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Exploring Various Search Fund Structures

There are many ways to approach launching a search fund

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Search funds are entrepreneurial venture and investment vehicles that enable entrepreneurs to source, acquire, manage, and expand private companies over the medium or long term. They can be operated individually or in partnership, with or without the support of a group of aligned investors. Search funds offer recent MBA graduates and mid-career professionals the opportunity to become equity-owning CEOs, and they provide investors the chance to mentor developing entrepreneurs leading growing companies and to benefit from attractive financial returns.

In recent years, search funds have become increasingly popular among both investors and entrepreneurs. According to the 2020 Stanford Graduate School of Business Search Fund Study, 401 search funds were formed in the United States and Canada between 1984 and 2020,[3] with 88 of those being formed in 2018–19 – and we think these data points are understated since the study does not capture self-funded search activity. This suggests that the entrepreneurship through acquisition (ETA) concept behind the search fund model is increasingly popular among aspiring entrepreneurs. In this case note, we use the terms search funds and ETA interchangeably.

ETA presents prospective entrepreneurs with an alternative to the startup model, offering them a current income (when the project is funded), high short-term growth, very high levels of control over their work, a high potential for impact on the final product or service offered, a healthy degree of work-life balance, a lower level of risk than is the case of a startup, future opportunities depending on exit options, and abundant, meaningful learning opportunities. We believe that ETA is a wonderful career and entrepreneurial path that presents a compelling risk-reward profile and provides many desirable qualitative and quantitative rewards.

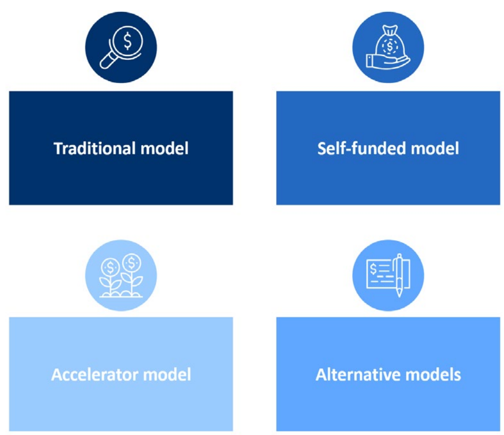
Once an aspiring entrepreneur decides to pursue a search fund, the next key decision is exactly what type of search fund structure will be used. As search funds have proliferated, the search fund vehicle itself has iterated, permutated, and expanded to include multiple ways to pursue this enticing entrepreneurial path. What was once a 'one size fits all' approach to search funds has morphed into a wide array of choices. We think this expansion of choices for aspiring entrepreneurs is fantastic. It allows prospective ETA entrepreneurs to find a vehicle that best suits their goals and needs. Additionally, more choices likely increase the probability of finding an advantageous fit and producing a successful outcome.

The purpose of this case note is to illuminate all the current ways a search fund can be structured (see **Figures 1 and 2**). It is not our aim to assess the best way to pursue ETA – we do not think there is a single best approach. We do believe that there is a best method for each individual considering this entrepreneurial pathway. We hope this note will assist aspiring ETA entrepreneurs in discovering their best particular search fund structure.

We will explore the following search fund models:

- Traditional model
- Self-funded model
- Accelerator model
- Alternative models
    - Holding company model
    - Single sponsor model
    - Self-funded accelerator model
    - Mid-career accelerator model
    - Concentrated model
    - Impact model
    - Emerging market model
    - Search funds with majority equity accruing to the searcher

Figure 1: Four ways to structure a search fund



The traditional search fund model

In a traditional search fund, an entrepreneur or team of entrepreneurs raises approximately $300,000 to $750,000 in search capital to compensate the searcher with a salary and fund the search process. This allows the searcher to attempt to find a business to acquire over a two- to three-year period. If the entrepreneur finds a business to acquire, their team of 10 to 20 investors has the ability to help conduct commercial and legal due diligence before investing equity in the acquisition of the target business (investors have the option but not the obligation to invest additional equity). Usually, only a few of the investors will be directly involved in the deal, with the remainder taking a more passive role. The operator will then run the acquired business as the CEO for five to ten years, with the investors serving as board members. At some point, the business is sold to either a private investor or a strategic acquirer. The entrepreneur has the opportunity to earn a percentage of equity based on closing a deal, vesting over time, and achieving specified IRR[*] hurdles. This model is usually available to recent MBA graduates from target schools as well as to mid-career professionals.

The popularity of this model is evidenced by the numerous entrepreneurs and investment funds that have adopted it. For example, Rich Kelley and David Carver (both Stanford Graduate School of Business, 1989 and 1974, respectively) are traditional search fund investors and are credited with launching the first institutional search fund investment vehicle, Search Fund Partners (SFP), more than 20 years ago. Kelley says the following of its continued use and growing popularity:

> Since its founding, SFP has invested in more than 175 searches, closed more than 100 deals, raised six funds, brought on two former searchers as partners, and seen an explosion in the popularity of institutional investment funds like Anacapa and Pacific Lake Partners. Our model remains successful because of the superior financial outcomes it delivers. With excellent searchers who can source high-quality deals, growing profits and cash flow streams are made available to searchers and investors alike. In this case, a 'good searcher' is someone who is capable and willing to deal with the 10 to 20 investor-advisors whose viewpoints they'll have to work with while conducting their search and running the company they acquire. Those who may migrate towards a self-funded model risk being too resistant to advice to be productively accommodated by the traditional model.

There are significant advantages to this model – the ability to conduct larger deals with companies exceeding $2,000,000 of EBITDA,[†] the availability of a large ecosystem of advisors, and the ability to focus on high-growth businesses.

David Obia (University of Michigan's Stephen M. Ross School of Business 2016) is the founder and managing principal of Kola Capital Partners, a traditional search fund. Before shifting into search, Obia did a three-year stint in investment banking with Goldman Sachs, beginning in 2016. After a year with the startup Airfox, he founded Kola in 2020.

> There are many risks associated with entrepreneurship. Having been in the startup space prior to my ETA journey, I saw a number of emerging founders struggle with numerous challenges like achieving product-market fit or building the right team. While Airfox was able to get to a successful exit, it is not lost on me how difficult the journey was for the founder. With ETA, you have the opportunity to somewhat de-risk the entrepreneurial process by finding established businesses. Having decided to take the ETA path, I felt the traditional model had the best risk-reward tradeoff of the models I could pursue. Having advisors and people I could count on would set me up for future success, but having those people invest their capital in my success adds another layer of security to my search.
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> Though at the time that I began searching, the traditional model was far and away the most popular model being discussed in the literature, my opting for it was by no means an unconscious choice. I was raised by Nigerian parents in Detroit and, though I would go on to make it to Wall Street, financial security has remained important to me. I thus didn't want to jeopardize the financial foundations I had laid for myself by going with the self-funded model. Being paid a salary, having my search costs covered, and having a pool of skilled investors to rely on seemed and still seems today to be the best way forward. On the

[*] Internal rate of return.
[†] Earnings before interest, taxes, depreciation, and amortization.

> flip side, I still wanted the experience of building something from scratch. The accelerator model, for instance, would offer a lot of the same security as the traditional model; however, it could still feel like being a private equity associate at a bigger firm when I wanted the feeling of really starting at ground zero, doing the work to build out the business myself.

The self-funded model

In a self-funded search fund, an entrepreneur or team of entrepreneurs seek to purchase a business to run and operate using their own capital to search for the target business. Since this search fund model draws on more limited capital reserves than comparative search fund models, the entrepreneur does not earn a salary during the search but may own up to 100 percent of the company equity, especially since self-funded projects tend to be smaller in scale than traditionally-funded projects. After a period of time managing the company, the entrepreneur determines if and when an exit is appropriate. In a self-funded search, the entrepreneur might seek outside capital for the acquisition or might structure the deal in such a way that no outside capital is required by using bank debt, seller debt, and a small amount of personal equity.

Self-funded searches provide a very high degree of autonomy and flexibility, with no investors to be accountable to. It can allow a searcher to be tightly focused on a specific industry or geography and might provide an avenue for searchers with less typical search fund backgrounds. Self-funded searchers are popular with many entrepreneur groups but have attracted a lot of interest from military veterans.

Steve Ressler is a serial entrepreneur with expertise in SaaS businesses in general and those serving government end-markets in particular. Ressler invests across the search fund spectrum, including both traditional and self-funded search, and has invested in more than ten self-funded search deals.

> In many ways, the self-funded model is the highest risk form of the search fund: The searcher typically has to personally guarantee the transaction debt; the searcher isn't paid to search and has to pay all search expenses out of pocket, including any broken deal costs; and finally, there is no built-in, formal team of investors and advisors providing guidance. However, a key benefit of the self-funded search is that not everyone can obtain the investor backing to conduct a traditional search: The self-funded model opens up the asset class to a broader swathe of individuals who can write the smaller investment checks that are part of self-funded deals.
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> There is also more flexibility in the self-funded structure: With a self-funded search, the searcher typically retains control of the business from both an economic and governance perspective, and the searcher can constrain their search to a specific geography in a way usually not available to traditional searchers. Finally, the entrepreneur is less on the clock when pursuing a self-funded model and can move at their own pace. Many self-funded searchers are recent MBAs from strong schools, consultants from major management or financial consulting firms, and mid-career professionals with backgrounds in the financial sector. I also see self-funded searchers who are veterans and searchers who did not go to business school.

This model is popular among entrepreneurs who want more control over the direction of their fund than might be possible under other models. There are many advantages to pursuing it: first, smaller companies can be acquired with EBITDAs ranging from $500,000 to $1,500,000; second, it gives more control to the search fund operator; third, it allows for a more constrained search, either by geography, industry, or personal preference; fourth, it allows for the use of SBA 7(a) loans and thus for higher debt percentages in company acquisition; and fifth, it is open to a more diverse background of potential searchers than other search fund structures. However, it also has important disadvantages: first, it offers less of a built-in ecosystem of advisors who can help with sourcing companies, conducting due diligence, and enforcing best practices; second, it makes it difficult to organize bigger deals; third, it requires the search fund operator to personally guarantee the SBA 7(a) loans taken out; and fourth, the search fund operator is not paid to search, making the venture more high-risk.

A New York native, Earl Gordon (Harvard Business School 2008) graduated from NYU in 2000 and began a six-year stint on Wall Street, working in investment banking and private equity at Goldman Sachs, UBS, and Altaris Capital Partners. Having experienced the buy-side and the sell-side, he used his newly minted HBS MBA to move to the startup world in 2008, working at Kidrobot, Quidsi, Kikin, and littleBits from 2008 until 2013. In 2014, he launched his self-funded search fund – Fenton Avenue Capital – that came close to acquiring a commercial wine rack manufacturer. Although that deal fell through, he ended up acquiring a commercial painting company in 2016. He has now taken a back seat from that and became the CEO of a commercial security integration company in 2020, which he acquired through a self-funded search.

> I felt confident choosing to pursue a self-funded search given my good financial standing and the network of advisors I had assembled during my time in the banking, financial, and startup sectors. When seeking to acquire the commercial painting company, I self-funded the search and raised the capital structure around it. One institution provided the debt and the majority of the capital, while I relied on friends and family to round out the rest of the money needed.
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> This is the same strategy I pursued years later with the commercial security integration company – never raising capital in the search process, only for a deal. The acquisition was financed through a mix of SBA 7(a) loans, personal network capital, and my own funds.
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> I chose to do a self-funded search because I felt more comfortable taking on the risk of an SBA 7(a) loan and being accountable to a small circle of friends, family, and investors from my extended network who had invested capital. So, for me, the first question wasn't "Why should I go self-funded?" It was "Why shouldn't I?"

The accelerator models

A search fund accelerator (or incubator) operates as a sponsor organization that trains aspiring search fund entrepreneurs to efficiently search for suitable companies, effectively deal with sellers, and responsibly acquire and run companies. While the searcher retains control of the deal, the accelerator provides guidance (e.g., diligence experts, lenders, lawyers, and experienced mentors), material assistance (e.g., templates and logistical support), and financial support (e.g., paying the searcher a salary during the search process and providing equity financing to supplement the debt financing organized by the searcher). Post-acquisition, the incubator helps the searcher select the right board of directors and navigate the challenges of running their new business; then, at the point of exit, the entrepreneur typically receives a significant portion of the equity. Accelerators additionally offer their participants valuable emotional support through the cohort system and office sharing during the search. Furthermore, accelerators typically kick off each cohort with an intensive boot camp learning and training experience to catalyze the search process.

Jay Madsen (The Wharton School of the University of Pennsylvania 2011) is a partner at Search Fund Accelerator (SFA). SFA is credited with being the first accelerator focused exclusively on search funds. He explains their version of the accelerator model:

> We put our annual cohorts of searchers in a financial and management skills boot camp up front to provide them with the skills to help them navigate their search process. Searchers then gain access to our coaching, databases, customer relationship management tools, key performance indicator metrics, banking relationships, and legal and financial support services to help them find and express interest in companies. Once a company is located, we provide 100 percent of the equity to the searcher for the acquisition, allowing the searcher to skirt the problem of putting a fund together and assembling a network of aligned investors. Post-acquisition, we take two board seats in the company, the searcher-CEO takes one, and we reserve two for independent advisors.

Ricardo Aguirre (Harvard Business School 2015) is the CEO of American Plant Maintenance LLC (APM). He was a member of the first-ever SFA cohort. Before beginning his MBA in 2013, Aguirre worked as an engineer at Motorola for seven years, spending five of those in the U.S. with a focus on technical operations and two in Malaysia with a focus on management. Prior to and throughout this time, he helped his father – an immigrant to the U.S. from Venezuela – get by as a small businessman operating mall kiosks and frozen yogurt franchises.

> After deciding to do a search fund, I was initially torn between the accelerator and self-funded models. Eventually, the better quality of life during the search phase and my more geographically selective search pushed me towards the traditional approach. This ended up working out for me, as I acquired a business just outside of Boston and continue to live with my wife in Cambridge. Having made this decision, I set about looking for sponsors. This was an anxious time for me: I feared that given my background in product management – as opposed to the other potentially more desirable paths into an MBA from the banking and financial sectors – and the temporally diminishing returns on my 'golden ticket' from HBS, my window to financial success was closing rapidly. In looking for a sponsor, I was also looking for someone with whom I could develop a personal relationship that would help assuage some of this anxiety. This is what led me to Tim Bovard and SFA.
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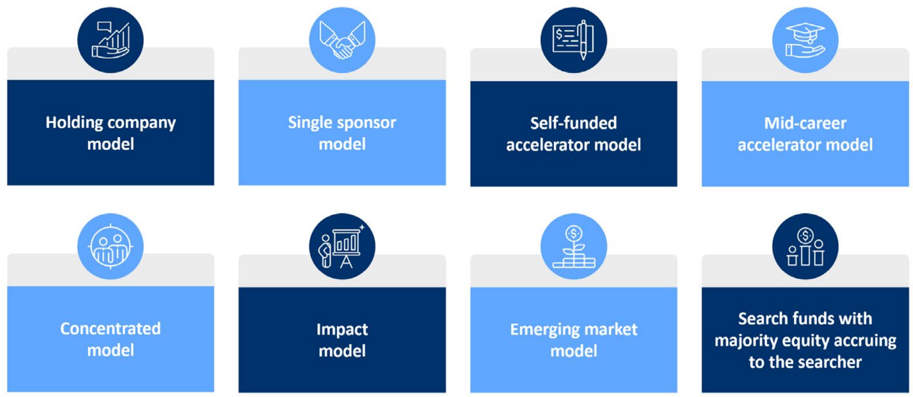
> Two things, in particular, drew me to SFA: the cohort model and the single source of capital. Though initially skeptical, I came to see my cohort as an important network of friends and advisors that helped me during and after my search. SFA's ability to act as a sole sponsor streamlined and informalized a number of investor-relations processes that I feel might otherwise have been a bureaucratic and administrative burden as I tried to grow my acquired business. A single sponsor meant a short feedback loop on advice, clear and simple accountability mechanisms, and a more personal relationship with investors. Six years after graduating from HBS and five after acquiring APM, I'm confident SFA was the right choice for me.

Alternative models

One of the many exciting things in the search world is how structures, strategies, and approaches are continually evolving and iterating. What were previously thought of as alternative search fund models (self-funded and accelerator) are now completely normalized and mainstream. And what today might be considered unique or alternative approaches will likely be standardized approaches within a decade. Below are a few of the more cutting-edge search fund permutations which we will explore (see **Figure 2**).

Figure 2: Alternative approaches to structuring a search fund



The holding company model

A holding company (HoldCo) exists when an entrepreneur seeks to acquire and operate multiple businesses held under the ownership of a single umbrella organization. In this construct, the principal entrepreneur tends to focus more on deal sourcing, strategy, and capital allocation – how and where to create equity value using free cash flows and capital raised. The holding company entrepreneur tends not to be a fully hands-on operator like in most search fund vehicles. Instead, the holding company entrepreneur likely has key leaders serving as CEOs in each operating unit. Many search fund entrepreneurs look to Warren Buffet's Berkshire Hathaway as an aspirational vision of a holding company.

Entrepreneurs are raising between $10 million and $50 million in equity to seed these holding company vehicles. A distinguishing factor in most holding company strategies is the desire to own, operate, and compound the assets for very long time frames (think multiple decades). This is quite different than the typical search fund holding period of approximately five to ten years. One of the first holding company vehicles established in the search fund world was Chenmark Capital, a Portland, Maine-based operation founded in 2014. Since then, numerous holding companies have been launched in the search fund landscape.

Mark Anderegg (Kellogg School of Management at Northwestern University 2010) conducted a traditional search after completing his MBA. That search led him to acquire Little Sprouts, an early education, and childcare business. Anderegg operated Little Sprouts for six years before selling it to the Babilou Group in 2018. Since then, he has taught courses on search funds at both Tuck and Kellogg and, in 2020, co-founded his holding company, Newbury Franklin.

I set up Newbury Franklin the way I would have liked it to be set up if I were one of our investors, which of course I am. We're a bit of a hybrid of HoldCo and accelerator in that we start with the entrepreneur, undertake a search with them, finance their acquisition, and install them as CEO. We thus attract investors not by asking them to invest blindly into a fund but with full visibility into the company and entrepreneur to which their investment will be funneled.

I started a HoldCo for several reasons. The first was its viability as a long-term enterprise; of course, other search fund models can also theoretically be pursued long-term, but the HoldCo model necessitates long-term management and investment in its portfolio structure. The second was the opportunity to avoid the risk inherent in investing in just one company. I feel like I got somewhat lucky the first time with my traditional search fund; when thinking about the next chapter of my life, I had to think about whether I could handle the risk of putting all my eggs in one basket again. This led me to opt for the diversification made possible by the HoldCo model since my risk was now distributed across a few operating companies.

That being said, I didn't and don't want to be in the portfolio management business. I didn't want to be involved with these companies on a monthly or weekly basis on questions of capital management but rather on a day-to-day basis with questions of essential business operations. I'm only able to say that, however, because of my previous experience as a CEO. I wouldn't trade my experience as CEO of Little Sprouts for anything and thus wouldn't, in retrospect, have chosen the HoldCo model in my first foray into the search fund world.

The way I see it, on one end of the spectrum, you have the ultra-passive investor, who doesn't sit on boards and simply invests; on the other end of the spectrum is the self-funded searcher who buys and runs a company themselves. I romanticized the former model for a while and did it for a time after leaving Little Sprouts. Ultimately, however, I found it unsatisfying.

I like to build businesses and am more of a CEO than a capital allocator. This informed my decision to go with a HoldCo model in which I could focus on the day-to-day operations of a few businesses. The day-to-day operating stresses are often less acute as HoldCo CEO, which is great, but I have found that serving in that capacity requires a different set of skills than the operating CEO role. For instance, when the flames of a business problem arise, for someone like me accustomed to being the firefighter, it's difficult to take a step back and realize that you are now just the advisor to the firefighter; you are no longer the operating CEO. However, I wouldn't be able to do either had I not first had experience as an operating CEO.

The single sponsor model

Single-sponsor search funds raise capital from a single source rather than a group of investors, streamlining and in-housing the capital-raising process. These single-sponsor search funds often raise funds from family offices, which are private wealth management vehicles that serve a single or group of high-net-worth families. Family offices are increasingly taking note of search funds as a direct form of private equity investment that allows them to take a more active role in their investment. Managing Director Shannon Jones and Principal Investor Matt Littell (both Kellogg School of Management at Northwestern University, 2008 and 2007, respectively) are investors at Halstatt Legacy Partners – a single-family office based in

Naples, Florida, managing the wealth of the Sproul family. Jones comments on the single-sponsor search fund model:

> We enjoyed the experience of direct traditional search fund investments but were dissatisfied with it for two reasons. First, the family behind Halstatt preferred very long-term investments (we think in multiple decades) and found it challenging to find similar long-term orientation among other search fund investors. Second, some entrepreneurs understood that it would be easier to find alignment between them and a single partner, rather than a group of limited partners. They could achieve this by engaging a family office like ours. This led us to pivot towards a single-sponsor search fund investment model. I am very enthusiastic about our approach. We are committed to our entrepreneurs and will do everything to support their success. The biggest factor that differentiates us is our time horizon. We want to be in good businesses forever. We do not need to sell if the company continues to create value at appropriate rates. This long-term view is baked into our DNA since the wealth we manage has been created over a century. We understand and value long-term compounding and want our search entrepreneurs to embrace that orientation if it fits for them.
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> As of June 2020, Halstatt has sponsored seven searches, four of which have concluded in an acquisition, two of which are ongoing, and one of which concluded with a transition to a self-funded model.

A single sponsor supports the entire cost of the search, eliminating the need for the entrepreneur to raise a search fund from 10 to 20 limited partners. After the searcher has found a company to acquire, the sponsor also contributes 100 percent of the equity needed to secure the deal. Given their heavy capital involvement, while searchers do proprietary searching at their own site, the sponsor often provides teams that vet intermediary deal flow and help the searcher evaluate potential target companies. After the acquisition, the sponsor helps the searcher achieve a sustainable leadership position as the enterprise's head.

Jordan Scheiman (University of Virginia Darden School of Business 2016) is the CEO of Cleveland, Ohio-based RedRock Financial LLC. Scheiman has a professional background in management consulting and a family background in small business ownership. He did a search fund immediately out of business school with the backing of Halstatt. Scheiman acquired his business in eleven months and has owned and operated RedRock since 2017.

> I knew going into my search that I had experience with insurance and sought to apply this knowledge of risk, credit, pricing, and portfolio management to a business services company that could scale quickly by attracting greater investment without itself investing in acquiring more assets. RedRock is a subprime auto lender that finances people who don't have great credit. We're an indirect lender that acquires contracts and loans through a dealer network, thereby assuming first position on the auto asset. In 2020, approximately 30 dealers submitted contracts to us and asked RedRock to consider buying them. Though we currently operate on a business-to-business basis, I hope to flip the company to a business-to-consumer model to obtain loans from end-users rather than dealers. That way, dealers need us rather than us needing dealers.
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> At a certain point, a searcher takes any capital that is available to them; Halstatt was right for me. Despite my background in consulting, I didn't have the financial, deal-making, or acquisition skills to source and close a deal myself. In addition to the all-important capital, I needed those skills in one package: I didn't want to have to get a dozen investors with

> different perspectives to sign off on the transaction the way I would have had to do in a traditional search. What you get with Halstatt is an incubator mixed with a sole sponsor model that gives the searcher an important degree of autonomy and control, access to credibility that makes negotiating with sellers and banks easier, access to advice and brokerage services that fill in the gaps in the searcher's knowledge, and access to a single source of capital that streamlines the search and acquisition process. For me, they decreased the risk associated with the pursuit to a significant degree, meaning I just had to focus on getting the seller to close.
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> I also love their long-term view of the world. They are genuinely experienced entrepreneurs and investors and understand what it takes to build a successful enterprise over multiple decades. They are an incredible partner.

The self-funded accelerator model

A relatively new iteration in the search fund community is marrying the accelerator framework with self-funded searches. This innovative, creative, and unique approach allows self-funded entrepreneurs to have independence and autonomy with some infrastructure, support training, and tools for their search. Additionally, capital for an acquisition can be part of the self-funded accelerator package.

Sam Rosati (University of Virginia School of Law 2014) is an entrepreneur and investor and is the founder of Pursuant Capital. Pursuant is the first self-funded accelerator. Rosati says the following of the self-funded niche he chose for himself:

> After buying Alpha Dumpsters as a self-funded entrepreneur (and subsequently selling it to a strategic buyer), I re-established Pursuant in 2020 to buy and grow Florida-based small businesses and advise and invest in self-funded search funds across the U.S. We look for people with the balance sheet and risk tolerance to do a self-funded search but the awareness to realize that they may not have access to the other things that make a self-funded search fund work: advice, guidance, mentorship, and general business experience and acumen. Pursuant helps operators up the steep learning curve of conducting a self-funded search, closing a deal, and finishing their first 100 days as a CEO.
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> More than with other models, the self-funded accelerator model is hugely reliant on the caliber of the searcher. Leadership qualities, negotiation abilities, and general confidence and risk-endurance are necessary to be a good owner-operator. Those with brilliant resumes – and particularly those with good MBA pedigree and from moneyed backgrounds – are unlikely to need to pursue an accelerator self-funded model since they will find it easier to attract investors through the traditional model. We partner with our self-funded searchers in cohorts, taking them through a boot camp that covers everything an entrepreneur would need to know, from how to find a deal, to how to diligence and close, to how to manage a firm for the first 100 days. After this boot camp, we continue to support each searcher with a personal deal team (i.e., lawyer, SBA lender, accountant, etc.) to supplement the experience the searcher brings to the table.

A Pittsburgh native, Joshua Johnson (UNC Kenan-Flagler Business School 2019) served as an aviator in the U.S. Navy for eleven years before leaving to begin a career at General Electric (G.E.). Having earned his MBA, he now works at G.E. as a director of business development while aspiring to become a self-funded searcher with Pursuant Capital.

Had the COVID-19 pandemic not begun in March of 2020, I would most likely have chosen the traditional search fund path. Three months down the self-funded road, however, I realized I was spinning my tires, wasn't understanding the search process properly, and didn't have a solid network or body of knowledge on SMB operation. I also realized I needed equity partners to graduate from the $250,000–$500,000 EBITDA companies I could afford using my own money to the $750,000–$1,000,000 EBITDA companies I wanted to acquire.

That's what led me to a self-funded accelerator like Pursuant. Now, I'm on a two-year clock to find and acquire a company, with the opportunity to bring in more equity investors and the ability to rely on Pursuant for support. When it comes time to acquire, I anticipate relying on SBA 7(a) loans, investor financing, and personal equity to be able to shoot for companies in the $750,000–$1,000,000 EBITDA range.

My family circumstances dictate a lot of my search criteria. Having kids means I can't really afford the high-risk profile of not having a job while searching, and, in addition, my having spent my navy career in Florida and having family in North Carolina mean that I'm targeting companies in those areas. In terms of industry, I'm focusing on business services, light manufacturing, and small aviation – all things that don't require a lot of technical or engineering know-how.

The mid-career accelerator model

Just as some accelerators specialize in self-funded searchers, others focus on mid-career professionals who choose to leave their careers to pursue their ambition of being an owner-operator. Drew Gottenborg (Williams College 2006), co-founder and managing partner of SPUR Acquisitions, says the following of his firm's decision to pursue a mid-career accelerator model:

> As you would expect of an accelerator, SPUR is heavily involved in the day-to-day proceedings of the search and acquisition process. We work with searchers to generate acquisition criteria and a consistent flow of deal prospects. Once the deal is tied up under LOI, our role shifts to performing due diligence and coordinating the capital-raising process with investors. SPUR typically takes one seat on the five-member board of the newly acquired company, with the understanding that once the transition period is over and the business has moved to its execution phase, they would collaborate with the CEO to find an independent advisor to take their seat.

Gottenborg emphasizes, however, that two things make this model unique:

> SPUR tries to combine a conventional accelerator model with the financial structure of a traditional search fund model. We do this by providing 100 percent of the capital to searchers for their search and acquisition without managing a fund: Investors can directly invest in the

opportunity, allowing them to skirt the management fees charged in other models. This unique financial model builds upon SPUR's demographic preference for mid-career professionals. We'd much rather take an experienced operator with previous hands-on industry knowledge and experience than a green post-MBA from a target school.

John Sheffield (Yale University 2010, Haas School of Business, University of California Berkeley 2019) worked at education startup ESM Prep from 2011 until 2017, when he began his MBA. After an internship with EY in 2018, Sheffield graduated in 2019 and became an operating partner at SPUR Acquisitions. In July 2021, SPUR and Sheffield acquired Advanced Classroom Technologies, where he is now the CEO.

I see the search fund process in four stages: fundraising, searching, acquisition, and operating. I felt more experienced in fundraising, acquiring, and operating. The problem was that I had no idea how to search. In addition, each searcher builds their own search to ultimately find one deal, and I felt as though there was a lot of waste in that. My other motivation in joining SPUR was its emphasis on teamwork. I wanted a peer group and a collaborative environment in which to work.

I was the first operating partner hired at SPUR. At that time, they hadn't yet formalized the cohort model; rather, people who started around the same time but weren't geographically proximate formed a kind of informal cohort. SPUR raises capital on a deal-by-deal basis and helps get the deal funded using their network of investors but prefers not to act as a sole sponsor. While it's important that operating partners bring in significant equity from outside SPUR, usually from professional or familial sources in the form of high-net-worth individuals, I feet this structure works to get the right deals funded.

I just closed on Advanced Classroom Technologies after 24.5 months of searching. It's a 21-year-old, $2.4m EBITDA education technology company that sells, installs, and services A/V equipment to K–12 schools on the West Coast. Investor support was outstanding. There is a lot of work to do, but there is also a lot of upside.

Being a mid-career professional can be an awkward time to launch a search. However, being part of an accelerator – and one that is attuned to mid-career professionals –made that transition to entrepreneur-CEO smoother and more comfortable.

The concentrated model

Some search funds are structured with a very narrow focus on one dimension of the fund structure. For example, a search fund entrepreneur can approach their search with a concentration on industry – only searching within a single, pre-defined sector – or the searcher can have a concentrated shareholder group with just a handful of traditional investors, as compared to the more typical dozen to twenty investors in a cap table. Finally, a search can be hyper-focused on a geographic region like the Pacific Northwest or even a single state or metro area.

These concentrated approaches can bring discipline and expertise to the search and subsequent operation of a company. The concentrated approach can also lend itself to an existing domain expertise or lifestyle requirements regarding location. When narrowing the aperture on potential acquisition targets, searches might need to widen it on other dimensions. For example, if a searcher intends to acquire a payroll services firm, they might need to be more flexible on where that business is located. If a searcher wants to purchase a business only in metro Atlanta, they will need to be more accommodating on the type of business they are willing to acquire.

Derek Turner (Stanford Graduate School of Business 2017) is currently the CEO of IMS Infrastructure Management Services, a Phoenix, Arizona-based company providing pavement management services to municipalities. Turner acquired the 35-year-old business in 2018 after conducting an Arizona-only search. Since completing the purchase, Turner has doubled revenue and expanded profitability. Today, IMS is the leading municipal pavement management company in the United States.

> My approach to my search fund was focused on aligning my career choices with my values. In pursuing an entrepreneurial path, I want the risks I take to create jobs in my home state and benefit my community. My family and I are all about Arizona. I grew up here and met my wife here when we were in high school. Our families, friends, and church are here. This is our community, and we want to invest in it through job creation, civic leadership, and community involvement. So, when I decided to be a search fund entrepreneur, I wanted it to align with my family's mission to give back to our home state.
>
> I also had conviction that a geographic focus in Arizona would be a strategic advantage. In the business buyer's market, having a local presence and local relationships is a differentiator. Sure, the pool of actionable opportunities is smaller than with a national search, but I am part of the Phoenix community. I can talk about my role and place in the community and my commitment to keeping and growing the business locally – that really resonates with a lot of sellers. I was very explicit in signaling my local roots and intentions. I named my search fund Chaparral Capital, after the local high school I attended.
>
> Ultimately, what this approach lacks in quantity of businesses can be made up in quality of connection to sellers. My advice to searchers is to structure your search to align with your values and leverage what differentiates you from other buyers who are pursuing the same sellers you are. Life is multifaceted, and your career is a choice that indicates your values – your search can solve for more than just likelihood of close.

The impact vehicle model

Impact investing is a strategy seeking non-financial goals in conjunction with equity returns. Some of these non-financial goals might include social impact objectives; diversity, equity, and inclusion objectives; and employee ownership. Impact vehicles are cropping up in the search fund space, adding a fresh twist (impact) to an already existing model (search funds). Two such vehicles are New Majority Capital and Obran Cooperative.

New Majority Capital are entrepreneurs and impact capitalists working on creating a better financial future for under-represented business owners. They do this by providing equity investments and management support to under-represented entrepreneurs who want to acquire and run existing small businesses. They believe this is a sustainable path to reduce wealth disparities in our society and a path that can naturally lead to an evolving ecosystem that has a lasting impact on communities. The firm believes it can deliver returns similar to private equity but with a strong measurable social impact centered around economic mobility.

Obran Cooperative is a cooperative conglomerate corporation. They acquire and hold profitable small- to medium-size businesses and real estate on behalf of their worker-owners. Obran believes that everyone should own their most precious asset: their time. Through their portfolio of small businesses and real estate holdings, Obran Cooperative is building a network of human-centered businesses that empower workers through ownership and education. The unique holding cooperative structure allows them to invest for long-term wealth and opportunities for their members. Obran Cooperative is on a mission to change the system of employment in this country.

Additionally, some search fund entrepreneurs using more mainstream search vehicles (traditional search funds) explicitly make social impact part of their mandate. For example, Jake Levine is conducting a search with the objective of making an impact through the company he acquires.

Adam Rose (Yale School of Management 2013), Chief Operating Officer of Obran Cooperative, says the following of Obran's use of the search fund asset class to support their social mission of establishing worker-owned cooperative businesses around the U.S.:

> We aspire to make equity ownership and the distribution of capital within society more equal through the mechanisms of worker ownership. Obran Cooperative operates through a holding company structure that manages several strategic verticals and holding lines. The workforce of the operating companies owned by the holding companies collectively owns the entire holding company. The impact vehicle model is not beholden to a particular incubation or investment model as it is defined by the social purpose it pursues. This gives rise to additional criteria when sourcing investors and entrepreneurs since it may be more difficult to find candidates who are aligned with the social impact being pursued. Though Obran takes the form of a holding company, the impact vehicle model may, in different forms, share more similarities with other search fund structures.

Shaun Randolph has a background in both innovative finance (specifically in the arena of public-private partnerships) and venture capital, having spent time with NEX-Impact, Launch Tennessee, and Project Equity as well as running his own consulting firm, SoTech Ventures, for several years in Los Angeles. He now serves as a FUSE Executive Fellow with the New Orleans Mayor's Office while also working for Obran Cooperative.

> I spent the early years of my career doing grassroots work at various nonprofits in Los Angeles. I initially felt I had found my calling, but after some time on the front lines, I inevitably burnt out. Spending so much energy trying to move the needle for a good cause led me to pivot into the world of entrepreneurship, where I felt greater change could be fostered with the right combination of technology, innovation, and nonprofit experience. Surprisingly, entrepreneurship resulted in an almost accidental foray into the venture capital arena. When I eventually left that world behind, I knew I wanted to do something that would let me bring together my interest in business and entrepreneurship and my desire to do good for the communities that matter to me. Truth be told, I have a healthy irreverence for how many mainstream players in the world of finance attempt to balance social impacts and their bottom line rather than recognizing that innovative social enterprises can organically generate the best bottom lines. I found a diverse group of like-minded contrarians at Obran, and that's what motivated me to join them.

> I never considered following the traditional or self-funded search routes. My resume wasn't one that a traditional or self-funded entrepreneur would succeed with, and I knew that. I had to fight to break into venture capital with my unorthodox resume, and that was a much easier industry to break into than the world of private equity and search funds.
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> Right now, I'm in the midst of my search process. I'm one month in, have my first NDA signed, and am looking forward to soon issuing an LOI. I have every confidence that the worker-ownership model will appeal to all the stakeholders of a deal going forward. Combining entrepreneurship, impact, and search really resonates with me. It is a way to seek market returns while doing good with a tilting of the probabilities of success. I am very excited about what Obran is doing and the role I can play to make it happen.

The emerging market model

When search funds were first conceived in the 1980s by Irv Grousebeck (currently the MBA Class of 1980 Adjunct Professor of Management at the Stanford Graduate School of Business), for many years, this entrepreneurial vehicle existed exclusively in the U.S. Slowly, search funds crept into Canada, western Europe, and Latin America – which now have many search funds and investors. The next geographic boundary for search funds is frontier, emerging markets. Africa, eastern Europe, and Asia are in the incipient stages of search fund development. Although activity in these markets is not yet robust, it is percolating.

Entrepreneurs in emerging markets are usually more generalist and opportunistic in searching because seller markets are not as thick and can be unique and idiosyncratic. Emerging markets are also particularly well suited to partnered ventures since this provides the search with extra bandwidth and horsepower; given the venture's individual risk profile, it can often be hard to find a partner. When partnered searches do proceed, the partnership is usually based on a pre-existing relationship built during time spent operating an SME or pursuing an MBA. Especially in the absence of a partner, the ability of the searcher to build a team around themselves and scale it is a crucial indicator of success since talent can be particularly expensive and hard to come by in emerging markets.

Rob LeBlanc (Harvard Business School 2012) is the co-founder and managing partner of Ambit Partners, a Canada- and South Africa-based institutional search fund investment firm making investments in frontier markets. He believes the time is ripe for more search activity in emerging markets and that search funds are a compelling choice in developing markets:

> There are four distinct advantages to investing or operating with traditional search funds in new and emerging markets. First, there is the type of searcher electing to go for it. These folks may, on balance, be more pioneering and driven than in other, more established markets, looking not unlike the searchers of the 1990s in the U.S. Second, there can be arbitrage on the search itself. Since few people are looking at the market and there is a dearth of well-researched, capitalized, full-time buyers in frontier markets in general, there is a competitive advantage that accrues to well-experienced and networked people.
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> Third, once an asset is acquired, emerging markets tend to be faster-growing, more fragmented, less professionalized, more open to opportunity, and populated by competitors who are easier to leapfrog and less competitive in their operations. Finally, on exit, there is such a scarcity of good deal flow for acquisitive large local or regional corporations or middle

size private equity assets that mid-market private equity firms are forced into greater competition to buy the company in question.

Despite these four attractions, there are, of course, specific risks to operating in frontier markets: the risk of currency devaluation, the possibility of a breakdown in the rule of law, the potential collapse of functioning infrastructure, the lagging speed of administrative work, and the volatility of tax treaties and exchange controls; all of these things factor into the World Bank's 'ease of doing business' index.

Jane Kaggwa-Snow (MIT Sloan School of Management 2006) is the CEO of Nairobi-based Aqua Vita LLC. Born and raised in Kampala, Uganda, she has a background in banking. In 2012, she started Impala Investment Holdings LLC, a search fund focused on the East African region.

In seeking to break into emerging markets in East Africa, I found that, while access to capital was good, there was a dearth of middle management experience that could help a business establish itself in the local operating environment. So, with a focus on the health sector and a need to educate American investors on an African financial environment to which they had little exposure, I launched Aqua Vita LLC in 2014 to deliver bottle-less water cooling and filtration solutions to the East African region.

When it began as a pilot greenfield project, I was advised against pursuing the venture by one of my U.S.-based investors who had a difficult experience with a startup in emerging markets. Seven years later, my business now operates in three different tax jurisdictions, uses five currencies, covers large regional geography in East Africa, and achieved annual recurring revenue of about $1,500,000–$1,750,000 in May 2021.

Things were tough at the beginning, however. Though Kenya's deep talent pool of mechanics and engineers that could be used to assemble installation and service teams made employee acquisition relatively easy, finding a marketing team for B2B services was more difficult. I went through three sales managers in three years, with each needing a lot of guidance to understand how effective marketing was to be done. Even with effective sales management, customer adoption was disappointing: People liked the product but were confused as to why they should buy it. In addition, having to work with procurement teams across languages and cultures made building relationships with customers difficult. Finally, success came with the acquisition of local and regional insurance and banking services businesses. Though it took two years to get Barclay's and Standard Chartered on board, they're now our primary commercial customers in the region. My next hope is to expand into government contracting.

Search funds in frontier markets pose unique challenges to entrepreneurs and investors. But the model works and now can expand geographically. There was a time when search funds in Canada were considered unique, and now they are ubiquitous. I envision a time when search funds in developing markets are as common as in the U.S. A search in a frontier market is absolutely possible.

Search funds with majority equity accruing to the searcher

Another new and innovative approach to search funds, which combines some elements of a self-funded project with those of a single sponsor, is being developed by Justin Burris (Dartmouth College 2015) and Tim Ludwig (University of Michigan's Stephen M. Ross School of Business 2000). In their program, searchers have the ability to earn the majority of the equity in a business based on certain prescribed growth-rate hurdles. The searcher's equity compensation is 100 percent performance-based with materially more upside than in some other search structures. For Burris and Ludwig's firm, Majority Search, the aim is for small businesses to be owned by the people with the skills to lead them, not the people with the capital to buy them. They assert this ownership culture inspires tighter communities and stronger business performance. Majority Search backs operators to find, buy, and run established small companies and awards equity based on their performance. If operators grow their businesses fast enough, they can earn majority ownership, which was never before possible without assuming an SBA 7(a) loan that requires a personal guarantee. Burris and Ludwig have an eye towards long-term compounding and hope the operators they back will build multi-generational family companies. Their unique fund structure gives investors the flexibility to compound with each operator over the very long term at their own election.

Burris shared his thoughts on his approach:

> Some models occupy niches in the market that are difficult to define in terms of familiar categories. This is what we tried to do with Majority Search, which targets those unserved by the traditional and self-funded search models, that is, those who have proven leadership experience but not the MBA pedigree to go with a traditional search or the ability to sign a personal guarantee on an SBA 7(a) loan in a self-funded search. That is to say, we offer experienced operators a path to majority ownership without a personal guarantee. With respect to our involvement in the search and acquisition process, we straddle the divide between traditional and self-funded models. We provide deal sourcing and execution expertise, offer operators larger companies than are possible in self-funded searchers, eschew third-party debt to enhance growth flexibility, and lay out a path to majority ownership without a personal guarantee.

To make this model work, Burris notes that a number of refining criteria have to be adhered to:

> We don't take on startups or turnarounds, preferring established companies with a history of profitable growth that operate in business services, industrial services, consumer services, light manufacturing, and healthcare rather than high technology, heavy manufacturing, financials, real estate, or energy. We focus on sellers selling for non-economic reasons (e.g., moving or retirement) rather than opportunistic sellers looking to maximize value through a sale. Finally, we focus on businesses with recurring or reoccurring revenue, niche markets, growing markets, large markets, markets with limited exposure to cyclicality, businesses with low customer concentration, and industries with durable barriers to entry. We desire businesses with high switching costs that increase customer retention, industries with little risk of technological or regulatory disruption, and companies with no owned real estate.

Conclusion

Search funds are an increasingly popular entrepreneurial pathway. Previously, when an aspiring entrepreneur decided to launch a search fund, there was only one way to structure the project – as a traditional search fund. Now, when an aspiring entrepreneur commits to doing a search, which is an enormous decision, they immediately face another important option – how to structure the search project vehicle. There are many choices, and we firmly believe that all are desirable and have advantages and disadvantages. There is no one right way or best way to pursue ETA – there is only the right way and best way for you and your personal situation and goals. We believe that entrepreneurs should select whatever search fund vehicle helps them get into the arena and operate a business as CEO. No approach is perfect, and landing in a CEO role in an imperfect vehicle is superior to not being a CEO at all.

We hope this case note has illuminated the many ways to approach ETA and a search fund. Good luck in selecting the right path for you and starting your entrepreneurial journey!

This case has been developed for pedagogical purposes. The case is not intended to furnish primary data, serve as an endorsement of the organization in question, or illustrate either effective or ineffective management techniques or strategies.

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Endnotes

[1] Nicholas Rice is a case writer and a current student at Yale University (2023).

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

[3] Peter Kelly, and Sara Heston, Search Fund Study, Stanford Graduate School of Business, Case E-726, August 13th, 2020.