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Search funds: What does not seem to work and what can be done about it?

Part I: Vendor involvement and leadership

Jan Simon

IESE Business School
University of Navarra

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Author

Jan Simon
Professor in the practice of management in entrepreneurship and a managing partner at Vonzeo Capital Partners

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Introduction[1]

Back in 2014, IESE published one of the first international notes on search funds. Unsurprisingly, it was written by Rob Johnson, one of the very early investors in search funds and the driving force behind the internationalization of the model.

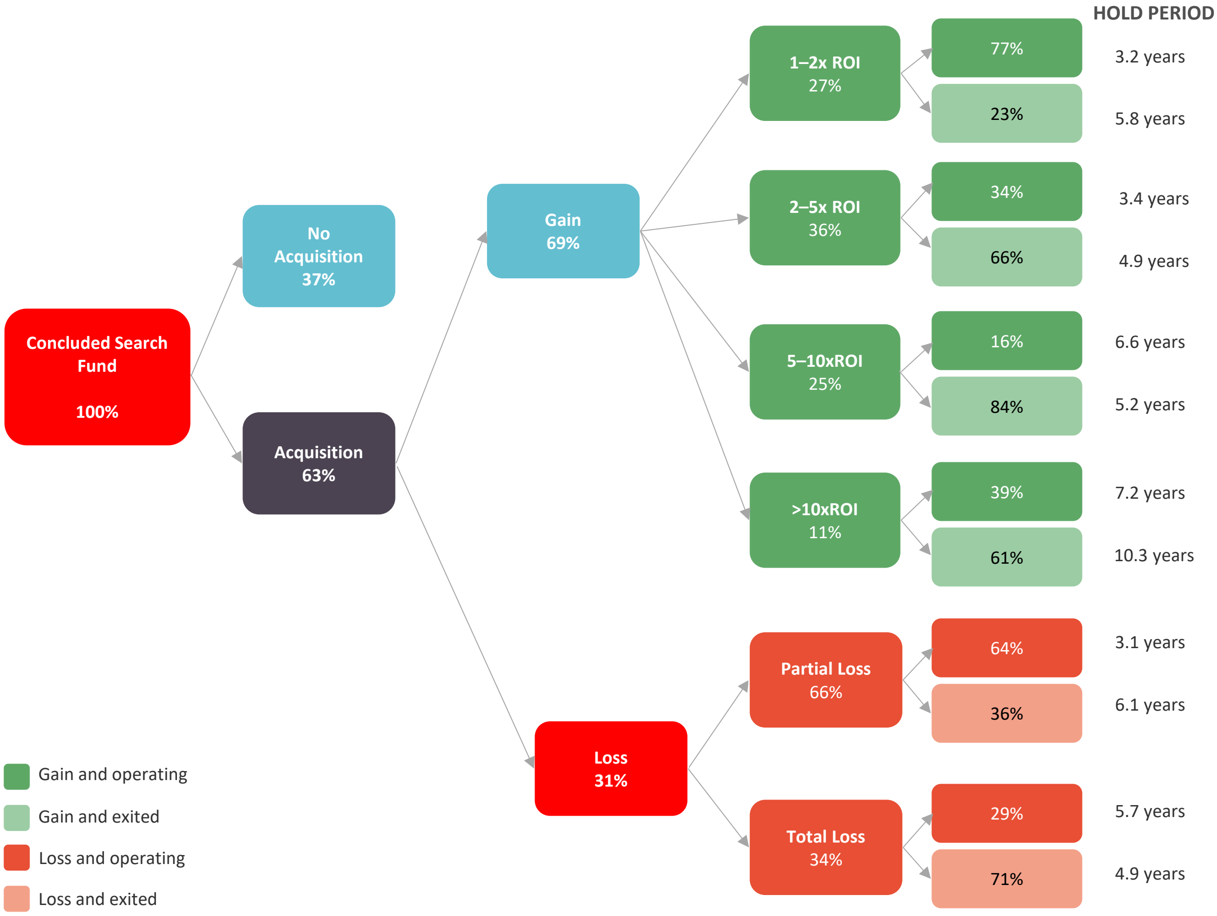
In "Search Funds- What has made them work?,"[2] Rob interviewed over a dozen of the early investors to explain a) the critical elements of the search fund path and b) the essential characteristics of their performance. In the note, one finds, for instance, that "It is difficult to pick the 'right' entrepreneur upfront," but that "Search fund investors want to back someone who is hungry, talented, focused, listens and shows some humility" or that company selection "...is based on a proven set of criteria, including: growing market, a history of growth and profitability, a major component of recurring or repeat revenue, and low CAPEX requirement." From the note, one also learns that "Leverage does make a difference. EBITDA growth plus financial leverage leads to good returns. Securing debt is also important in validating the robustness of the businesses: "It matters to investors who the directors of the acquired company are. Serial search fund investors must share the workload across search fund deals."

Bar some sporadic noises from a disgruntled ex-searcher, in general, technical notes, newspaper and magazine articles, interviews, and podcasts almost exclusively praise the search fund model. And while in the aggregate, there are solid reasons for this praise, when one looks into the weeds or rationally reflects, the journey is not a straight walk in the park for searchers, CEOs, or investors. Some searchers do not find companies; some CEOs destroy (all the) value. For investors, this is not a treasury bond with returns eclipsing venture capital (VC) investing. Again, in the aggregate, this is a phenomenal asset class to invest in, but as one would expect, some investments do not work out. Indeed, about a third of searchers close their funds without acquiring, and the return profiles of the acquirers are presented in **Figures 1** and **2**.

[1] With thanks to the participants at the 6th IESE Annual Investors in Search Fund Conference for their input and to Juan Naranjo for his observations on a previous version.

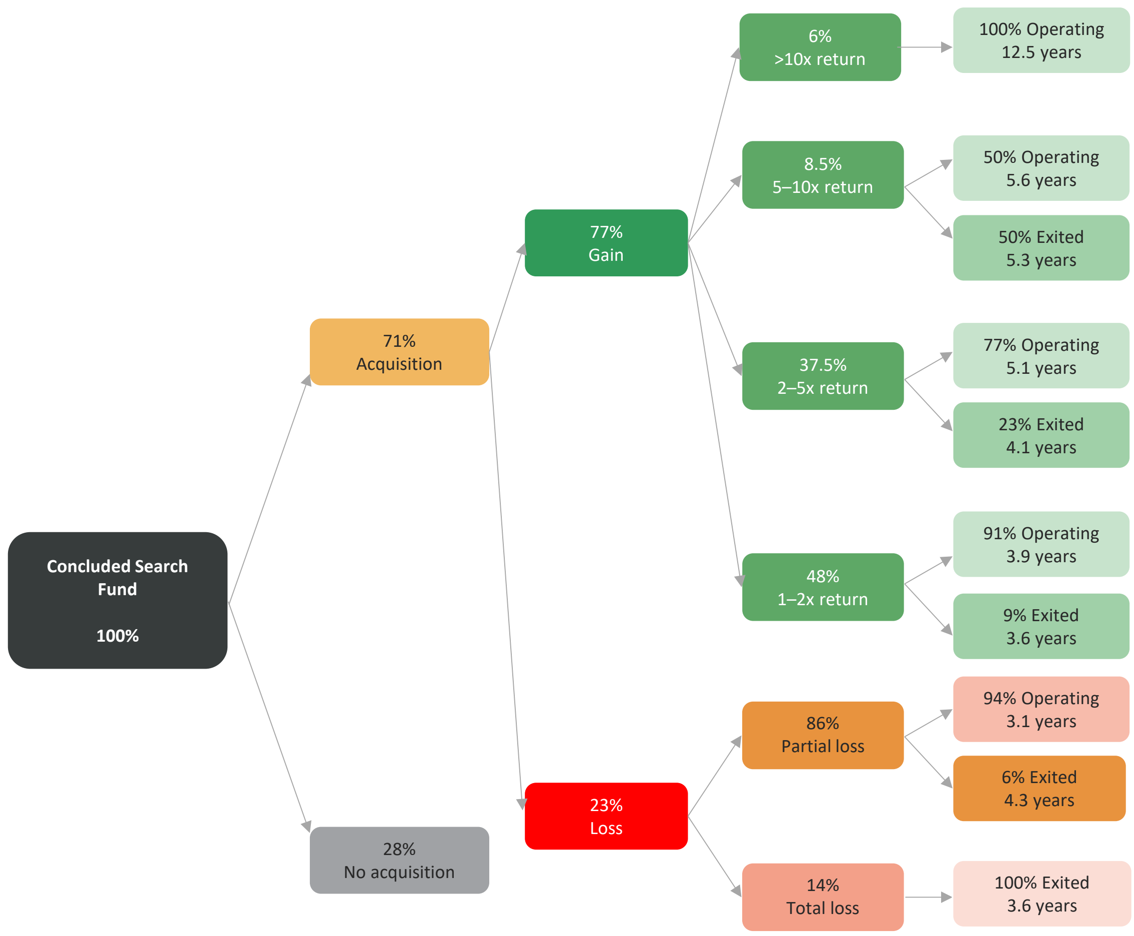
[2] International Search Fund Center. "International Search Fund Center", IESE Business School. Last modified 2025. https://www.iese.edu/entrepreneurship/search-funds/

Figure 1. Search Fund Return Profiles in the United States and Canada



Source: Stanford CES.

Figure 2. Search Fund Return Profiles in the rest of the world



Source: IESE International Search Fund Center

Putting together observations from fellow investors shared during the 6th IESE Search Fund Investors' Summit held in Madrid on May 13, 2025, along with analysis made as part of the International Search Fund Centre, I thought it could be useful to look at the other pole of Rob's article by asking the following question: *"Search funds—what does not seem to work and what can be done about it?"* The answer to this question and its analysis can be read in this note and its sequel. Before one does, it is important to make the point that there is no particular order represented, i.e., #1 (Continuing role of the vendor) is not necessarily worse than #2 (Leadership failure). Moreover, while all of the situations analyzed had at least one of the ailments, in the absolute majority of cases, several of the ailments coincided. This first part tackles the ongoing role of the vendor and leadership issues. Part two will discuss customer concentration, market disruption, and the role of the government.

Cause #1: Continuing role of the vendor

When analyzing companies in which shareholder value was destroyed under the tenure of a searcher, one frequently recurring factor is the active presence of the seller. This recurring scenario typically plays out as follows:

As part of a proprietary search, a searcher reaches out to an owner-CEO of what looks like a good company in a great industry. This potential seller was not waiting for a call of an aspiring buyer, and definitely not from a recently graduated 32-year-old. Over the next 4 to 6 months, the two form a trust-based relationship to the point that an often-made seller's remark sounds as follows: "If I only had a son/daughter like you." It does not necessarily mean that the seller has no children but that—for a variety of reasons—there are no children in line to step in the seller's shoes.

It is worth noting that without creating this basis of trust in the searcher's capabilities to lead the business to the next level and in their integrity, there would be no deal. But there is more! As referred to in the parent–child observation, there is a strong emotional connection between both searcher and owner. Dealmaking in search funds is based on embedded relationships, unlike in private equity, where deals are professional and at arm's length. This difference is a common reason sellers would rather sell to a searcher than to a more institutionalized investor.

However, this strong and personal relationship has consequences. First, it can reenergize the seller to the point that they somehow want to stay involved and possibly capture a part of the upside. Second, this strong sense of partnership works both ways; the searcher finds themself heavily invested in the relationship with the seller. A beautiful thing, one might say, as it makes due diligence easier, transition more comfortable, valuation a touch more flexible, and the probability of a transaction higher. True. But it also helps explain why, when the searcher argues to investors for ongoing seller involvement and investors warn against it, the searcher does not heed their advice. They honestly believe that their relationship with the seller is unique and, hence, that investors do not really "get it." Additionally, in some cases, the seller makes it clear that without their further involvement, there will be no deal. But so far, so good.

The problem starts to fester as a result of two very human conditions: grief and ego. It is very human for the seller—once the exuberance of having sold the business, received plenty of cash, and experienced the rewards wears off—to experience a sense of loss. After all, what they refer to as "their baby" is no longer theirs. Astute observers regularly detect the five stages of grief[3]: denial, anger, bargaining, depression, and acceptance. This can understandably be accompanied by a hurt ego. Whereas the seller was once the oracle of good ideas, the center of attention, the source of jokes everybody laughed at, and the undisputed leader of the company (maybe the thought guru of the sector), the searcher has now replaced them. "They" now go to the searcher for ideas and think they are hilarious, and even worse, they keep telling the seller how great the searcher is. Thus, the broken record continues:

[3] Marie Curie. "Stages of Grief: Are the Five Stages of Grief True?" Marie Curie. Last modified November 7, 2022. https://www.mariecurie.org.uk/information/grief/stages-of-grief

After having been exceedingly helpful during the transition period, the seller—who was kept as head of sales, for example—keeps on getting involved in decisions and actions that have nothing to do with his sales function (denial). All is clearly well meant, but it undermines the CEO's authority, especially since in some situations, the seller openly questions their decisions (ego).

At board meetings, the searcher also sees a clear change in the behavior of the seller. While during the first board meetings the seller hardly participated (it tends to be the first board a seller sits on, and thus, they do not really know what to do or expect, hence the silence), they now question many of the searcher's points (ego) and are even outright hostile toward them (anger).

It is important to acknowledge that both the process of grief and the sentiments the seller's ego unleashes do not have anything to do with this seller but everything to do with the situation and the fact that the seller is a human being. Unfortunately, if not handled well or not anticipated, the situation can strangle the business by either preventing the new CEO from being effective or allowing the seller's unchecked anger to affect the company.

Remedy cause #1: Continuing role played by the vendor

Before discussing some potential solutions for vendor involvement, it is worth pointing out that not all seller experiences are negative. There are indeed cases where the vendor has stayed on, playing an important role in successful outcomes. These cases are, however, fewer than one would expect, and in cases in which the seller's involvement turned sour, the valuation of the company and the CEO's growth and experience were seriously impacted.

One solution lies in preventing the situation in the first place. This is what most investors try to convince the searcher—and at times the seller—of. As alluded to before, this is often met with muted success. The reasons for this are three-fold. First, the fact that the seller is willing to sell to the searcher means, among other things, that they have forged a strong personal relationship. Its strength is far superior to the relationship searchers might have with any of their 15 investors. This is even more true for the relationship—if it even exists—between the seller and some investor. Second, for the searcher, this beautiful connection with the seller seems unique and is something investors "do not really understand"; it is there to stay—or so the searcher thinks. Third, investors make the point but are reluctant to push their advice hard; in the end, this is the searcher's deal.

For seller engagement solutions, we must first distinguish between a seller who stays operationally active, a seller who is a board member, and a seller who stays on as an investor.

a. Seller operators

In this form of engagement, the seller does not necessarily have to be a formal employee. At times, sellers take quite some time before clearing their office or continue to show up to share their advice with all—uninvited. This is a hard no. Offices and desks need to be cleared from day one, and the CEO needs to make it clear that spontaneous visits, if problematic, are not helpful and should stop. A board member close to the seller having a quiet word with them is often most effective. For this, and other matters, it is wise for one of the investors/board members to build a closer relationship with the seller during and after the transaction.

A more frequently recurring situation is where a seller stays on because they are not really ready for retirement, wants some liquidity, or prefers focusing on their expertise, such as sales or technology. The searcher provides an ideal solution by not only providing liquidity but also solving the question of whether to professionalize the company or bring it to the next level. Furthermore, the seller can now dedicate their time to what they want to focus on. For the searcher, this can be manna from heaven, as the seller provides continuity and support while fulfilling a key-person role. Thus, it is important that the board provides the searcher with critical tools to manage this situation. These include how to conduct the relationship with the seller so that they feel acknowledged yet understand their new position, how to become ready to replace him when necessary, and how to provide support to the seller when they get emotional.

For a seller who stays on as an employee in a noncritical role, there is of course less of a problem. In this case, firing becomes an easier option. Note that it is important for board members to monitor this situation because new CEOs are not good at firing people in a timely manner; this is especially true if the person to be fired is the seller.

b. Seller board members

It is understandable when a seller wants to become a board member. While they want to "move on," they still feel responsible for "their" customers, "their" employees, "their" supplier relationships, and so forth. After all, they are selling to an inexperienced operative. A board position allows them to help steer the ship in the right direction. It also allows the CEO and other board members to leverage the seller's industry expertise and the corporation's historical context. But because of the reasons mentioned before-ego and grief- , a board position should also be avoided. But what if the searcher insists, or the seller makes it clear that without it, there is no deal?

In this case, an essential tool is the shareholder agreement. It should include a clause explaining how board members can be removed. Typically, this is by majority voting (most boards in search funds have five members, while removal requires three members). If the seller (or any other board member) turns against the company, removal becomes a solution, provided that the other board members do not have special relationships with the vendor.

Another solution, provided that the seller agrees, is making the seller an auditor to the board, i.e., does not enjoy voting rights.

A fix that works particularly well for this, as well as for other demands where the seller wants to "hang on," is to offer a paid consultant or advisory role. In this case, the seller is "on call" and gets a nice salary. This sends a signal to the seller that they will still be involved but that the initiative lies with the CEO. The typical length of such a contract varies from 6 to 12 months.

c. Seller investors

If a seller no longer has an influence on the creation of value, why should they keep a stake in the business? Additionally, with dispersed ownership being a key characteristic of the search fund model, a seller that holds 20%–30% of the shares will be the largest shareholder, eclipsing the others. This is not a healthy situation, especially if the vendor has tantrums and tries to influence key employees with the argument, "And who is still the largest shareholder in this business?"

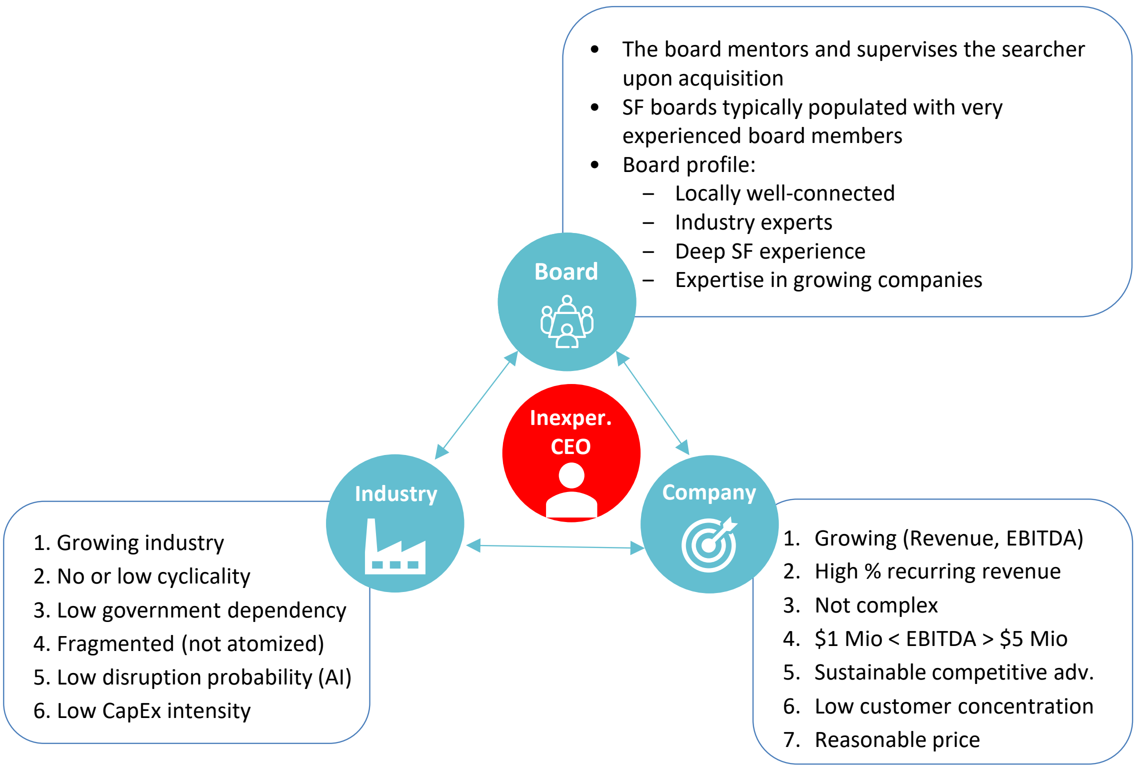
But what if a good deal is otherwise not in the cards? In some cases, a good result can be achieved through a one-year put/call option. This gives the seller the right to sell his stake in the company at a strike equal to the acquisition price, while the company has an equivalent right to take out the seller's stake. If the seller turns against the company or its CEO, exercising the option solves the issue. For the seller, in case they do not believe in management anymore or want to really move on, they are guaranteed both further liquidity and price.

Cause #2: Leadership failure

A second commonality in a vast number of failures has to do with the weakness (and at the same time, the largest opportunity) of the traditional search fund model: an inexperienced CEO. As a refresher, the risk of putting an inexperienced person at the helm of a company informs the twofold task of the search: (i) to purchase a good company in a great industry at a reasonable price and (ii) to prepare the aspiring operator to become CEO-ready. Indeed, many industry and company dynamics are merely ways to reduce risk. The purchase of the corporation at a reasonable price adds a margin of error, i.e., gives the new CEO some room to mess things up.

Importantly, the risk is further reduced by installing an experienced search fund board. This means a board of directors—an entity of corporate governance by excellence—that fully understands (i) what it means to supervise and give guidance to a nascent CEO and (ii) is equipped with the necessary board expertise and board capabilities to grow the target company's worth as well as address problems when they arise.

Figure 3. The search fund model

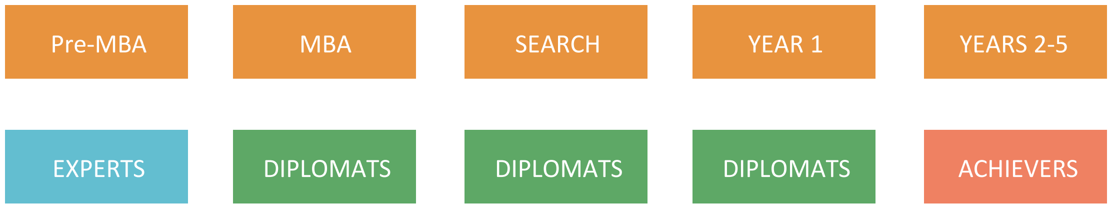


If one buys a good company in a great industry at a reasonable price, what can go wrong? In essence, there are two main things: (i) the industry changes for the worst or (ii) a failure in leadership. The former is the subject of Cause #4: Market disruption. The latter is discussed here. Leadership failure can be split into two parts: leadership failure at the CEO level and leadership failure at the board level.

a. Leadership failure at the CEO level

Elsewhere,[4,5] I have written about the importance of the leadership transformation of search fund CEOs. Borrowing well-established archetypes from the leadership literature (see **Figure 4**), it has been explained that a successful search fund CEO typically transforms from an Expert pre-MBA into a Diplomat during the MBA. Diplomat is an ideal archetype to build trust and emotional connection, two essential ingredients in establishing an embedded relationship with the seller. This archetype is also most helpful in creating a rapport with the employees and doing the necessary learning during the first year of the CEO's tenure.

Figure 4. The Search Fund Model and leadership archetypes



The leadership style that is grounded in specialized knowledge such as domain expertise (Expert) or one that is reflected in a cozy, cooperative, and collaborative CEO who likes to see everyone as a happy camper (Diplomat) will not lead to high returns. After the initial honeymoon period (one year, for example), free riders will increase their effort to take advantage, while others will undermine the CEO's authority. If the seller is still involved, this will be the moment that they might want their "baby" back.

What is needed is an Achiever. Someone who can rally the troops, communicate clearly what is expected, put a management team in place that will deliver (A-players in A-positions), create an environment in which people can be awesome, and execute the board's decisions. What about the slackers, the free riders, the undercutters, and the jealous owners? See you later! Achievers do not shy away from hard decisions and understand their role in outsized performance. They are humble, hungry, hardworking, and disciplined and come with a strong sense of urgency. Gone is the tolerance for working with incompetent people.

Humble people listen; people who listen learn. Learning and experience lead to change, assisting in turning a Diplomat into an Achiever. An Achiever is, per definition, hungry, but they also "do not have all day." This sense of hungriness and urgency is also common to successful startup CEOs.

Leadership issues arise when the CEO is not coachable, as this makes the board ineffective in supporting the transformation. Consequently, problems tend to fester, and the business health spirals downwards.

b. Leadership failure at the board level

A second type of leadership trouble takes place at the board level.

Blaming all leadership failure on the CEO is plain wrong. In the end, it is the board that holds the ultimate fiduciary duties—namely, the duties of loyalty, care, and candor—to the shareholders and the corporation. It is also the board that is responsible for firing and hiring CEOs and, in the search fund world, "mentoring."

[4] Sara Rosenthal and Jan Simon, "Search fund transformations: A path to excellence," *IESE* (2024).
[5] Jan Simon and Anne-Sophie Kowalewski, "Nurturing Leadership in Search Funds,"ST-647-E, *IESE* (2023).

Board leadership in the search fund world is tricky, to say the least. On the one hand, it has fiduciary duties stipulated by both by laws and case laws to the corporation and its shareholders. On the other hand, the investors have handed the board a newly minted CEO. To make things worse, the culture in search funds is one of collaboration, in which the community feels that part of its raison d'être is to support young entrepreneurs in their quest to become CEO. However, the law does not make a distinction between big board, private equity–owned, or search fund–acquired companies when it comes to corporate governance duties.[6]

This multifaceted situation is reflected in an often-heard expression used by SF-CEOs: "The board works for you until it fires you."

Board leadership failure can happen on several levels. Following are some examples.

- Failure to understand its fiduciary duties.
- Failure to assist the CEO in achieving their key objectives, specifically setting performance objectives, clear communication of how those could/should be achieved, and feedback.
- Failure to acknowledge the cognitive and emotional impact of bad results (e.g., the loss of an important client, the departure of key employees, or market disruption) on the CEO.
- Not respecting corporate governance, such as by not disclosing conflicting interests.
- Not acknowledging the lack of expertise needed for the next phase of the company.
- Too close a relationship with its CEO.
- Failure to do its duty to inform other shareholders of important issues in a timely manner.
- Failure of nonexecutive board members to refrain from involvement in execution. NIFO! Nose in, fingers out!

Remedy Cause #2: Leadership failure

It is critical to point out that the wrong leadership diagnosis leads to a wrong set of solutions. For example, in a growing industry where competitors seem to be doing well, the search fund–acquired company is struggling. If the origin of the problem lays in a dysfunctional board having cooked up a bad strategy, then this is a board issue. If the cause is the loss of critical clients because the CEO decided to ignore the need to focus on quality, then the problem resides at the CEO level.

An important factor of distinction is captured in the idea of "coachability." If a CEO is truly coachable, and there is a CEO leadership issue, then there is an ample number of remedies available, as discussed below. If they are not coachable, then the solution will often be termination. In *searchfundlandia*, termination is typically a result of a) unethical behavior, b) unlawful practices, or c) bad performance combined with the CEO not being coachable.

But when is someone coachable? I would argue that *being coachable* consists of three important components: a) skillset, b) capacity to listen (humbleness), and c) commitment. The CEO needs to have certain skills to run a company. Many of these can be acquired, but ideally, the CEO has some of the critical ones in advance. Think, for instance, of the ability to read an income statement, leverage communication skills, or develop a competitive strategy.

A second important factor is the CEO's capacity to listen. This is why the search fund community puts so much emphasis on the humbleness of the searcher. Humble people listen; egocentric people do not.

Last but not least, the CEO needs to be committed to their fiduciary duties and the execution of the board's decisions. If they are not committed to this, fail to listen, or do not have the necessary skillset,

[6] In some jurisdictions a distinction is made between tenure of public company and private company boards. The core governance duties stay the same though.

then indeed there is a CEO leadership problem with very few solutions bar termination. Having said this, with a good board and a coachable CEO, there are not that many "big issues" that cannot be rectified. Let's look at some remedies for both CEO and board leadership problems.

a. Remedies for leadership failure at CEO level

As described in "***Search fund transformations: A path to excellence***," top performance is a function of transformations at three levels: CEO, corporation, and board. As explained, an important reason for failure is the failure of a CEO to develop into an "Achiever." In some cases, this leads to suboptimal performance: The company does okay, but no transformation takes place. In other cases, it explains why the company is "stuck" or worse: A negative vortex develops with key stakeholders opting out. Board intervention is needed, which can take on the following three forms:

1. **Board mentorship**
   Often, someone on the board, with the board's approval, will take ownership of the issue and engage in structured mentorship of the CEO's leadership. Typically, this is a seasoned board member with strong operational and leadership experience. Note that this should not be on a paid consultancy or advisory basis as this creates conflicts of interest. One is either a consultant or a board member, not both.

2. **Coaching**
   Many US and Canadian searchers have coaches who assist them in their leadership development. Outside of the US and Canada, the use of coaches is limited. I believe that many searchers would benefit from coaching. If CEOs of bellwether companies find value in their services, why not SF-CEOs?

3. **Termination**
   Board mentorship and coaching only provide a solution if the CEO in question is coachable. This means that the CEO has (or is able to develop in the short term) the necessary skillset ***and*** has the capacity to listen ***and*** has the commitment to transform. If this is not the case, the board has a fiduciary duty to the shareholders and the company to replace the CEO with someone who is capable and committed to implementing board decisions and managing the corporation in a professional way. Timing can be tricky as firing too early might be a missed opportunity and firing too late makes it difficult to attract top talent. The latter can lead to the loss of a company that was savable.
   Termination is naturally the only option in case of ethical issues or unlawful practices, such as theft, fraud, or sexual harassment.

b. Remedies for leadership failure at the board level

Observers of professional team sports will know that it is easier to fire the coach than to change the team. Similarly, observers of corporate America will have noticed that the turnover rate of CEO positions dwarfs the velocity of board adjustments. Here lies a caution. It is the responsibility of the shareholders to conclude whether a leadership failure is taking place at the CEO or board level. If it is the latter, shareholders should get involved. If it is the former and no board action is taken, then the leadership breakdown is twofold, and again, shareholders should get involved.

Until recently, search fund boards were populated with experienced professionals, many of whom had sat on boards of larger and more complex companies. Search fund–acquired companies' performance and the turnarounds of problematic situations are testimony to this. However, as the space is growing rapidly, board experience is dropping. We believe therefore that "shareholder engagement" is becoming of the essence.[7] Shareholder engagement allows shareholders to better assess boards and, where needed, intervene in order to have a board change.

The remedy for an underperforming board is to change it. This can be triggered by the board itself, provided that the shareholder agreement stipulates how board members can be removed. In reality, if such a provision does exist, it will be used to change one board member (technically it could be used to replace two, as search funds boards tend to have five voting members, and majority is required).

If the majority of the board or the board in its entirety needs to be replaced, this becomes a shareholders' decision.

In conclusion, this first part discussed two of the most common causes of search fund failure post acquisition: first, the ongoing role of the seller, be it as employee, board member, or investor, and second, a breakdown in leadership. This can happen at the CEO level and at the board level. Solutions were suggested for each cause of failure. A second note will explain failures in search fund–acquired companies that often–but not always–originate from weak due diligence, be it because the seller is less forthcoming than they should be, the searcher lacks experience in the matter, or investors and searchers work with budgets that are dwarfed when compared to the due diligence expenses in private equity. These are failures are customer concentration, market disruption, and government involvement.

[7] In some jurisdictions, a distinction is made between the tenure of public and private company boards, although the core governance duties stay the same.

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