Tweaking the search fund model for optimal results

How might entrepreneurs and investors better align their interests in search funds? Changes to incentive structures can motivate the former while still rewarding the latter.

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Search funds can offer young entrepreneurs the opportunity to put their MBAs to work at the helm of a company backed by investors looking for a healthy yield.

For search funds to work optimally, these entrepreneurial searchers and their investors need to align their interests. In "Re-Thinking Search Fund Incentive Structures," professors **Rob Johnson** and **Jan Simon** analyze some of the options being considered to further strengthen the structure of search fund acquisitions.

The study focuses on several structural issues:

1. Whether or not to include a preferred return,
2. How best to structure the searchers' equity vesting schedule,
3. The optimal performance measurement [internal rate of return (IRR) vs. multiple of capital], and
4. The role of the board in dealing with vesting provisions in order to keep searchers motivated and focused on building the business.

Now that search funds have been around for three decades, serial investors and experienced searchers are able to discuss ways to better align incentives in each deal. The goal is to motivate the entrepreneurs to perform their best at the helm of a company while rewarding investors for providing the capital. This note analyzes the effects of various incentive structures and discusses alternatives designed to better align searchers' and investors'

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interests.

See also: "**Searching Highs and Lows: Understanding International Search Funds**"

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