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The Evolution of a Search Fund CEO and Company

The Arc of a 10x Outcome

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Search fund companies and small businesses in general go through relatively predictable stages and patterns in their evolution. Each stage has unique concerns and characteristics and requires the CEO to harness different stage-appropriate skills to grow, thrive, and move into the next phase of development. Not every CEO is capable of moving through the multiple stages of a company's progression. We hope that this note will provide search fund and small business CEOs with a clear framework for understanding and navigating the evolutionary arc of an emerging growth organization.

We write from personal experience and observation. We, Kent and A. J., have been both CEOs and investors in small businesses. We have lived the journey and witnessed countless successful and unsuccessful CEO and company transitions as investors. Kent acquired Progressive Home Care as a self-funded searcher in 2005 and is still the Executive Chair of the $30 million–revenue business based in Sacramento, California. A. J. started ArchivesOne, a document storage business, in 1991 and marched through the ongoing stages of the company while scaling the business before an exit. Additionally, A. J. was the CEO of Onesource Water. In total, Kent and A. J. have invested in over 100 search funds.

The model we present can be thought of as four distinct and predictable stages of development for the entrepreneur to consider. Like humans, all companies travel through infancy, adolescence, young adulthood, and adulthood. We focus exclusively on the low end of middle market (companies with initial EBITDA[*] of approximately $750,000 to $3 million) and the specific challenges and opportunities that these companies face. Our thoughts draw on and are influenced by the work of the late Professor Emeritus of Management and Organization at the USC Marshall School of Business, Larry E. Greiner, in his article "Evolution and Revolution as Organizations Grow,"[4] Professor Ichak Kalderon Adizes in his book *Corporate Lifecycles: How Organizations Grow and Die and What to Do About It*, and Harvard Business School Professor Howard Stevenson in his article "The Heart of Entrepreneurship."[5]

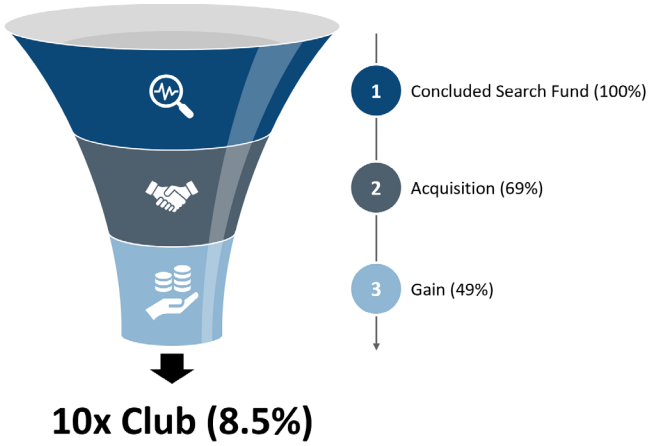
We frame our discussion in terms of a 10x outcome because it's a high but achievable goal that many search fund entrepreneurs aspire to. These CEOs' efforts and abilities place them into the vaunted 10x club: the CEOs who enjoy for themselves and deliver to their investors a heroic return of 10 times MOIC (multiple of invested capital). This is indeed an exclusive group of entrepreneurs. According to the Stanford University Graduate School of Business's 2018 Search Fund Study[6] (**Exhibit 1**), a scant 8.5%[†] of search funds to date have earned entry into this 10x

[*] Earnings Before Interest Taxes Depreciation and Amortization

[†] 71% of search funds have a gain and 12% of those result in a 10x MOIC or higher (71% of 12% = 8.5%).

club. We think of admission into the 10x club as occurring within seven to fifteen years from the inception of the search fund. This implies an enviable internal rate of return (IRR) in the 17% to 39% range. **Figure 1** below depicts the 10x club funnel.

Figure 1: 10x Club Funnel



Source: Prepared by case writers using data from Stanford Graduate School of Business, "2018 Search Fund Study: Selected Observations."

While we use the 10x moniker as a mathematical indication of success, we also believe that to be a 10x CEO, an entrepreneur will also need to run a wonderful business—one that consistently delights customers over long periods of time, attracts, trains, and retains topflight people, and embraces excellence. Being a 10x CEO and company is the outcome of doing many things exceptionally well. While we use a financial metric, 10x MOIC, to paint the picture of success, we wholeheartedly believe that our framework will also help entrepreneurs understand how to build outstanding customer-centric businesses that celebrate employees and pay attention to operational systems and processes.

The most feasible way to earn 10x returns is to significantly scale the business in some manner, both organically and inorganically. We think of this process as climbing the 10x ladder. Our framework will highlight what the path to that scaling feels like, what must be done to do it well, and what challenges might derail progress.

We use 10x as an ambitious image for aspiring entrepreneurs. But we do not want to imply that an outcome less than 10x is undesirable. We encourage search fund entrepreneurs to pursue excellence and growth in their journeys, and we fully acknowledge that landing at a 10x result is at least partially due to chance and good fortune. There will be many search fund entrepreneurs who build excellent businesses that move through the four stages we describe below and deliver 6x MOIC outcomes. We think that is an outstanding result, and the entrepreneur and the investors should be thrilled and proud. So, while we use 10x as a target, we also admire and applaud all successful outcomes. We also believe that entrepreneurs should not seek excessive risk to get to 10x. A 6x outcome with significantly less risk dispersion might be a far superior result than a highly risky 10x one. Finally, to channel President Teddy Roosevelt's speech at the Sorbonne, we laud *any* entrepreneur who leaves the comfortable spot on the sideline as a critic, to venture into the arena, daring greatly while seeking the triumph of high achievement.[7]

There are different chapters and ways in which entrepreneurs can create value in the search fund journey. Tom Bird is a successful former entrepreneur and is now the head of FARM Capital Services, a multi-family office with a focus on impact investing. Bird believes three critical components drive outcomes in a search

fund process: buying, operating, and selling (**Figure 2**). Buying is the phase in which an entrepreneur crafts the specific deal and economic terms for the base acquisition. This hopefully results in a fair entry valuation. Selling is running a highly competitive exit auction, which ideally results in a premium valuation that recognizes the operational value created in a best-in-class business. This note will focus exclusively on operating well where we believe the bulk of value creation happens, in the operations and growth of an enterprise.

Figure 2: Three Components that Drive Value in a Search Fund Outcome

We believe that the four stages a search fund entrepreneur will move through during the operating well phase while pursuing a 10x outcome are:

- **Stage 1: Embrace & Extend**
- **Stage 2: Develop the Platform & Hum**
- **Stage 3: Grow & Scale**
- **Stage 4: Professionalize & Institutionalize**

Each stage of the evolutionary process can be analyzed in terms of the following areas:

- **Relevant Goals**
- **Primary CEO Roles**
- **Fatal Flaws**

See **Exhibit 2** for The Evolution of a 10x CEO Framework, which details the four stages and the key components of each stage. We will also include a CEO profile in each stage analysis to provide color and context as to what it feels like to be a CEO in each stage.

We will now examine in greater detail each stage of the journey and the specific components of each phase. In our analysis, we explore the four stages and examine the relevant goals, primary CEO roles, fatal flaws, and a CEO profile associated with each phase. Becoming a 10x CEO is a lot about attracting the right people at the right moment, building infrastructure (systems and processes), and constantly adapting with the company's development. It is also largely about crossing bridges from one to the next—a very challenging feat for any entrepreneur.

Dave Rehmus (Stanford Graduate School of Business, 1988) is a former entrepreneur who now counsels post-exit entrepreneurs on all matters relating to wealth management at **Portola Partners LLC**. Rehmus believes, "Being a small business is not hard, and being a big business is not hard. What is extraordinarily difficult is transitioning from being a small business to a big business. The skill sets are very different as you make the transition. An entrepreneur needs to let go and delegate – and accept that decisions might not be exactly what they would have preferred. The concept that close enough, for a delegated task, is a home run is hard for most entrepreneurs to navigate as their businesses grow. That's why aligning goals,

hiring key recruits, and creating incentive systems that autocorrect is important. Taken together, I think most entrepreneurs will fail while transitioning into larger businesses."

Being an excellent CEO and entrepreneur in any one stage does not guarantee success in another stage. Every time a CEO attempts to move into a successive stage and cross another bridge, there is company risk and CEO risk—the risk that either cannot make the leap forward. This bridge-crossing exercise is fraught with personal and corporate challenges. We hope that this note illuminates the predictable evolutionary arc through which a company travels, and helps increase the probability of success for aspiring 10x CEOs.

A final thought on CEO development: we do not believe that any CEO is tenured and permanently entrenched in an organization's leadership role. The CEO must continually earn the right to attempt to cross the next bridge and move into a successive stage. The CEO must be emotionally aware of flaws and challenges that might prevent the next step forward and work on improving those shortcomings. Finally, an enlightened CEO will know when the organization has outgrown her abilities and will proactively seek to find a replacement and redefine her role, perhaps as a board member. The very best CEOs are focused on the organization's success, growth, and development first and their individual achievements second.

Stage 1: Embrace & Extend

Sales: < $3m –$10m
Employees: 10 – 40

When a search fund entrepreneur acquires a business, the initial infancy phase can be overwhelming and chaotic. The CEO's goal must be to observe, learn as much as possible, and embrace what currently exists. Like a doctor's Hippocratic Oath, the entrepreneur should first seek to do no harm. If the acquired business was a profitable and thriving going concern, we recommend considering Stanford Graduate School of Business Professor Irving Grousbeck's track, horse, and jockey analogy.[8] The jockey is being switched, and the horse is gently walking around the track with no increased speed. The 10x entrepreneur first simply absorbs and embraces what exists. We are pretty sure the rock group 38 Special did not pen the lyrics for their hit song "Hold on Loosely" with search fund CEOs in mind, but the chorus contains advice that is worth heeding in the infancy stage of a search fund CEO's journey: "Just hold on loosely, but don't let go / If you cling too tightly / You're gonna lose control."[9]

Stage 1 is marked by loosely grabbing control and holding on in a deliberate manner, but not so tightly that the CEO alienates employees and customers or suffocates the organization. Remember, the company existed and was successful for many years before the new search fund CEO entered the picture. Once the CEO feels that she has some understanding of the business and things are not immediately falling apart, the orientation can be shifted to extending—carefully moving beyond where the company was upon the initial acquisition.

In the context of a search fund, the entrepreneur typically acquires a business with $3 to $10 million in revenue, approximately $1 to $3 million in EBITDA, and 10 to 40 employees. The company can be thought of as a shop rather than an enterprise. People tend to be generalists rather than specialists. There are rudimentary systems and processes in place, and the business runs on people—especially the CEO. Everybody tends to know everything that is going on in the organization because the team is relatively small, and the entire team sees each other every day. Despite being a going concern, the size of the business makes it very tenuous and fragile; there is not a lot of room for mistakes. There might be customer concentration or critical employee risk, or both.

Relevant Goals

The first goal as the new CEO of a reasonably profitable going concern is not to break anything. She must observe the people and processes that make the organization what it is without trying to fix anything. She does not have enough information or understanding to be sure that what she is trying to fix in one area will not break something in another. This can be quite hard for young, ambitious entrepreneurs who are excited to get in and start improving the business. We understand this desire but urge budding entrepreneurs to take it slow. They need to do more maintaining than fixing; preserve what was working; maintain relationships with customers, vendors and employees; maintain processes; maintain the goodwill that the previous CEO accumulated with the business's stakeholders and transfer it to the new CEO. If the new CEO quickly changes the way things are done, it tends to worry stakeholders and tends to destroy goodwill.

As the new CEO will likely be itching to make changes and improvements to the organization, we suggest she look for "quick wins" or "low-hanging fruit." These should require relatively few resources, whether it's money, time, or energy, while signaling a commitment to the improvement and success of the business. These quick wins could include vehicle or infrastructure upgrades, vendor renegotiations, or outsourcing certain functions. Beyond her personability, her first moves as CEO will form the impression of her that others (including employees, customers, suppliers, and investors) have. The outcome of early decisions and changes will affect others' assessment of her and the likelihood of their buy-in to her subsequent decisions. Therefore, these changes should have a high probability of success and significantly capped downside risk. She should show people she can hit a few singles and doubles before asking them to trust her to start swinging for home runs.

At the risk of stating the obvious, it's very important that the business be run profitably. The acquiring CEO needs to assess the accuracy of her assumptions about the business's profitability and valuation. She must determine whether or not the business plan she underwrote can be operationalized and executed. Of course, assumptions and models are never 100% accurate, but it's time to pin them down and ensure that what she bought is worth what she paid.

Primary CEO Roles

The CEO's role in the infancy stage is to be a doer. Warehouse is a mess? Clean it up! Certain customer complaining and threatening to leave? Appease and retain them! There is no task too small or menial for the CEO at this stage. She must be willing to get her hands dirty and take on any task that needs to get done. This is not only necessary because of the business's size, but it also helps the new CEO earn the respect of her employees while giving her opportunities to interact with them without managing them.

As the CEO of an enterprise of this size, she is a solo player. She may need to make sales calls, do the bookkeeping, and respond to customer service complaints, all in one day. It's her company now, and the buck stops with her.

Fatal Flaws

While there are numerous ways that a CEO can trip up in her newly acquired enterprise, we will highlight a few common issues to be aware of and actively avoid. It should be noted, however, that a CEO can make every right move and still catch a bad break that harms or even destroys the business.

The first red flag for a new CEO is missing on the targeted cash flow. This can be a matter of realizing that the investment thesis was underwritten incorrectly—perhaps, the conversion of EBITDA to free cash flow

is lower than expected, growth is slower than expected, or anticipated cost savings did not materialize. Beyond poor acquisition assumptions, small and medium enterprises (SMEs) miss on cash flow when accounts receivables balloon, a big client is lost, or the new CEO engages in premature CapEx spending.

Another major error a new CEO can make is alienating the incumbent leaders and employees. If the CEO enters the business filled with hubris and a condescending tone, there is a risk of offending tenured employees. She is likely to lose the respect, commitment, and work ethic of her employees. Search fund entrepreneurs underwrite cash flows, but they also underwrite the human capital, especially key managers and leaders, that are in place. If she causes the company's best talent to become frustrated, question her judgment, or leave, the business will suffer serious short-term consequences. This disharmony can often be avoided by demonstrating humility early on.

It can be a flaw for the CEO to view the world exclusively from an ivory tower. Many search fund CEOs have impressive credentials, academically, and professionally. They have proven themselves to be book smart but have not yet established their street smarts. They are often fresh out of elite MBA programs armed with dozens of academic frameworks they cannot wait to apply to their new businesses. We love investing in these eager and energetic CEOs, but they can fall into the trap of relying more on their education and background than on the experience, knowledge, and judgment of their employees. The CEO's style and approach in this phase should be soft, self-deprecating, and filled with humility. Coming across as an MBA slickster who has all the right answers can be alienating and off-putting to employees. It takes far longer to fix these damaged relationships than it does to respectfully listen to and consider the thoughts and opinions of employees.

CEO Profile

Kalil Diaz (Yale School of Management, 2014) launched a traditionally funded solo search fund to acquire a business in his native country of the Dominican Republic immediately after receiving his MBA. Diaz raised capital from U.S.-based investors and local investors in the Dominican Republic. After searching for a business to purchase for about 19 months, Diaz acquired **Contact Centers Dominicana** (CCD) in an all-equity transaction. CCD is a specialized call center operation specializing in inbound medical appointment scheduling. Diaz, who has been operating CCD for three years and is emerging from Stage 1, recalls the challenges and issues of a young, inexperienced first-time CEO taking the reins of a going concern:

> Doing a search fund was a dream opportunity for me, post-MBA. Searching was hard, but the reality of walking into CCD as the CEO was a new level for me. Here I was, a young entrepreneur walking into a business and not knowing that much about the industry and trying to figure it out. When I bought CCD, it was a USD $4.05 million–revenue business with USD $700,000 in EBITDA. It was a very nice little business that had been working well. My initial goal was not to go backward in any way—I just did not want to mess anything up. The seller of the business was a real gentleman, and I just wanted to learn as much as possible during the transition period. Customers (we only had six) thought highly of the business and the seller. I was just looking for a smooth changeover.

Diaz spent as much time as possible trying to embrace the business and learn the actual underpinnings of how things worked. He felt good after several months of operations when the financial results were landing in the anticipated range. One material setback was losing a key customer, which CCD overcame in subsequent years. Diaz elaborates:

> Taking over as a CEO is scary. I don't want to glamorize it. You so badly want everything to work, but you don't know how to do it exactly. It's this odd combination of staying out of the way and trying to be helpful. Eventually, I felt like I learned the mechanics of the business, and then I shifted into work mode. I did everything in the business—sell, set up accounts, work on financials, hire, fire. There was nothing below what I was willing to do, and it was satisfying and fun. Getting to know the employees, who were certainly not all great, and customers was important and a big use of my time. Making sure the investment thesis was working, at least directionally, mattered a lot in the first year or two. The only way to describe Stage 1 is like drinking from a fire hose. I learned and listened and tried not to make too many mistakes (although I definitely made my fair share). One tip I would give to new CEOs is that you don't know everything at all, even with a fancy MBA. Be humble, be appreciative, be respectful, and do not break anything! I know that all search fund entrepreneurs want to jump in and fix. There will be time for that, I promise—just don't rush it.

Stage 2: Develop the Platform & Hum

Sales: $10m–$20m
Employees: 40–75

As the business enters the next stage of development, its adolescence, some of the initial chaos will be tamed with new systems and processes. While there is still a long way to go to deliver a 10x result, the seeds of success have been planted and are beginning to take root. The company is aligned on its strategy and execution for customer acquisition, sourcing and deploying capital, and profitability. The business is no longer a shop, but a small corporation with a mix of generalists and specialists. As the company grows, the CEO may not know who showed up for work that day, whereas in Stage 1 she likely knew what everyone had for lunch.

Stage 2 is characterized by standardization. The company transitions from ad-hoc fixes and last-minute saves to reliable operations and procedures. While many of the systems and processes initiated during this stage may later frustrate employees as either constraining or bureaucratic red tape, they are absolutely necessary to wrangle disorganized and disparate functions and personalities into a unified direction and vision for the business.[10] To avoid becoming overbearing and to better leverage her own time, the CEO delegates and manages skilled employees in charge of functions and processes that work consistently. The CEO dedicates her own time to leading new initiatives, setting company strategy, and determining best practices to be implemented throughout the organization.

Relevant Goals

Hopefully, the CEO has made it successfully through the first stage by not breaking anything. In the second stage, it is time to establish the systems and processes of a well-oiled machine. Typically, the first priority should be to develop a robust and predictable customer gathering process. The first stage might have been characterized by not losing customers. The second stage is about winning desirable incremental customers. Until generating sales is reliable and certain, it will be difficult to make decisions about financing, growth plans, human resources, and other things.

In parallel, but subordinate to solidifying the sales engine, the CEO needs to acquire resources and build capacities, including human, financial, and infrastructure capacities. The business has grown out of infancy and into adolescence, which means preparing for and growing into young adulthood. This process involves building out a quality team and running a tight business, which will be discussed in subsequent

paragraphs. Building infrastructure capacity takes many forms, including the simple but necessary technology upgrades, like switching accounting software from QuickBooks to a scalable, multi-user enterprise-grade accounting solution. Investments need to be made to convert manual processes to automation. Overall, the business should feel rock solid by the end of this stage, so it's ready for accelerated growth in Stage 3. Right now, the business may only be in a few locations, but where it is, it's bulletproof.

As the CEO comes into her stride, she will need to surround herself with a great team. This likely involves both hiring and firing to make sure that the company's leaders are aligned on the vision for the company and have the necessary skills to get there. The search fund CEO is, ideally, transforming a local mom-and-pop business into a regional heavyweight. It should come as no surprise then that many of the original employees are not up to the task of making this transition happen. She needs to evaluate what her company's upcoming needs are and who can best serve them.

Tactically, the business needs to run smoothly before the rapid-growth phase begins. A small business's minor hiccups can devastate it reputationally or financially at scale. The business should be humming along, meaning that most things work most of the time. Customer orders and service requests are addressed on time. The product or service quality is high. Operations are delay- and defect-free. Money is spent efficiently and without waste. Employees are confident and successful in their roles. There is a robust infrastructure in place to handle the inevitable minor failures and deviations without relying on frequent fixes and course corrections from the CEO. There should be tools and protocols in place like a balanced scorecard, key metrics, and communication patterns to effectively focus attention and disseminate information coherently and consistently. All of these mundane practices are critical for the 10x CEO to achieve a successful outcome for the business.

By the end of Stage 2, the business's profit, growth, and capital models should be validated. They may be slightly different from what was assumed at the time of the acquisition, but now they work and are solid. The CEO understands how to grow and what growth costs. She knows how much incremental profit she can squeeze out of each CapEx dollar. She understands every piece of the equity value creation puzzle and can confidently explain how it works to investors and lenders. The business model is validated and will consistently generate cash if executed well.

Primary CEO Roles

Fundamentally, the CEO's role changes from that of a doer to a manager in Stage 2. By removing herself from doing and transitioning to managing, she will get a better view of the entire organization. This higher-level view enables her to solve cross-functional problems, allocate firm resources efficiently, and establish company-wide processes and norms. The CEO begins to shift from working *in* the business to working *on* the business.

The CEO must ensure that all the pieces of the company puzzle are working together effectively. Being a CEO is akin to coaching a sports team. The CEO must pick the right player for each position and train that athlete on how best to do his job. Both picking and training require the CEO to know her employees' talents, personalities, and potentials. She should also understand how people will work together and look to hire individuals who perform better collectively than individually. At the beginning of Stage 2, the CEO is a skilled and versatile player, but as she morphs into a coach, she should pick and teach employees to be better than herself in each of their respective roles.

Periodically, an emergency will arise, and the CEO will need to step back in as a player. This may be necessary because of her superior ability relative to an employee's, a lack of resources, or her inherent

authority as CEO to make decisions and speak for the company. 10x CEOs fully embrace their role as a coach but can still be an all-star player when needed.

A hallmark of Stage 2 is establishing processes and procedures that will only be fully leveraged after the growth in Stage 3. One of the crucial hats a Stage 2 CEO wears is that of a systems architect. Whether it is dispatching vehicles to optimize routing, prioritizing accounts receivable collection, or targeting new customers, it is up to her to determine the best path forward and create systems and processes that will standardize implementation so anyone in the organization can carry it out. Although the CEO should be able to create bespoke processes, she should also look for off-the-shelf solutions whenever appropriate.

Some examples of processes that need to be considered in Stage 2 include, but are not limited to, cash application; fleet acquisition, maintenance, and disposition; employee recruiting, on-boarding, training, compensation, and separation; establishing a robust, balanced scorecard, and evaluating individual customer profitability and product or service profitability; and implementing and communicating customer price increases. For a thorough list of functions that will need to be changed and scaled see Exhibit 2 in Eisenmann and Wagonfeld's "Scaling a Startup: People and Organizational Issues."[11]

Fatal Flaws

As described above, the CEO's role changes as the organization evolves from infancy to adolescence. Naturally, if the CEO does not acclimate to that change, she will hinder the organization's development.

One adaptation many CEOs struggle to make is the switch from player to coach. Playing and coaching are two fundamentally different skill sets. While people naturally tend toward one or the other, we generally believe that most people can develop either. More often than not, CEOs are inferior coaches because they continue seeing themselves as all-star players, not coaches. They continue spending too much of their time doing, when they should be managing. Doing something well can feel both productive and gratifying (especially in the short term), so it is difficult for some CEOs to stop doing what they are good at. If a CEO persists as a player and cannot morph into a coach, the business will stagnate. It might be an excellent Stage 2 business, but it will not be able to cross the bridge to Stage 3.

Additionally, the CEO needs to recognize when the competitive environment is changing. In Stage 1, the business was likely nonthreatening. It was either too small or too stagnant to be noticed. Now, it is likely winning customers from competitors, which will certainly draw attention. The 10x CEO understands her strategy and sticks to it. She has systems and processes in place to retain customers as competition fiercens. Importantly, she maintains her standards. She works hard to keep her customers, but she doesn't make unprofitable deals.

An obvious, but critical component of success is the company's financial performance, whether measured by EBITDA, ROI, or another metric. The CEO cannot graduate into the rapid growth of Stage 3 until the financial model is profitable and consistent. The CEO is in a kind of purgatory until all relevant stakeholders are confident in her ability to generate cash flow and create equity value. Investors, lenders, employees will not rally behind the CEO if the company is not consistently profitable and on a clear path to creating desirable equity returns. Just as the operations need to be bulletproof before an expansion, so does the economic model.

Assuming the company's financial model is functioning smoothly, some investors may see an opportunity to exit, earning a respectable return on their investment (perhaps 3–5x MOIC). While there may be nothing wrong with this, the CEO must understand the intentions and expectations of her shareholders, board members, and executives around exit strategy and timing, rate of growth, dividend payments (or

lack thereof), and follow-on equity investments, among other things. A CEO must ensure that these stakeholders are aligned. Disagreements hinder progress and growth. A manager creates value by running and growing her business, not by resolving conflicts between board members and investors who don't ship products. Investor and board member disharmony can lead to a successful but premature exit and impede the path to a 10x outcome.

CEO Profile

Robin Kovitz (Harvard Business School, 2007) took a job in private equity in Toronto, Canada, after receiving her MBA. After several years of long hours and hard work for someone else, and catalyzed by the birth of her first child, Kovitz decided to follow in her father's footsteps and launch an entrepreneurial venture in which she could work long and hard *for herself*. Kovitz launched a self-funded search to acquire a business in Toronto that was profitable and could grow through her efforts. She wanted to find a business that would fit for her, but she was industry agnostic. After three years of searching for a business, Kovitz acquired **Baskits**, Canada's largest gift basket business.

When Kovitz took over the business in October 2014, Baskits was being run with haphazard manual systems and processes. Inventory was managed by individuals who ordered whatever they needed whenever they wanted. It was a highly seasonal business that felt like a shop that could be turned into a great business. Kovitz explains:

> Baskits had a great business model when I discovered it. It had all the characteristics I was looking for, and it was the right fit for me. Even though the business dated back to 1985, it had not evolved. After I got my arms around the business, I shifted into Stage 2 and began to invest in the business. I knew that to operationalize my vision for Baskits, I had to invest in people and infrastructure. I needed the right tools, systems, and processes and the right people to set the stage for growth.
>
> The two key infrastructure changes I made were to move the business to the right type of facility and install an ERP (Enterprise Resource Planning) that could serve as a platform software solution. The move allowed us to remove the seasonality in the business by building a 12-month strategy. It also allowed us to focus on new customer segments who valued our capabilities and infrastructure. The ERP pushed us forward and made us better operators.

Kovitz knew that many of the legacy employees would not be a match for Baskits as the company grew and changed. She also understood that if she did not have the right people, the business would be stymied, and all the investments she made would not be leveraged or monetized:

> Changing people is a very difficult and emotionally hard thing to do. I can't imagine that anybody enjoys it. But when a business is evolving, the people either need to develop and grow with the company, or they need to be gracefully and respectfully exited. I had to change a bunch of people, and as painful as it was, it was the right move. Some people decided the new Baskits was not for them and made the decision to leave for themselves. I needed to have the right people in place so I could focus on being a manager of people instead of doing tasks that people should have been doing. I was tweaking and validating the model. Sometimes, I got sucked into the muck of the business, but I really tried to focus on how to build the machine and make it work.

Five years into her entrepreneurial venture, Kovitz is on track. Her efforts in Stage 2 have paid off. Revenue has grown fourfold in five years, and she is now shifting into Stage 3 and exploring how to truly scale the business further.

Stage 3: Grow & Scale

Sales: $20m–$50m
Employees: 75–500

As mentioned above, many searchers and their investors may exit after Stage 2 with very respectable results. This can be a significant and relatively quick win. However, in our experience, a 10x exit requires the scaling and growth of Stage 3. It is during this phase that the company transforms into a full-blown, multi-market corporation. It realizes the economies of scale enabled by the technology and process infrastructure investments made in earlier stages. It increases and utilizes its operating leverage with targeted acquisitions and organic expansions. The company begins reinvesting the cash it generates without needing external equity infusions for accretive growth. And if done right, it is at this stage that substantial equity value is created.

As the company grows and develops, so must the CEO. She comes into her own just as a young adult is much more capable, polished, and wise relative to her adolescent self. It's an exciting and fast-paced period of growth and development, not unlike early adulthood, when people often make many of the biggest decisions that will shape the rest of their lives. The CEO transforms from a manager into a leader. While she may be constantly filled with apprehension (or as Andy Grove, the former CEO of Intel, put it, paranoia in his book *Only the Paranoid Survive: How to Exploit the Crisis Points That Challenge Every Company*[12]), she is no longer scared. She begins seeing employees step up and take leadership roles. Things start happening without her asking or suggesting. She does not know everyone in the organization anymore. There is a flywheel at work that generates value with minimal manual intervention. While these significant changes may be discomforting for some, they are signposts of natural growth and progress.
We think of Stage 3 as a magical window of rapid evolution, growth, monetization, and sheer fun. This is when the CEO feels like she has a real organization behind her that is committed to a common vision. The company has a reputation for customer and operational excellence. We hope all search fund entrepreneurs have an opportunity to experience the joy of being CEO in a Stage 3 company.

Relevant Goals

The most important goal in Stage 3 is to fully explore and execute on growth pathways. This stage is all about driving growth and scaling the business profitably—and climbing the 10x ladder. In Stage 2 the foundation was established by building infrastructure and assembling the right leadership team. In Stage 3 all of these resources are fully harnessed to drive growth. This is when operating leverage is realized. Previous investments allow for incrementally more profitable growth because incremental expenses are zero or are increasing at a declining rate.

While driving growth in Stage 3, the CEO is fully exploiting established and tested growth channels, such as the current portfolio of products and services, the current geographies in which the company operates, proven customer segments, and proven growth channels (organic and inorganic). While a Stage 3 CEO might choose to experiment with growth strategies at the edges, the core machine is a proven winner that consistently delivers results.

While having good people is always necessary for a CEO, it takes on additional importance in Stage 3 as her proximity to each individual decreases due to the increased layers of management as well as functional and departmental specialization. As management guru Jim Collins famously shares in his book *Good to Great: Why Some Companies Make the Leap ... and Others Don't*, the CEO needs to get the right people on the bus and in the right seats and the wrong people off the bus before she can successfully navigate it anywhere.[13] Generally, the right people are those whose mission and values are well aligned with the company's mission and values. Picking the right seats will be based on each person's abilities and performance.

As the organization's executives and managers will funnel and disseminate cultural and business values from the top to the rest of the organization, it is critical for the CEO to focus her attention on picking and coaching these leaders effectively. A CEO should aim for cohesive cooperation and concurrence around priorities among her top executives and managers. If she does, then she can spend her time supporting leaders instead of butting heads with them. Executive team meetings and one-on-ones will be collaborative and not corrective. If the CEO looks forward to team-member interactions, she will be in a wonderful place and know that the right people are on her bus.

Once the CEO has the right team in place, she must ensure the organization functions smoothly and effectively. Because of the sheer size of the business, it has become more effective for her to spend her time designing the business rather than toiling in it. We have found the business architecture of OpCo, SellCo, and BuyCo to be useful for many search fund CEOs.

The operating company (OpCo) fulfills the service promise to the customer. OpCo should be mostly on autopilot and very lucrative. The majority of the organization's people are in OpCo. SellCo is the organic growth engine. SellCo finds attractive new customers, makes pricing decisions and manages the competition. BuyCo is the acquisition arm of the company. It is another customer-gathering function. Once customers are acquired by BuyCo and SellCo, they are serviced by OpCo, which sustains and nurtures those relationships profitably. Although the CEO may, in some circumstances, lead one of these three silos, her primary concerns are making sure that the correct leaders are in place for OpCo, SellCo, and BuyCo and ensuring that the three silos interact well. She makes sure each has the resources it needs and discourages any elevation of one over the others, whether in terms of resources or internal respect and importance.

Finally, excellent capital formation can turbocharge a great organization, but the organization must be stable and robust first. Some CEOs lead with complicated financial engineering. We favor CEOs who create value through the business's fundamental operations and amplify returns through wise and savvy balance sheet management. Great CEOs carefully consider their financing options and how they can lower their cost of capital, but this is a secondary strategy, subordinate to creating value for customers and employees. To fully take advantage of capital formation, a CEO must deeply understand her business. For example, if she wants to allocate external capital to growth, she must understand where growth is occurring and what is accelerating it. Prudent financing is a powerful lever, but using it on a subpar business can lead to disastrous consequences.

Primary CEO Roles

At this stage of the company's evolution, the CEO fully moves from a supervisor (a manager) to an executive (a leader). The days of doing and being a player are long gone, perhaps with the exception of high-impact activities like acquisitions. The CEO's style of leadership should shift. The organization has expanded to include a few hundred employees and over a dozen locations, so the CEO cannot browbeat the workforce into falling in line (nor would we recommend that tactic at any stage). Spending time *on*

the business and not *in* the business can mean developing motivation and retention schemes, training company executives and managers, and defining values and setting norms.

As the business now includes different geographies, divisions, and functions, the CEO must define company values and foster a company culture that holds the business together. This role cannot be delegated. People will always take their cues from the top person. If that person behaves in a manner contrary to the stated or tacit culture, there will be disharmony and confusion throughout the company. Culture must be exemplified at the top levels and flow down through the organization. Accordingly, the company's executives must play an active role in the training and development program, as this is one of the most effective ways of instilling a cohesive culture.

To be effective, the corporate values must be genuine, and to be genuine, they must derive from the CEO's personal values. Time and energy spent embedding these values into the company's ethos is not time wasted. In fact, it should generally begin during Stage 2, but Stage 3 is where it becomes indispensable. Some leaders find it useful to write a monthly newsletter that is distributed to the entire company to communicate these values along with business updates, goals, and metrics. While words matter, actions speak louder. If a CEO elevates a high performer with low integrity, the workforce will quickly see through the values on the walls and in the newsletters to the CEO's true value: profit, above all else. If the CEO applauds good failures, people will take smart risks. If she takes care of her employees during difficult times, they will be loyal in return. If she celebrates an employee's success, they will celebrate the company's success.

The talent training that we discussed in Stage 2 needs to be upgraded in Stage 3. Instead of coaching and selecting players, the CEO will be coaching and selecting other coaches. She needs to pick, develop, and allocate managers to be stewards over all the employees and departments of the organization. This requires one-on-ones, phone check-ins, and group leadership meetings with executives and the broader leadership team. The style and frequency of communication will be determined by the business context and the CEO's personality. Departmental needs, progress on goals, and status updates will need to be communicated so that decisions can be made effectively, everyone is moving in the same direction, and unimportant and time-consuming projects don't become distractions.

Finally, we believe that Stage 3 is the most fun stage because the CEO really drives and exploits the value creation plan here. Up to this point, the organization has invested in infrastructure, processes, and human capital development. Now is the time to harness the operating leverage and reap the rewards. Shared services as a percent of revenue decreasing and new sales coming in at accretive rates are signs that the value creation plan is working. Since consistent profitability is necessary for a business to move into Stage 3, the CEO will need to decide how to allocate that profit. She can choose to issue dividends, acquire businesses, extinguish debt, or pursue other growth opportunities. She has all the tools in her arsenal now; she must decide how to allocate capital efficiently to monetize the business most effectively. The CEO should be excited but prudent. There are more good things ahead than behind.

Fatal Flaws

A new set of priorities and responsibilities translates to a new set of ways a CEO can miss the mark. If a CEO does not transition from a doer and a manager to a leader, she often becomes a logjam causing delayed decision-making and time wasted waiting on her approval. Funneling everything up through the CEO might work in Stages 1 and 2, but not in 3. Every company has a certain rhythm (how things get done and how decisions are made) that's driven by the CEO. But, if she needs to be physically present for the pace she sets to spread throughout the organization, it will waver, and the company will falter as a result. The systems and processes the CEO has established, and the executives and managers she's hired and

trained need to be able to drive that tempo on her behalf. Though she may try, the organization is simply too big for the CEO to do it herself.

Another common (and potentially fatal) trap CEOs fall into at this stage is turning into an empire builder. As the CEO begins to see evidence of her success, her ego may grow, and she may gain undue confidence in her decision-making and other abilities. The 10x CEO remains introspective and humble here. She is a servant leader,[*] not an autocrat. She continues to listen to the advice of her trusted counselors. When CEOs fail to recognize that they could be wrong or get unlucky, they tend to grow for the sake of growth or bet the balance sheet on a big acquisition with overly optimistic assumptions, and the company implodes. Things can always go wrong. Past success is evidence not only of skill but of good fortune as well.

While becoming a logjam or an empire builder are character-driven defects, the company can suffer from flaws that are more easily avoidable with appropriate maintenance and safeguards. During this growth stage, weak companies are exposed quickly. If the company is still dependent on manual processes, it will almost certainly crumble under the weight of rapid scaling. Automated systems and processes hold everything together, keep customers and employees happy, and maintain financial stability. What got the company through Stages 1 and 2 is not what will get it through Stage 3. Before, running a tight business was a goal. Now, it's table stakes for survival.

As in previous stages, capital allocation is again critical. In this stage, CEOs are often tempted to launch unproven products or geographies. These kinds of gambles seem exciting, and the size and success of the company now allow for them. But the 10x CEO remains maniacally focused on squeezing the greatest returns from her capital. She uses the company's size to improve margins and profits rather than fritter away the advantage on high-risk, low-return ventures. Stage 3 CEOs stick to their core and ride the proven and profitable strategies that got them there. For example, using McDonald's core profit engine as a metaphor, a Stage 3 CEO knows what her burger, fries, and coke are—the foundational building blocks of her menu and offerings. She is fantastic at delivering burgers, fries, and cokes that customers desire, and she does so profitably. She is highly skeptical about adding sushi to her established and tested offerings. She embraces focus and relentlessly executes on a profitable growth strategy. Similarly, Andrall Pearson, the former President of PepsiCo, says that many managers make the mistake of believing it's "easier to build a 5% market share to 10% than to grow 30% to 35%."[14] He asserts that the latter is more feasible for most companies, and moreover, that playing on a company's strengths keeps its competitors so busy playing defense that they can't take the offensive.

[*] The concept servant leadership was developed by Robert K. Greenleaf in *The Servant as Leader*, an essay that he first published in 1970. Greenleaf said: "The servant-leader is servant first. A servant-leader is first motivated to serve and only later aspires to lead. A servant-leader focuses primarily on the growth and well-being of people and the communities to which they belong. While traditional leadership generally involves the accumulation and exercise of power by one at the top of the pyramid, servant leadership is different. The servant-leader shares power, puts the needs of others first, and helps people develop and perform as highly as possible."
What is Servant Leadership? Retrieved April 26, 2020, from https://www.greenleaf.org/what-is-servant-leadership/

CEO Profile

Mark Anderegg (Kellogg School of Management, 2010) is the Chairman of **Little Sprouts**, a Boston-based provider of early-education centers. Anderegg acquired the business in 2012 through a funded search, and the company has grown at a CAGR of 25% during his tenure as CEO. It is now the largest private preschool company in New England. Little Sprouts had $17 million in revenue and $2 million in EBITDA when Anderegg took over, and once Anderegg moved through Stages 1 and 2, he really drove growth in Stage 3. Anderegg explains:

> I was so excited to do a search fund. After doing investment banking and private equity for a few years, I really wanted to be an entrepreneur and an operator. The search fund model was the best route for me to catapult into a CEO role at a young age. Each stage of the process was fun for me – exploring the idea, raising money, evaluating deals, closing a deal, and jumping into the business as a CEO. Becoming a CEO was great, but being a Stage 3 CEO is where you want to be—that is what the journey is all about. Stages 1 and 2 are good, but Stage 3 is when it all comes together, and everything you worked on over several years comes together for acceleration and growth. Stages 1 and 2 are all about planting the seeds and laying the foundation for Stage 3, and that is where the real fun is. Everything fell into place in Stage 3. We built the infrastructure—the model, the team, the systems and processes—and leveraged it for growth. We grew organically, and we grew through acquisition. It was very gratifying.

Anderegg enjoyed his morphing role as well. The tasks he focused on and the role he played evolved as Little Sprouts grew, and the organization seasoned. Anderegg was particularly well suited for some of his new activities:

> Little Sprouts is in the early-education business, something I am passionate about and really believe in. Our graduates excel at reading proficiency compared to non–Little Sprouts peers. At first, you do everything as a CEO, and I mean everything. I read to kids, assembled toys for new schools, and helped build playgrounds. When we hit Stage 3, my time was spent working on the business and driving growth. Another key role I loved to play was focusing on culture and designing what a growing Little Sprouts was about. I am a touchy-feely type of guy, so designing and impacting culture felt great for me. I am much more of a leader now and far less of a manager. I spend my time gathering and allocating resources, lifting employees up, and envisioning how Little Sprouts can continue to grow and thrive—it's a lot of fun.

Stage 4: Professionalize & Institutionalize

Sales: > $50m
Employees: > 500

As the company surpasses a certain size ($50 million in revenue and several hundred employees), it is moving into Stage 4 and is in the process of becoming fully professionalized and institutionalized on a scale basis. The company is entering adulthood and maturity. The concepts of being professionalized and institutionalized do not to suggest stagnation or bureaucracy, but rather indicate the arrival of a new level of accomplishment, confidence, wisdom, and scale and scope.

At this stage, the company is a nationally recognized industry leader, if not because of its size, then because of its growth and overall excellence. It has achieved the next level up in terms of recognition, capital cost reduction, margins, and customer diversification. While the company should adhere to its core strategy, it must also resist stagnation and complacency. Established competitors and industry entrants will see the company's success and profitability and try to take some of it for themselves. Stage 4 CEOs and businesses will face the additional challenges associated with scale and scope.

Relevant Goals

As the business enters Stage 4, it is becoming an institution. The CEO needs to make sure that what got it there is sustainable. Systems and processes can rust out or be outgrown as the organization catapults into yet another level of growth and size. The company needs a sustainable competitive advantage to survive profitably for years or decades to come. There is a delicate balance between innovating enough to stay ahead of the competition (which is likely from national and regional players and significantly stronger and more adept than in previous stages) or finding new growth channels and overstepping with risky acquisitions or product launches that destroy value and credibility.

As a result of more competition, it will be challenging and imperative for a CEO to fully understand how the business can continue to create value. A Stage 4 CEO must be able to achieve sustainable and profitable growth. One way great CEOs track the strength and trajectory of their organization is via dashboard metrics. While the CEO's dashboard in previous stages likely encompassed many granular statistics (on-time delivery rates, for example), the CEO dashboard now needs to be high level and focused on the most important drivers of value creation. Metrics like customer profitability, conversion rates, and new customer backlog keep the CEO focused on accretive growth, not just growth for its own sake. The systems and processes developed in previous stages should be adapted for the company's new organizational design, market position, and strategic focus.

In order to sustain the company's success, it will need to attract, develop, and retain the top talent in its industry, especially as the other large players begin to see it as a significant threat. In Stage 4 at least some of the key players in the company who thrived in Stages 2 and 3 will likely need to be replaced. The CFO, who was excellent at running a $30 million accounting and finance function, might be overwhelmed at $100 million. This is not a sign of failure or inappropriate previous people-selection. It is just part of a normal growth process. As the size of the organization begins to justify and necessitate it, the company may start hiring highly-educated specialists with experience either in the industry or a function like M&A or operations. Because of the increased size and stability of the company, it may be able to recruit from a pool of talent that was unwilling to join a smaller and riskier business. Attracting and retaining talent is about more than just compensation. 10x CEOs develop a culture of excellence, appreciation, and growth that high performers thrive in. Having great talent is critical to improving and sustaining the company's ability to compete at a high level, often in several regional markets.

The CEO must recognize that the skills and personalities that excelled in previous stages may not work in Stage 4. Experienced and sophisticated new team members with specialization may do great in Stage 4, but they may not have been the right fit in earlier stages. Greiner suggests that "managers, realizing their own managerial styles are no longer appropriate, may even have to take themselves out of leadership positions. A good Phase 2 manager facing Phase 3 might be wise to find a position at another Phase 2 organization that better fits his or her talents."[15] 10x CEOs make sure that executives and managers—including herself—are well suited for each stage.

Primary CEO Roles

In Stage 4 the CEO role evolves again. While she remains a leader, she must lead as an ambassador. She must represent, both internally and externally, the company's values and mission. With continued growth, the percentage of employees she knows by name (or has even met) decreases substantially. Therefore, she is the personification of the company's cultural norms, ethical standards, effort, and behavior. Of course, culture must be instilled systematically and not just through the CEO's personality, but if there is a conflict between company values and the CEO's personal values, all the programming in the world will not be able to get employees to embrace company philosophies.

In this stage, the CEO will spend time interfacing with external constituencies like acquisition candidates, capital sources, and key potential new hires. Even within the context of these activities, the CEO will likely have material functional support from within the organization. The CEO might play a large role in industry association activities advocating for industry standards or lobbying activities. With scale, the CEO might judiciously contemplate diversification into product and service adjacencies. A key function the CEO still owns is capital allocation. Whether or not external funds should be sourced and how external and internal funds can be deployed are within the purview of an excellent Stage 4 CEO.

The CEO still owns the strategy, direction of the company, and the visionary role. While her leadership team is managing current operations, she must think a few years ahead, anticipating and preparing for changes in the market. Only the CEO can decide to reallocate resources away from profitable business lines to stave off competitive threats. Alternatively, because the company is now more established reputationally and financially, she can consider bigger, long-term moves. What were once aspirational acquisitions may have become transformational possibilities. Launching a new, adjacent product or service could drive the company's next few years of growth. While these are exciting moves, the CEO needs to plan and prepare for them appropriately, so she can act swiftly and confidently when the right opportunity appears.

Fatal Flaws

Now that the business is a full-fledged professionalized corporation, the CEO must fully let go of day-to-day operations. She needs to hire, promote, and train the right people. Then, she must trust these executives and leaders to do their jobs effectively. By this point, they are extremely qualified managers with equivalent, if not more, education, experience, and abilities than the CEO in their respective functions. If the CEO cannot let go or still has to be the smartest person in the room, she will stifle the executives' effectiveness with her insecurity. She can also get too bogged down in the minutiae of running the company or unable to see the bigger picture, competitive threats, and long-term strategy of the business.

Along the lines of seeing the bigger picture, some CEOs still pay attention to too many or unsuitable key performance indicators (KPIs). Just because revenue and EBITDA are growing does not mean the company is creating equity value. By Stage 4 the 10x CEO is maniacally focused on equity value creation and the MOIC and is not seduced by growth for its own sake. The CEO understands the cost of growth and how growth translates into equity value. Of course, someone should keep an eye on the granular details of the business, like the on-time delivery KPI mentioned earlier, but it does not need to and should not be the CEO. The point of hiring great talent is to be able to delegate real responsibilities and leverage their time, expertise, and abilities. They must be empowered to make decisions concerning their division, function, and knowledge area.

Many of the common pitfalls for Stage 4 CEOs are due to what business academic Noam Wasserman describes as the tension between two of the strongest motivations among entrepreneurs: wealth and control.[16] Typically, a CEO must choose one or the other. A 10x CEO relinquishes autocratic control by relying on top talent to help her grow and run the business to the benefit of equity holders. She typically ends up with a relatively smaller piece of a much bigger pie. A control-motivated CEO keeps the reins tight, sacrificing growing the pie in order to have control over how, when, and who gets to eat it. It may seem like we are favoring wealth creation over control. We are, not out of greed, but because it typically benefits more stakeholders and improves employees' job satisfaction and compensation.

CEO Profile

Karen Moriarty (Stanford Graduate School of Business, 1989) is the CEO of North Carolina–based **Carillon Assisted Living**. Moriarty launched Carillon in 1996 through a search fund structure. For 24 years, Carillon and Moriarty have grown and evolved. Carillon is now the premier licensed assisted-living operator in North Carolina. Carillon currently has 22 facilities and employs more than 1,000 people. Carillon allows seniors to live independently and receive the care they need. Moriarty is an elite entrepreneur and part of the 10x MOIC club, so many search funders aspire to join. Through her leadership and operational excellence, Carillon has distributed $148 million to shareholders who initially invested $6.4 million. The 23x MOIC is a rare achievement and reflects Moriarty's commitment to serving residents in Carillon's communities and her shareholders simultaneously. Carillon is now a fully professionalized organization, and Moriarty's role within the organization has changed too. Moriarty elaborates:

> Carillon has been a great experience for me. I have loved each chapter of the search fund journey and growing Carillon. I am really passionate about eldercare. We have a great team, and when we developed our first facility, I was completely in the guts of the plans, which was appropriate back then. Now, my role is much more of a leader and even a visionary and ambassador with Carillon and the industry. My team is strong, so they run the day-to-day business, and I am focused more on strategic issues like growth, capital allocation, and new service offerings. For example, initially, Carillon was exclusively an assisted-living facility, but now our service offerings include Alzheimer's care and respite care. As we have grown, we can do more for our residents because we have the team and infrastructure.

In addition to overseeing Carillon's growing portfolio and operations, Moriarty has taken a lead role in advocating for North Carolina seniors' health and living needs at the state and federal levels:

> I have devoted my career to eldercare. I am deeply involved in the industry and am an advocate for both the industry and eldercare. As an entrepreneur, I care a lot about our financial performance in addition to our mission of providing high-quality care for our residents while seeking to enrich their physical, social, and emotional well-being. Being outstanding at both is rewarding, and part of that excellence is continuing to get better as an individual and a company. We continue to improve and innovate, and being able to create value for shareholders and our residents is immensely gratifying.

Conclusion

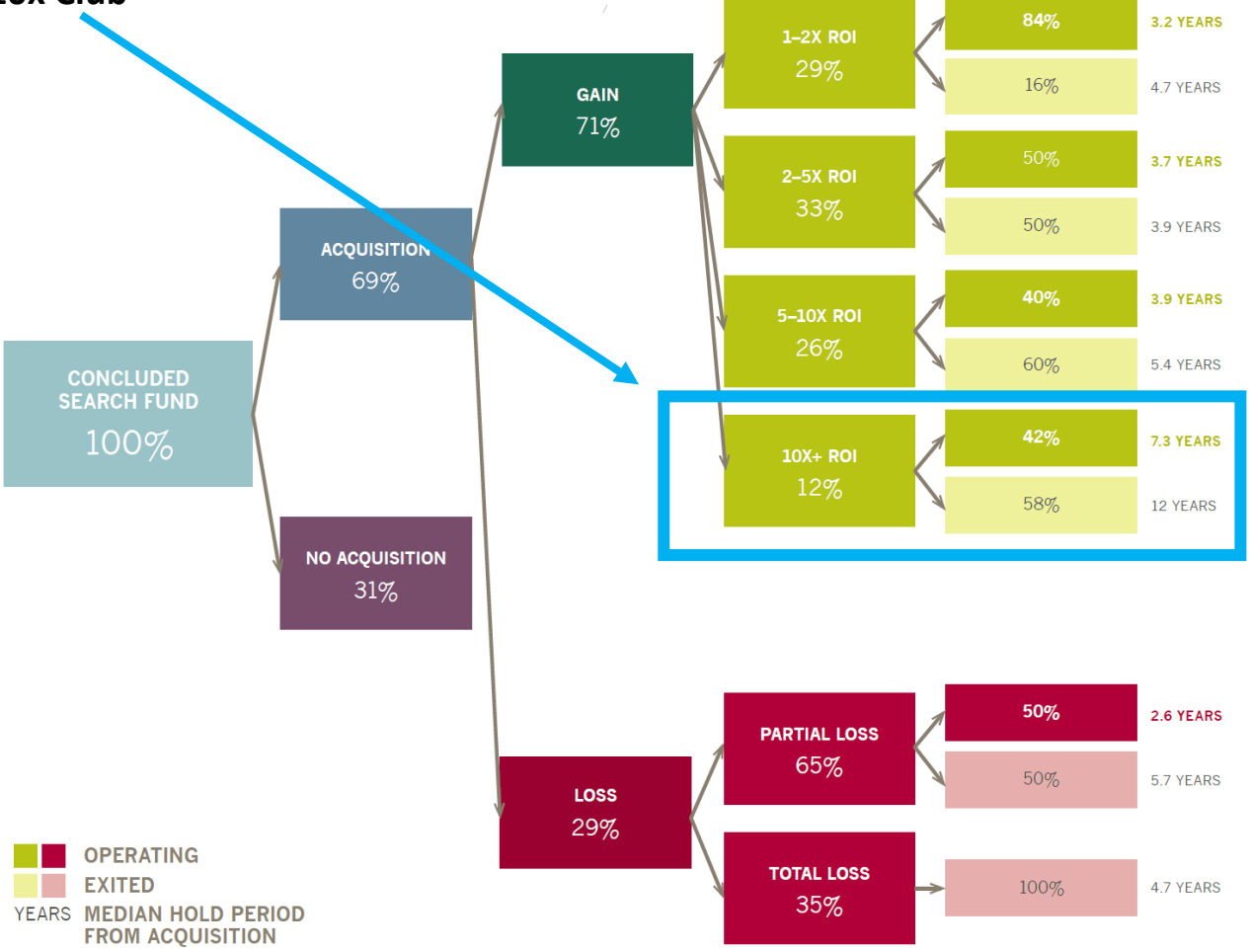
Becoming a 10x CEO is an extraordinary accomplishment for a search fund entrepreneur. It is an elite and exclusive club. While earning admission into the 10x club is certainly not an easy endeavor, there are predictable stages and evolutionary chapters that the CEO and business will move through. The successful CEO understands that crossing each bridge from the current stage to the next is filled with challenges and risks. Clearly defining what the goals are in each stage and what role the CEO plays helps increase the probability of a successful outcome. Additionally, being aware of what fatal flaws lurk in each stage will help aspiring entrepreneurs sidestep the traps that can derail a successful journey.

While this note examines and celebrates the 10x CEO, we applaud all entrepreneurs who leave the sidelines and venture into the arena, regardless of the outcome. It is not our intention to imply that a 3x, 5x, or 7x CEO is a failure or disappointment—that is absolutely not true. These are wonderful outcomes, ones that can be lucrative, and the CEO should be proud of her accomplishments. A 10x outcome is rare, and a dose of serendipity plays a role in determining this result in addition to the CEO's decisions, temperament, and skills. Enjoy the ride, whatever the outcome.

We hope that this note propels budding entrepreneurs along their 10x entrepreneurial journey. Have fun!

Exhibit 1: 10x Search Funds

The 10x Club



Source: Stanford Graduate School of Business, "2018 Search Fund Study: Selected Observations"

Exhibit 2: The Evolution of a 10x CEO Framework*

Stage	Size	Relevant Goals	Primary CEO Roles	Fatal Flaws
1 **Embrace & Extend (Infancy)**	Sales: < $3m –$10m Employees: 10 – 40	• Don't break anything • Transfer goodwill • Learn/connect/assess • Quick wins/few resources • Tenable EBITDA and equity creation model	• Doer • Solo player	• Miss on cash flow • Team misalignment or mutiny • Do not learn – ivory tower
2 **Develop Platform & Hum (Adolescence)**	Sales: $10m–$20m Employees: 40–75	• Customer gathering process hums • Build quality team • Acquire resources • Run a tight business • Growth/EBITDA/Equity model is proven	• Manager • Backup employee • Selector of line workers • Manager to line workers • Systems architect	• CEO cannot evolve from doer to builder and manager • EBDITA/ROI underperform • Stakeholder misalignment • Competition amplifies
3 **Grow & Scale (Young adulthood)**	Sales: $20m–$50m Employees: 75–500	• Fine tune the people machine • CEO as architect: coach to OpCo, SellCo and BuyCo • Savvy capital formation, allocation and growth pathways	• Leader • Standard bearer of culture and values • Selector of managers • Coach to coaches • Driver of value creation plan	• CEO cannot attract capable coaches and cannot delegate • Ego and empire builder • Foundation Is weak • Poor capital allocation
4 **Professionalize & Institutionalize (Adulthood)**	Sales: > $50m Employees: > 500	• Maintain a competitive advantage • Sustain profitable growth • Ensure talent is appropriate for new level of size and professionalism	• Ambassador and visionary • Strategist and envisioning the future	• Does not fully let go • Focus on the wrong KPIs • Wants control more than growing the pie

* The framework is partially based on a similar unattributed model for venture capital financed companies in Kent Weaver's possession.

Exhibit 3: The Entrepreneur's Perspective on Becoming a 10x CEO (from 10x CEOs)

Jim Vesterman
Raptor Technologies (Wharton 2006)
raptortech.com

Linda Katz
Molded Dimensions (HBS 1994)
moldeddimensions.com

1	**Describe your firm.**	Raptor Technologies provides integrated safety software solutions to K-12, corporate, and healthcare clients across the United States. Raptor products include Visitor Management, Emergency Management, and Volunteer Management SaaS software solutions.	Molded Dimensions, LLC is a molder of custom-engineered thermoset elastomers, including rubber and cast polyurethane. The molded products we manufacture are used in a wide spectrum of industries, applications, and environments. This is something in which we have taken great pride since purchasing the business in 2001 through a self-funded search with my husband, Mike.
2	**What do you think are the key entrepreneurial traits to become a 10x CEO?**	The first is low ego. If a CEO is focused on protecting his/her ego, then he/she is investing his/her energy as well as that of the employees in the wrong place. The second is focus. If you are not aware of and focused on the key elements that will create a 10x outcome for your company, you will not be able to apply the crux of your energy and efforts properly. The third is that you must be good at hiring talent at each stage of the company or have someone for whom that is a true skill.	I think to be a 10x CEO you first have to have the ability to live with risk. Usually, the entrepreneur/CEO has to make risky decisions with limited data, so it is extremely important that the CEO has the fortitude to do that. The CEO also needs to be a servant leader. This is someone who understands their role is to serve their employees and their customers and in turn, they, the CEO, are able to reap the rewards, it does not work the other way around. Lastly, introspection to be able to understand where you have deficiencies and hire good people to moderate that.
3	**What do you think are the key company characteristics that result in a 10x outcome?**	Key company characteristics include an attractive total addressable market (TAM) and an annual compounded average revenue growth rate above 25-30%. In the case of software companies, these key characteristics also include an annual gross customer retention rate above 95% and a Rule of 40+ (annual recurring revenue growth % + EBITDA margin% >= 40%).	Being in a great business that matches the CEO's skills and is a fit certainly helps. Molded Dimensions is all about premium pricing for smaller orders being sold to smaller customers – that is our sweet spot and we stick to it relentlessly. Premium pricing drives profit, spurs employee engagement in our ESOP, and allows us to be a great partner to our customers – this all creates value for the equity holders. It's a loop.
4	**What is the most important element to achieving a 10x outcome?**	Relentless execution. More specifically, a deliberate and steady march toward putting into place at the company world-class people and processes, both of which need to evolve as the company grows. To do this, you must get access to those that can assist you in knowing who/what these are and how to hire/implement them.	Part of our success stems from a long view. We have been doing this for 20 years. We get better as operators and the company gets better, too. Truthfully, there are no magical secrets. It's all about smart decisions everyday and incremental progress. We have built a culture that is about creating a place where great people choose to work. We reward people that thrive in that environment and are not scared about separating people who do not embrace the culture.
5	**What advice would you give aspiring 10x search fund entrepreneurs?**	I would advise Search Fund Entrepreneurs to hold out for the right company for them and their investors. Prior to acquiring Raptor, I had a deal in which I obtained all of the necessary equity, debt, and paperwork, but as we approached execution, I realized that it was not going to be a 10x deal, so I walked away. No acquisition candidate is perfect, but you should hold out for a company that has the potential to be great.	I am not sure you can start the game thinking about a 10x outcome. We thought about building something that fit our needs and goals – our lifestyle – and over time it became something really special and significantly bigger. We did use a bunch of leverage to acquire the business and that has helped amplify returns. Time and a bit of luck have been our friends.

Exhibit 4: The Investor's Perspective on Becoming a 10x CEO

Tiffany Clay Augustyn (HBS 2012)
Endurance Search Partners
endurancesearchpartners.com

Jeff Stevens (Stanford GSB 1990)
Anacapa Partners
anacapapartners.com

		Tiffany Clay Augustyn (HBS 2012), Endurance Search Partners	Jeff Stevens (Stanford GSB 1990), Anacapa Partners
1	**Describe your firm.**	We are a family investment office that has partnered with more than 150 Search Fund Entrepreneurs over the past 10 years. We dedicate ourselves to a limited number of exceptionally talented Searchers at a time, providing capital, investment guidance, operating resources, business networks, strategic leadership, and board engagement with the objective of laying the foundation for long-term partnerships.	Anacapa Partners is a boutique private equity firm whose strategic focus is investing in operating companies that have been identified by principals operating within the search fund business model. Over the past 10 years, Anacapa has invested in 140 entrepreneurs looking to acquire a nano-cap company and has made 50 investments in companies acquired through the search funds, managing $120 million of investments.
2	**What do you think are the key entrepreneurial traits to become a 10x CEO?**	• Grit and perseverance – searching for and running a great business takes tremendous energy and persistence. It also requires resilience to weather the "ups and downs" of searching and operating. • Humility – willingness to engage others for guidance. • Action orientation – cannot get caught up in "analysis paralysis". Must be inclined to act. We like to say, "Decide today, act tomorrow, react the next day".	• The ability to persevere (balance of action orientation and patience). • The ability to connect with people (build relationships). • The ability to simultaneously manage short-, medium- and long-term views (what do we need to do today, where do we need to invest for tomorrow, and what do we ultimately want to be). • A unique balance of confidence and humility (the willingness to advocate for a position and the intelligence to seek out feedback and incorporate other views).
3	**What do you think are the key company characteristics that result in a 10x outcome?**	• Industry tailwinds – "nose of the plane is up"; fueled by accelerating secular growth. • Exceptional operating leverage – high free cash flow allows for rapid business scaling. • Strong defensible market position – a moat that can sustain 20%+ EBITDA margins • Strong revenue stability – not only protects your downside but frees up time and resources to focus on growth. • Sizeable enough business - $1.5mm-$2mm+ EBITDA…easier to "get the flywheel going".	• Clearly defined demand drivers that are increasing (need vs. desire, with the elements of need becoming more pervasive with time). • Stable core business model with a manageable level of operational complexity that provides predictability to build upon (frees up time sooner to focus on growth initiatives). • Threshold scale today and high free cash generation to provide resources to invest in growth. • Multiple potential growth levers to explore maximizing the likelihood of growth.
4	**What is the most important element to achieving a 10x outcome?**	As Buffet says, "When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact." While finding a great business and having the right team leading it are both important, even a great CEO cannot make up for fundamental issues with the business model and/or industry.	• Buying a great platform (e.g., a sustainable business model in a growing industry). • Time (buying a company that doesn't require immediate decisions to ensure survival and has the wherewithal to operate for a decade or more to allow for compounding of returns on investment). • A solid team (management, board, etc.) that are aligned in vision and willing to actively debate process. • Luck.
5	**How do investors help facilitate a 10x outcome?**	• Providing tactical coaching on how to handle day-to-day issues as a first-time CEO. • Avoiding major "unforced" errors such as taking on too many risks during the first year or two (e.g., add-on acquisitions). • Developing a "value creation plan", including taking calculated risks and making multiple, small-growth bets. • Working with the CEO to design a plan to "scale up" the growth on bets that are working.	• Providing a solid combination of support, mentoring, guidance and governance • Utilizing experience and pattern recognition to help the entrepreneur and the business avoid mistakes so that resources can be fully engaged on generating value (vs. overcoming setbacks). • Utilizing experience and pattern recognition to help the entrepreneur and business increase investment in scaling exceptional opportunities. • Ultimately, being a true, engaged partner with a singular focus on a great outcome for all involved (supporting all three stages of the journey – acquiring well, operating well, and exiting well).

Exhibit 5: Entrepreneur and Investor Bios

Entrepreneur 1: Jim Vesterman, CEO, Raptor Technologies

Jim Vesterman is the CEO of Raptor Technologies. Jim was the founder of Liberty Place Capital and brings broad experience from some of the nation's top strategy consulting, investment banking, private equity and operating firms. Mr. Vesterman also was a member of the U.S. Marine Corps' elite Force Recon, the Special Operations element of the Marine Corps. Mr. Vesterman served in Iraq where he was awarded the Navy and Marine Corps Achievement Medal and the Combat Action Ribbon. He is the author of the article "From Wharton to War" published in Fortune magazine in June 2006. Mr. Vesterman holds an MBA from The Wharton School of the University of Pennsylvania and a Bachelor's degree from Amherst College.

Entrepreneur 2: Linda Katz, CEO, Molded Dimensions

After 18 years as CEO and majority owner of Molded Dimensions, Linda Katz is currently a board member and minority owner of this Port Washington, WI-based provider of choice for companies across a diverse selection of markets for their polyurethane and rubber molding needs. In 2015 Katz was chosen as "Rubber CEO of the Year" (RPN) for leading Molded Dimensions as it grew steadily in sales and profits while empowering employees. Under her leadership, the company was 36% ESOP owned and was regularly recognized for its employee satisfaction and engagement. In 2018 Linda sold the majority of the company to a PE company. Linda's husband Mike Katz is currently acting CEO of Molded Dimensions. Before acquiring Molded Dimensions, Katz worked at Cummins, where she managed a 250-person production area. Earlier in her career, Katz worked at General Electric in their manufacturing management training program. She is a graduate of Duke University and Harvard Business School. Avocationally, Linda is a trapeze enthusiast and is an alpine skier and instructor.

Investor 1: Tiffany Clay Augustyn, Partner, Endurance Search Partners

Tiffany has spent her career as a middle market and growth equity private equity investor working alongside driven leaders and management teams to build great companies. Prior to joining Endurance, Tiffany was an investor with the global private equity firms TPG Capital and L Catterton, where she helped lead a number of buyout and growth equity investments and served on the board of several operating companies. She started her career as a Consultant with McKinsey & Co., serving public and private sector clients throughout North America and the Middle East. Tiffany received her MBA from Harvard Business School, where she graduated with high distinction as a George F. Baker Scholar. She received a BA from Yale University, where she graduated summa cum laude and was elected to Phi Beta Kappa. Tiffany is a term member at the Council on Foreign Relations and also serves on the Board of Lorman Education Services. Like the rest of the Endurance team, Tiffany has a passion for acquiring, operating, and growing businesses, and she particularly enjoys working with early-career, excellence-oriented operators and their investors.

Investor 2: Jeff Stevens, Managing Partner, Anacapa Partners

Jeff Stevens has 20 years of experience structuring, operating, and investing in search fund companies. Jeff has operated three funded searches from 1990 to 2005, each one culminating in the acquisition of a lower middle market company. Jeff understands the elements of the search fund model that drive success. In addition, Jeff's relationships with other experienced, successful search fund investors and current search fund principals allows Anacapa Partners to invest in concert with a group that has been participating in this business model for over 20 years.

Prior to founding Anacapa Partners, Jeff was the CEO of three venture-backed buyouts: Balkin Cable Holdings (a cable television system operator), Ancora Capital (a mail presort), and Liberty Fitness (a women's fitness center chain). Following these three buyouts, Jeff founded Deeelish!, a manufacturer and retailer of ready-to-cook gourmet meals. In each of Jeff's four ventures, he has maintained responsibility for all aspects of sourcing acquisition and start-up opportunities, including identifying potential targets, industry analysis, company-specific due diligence, and fundraising (debt and equity) to complete the transaction. Following the completion of each acquisition, Jeff became the senior executive of the acquired company with direct reporting responsibilities to a shareholder group and board of directors. Prior to beginning his entrepreneurial path, Jeff was an Associate Consultant at Bain & Company. Jeff received his BA and MBA from Stanford University and remains actively involved in the Stanford community. He participates in classroom case discussions for entrepreneurship courses in the Stanford Graduate School of Business, serves as a mentor for students participating in a two-quarter business planning course, and volunteers in numerous capacities for the Center for Entrepreneurial Studies. Jeff is also a member of the Ford Committee at DAPER.

Jeff is a member of the Board of Directors for developerprogram.com, the National Center for Faculty Development and Diversity (NCFDD), and Dooblo.

Exhibit 6: Additional Resources

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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] Kent Weaver is the Founder, CEO, and Managing Member of Granite Point Partners, a middle market investment firm.

[2] Case writer, Yale SOM MBA 2020.

[3] Eugene F. Williams Jr., Lecturer in the Practice of Management

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