lot of gumption from the CEO and could result in fractured investor relations, but it is a choice for the CEO to consider.

05 *Make a market for search investors who want to exit*

If some investors are catalyzing the exit because they want or need liquidity (think institutional fund life or raising a new fund), a market-making mechanism could be established to get that investor liquidity without a full exit. This would prevent the CEO from having to roll equity and time into a fresh transaction with a new equity partner. Perhaps existing shareholders could purchase equity from a shareholder who wants to leave. Alternatively, new search fund investors could be brought into the cap table while still predominantly preserving the original cap table and the CEO's relationship with the search-round equity providers.

Furthermore, the company can repurchase shares from existing shareholders who want to exit by using free cash flow or taking on debt to facilitate the transaction. The goal is to avoid the new PE investors. Problems with this approach include an exiting equity owner not getting a full enough valuation and the stress it might put on the company's balance sheet through the share repurchase. While not a perfect solution for all situations, this approach might have some utility in helping prevent the CEO from moving into a harmful situation.

06 Seek premium compensation for an equity and labor roll from the search investors

For our last point, we will suggest something that will surely be controversial. If a CEO cannot avoid signing up for another stint as CEO with the new owner and rolling equity, they should at least be compensated by the search fund investors. If the company trades at a higher valuation because the CEO is attached to the business and rolls equity, it does not seem like the CEO is rewarded for the value they are creating. If the search investors claim more rewards because of what the CEO is willing to do, some of that should be or could be shared with the CEO.

The CEO is making the pie bigger for free and will not enjoy the experience of doing so (at least according to our research and data). If unavoidable, the next chapter might be more tolerable with battle pay. It is easy enough to know what the CEO's presence and roll are worth; just price the asset with and without them. If the delta is $5 million, as an example, surely the CEO should claim some piece of that. Perhaps one way to approach this is to accelerate unearned performance equity if the CEO missed earning all of the incentive tranche by a few points. Alternatively, the CEO can take a disproportionate amount of a pending earnout. These concepts can be thought of as a stay bonus.

Yes, we acknowledge the CEO is benefiting from their incentive and performance shares, but that does not account for what they are doing for the next set of owners. Yes, the new owners might provide an equity top-off, but that is based on what the CEO is going to do for them. There is a fundamental divergence in interests when the CEO and search investors exit. One way to tamp down the divergence is to pay the CEOs for what they are doing to facilitate the deal at the highest price.

Conclusion

For most ETA CEOs, the pilgrimage does not end with the first exit when their search fund investors depart – typically after a five-to-six-year operating window. Instead, CEOs will likely stay with the company and roll equity into the deal with the subsequent equity owners. The most likely buyers of ETA assets are financial sponsors – think PE firms. CEOs have very different relationships with these investors than with search fund investors despite being actively involved in their selection. CEOs report feeling less connected personally, experiencing less coaching and support, and feeling diminished independence and autonomy – and NPS data supports this.

CEOs enjoy some of the elements of their new situation. Specifically, they like increased cash compensation, refreshed compensatory equity, and the potential to grow their rolled equity. If CEOs do not want to wind up in a partnership with new equity providers, there are multiple steps and strategies they can take to either avoid or attenuate the exposure.

The search fund quest is filled with many chapters, ups, and downs. It is not all good or all bad, and the reality of the exit might not be the highlight – but that does not mean the journey is not worth the effort. We hope this note helps aspiring entrepreneurs better understand this moment in the process. We wish you good fortune, success, and happiness in your project – and a smooth exit!

Endnotes

[1] Keith Burns is an Adjunct Assistant Professor of Entrepreneurship at The University of Chicago Booth School of Business.

[2] A. J. Wasserstein is the Eugene F. Williams, Jr., Senior Lecturer in the Practice of Management at the Yale School of Management.

[3] Kelly, Peter, and Heston, Sara. *2024 Search Fund Study Selected Observations.* Stanford University Graduate School of Business. Case E-870. June 28, 2024.

[4] Ibid.

[5] "Goodwin Rollover and Incentive Equity Terms Middle Market Survey." Goodwinlaw.com, Goodwin, 2018, www.goodwinlaw.com/en/flex-pages/rollover-survey.

[6] Kelly, *2024 Search Fund Study Selected Observations*.

[7] "Goodwin Rollover and Incentive Equity Terms Middle Market Survey."