Since 1996, the Center for Entrepreneurial Studies at Stanford Graduate School of Business has conducted a series of studies on traditional search funds: investment vehicle formed by one or two individuals with a group of advising investors to fund the search for and acquisition of a privately held company.¹ Through this research, Stanford seeks to provide insight into the factors that influence successful outcomes for first-time owner-manager and their investors. This 2018 study reports on more search funds than ever and presents new analyses of acquisitions, geographical considerations, and entrepreneur compensation.

Austin Yoder and Peter Kelly, Lecturer in Management, prepared this study with assistance from Sara Rosenthal (MBA ’04) and H. Irving Grousbeck, MBA Class of 1980 Consulting Professor of Management.

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¹ This study focuses on search funds formed by first-time searchers and funded by groups of investors, termed herein “traditional search funds” or “search funds.” Other forms, such as searches that are self-funded or funded by a single entity, are noted on page 20.
Executive Summary

Search fund activity has flourished in the two years since our last study. The number of active searches is at an all-time high, although the number of newly raised search funds has leveled out, and search fund entrepreneurs acquired a record 17 companies in 2017. Seven search-acquired companies were sold in 2017, with more than eight sold through August 2018.

Notably, the number of search funds raised by female entrepreneurs climbed to eight, a gradual but welcome trend. Most search fund entrepreneurs are still recent business school graduates, with more midcareer entrants on this path, many with general management backgrounds (see Exhibit 1). The median search fund acquisition purchase price grew to $13.1 million in this study, up from $12 million in the previous study period, and the largest search fund acquisition ever was completed in 2017, for $117 million.

From 1984 to 2017, $924 million of equity capital has been invested into search funds, generating an aggregate equity value for investors of $5.7 billion (and roughly $1.5 billion for entrepreneurs). Using reasonably conservative assumptions, the aggregate pretax internal rate of return (IRR) for all search funds through the end of 2017 was 33.7 percent, down from 36.7 percent through the end of 2015, and the aggregate pretax return on investment (ROI) was 6.9x, down from 8.4x in 2015. Aggregate IRR and ROI have declined since the last Search Fund Study in part due to the large cohort of recent acquisitions, while returns excluding the top three funds have increased steadily since 2009, driven by more exits, returning in excess of both 5x and 10x investor capital.

In this 2018 study, we include both more search funds and returns data from the highest proportion of known funds in recent studies (312 of 325), largely because of success gathering data from older search funds that were not included in earlier studies due to insufficient information. We expand our analysis of entrepreneur salaries and equity, explore the geographical considerations of search funds, and include new analyses of investor returns.

In the next section, we examine historical search, acquisition, and exit activity. We then present financial returns and characteristics of search-acquired businesses. After reviewing IESE Business School’s sister study of search fund activity outside of the United States and Canada, we conclude with observations on the growing field of search funds.

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2 In an effort to report returns conservatively, we have not included tax distributions in the IRR and ROI calculations in this study.
What Is a Search Fund?

A search fund is a financial vehicle created by one or two individuals who raise money from a group of advising investors to support their efforts to locate, acquire, and lead a privately held company over the medium to long-term.

The term “search fund” originated at Harvard Business School in 1984, was popularized at Stanford GSB in the following 10 years, and has spread steadily to business schools and private investors around the world. A typical search fund progresses through four stages:

**FIGURE A | THE SEARCH FUND LIFE CYCLE**

A detailed explanation of the search fund model is included in the first part of the Appendix, “What Is a Search Fund?,” beginning on page 30. Also, Stanford GSB’s Search Fund Primer more deeply examines the formation, search, and acquisition stages.

Survey Results: Fundraising, Search, and Acquisition

This study includes 325 first-time search funds formed since 1984. In keeping with our previous studies, we excluded funds led by principals who had previously raised a search fund, who self-funded their search, or who pursued their search with a single search sponsor. While those forms of search are noteworthy and mentioned later in this note, they historically have not been included in this study. The focus of our research is the returns associated with investing in a first-time search fund entrepreneur backed by a group of advising investors.

For each search fund, we collected information on the demographic characteristics of the principals, as well as key fundraising, acquisition, company, and valuation metrics. We made every effort to include all known traditional search funds.

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3 To obtain a comprehensive description of the search and acquisition process, readers can access the Search Fund Primer from Stanford GSB’s Center for Entrepreneurial Studies.

4 This is all the known search funds in the United States and Canada except two that did not respond. Note that data through 2009 include international search funds, tracked thereafter in IESE’s sister studies on international search funds. See “International Search Funds” on page 18 for more information.

5 Serial, self-funded, and single-investor search fund entrepreneurs have track records that imply different fundraising, management, and operational capabilities, as well as distinctive networks of investors, intermediaries, and sellers. See “Alternative Search Fund Models” on page 20 for more information.

6 For the 160 search funds that acquired companies, we gathered complete data on 153 and included 137 in our aggregate financial analysis. This financial analysis excludes seven companies that were unable to provide sufficient data on either financing or equity valuation, and 16 companies that had been operating for less than one year.
The number of search funds raised and acquisitions completed has increased steadily over the years, as seen in Figure B. The rise in acquisitions roughly follows the rise in funds raised, while exits vary considerably by year.7

**FIGURE B | SEARCH FUND ACTIVITY BY YEAR**

![Search Fund Activity Graph]

Source: Data from Stanford GSB search fund surveys.

Figure C shows the status of all funds as of December 31, 2017. Since 1984, searchers have raised 325 search funds. Of those, 86 were searching for an acquisition as of December 31, 2017, and six had deviated from the search fund model (e.g., by using the search capital to start a company rather than acquire one). Of the funds no longer searching (233), 69 percent (160) had acquired a company and 31 percent (73) had ended their search without an acquisition. Of the 160 acquired companies, 90 were still operating with original search fund investors (seven had insufficient returns data) and 70 had exited. Of those that had exited, 43 provided positive investor returns and 27 had exited with a loss of capital. Further outcomes are described in the “Returns” section and Figure F.

7 While this study records activity only through December 31, 2017, at least eight exits — all with positive returns — were achieved through August 2018.
PROFILE OF PRINCIPALS

Although the number of new female searchers increased from five in 2015 to eight in 2017, women remain underrepresented in search funds, accounting for eight percent of new search funds raised in 2016 and 2017.

Of all search funds raised in 2016 and 2017, one-quarter were raised by entrepreneurs within one year of graduating from an MBA program; meanwhile, more midcareer searchers once again entered the field. Entrepreneurs with at least eight years of post-MBA working experience accounted for 16 percent of all search funds raised in 2016 and 2017, compared to 10 percent in 2014 and 2015 and 4 percent in 2012 and 2013. See Exhibit 1 for further demographic information.

Search fund principals come from diverse professional backgrounds (Exhibit 2). In 2016–2017, Operations experience represented the largest cohort (23 percent), followed by Investment Banking/Finance (16 percent), Private Equity (14 percent), and General/Line Management (14 percent).

FUND-RAISING AND SEARCH

Entrepreneurs must address numerous questions when deciding to raise a search fund: whether to partner or go it alone, where to base the search, which industries to target, how much money to raise, and so on. The split between partnered and solo searchers has varied over the years, with solo searchers raising 55 percent of all search funds in the last two years. The median capital raised per principal (rather than per fund) rose to $398,000, while the median number of investors per fund remained at 15 investors and the median time to raise a fund remained three months. The median length to close an acquisition rose to 23 months for deals completed during this study period, materially longer than in past studies. See Exhibit 3 for fund metrics.
Exhibits 4A to 4C present the industries targeted by searchers, including detail on the Technology and Health Care categories. We refined industry categories over the last few studies; this complicates historical comparisons, but enabled us to find that searchers have increasingly targeted software, technology-enabled services, and health care businesses.

THE ACQUISITION

Prospecting
Searchers typically target acquisitions that are midsized, rapidly growing companies with high EBITDA margins.\(^8\) Thus, a searcher’s primary work during the search phase is to identify fruitful sources of such targets.

The median number of targets for search funds raised in 2016 and 2017 decreased to 386, down from 500 in the 2016 Study. This suggests that searchers are taking a more focused approach to identifying attractive targets before making contact. The latter stages of the deal funnel also narrowed.

FIGURE D | ACQUISITION FUNNEL: 2008–2017\(^9\)

Many searchers combined deal flow from business brokers and proprietary search strategies to identify targets and learn about new industries. Proprietary search remained the predominant source of deal flow and typically involved contacting businesses that searchers had identified through their own research, while business brokers provided contact with business owners actively considering a sale.

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\(^8\) EBITDA: earnings before interest, taxes, depreciation, and amortization

\(^9\) Median values as reported by search funds that completed acquisitions. “Serious discussions” were not further defined in the 2009 Study and were defined as “Number of Companies Under Letter of Intent (LOI)” in the 2011, 2013, and 2015 surveys, likely accounting for some of the differences between 2009 and 2011–2015.
Acquisition Metrics
Purchase prices continue to trend upward. Acquisitions consummated during 2016 and 2017 had a median purchase price of $13.1 million and revenues of $10 million, compared to a median purchase price of $12 million and revenues of $7 million in the previous study. The median purchase price/EBITDA multiple rose from 5.8x in the previous study to 6.3x in the 2018 Study. This could be attributable to the purchase of higher-quality companies (time and returns will tell), lower expectations of returns by investors, the current state of the market, or other factors.

Since 1984, 98 percent of the companies acquired via a search fund acquisition had positive EBITDA margins at the time of acquisition (Exhibits 5 and 6).

Industries
For the first time, we present the industries of companies acquired by search funds, in Figure E. Data from the last seven years demonstrate a shift away from acquiring manufacturing businesses and toward technology, software, and other services businesses.

**FIGURE E | INDUSTRIES OF ACQUIRED COMPANIES (N = 160)**

Source: Data from Stanford GSB search fund surveys.

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10 This analysis includes all companies acquired as of December 31, 2017.
FINANCIAL RETURN METHOD

This study calculated financial returns from the perspective of initial search investors. That is, it measured returns based on investments from and distributions to the original search fund investors who invested in both the search and acquisition phases of the deal. As in the 2016 Study, this year's study excluded follow-on financing events.\(^\text{11}\) This study uses two measures of return: return on investment (ROI)\(^\text{12}\) and internal rate of return (IRR).\(^\text{13}\) Both ROI and IRR were calculated on a cash flow basis, including both equity and investor debt that was invested as initial search capital and as acquisition capital. These include the losses from searches that ended without an acquisition, losses in equity upon exit, and losses in equity value reported while operating the company.

All returns were calculated on a pretax basis using data provided by the principals of the funds or, in the few instances when they were not reachable, by their fund investors. Returns were calculated using the actual investments into each fund and the subsequent acquisitions, when they were made, along with eventual distributions. In this study, we conducted an independent audit of calculation methods, and checked returns information collected through our survey against data provided by investors, where possible.

RETURNS

This 2018 Study shows that search funds in aggregate provided an ROI of 6.9x and an IRR of 33.7 percent to investors. The median fund returned 1.0x of initial search fund investors’ capital, whereas the 75th percentile fund returned 2.9x and an IRR of 31 percent. The aggregate ROI in our current study declined from 8.3x in 2016 to 6.9x in 2018, due in large part to two factors: a higher proportion of more recently acquired operating companies and the inclusion of data from 16 older search funds not captured in prior studies, seven of which had negative returns.\(^\text{14}\)

Since the 2001 Study, the aggregate IRR of all search funds (which included both unsuccessful searches and those that completed an acquisition) has fluctuated between 32 and 38 percent, although the performance of individual funds has varied widely.

Of note in the most recent study, a lower percentage of searches ended with an acquisition (69 percent versus 73 percent in the 2016 study) and a larger number of companies reported higher returns (either 5-10x or greater than 10x returns). Figure F shows the percentage of funds in each phase of the search cycle, as well as return characteristics for terminal funds. For distributions of funds by ROI and IRR, see Exhibits 7 and 8, respectively.

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\(^{11}\) While follow-on financings can be an important part of search fund returns, the decision to exclude them from the performance calculations reflects an effort to simplify the data-reporting process for searchers — with the goal of increasing data integrity and accuracy — and to simplify the evaluation of search fund returns.

\(^{12}\) Return on investment represents the multiple of initial capital invested that is returned to investors (also known as MOIC) — i.e., if the group of initial investors invested $5 million and received received a return of $10 million, this would be described as a 2.0x ROI. A return of $1 million would be a 0.2x ROI, and so forth. A complete loss of capital is an ROI of 0.0x.

\(^{13}\) Internal rate of return represents the annual compounding rate derived from the actual amounts of search and acquisition capital invested and returned by an investment. For investments returning only a fraction or none of an investment, IRR is not a meaningful metric. Investor returns are calculated net of searcher returns.

\(^{14}\) This data may have disproportionately represented companies with lower returns either because those entrepreneurs were less willing to share disappointing results, or they had departed the companies, making the data harder to obtain. This bias is almost entirely corrected with the current study’s high response rate. Seven companies remain with insufficient data, and if highly conservative assumptions are made for those, returns would decrease slightly but not meaningfully.
For each category, we have included the percentage of terminal and operating companies, as well as median hold period. For example, the bottom box in the right-hand column of Figure F indicates that all companies in the “total loss” category are terminal, and that the median holding period for companies in that group was 4.7 years.

A small number of highly successful search funds disproportionately increased the aggregate returns, much as in other risk capital portfolios. A notable trend in this study is that the returns excluding the top performers have increased, reflecting a larger number of high-return (i.e., those with greater than 5x ROI) search funds. For adjusted returns when the top three and top five performers are removed, see Figure G and Figure H.

15 The gain and loss categories in Figure F exclude seven acquired companies with insufficient returns data and 16 companies operating for less than one year as of December 31, 2017. The top-performing fund in this study is categorized as having an exit event in 2008, when original investors sold a majority interest.
FIGURE G | AGGREGATE SEARCH FUND ROI (2009–2017)

Source: Data from Stanford GSB search fund surveys.

FIGURE H | AGGREGATE SEARCH FUND IRR (2009–2017)

Source: Data from Stanford GSB search fund surveys.
Isolating the returns for search funds that are still operating a business, the aggregate ROI was 3.3x, while the IRR was 29.4 percent. For terminal search funds (i.e., those for which the searcher acquired and then sold or exited the business), ROI was 13x and IRR was 36.9 percent.

For more insight into how returns have varied over time, we present IRR and ROI for acquisitions by year of acquisition in Figure I. Firm conclusions are hard to draw as this is the first time we prepared this analysis. The lower ROI for companies acquired from 2013 to 2016 is due in large part to a shorter holding period and fewer exit events, since companies in this cohort were acquired more recently.

**FIGURE I | IRR AND ROI BY YEAR OF COMPANY ACQUISITION (N = 136)**

![Figure I](image)

Source: Data from Stanford GSB search fund surveys.

**PARTNERSHIP STATUS**

Solo searches accounted for 55 percent of the search funds formed in 2016 and 2017. Data continued to indicate that partnerships (rather than solo searches) had a higher likelihood of acquiring a company and achieving a greater than 5x outcome, although this does not imply causation.

When we analyzed the aggregate ROI and IRR for all companies by partnership status, we found that companies acquired by a partnership seem to have outperformed companies acquired by solo CEOs. This difference in

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16 The top-performing fund was excluded from this analysis in order to observe underlying trends. In addition, by definition the analysis presented here includes only data from search funds that completed an acquisition, and not from search funds that terminated without an acquisition. As such, this analysis is not directly comparable to the overall analysis of search fund returns that includes terminated searches. In the overall data, the inclusion of terminated searches decreases IRRs by approximately 150 basis points.
Among those searchers who acquired a company, there is a nearly even split between funds operated by a single searcher versus a partnership. For all outcomes greater than 5x, 70 percent were partnerships (26 search funds) and 30 percent were solo searchers (11 search funds). One-third (33 percent) of solo searchers incurred a partial or total loss of capital, compared to 25 percent of partnerships.
Salary and Equity Compensation for Entrepreneurs

The 2018 Study marks the second time we have collected data on salary and equity compensation for search fund entrepreneurs. This evaluation includes funds that had made acquisitions (both currently operating and terminal) at least one year prior to December 31, 2017.

A total of 75 searchers, including 51 who are currently operating their companies and 24 who have exited, provided information on their equity for this year’s study. Accounting for partnerships, the average equity value for each entrepreneur still operating a company is $5.63 million, and $6.52 million for entrepreneurs who have exited their businesses. On the basis of time operating the company, those amounts equate to $1.47 million per year for current operators and $1.15 million per year for those who have exited.

The distribution by amount is shown in Figure L.

Source: Data from Stanford GSB search fund surveys.

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17 This evaluation included all funds that had made acquisitions (both currently operating and terminal) at least one year prior to December 31, 2017. Funds that were searching for an acquisition, had concluded as an unsuccessful search, or had not been operating for one year as of December 31, 2017, were not considered.
This figure represents a subset of entrepreneurs that acquired companies. Analysis of the companies represented in the figure and their returns indicates that they are representative of the aggregate.

Of 43 CEOs with individual equity value of $6 million and greater, 32 were in partnerships (representing 16 search funds), and 11 were solo. Of 42 CEOs with reported equity value of $2 million or less, 28 were in partnerships (representing 14 search funds) and 14 were solo searchers.

**CURRENT COMPENSATION**

The 2018 Study introduced new questions about the current compensation — salary and bonus — of searchers and CEOs.

**Searcher Current Compensation**

Our survey produced data from 59 individuals who began their search between 2013 and 2017 and provided self-reported data about their compensation as searchers. The range of searcher salaries was $30,000 to $145,000, with a mean of $103,636, and a median of $108,000. No bonuses were reported.
**CEO Current Compensation**
This data set was reported by 76 of the 96 CEOs who acquired their companies between 2003 and 2017 and includes data for both terminal and currently operating companies.

The range for base salary of the CEOs was $90,000 to $550,000, with a mean of $214,066, and a median of $200,000. The range for the annual bonus was $0 to $450,000, with a mean of $60,836, and a median of $50,000. The range of total CEO compensation (base salary plus bonus) was $90,000 to $1 million (a distant outlier), with a mean total compensation of $274,903, and a median total compensation of $259,000.

**FIGURE M | CEO COMPENSATION BY HOLDING PERIOD (N = 76)**

Source: Data from Stanford GSB search fund surveys.

**CEO Total Compensation by Company Revenue**
We analyzed 50 companies that shared both compensation and revenue information and found a moderate correlation ($r = .55$), indicating that a CEO's compensation is not primarily dependent on size of company.
ACQUISITION CHARACTERISTICS

The 2018 Study examined how company and industry characteristics correlate with ROI for a subset of funds grouped by returns. Specifically, those search funds that had acquired companies and were in operation for at least one year as of December 31, 2017, were asked about the firm's operating leverage, recurring revenue, industry growth rate, and complexity at the time of acquisition. Each of these characteristics appeared to have low correlation to outcomes or required further analysis.

Recurring revenue is often among the characteristics sought by investors and entrepreneurs in a company targeted for acquisition. Though the data show a moderate trend, it is clear that the majority of companies producing a positive return for their investors reported high levels of recurring revenue at acquisition. This factor, along with other company characteristics, will be explored in more depth in future studies.

FIGURE N | PERCENTAGE OF COMPANIES WITH 65%+ RECURRING REVENUE AT TIME OF ACQUISITION, BY FUND ROI (N = 98)19

Source: Data from Stanford GSB search fund surveys.

19 Because not all searchers with returns data provided information about the recurring nature of revenues at the time of acquisition, the actual results among all search fund companies could vary. This analysis includes data for both terminal and currently operating companies.
Geography

For those raising a search fund, deciding whether to conduct a national or geographically focused search is an important consideration. The 2018 Study analyzed the relationship between the locations from which entrepreneurs conduct their searches and the locations of the companies they acquire.

FIGURE O | ACQUIRED COMPANIES, BY STATE (N = 160)²⁰

Source: Data from Stanford GSB search fund surveys.

California has the highest number of search fund acquisitions, followed by Texas, New York and Illinois, and Florida. In Canada, Ontario has the highest concentration of acquisition activity, mostly in the city of Toronto.

²⁰ “State” is also used to refer to Canadian provinces here for the sake of simplicity.
Of 160 search funds that acquired a company between 1985 and 2017, 43 percent did so in the same state in which the search fund was located, 14 percent acquired within the same region, and 43 percent acquired outside of the state and region in which the fund was located (categorized here as “Other”).

For example, if a searcher based in Washington state acquired a company in Washington state, the deal would fall under the “Same State” category. If the same searcher acquired a company in California, the transaction would fall under the “Same Region” category, but the acquisition of a company in Texas would fall under the heading of “Other.”

INTERNATIONAL SEARCH FUNDS
In 2011, Stanford GSB partnered with IESE Business School in Barcelona, Spain, so that IESE could produce a separate study on the growing number of search funds outside of the United States and Canada. International search funds raised prior to 2010 remain part of the record retained herein, but were not included in the Stanford data subsequent to 2009.

The 2018 IESE study identified 83 first-time international search funds as of December 31, 2017. More than 75 percent of these were formed after 2010, with the earliest created in 1992. Of those 83 funds, 13 were in the United Kingdom, 22 in continental Europe, 22 in Mexico, 18 in other Latin American countries, 3 in Asia, 3 in the Middle East, and 2 in Africa.

As of the end of 2017, 30 international search funds had acquired a company, 5 had ended their search without an acquisition, 8 had deviated from the search fund model, and 40 were searching for an acquisition. Of the 30 completed acquisitions, 9 were sold with positive returns, 3 had exited with loss of equity, and 18 were currently operating (see Figure Q).

21 Based on geographic regions as defined by the U.S. and Canadian censuses. “State” is also used to refer to Canadian provinces here for the sake of simplicity.

22 Readers can visit IESE’s website to access International Search Funds — 2018 Selected Observations.
Of the 30 acquisitions made outside of the United States and Canada, 16 were in Latin America and 14 in Europe.²³

FIGURE Q | INTERNATIONAL SEARCH FUND ACQUISITIONS, BY REGION, COUNTRY, AND YEAR

International search funds have achieved an ROI of 2.3x and an IRR of 33.3 percent. The median fund returned 2.0x initial search fund investors’ capital, whereas the top-performing fund returned 9.2x. The aggregate international search fund ROI declined from 2.8x in 2016 to 2.3x in 2018. This reflected a shorter average hold period due in part to the greater number of recent acquisitions that have not reached a terminal event (sale, recap, etc.). Further detail and analysis of international search funds can be found in IESE's International Search Funds — 2018 Selected Observations.

²³ In the first half of 2018, there were four new acquisitions in Mexico, one new acquisition in Brazil, and one new acquisition in Spain. These acquisitions were not included in this study for consistency.
Alternative Search Fund Models

As awareness of the search fund model has grown over the years, different approaches have emerged and grown in popularity.

SELF-FUNDED SEARCH
Self-funded searchers do not raise search capital from others, and instead fund their own search costs, often living frugally, over similar search periods as traditional searches (up to three years). They maintain an informal network of mentors and investors who help them screen possible deals, and they work to bring this group of investors together formally at the point of acquiring a company. Self-funded searchers typically rely on raising more debt to complete an acquisition, and often target materially smaller companies than funded searchers. As a result, self-funded searchers typically wind up with a higher percentage equity ownership (50 to 70 percent) of a smaller company than funded searchers. They also often have a smaller set of investor-advisors and a different set of general management and leadership opportunities. The self-funded model may give searchers increased flexibility, notably in the location, industry, type, and size of business they target for acquisition.

SINGLE-INVESTOR, ACCELERATOR, OR EIR MODEL
In the single-investor or “captive” model, searchers are funded by a single investor, either a firm or occasionally a person, and receive a salary, advice, support, and access to networks from that sole investor. This may be a private equity firm, family office, single professional investor, or “accelerator.” Some, especially accelerators, provide common services to the searchers, which might include training, database access, shared interns, mentoring, bank introductions, and prearranged legal and accounting relationships. Economics for the searcher are generally similar to the funded model.

Each approach has advantages and disadvantages, as does the traditional funded approach to search. Stanford GSB has not collected sufficient data on companies acquired through self-funded, accelerator, or single-investor models to report on them yet, but the growing cohorts of entrepreneurs and companies acquired through these interesting alternative models warrant further study.

Conclusion
A record number of search fund acquisitions were completed in 2017. With seven successful exits, 2017 also was one of the most active years for exits to date, second only to 2015, which saw a total of nine exits. Anecdotally, 2018 has seen at least eight successful exits through August although this study only formally reports on data through December 31, 2017. It is likely that the next several years will continue to see an increase in activity — acquisitions, new searches, successful exits, and realized losses — as the funds that were raised over the past few years mature and the model continues to be adopted more broadly by entrepreneurs and investors. These events and other developments in the search fund community will be reported through future editions of this study.
Acknowledgments

The Center for Entrepreneurial Studies would like to thank Gerald Risk, Lecturer in Management, and Sunny Duggal, lead data analyst, for their exceptional assistance with this study. Additional recognition is due to the pioneering authors of previous versions: Doug Wells (1996 Study), Josh Hannah (1998 Study), Chris Flanagan (2001 Study), Mu Y. Li (2003 Study), Mike Harkey (2005 Study), Sean Harrington (2007 Study), Aimee LaFont Leifer and Tjarko Leifer (2009 Study), Arar Han (2011 Study), Lisa Sweeney (oversight on 2009 and 2011 studies), Jason Luther (2013 Study), and Susan Pohlmeier (2016 Study), and with special recognition of Sara Rosenthal (2011, 2013, 2016, 2018 studies). This study would not have been possible without the generous cooperation of the searchers who participated and the wise insights of several investors.
### EXHIBIT 1 | CHARACTERISTICS OF FIRST-TIME SEARCH FUND PRINCIPALS

**AGE AT START OF SEARCH**

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**NUMBER OF POST-MBA YEARS BEFORE LAUNCHING SEARCH FUND**

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<tr>
<td>No MBA</td>
<td>N/A</td>
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<td>N/A</td>
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<td>33%</td>
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</tr>
<tr>
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<tr>
<td>8+ YEARS POST-MBA</td>
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**GENDER**

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</tr>
</tbody>
</table>

Source: Data from Stanford GSB search fund surveys.

²⁴ Totals may not sum to 100 percent due to rounding.

²⁵ Negative numbers in the “Minimum” row reflect a small number of searchers who raised search capital and started searching before graduating from business school.
## EXHIBIT 2 | SEARCH FUND PRINCIPALS’ PROFESSIONAL BACKGROUNDS

<table>
<thead>
<tr>
<th></th>
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<td>26%</td>
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<td>14%</td>
<td>16%</td>
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</tr>
<tr>
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<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>INVESTMENT BANKING/</td>
<td>23%</td>
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<td>16%</td>
<td>27%</td>
<td>20%</td>
<td>11%</td>
<td>22%</td>
<td>11%</td>
<td>16%</td>
</tr>
<tr>
<td>FINANCE</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SALES</td>
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<td>4%</td>
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<td>LINE/GENERAL MANAGEMENT</td>
<td>5%</td>
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<td>15%</td>
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<td>19%</td>
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<td>14%</td>
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<td>0%</td>
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<td>4%</td>
<td>3%</td>
<td>4%</td>
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<tr>
<td>ACCOUNTING</td>
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<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
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<td>1%</td>
</tr>
<tr>
<td>ENGINEERING</td>
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<td>0%</td>
<td>6%</td>
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<td>1%</td>
<td>4%</td>
</tr>
<tr>
<td>MILITARY</td>
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<tr>
<td>INSURANCE</td>
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<tr>
<td>PRIVATE EQUITY</td>
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<td>5%</td>
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<td>27%</td>
<td>28%</td>
<td>31%</td>
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<tr>
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<td>7%</td>
<td>3%</td>
<td>0%</td>
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<td>7%</td>
</tr>
</tbody>
</table>

Source: Data from Stanford GSB search fund surveys.

26 We refined the professional-background categories for the 2018 Study, complicating comparison to categories in previous studies. For example, this year we introduced a new subcategory, “Operating Management,” represented here under “Operations,” which could be one factor contributing to the sudden rise in operations backgrounds.
### EXHIBIT 3 | COMPARISON OF SEARCH FUND METRICS

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
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<td><strong>NUMBER OF PRINCIPALS</strong></td>
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<td>SINGLE</td>
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<td>41%</td>
<td>42%</td>
<td>75%</td>
<td>36%</td>
<td>59%</td>
<td>72%</td>
<td>55%</td>
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<tr>
<td>PARTNERS</td>
<td>32%</td>
<td>59%</td>
<td>58%</td>
<td>25%</td>
<td>64%</td>
<td>38%</td>
<td>41%</td>
<td>28%</td>
</tr>
<tr>
<td><strong>AMOUNT OF INITIAL CAPITAL RAISED</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MINIMUM</td>
<td>$40,000</td>
<td>$125,000</td>
<td>$150,000</td>
<td>$200,000</td>
<td>$200,000</td>
<td>$140,000</td>
<td>$125,000</td>
<td>$175,000</td>
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<td>$395,000</td>
<td>$385,000</td>
<td>$450,000</td>
<td>$446,250</td>
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<td>$850,000</td>
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<td></td>
<td></td>
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<tr>
<td>MINIMUM</td>
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<td>3</td>
<td>10</td>
<td>5</td>
<td>8</td>
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<td>5</td>
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<td>13</td>
<td>12</td>
<td>14</td>
<td>15</td>
<td>18.5</td>
<td>16</td>
<td>15.5</td>
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<td>MAXIMUM</td>
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<td>20</td>
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<td>23</td>
<td>28</td>
<td>26</td>
<td>30</td>
<td>25</td>
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<tr>
<td><strong>NUMBER OF MONTHS FUND-RAISING</strong></td>
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<td></td>
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<td>MEDIAN</td>
<td>N/A</td>
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<td>3.0</td>
<td>4.0</td>
<td>3.8</td>
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<td>10.0</td>
<td>20.0</td>
<td>28.4</td>
<td>8.6</td>
<td>8.0</td>
</tr>
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</table>

Source: Data from Stanford GSB search fund surveys.
EXHIBIT 4A | TARGETED INDUSTRIES, 2016–2017 (N = 80)

Source: Data from Stanford GSB search fund surveys.

For historical data on industries targeted by searchers through 2015, refer to previous versions of the Search Fund Study.

27 Starting in 2016, principals had the option to select all industries targeted in their search, rather than choosing only one. The above data represent the frequency of each response across all search funds newly surveyed for these years. Additionally, the “Internet or IT” category was redefined as “Technology” in the 2016 study and broken into subcategories for the 2018 study, as shown in Exhibit 4B. “Health Care” as defined in the 2016 study is broken down into subcategories for 2018, as shown in Exhibit 4C.

28 Readers can find previous versions of the Search Fund Study through Stanford GSB’s Center for Entrepreneurial Studies.
EXHIBIT 4B | TARGETED TECHNOLOGY SUBCATEGORIES, 2016–2017 (N = 65)

Source: Data from Stanford GSB search fund surveys.

EXHIBIT 4C | TARGETED HEALTH CARE SUBCATEGORIES, 2016–2017 (N = 57)

Source: Data from Stanford GSB search fund surveys.
### Exhibit 5 | Median Statistics for Search Fund Acquisitions

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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Length of Search (Months)</td>
<td>19</td>
<td>19</td>
<td>14</td>
<td>18</td>
<td>19</td>
<td>17</td>
<td>23</td>
</tr>
<tr>
<td>Purchase Price</td>
<td>$11.6M</td>
<td>$9.4M</td>
<td>$6.5M</td>
<td>$7.9M</td>
<td>$11.6M</td>
<td>$12.0M</td>
<td>$13.1M</td>
</tr>
<tr>
<td>Company Revenues at Purchase</td>
<td>$8.0M</td>
<td>$9.1M</td>
<td>$5.3M</td>
<td>$6.0M</td>
<td>$6.2M</td>
<td>$7.0M</td>
<td>$10.0M</td>
</tr>
<tr>
<td>Company EBITDA at Purchase</td>
<td>$2.0M</td>
<td>$2.0M</td>
<td>$1.3M</td>
<td>$1.5M</td>
<td>$2.0M</td>
<td>$2.5M</td>
<td>$2.1M</td>
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<tr>
<td>Company EBITDA Margin at Purchase</td>
<td>22.8%</td>
<td>18.2%</td>
<td>20.5%</td>
<td>23.5%</td>
<td>29.9%</td>
<td>23.4%</td>
<td>22.7%</td>
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<tr>
<td>EBITDA Growth Rate at Purchase</td>
<td>11.0%</td>
<td>16.5%</td>
<td>9.3%</td>
<td>11.9%</td>
<td>18.0%</td>
<td>5.0%</td>
<td>20.0%</td>
</tr>
<tr>
<td>Purchase Price/EBITDA</td>
<td>6.0x</td>
<td>5.2x</td>
<td>4.9x</td>
<td>5.2x</td>
<td>5.6x</td>
<td>5.8x</td>
<td>6.3x</td>
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<td>Purchase Price/Revenue</td>
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<td>0.9x</td>
<td>1.5x</td>
<td>1.3x</td>
<td>1.6x</td>
<td>1.5x</td>
<td>1.1x</td>
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<tr>
<td>Company Employees at Purchase</td>
<td>49</td>
<td>60</td>
<td>38</td>
<td>38</td>
<td>21</td>
<td>46</td>
<td>45</td>
</tr>
</tbody>
</table>

Source: Data from Stanford GSB search fund surveys.
EXHIBIT 6 | SELECTED STATISTICS FOR ALL SEARCH FUND ACQUISITIONS

### Total Number of Months from Start of Search to Deal Close

<table>
<thead>
<tr>
<th>Minimum</th>
<th>Median</th>
<th>Maximum</th>
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</thead>
<tbody>
<tr>
<td>2.5</td>
<td>19.3</td>
<td>74.0</td>
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</table>

### Purchase Price Statistics

<table>
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<tr>
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<th>Median</th>
<th>Maximum</th>
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<tbody>
<tr>
<td>$1.9M</td>
<td>$11.6M</td>
<td>$117.0M</td>
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</tbody>
</table>

### Additional Statistics for All Search Fund Acquisitions

<table>
<thead>
<tr>
<th>COMPANY REVENUES AT PURCHASE</th>
<th>Minimum</th>
<th>Median</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1.2M</td>
<td>$8.0M</td>
<td>$100.0M</td>
<td></td>
</tr>
</tbody>
</table>

| COMPANY EBITDA AT PURCHASE    | -$1.6M | $2.0M  | $25.0M  |
| EBITDA MARGIN AT PURCHASE     | -18%   | 22.8%  | 57%     |
| EBITDA GROWTH RATE AT PURCHASE| -56%   | 11%    | 300%    |
| REVENUE GROWTH RATE AT PURCHASE| -20%   | 10%    | 450%    |
| PURCHASE PRICE/EBITDA MULTIPLE| N/M    | 6.0x   | 114.0x  |
| PURCHASE PRICE/REVENUE MULTIPLE| 0.1x   | 1.4x   | 4.7x    |
| COMPANY EMPLOYEES AT PURCHASE | 4       | 49     | 740     |

Source: Data from Stanford GSB search fund surveys.
EXHIBIT 7 | ROI DISTRIBUTION OF SEARCH-ACQUIRED COMPANIES (N = 137)

- **TOTAL OR PARTIAL LOSS:**
  - Acquired, Operating Company: 27
  - Acquired, Exited: 13

- **1–2X RETURN:**
  - Acquired, Operating Company: 23
  - Acquired, Exited: 5

- **2–5X RETURN:**
  - Acquired, Operating Company: 16
  - Acquired, Exited: 16

- **5–10X RETURN:**
  - Acquired, Operating Company: 15
  - Acquired, Exited: 10

- **10X+ RETURN:**
  - Acquired, Operating Company: 7
  - Acquired, Exited: 5

Source: Data from Stanford GSB search fund surveys.

EXHIBIT 8 | IRR DISTRIBUTION OF SEARCH-ACQUIRED COMPANIES (N = 94)

- **1–25%**
  - Acquired: 35

- **26–50%**
  - Acquired: 38

- **51–75%**
  - Acquired: 16

- **76–99%**
  - Acquired: 2

- **100%+**
  - Acquired: 3

Source: Data from Stanford GSB search fund surveys.

---

29 Of the 160 companies acquired as of December 31, 2017, for which we have data or collected data historically, 16 had been operating for less than one year and 7 reported insufficient returns data. Thus, ROI data were calculated for 137 companies.

30 Of the 137 companies for which we could calculate returns as of December 31, 2017, 94 reported positive IRRs as of December 31, 2017.
APPENDIX | WHAT IS A SEARCH FUND?

A search fund is a pool of capital raised from a group of investors formed to support the efforts of an entrepreneur, or a pair of entrepreneurs, to locate and acquire a privately held company for the purpose of operating and growing it. The life cycle of a search fund can be split into four stages:

- **Fundraising**: The *initial search capital* is raised to finance the search stage — the identification, evaluation, and negotiation of an acquisition. To raise initial search capital, principals often need to tap a wide network of potential investors, including friends and family, business associates, business school faculty, angel investors, business owners and executives, and institutional search fund investors.

- **Search and acquisition**: There are multiple steps in this stage: generating deal flow, screening potential candidates, assessing seller interest, evaluating and performing due diligence on the target company, negotiating the terms of the acquisition, raising debt and equity capital, and closing the deal. When a target is identified, contributors of search capital are given the right of first refusal on their pro-rata share of new *acquisition capital*. Initial search capital is commonly stepped up by 50 percent in the acquisition round, whether or not the search capital investors decide to participate. In addition to follow-on investment, acquisition capital can come from a combination of other sources: seller’s debt, bank loans, and equity financing from new investors. Investor debt, commonly in the form of subordinated debt, may also be part of the capital structure.

- **Operation**: While completing the acquisition, principals will recruit a board of directors for the company, which often includes substantial representation from the initial search fund investors. In the first 6 to 18 months after the acquisition, principals typically make few radical changes, opting instead to learn the business and gain management experience. After becoming adept at operating the business, principals then begin to make changes to improve and further grow the business.

- **Exit**: Most search funds are established with a long-term outlook, often no less than five years. A typical search fund entrepreneur may spend, on average, six years from the beginning of the search to an exit. Liquidity events for investors and principals can occur in a number of ways, similar to exit opportunities for equity holders in a privately held company.

Since the first known search fund was formed in 1984, aspiring entrepreneurs have been drawn to search funds for two main reasons. First, they offer relatively inexperienced professionals with limited capital resources a direct path to owning and managing a small business. Second, search funds have generated significant financial returns for a small but growing number of principals.

Although the search fund model is growing in popularity, relatively few recent business school graduates raise search funds each year as compared to those who pursue more traditional career paths. The narrow appeal may be explained in part by the nontraditional financial outlook for search fund principals. While many post-MBA compensation packages include a high starting salary and a signing bonus, the principal of a search fund commands a relatively lower income through much of the process, with the upside, if achieved, typically occurring upon exit several years later. The uncertain nature of the location and the industry of the ultimate acquisition are other factors that likely play into an individual’s decision to pursue the search fund model.
SEARCH FUND LIFE CYCLE
The following is an overview of the four stages in the search fund life cycle.

STAGE ONE: FUNDRAISING
Principals begin the process of raising initial search capital by writing a formal private placement memorandum. This document can serve as an initial point of contact with potential investors and can signal the principals’ commitment and professionalism. The memorandum typically includes the following sections:

- Executive summary and overview of details specific to this search fund
- Targeted industries
- Summary of personal backgrounds of principal(s) and allocation of future responsibilities
- List of specific criteria that will be used in the acquisition search and screening process
- Detailed timeline with expected completion dates for specific activities
- Explanation of financing sought and the structure of the search fund vehicle
- Detailed breakdown of expected use of proceeds
- Outline of potential exit alternatives

Since most principals lack significant management experience, they commonly look for investors who also can serve as high-quality advisors. The best investors offer expert guidance, assist in generating deal flow, and provide leverage with lawyers, accountants, and bankers. In many cases, the investors are drawn to search funds not only by the potential financial returns of an investment, but also by the psychological rewards of advising and mentoring young entrepreneurs.

In a typical search fund, investors purchase one or several units of initial search capital, at about $30,000 to $40,000 per unit. A community of small institutional investors and funds has emerged, facilitating principals’ fundraising efforts. Individual investors sometimes purchase half-units of initial search capital, increasing the number of investors per fund and allowing institutional investors to purchase more than one unit. As of this study, the median number of investors in a fund was 15.

Contributors to initial search capital receive the right, but not the obligation, to participate in any subsequent round of acquisition capital. As compensation for taking on early-stage risk and the time value of capital, original investors receive a percentage step up on all initial search capital, regardless of whether or not they participate in the acquisition round. For example, assuming an investor were to contribute $30,000 to the initial search capital and the search was structured with a 1.5x step up, the investor’s interest would be worth $45,000 of equity in any acquired company.

STAGE TWO: SEARCH AND ACQUISITION
Creating a stream of potential deals can be difficult for principals, many of whom have little buyout experience. Principals typically focus their search by industry, although many also review deals geographically and opportunistically (e.g., deals sourced from third parties such as brokers, bankers, and professionals outside of
the principal’s primary industries of interest). Whereas an industry focus provides deeper understanding of and networks within industries chosen specifically for their attractive qualities, a geographic focus helps a principal home in quickly on deals, network among local professional friends, and narrow the search area. Most searchers have conducted geography-agnostic, nationwide searches in order to maximize the number of high-quality target companies in attractive industries. While some searchers have found success by focusing on narrower geographies, regions of focus that are too small or highly competitive significantly reduce the chance of completing an attractive acquisition.

Industry-based searches generally target two to four industries to start. Searching by industry helps principals build useful knowledge as well as credibility with sellers and intermediaries, and can allow principals to screen potential acquisitions efficiently. Conversely, principals run the risk of spending too much time trying to identify the perfect industry.

By adhering to a strict list of acquisition guidelines, search fund investors have been able to greatly reduce the risks inherent in investing in individuals with little operating experience. To mitigate operating and investment risk, search fund principals generally target industry segments that have high growth (double GDP growth or more) and high margins. They also favor stable industries, such as those not subject to rapid technological or regulatory change and those that are straightforward for them to understand. Some might target fragmented industries, as they may offer opportunities for growth through acquisition, or product, geographic or market extension.

Within the preferred industries, companies are targeted based on their sustainable market position, history of positive, stable cash flows, and opportunities for growth and improvement. Search fund principals and their investors prefer healthy, profitable companies versus turnaround situations. Preferably, the acquired company provides adequate cash flow, without high debt service, so that the short-term survival of the company does not rely on immediate, significant improvements in company performance.

If the target is a sustainable business with modest growth, its purchase price will often be a multiple equivalent of four to eight times EBITDA. Purchase prices generally range from $5 million to $30 million. The equity portion of the acquisition tends to range between $1 million and $20 million, which typically represents 30 to 75 percent of the total purchase price. However, equity has at times accounted for as little as 10 percent and as much as 100 percent of the total purchase price.

Searching for a target acquisition and completing a transaction is a time-consuming process. The general economic environment, industry characteristics, sellers’ willingness to sell, personal relationship-building skills, and regulatory issues are among the factors that can prolong or derail the process. Depending on the complexity of the deal, four to six months, or more, can elapse between a signed letter of intent and the close of deal. If the initial search capital is exhausted before a target can be identified, principals may choose either to close the fund or to raise additional capital to continue the search.

**STAGES THREE AND FOUR: OPERATION AND EXIT**

After a company is purchased, search fund principals assume the role of top management and may create value through one or more ways: revenue growth, improvements in operating quality and efficiency, appropriate use of financial leverage, and product or geographic expansion. Revenue growth may result from internal growth initiatives, pricing improvements, or scale attained from acquiring similar businesses. If additional funds are required for acquisitions or other growth initiatives, either current or new investors may participate.
Before significant additional acquisitions are pursued, investors usually expect one to two years of successfully operating the existing company.

If principals successfully execute a growth plan, the company can be expected to gain value, even if sold at the same multiple at which it was purchased. Sales multiples can increase if the new CEO builds a professional management team and improves financial reporting, allowing the eventual sale to private equity firms. In addition to revenue growth, improvements in operating efficiency can make a business more profitable. If an acquired company is leveraged, the equity in the business grows as debt is repaid.

In addition to annual salary and other compensation, successful searchers usually earn a material percentage of the upside of the investment. This upside is almost always structured to vest upon achievement of specific hurdles. A common vesting schedule vests one-third when the acquisition closes, one-third over time, and one-third upon hitting defined performance targets.31

Principals evaluate exit alternatives throughout the life of the business: Companies can be sold in part or in whole. Investor equity may be sold to other investors or bought by the company, or dividends may be issued.

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31 In some search funds, principals’ equity is subordinate to investors’ preferred shares. As such, principals would only earn equity once investors have been paid back their original capital, possibly with a preferred return.