Search Funds: A Rising Asset Class Outperforming PE and VC

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Search funds are quietly minting millionaires by buying stable, profitable businesses while venture capital and private equity struggle with depressed valuations and exit freezes.

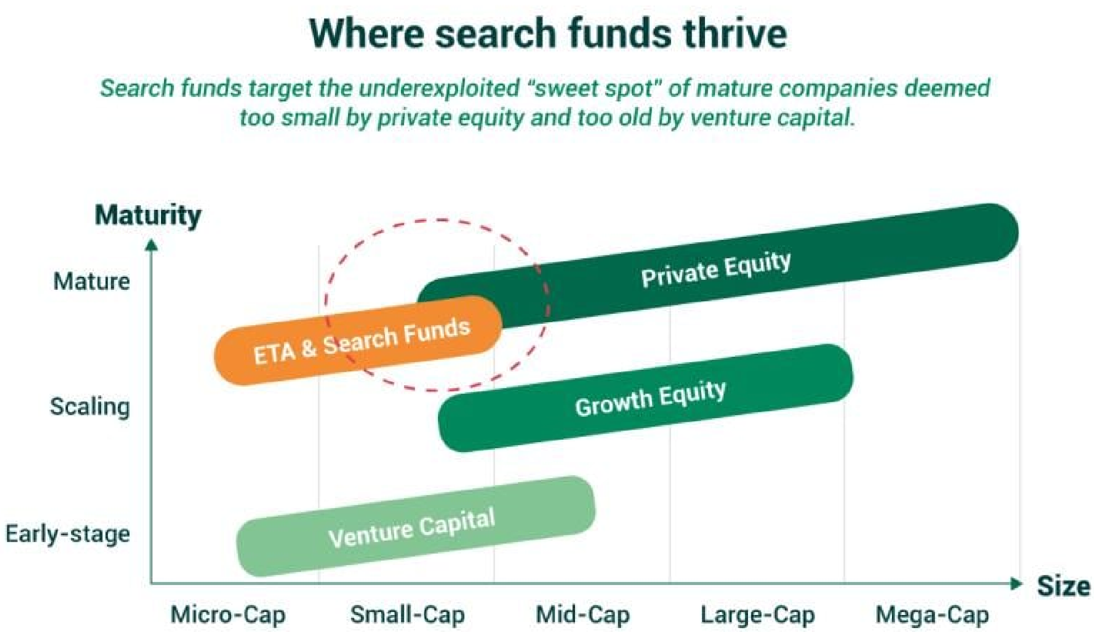
A quiet revolution is unfolding in the investment world. While venture capitalists chase unicorns and private equity firms compete for mega-deals, search funds are targeting a different opportunity: profitable, owner-operated small businesses in need of succession. Here's why this entrepreneurial investment vehicle is outperforming both VC and PE.

What are search funds?

A search fund is an entrepreneurial investment model where one or two individuals raise a small pool of capital to search for a privately-held business to acquire, a pathway called **entrepreneurship through acquisition** (ETA).

Investors commit to supporting the search process and in return, hold the right but not the obligation to invest in the acquisition. This two-stage model helps de-risk the process by allowing investors to get to know the searcher and assess their fit with the target company. After acquiring a business, search fund entrepreneurs run the company as CEOs. Effectively, they get to lead companies without starting from scratch, and with lower risks to boot.

Search funds were first introduced in 1984 at Stanford University and have become a compelling alternative to the more established PE and VC models. Search funds target small businesses (US$1-5m EBITDA) that are already

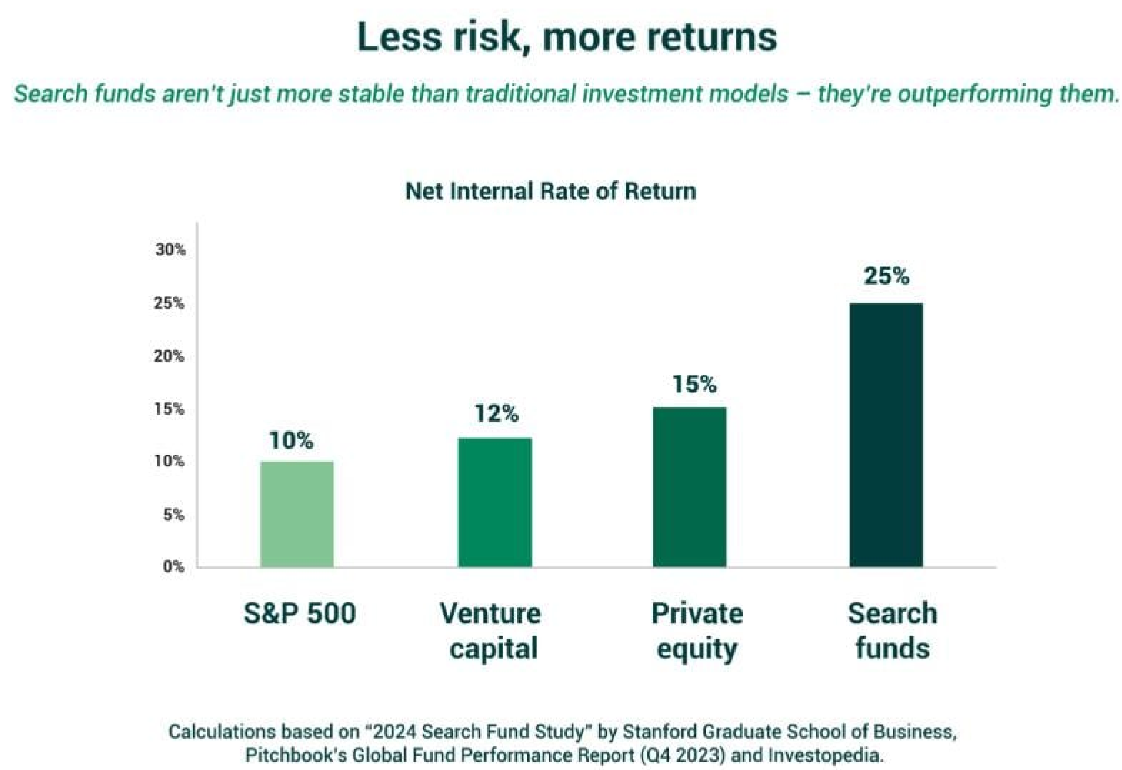


Search funds operate in a sweet spot; they target businesses too small for PE and too mature for VC. These companies are often overlooked despite their solid fundamentals and consistent cash flow. The typical seller is a retiring founder with no clear succession plan. The search fund entrepreneur acquires the business, usually at a reasonable valuation, and brings new leadership, energy and ambition.

INSEAD alumnus **Gernot Eisinger**, a leading PE and search fund investor, notes: "Because most searchers are relatively fresh out of their MBA when they become first-time CEOs, the role of supportive investors and a strong board is critical. With the right guidance and aligned incentives, these businesses often thrive under the new entrepreneurial leadership. That's a big reason why search funds have consistently delivered strong returns and can outperform more traditional asset classes like PE and VC."

Perhaps this may help explain why search funds are gaining traction globally, especially as VC deals stall and PE faces pressure to deploy and return capital quickly. Meanwhile, an increasing number of ageing business owners worldwide are seeking successors who will continue their legacy. According to a **report** by IESE Business School, in 2023 alone, 59 new international search funds were created and 31 companies were acquired outside North America. Search funds are also becoming increasingly popular at INSEAD. MBA graduates launched over 40 funds, many of them in new regions, in the past five years.

Less risk, more returns



“In search funds, we get similar or better returns at a fraction of the risk we take on in VC portfolios,” says **José Martín Cabiedes**, a seasoned VC and search fund investor. “We buy healthy businesses with leverage. The beauty is that even if enterprise value remains flat, strong cash flow can double equity in just a few years. Try doing that in VC.”

Put another way, search funds buy profitability and stable cash flows whereas VC trades in the promise of future growth (often tolerating sustained losses). Cash flow not only de-risks the search fund investment but also creates a compounding advantage over time. In the current environment, where VC-backed unicorns face compressed valuations and exit freezes, search funds continue to quietly deliver double-digit IRRs, or internal rate of returns.

That’s not to say search funds are risk-free. As Eisinger cautions, “They target smaller firms that often lack mature management layers. That’s why operational capability and a strong board are so important. Similarly experienced investment judgement and pattern recognition is critical to choose the right target company and structure the transaction.”

Governance and alignment

In VC, investors often hold aggressive control rights and complex equity structures. “You might own 40 percent on paper but walk away with 10 percent of the exit, or a VC might own only 10 percent of a company but still control it entirely,” says Cabiedes.

By contrast, search funds are built on a simpler and more transparent foundation. “The governance and economic rights are much more proportionate to the actual equity held. So, the investor's influence is more aligned with their percentage of ownership,” Cabiedes adds. “There’s a proper corporate governance structure, but the CEO enjoys a very high level of independence in day-to-day operations.”

Still, since most searchers are first-time CEOs in unfamiliar industries, having experienced boards and value-adding investors is critical. Coaching, governance and operational support all help flatten the learning curve and boost the odds of success.

This underscores the importance of choosing the right investors. Searchers should prioritise those who bring strategic value, not just capital. In a world where capital is increasingly commoditised, the true differentiator lies in the investor's ability to add value throughout the journey: from the search, acquisition, operations to the exit.

Time horizons and exit flexibility

When it comes to the timeline to profitability, PE is under pressure to return capital quickly, and VC timelines are often distorted by long-delayed exits. Search funds operate with more flexibility, typically aiming for a four- to six-year hold period. Exit takes on various forms: full sale, partial recapitalisations, secondaries (sale to a secondary buyer), or long-term holds.

Interestingly, search fund exits are now attracting PE buyers. "PE firms see search-backed companies as growth-oriented, profitable and de-risked," notes Cabiedes. "In Spain alone, we've seen multiple such acquisitions recently."

This trend marks the maturation of the search fund model; it is no longer seen an exotic niche but a validated route to value creation, liquidity and scale.

A maturing model sharing key traits with PE

Moreover, the crossover between search funds and PE could play a vital role in further professionalising the search fund ecosystem. As Eisinger puts it, "Search funds and PE represent different paths to approaching the same goal of buying and growing a healthy business. Each has its unique advantages, and both are often mutually reinforcing."

He identifies several ways PE complements search funds:

- Capital structuring: "Search funds tend to be more conservative with leverage, but with PE guidance, they can scale their financing intelligently as deal sizes grow."
- Operational focus: "You don't need 10 consultants. A smart operator and a strong board can implement changes that drive real value."
- Inorganic growth: Add-on acquisitions are a powerful lever. PE firms excel at sourcing, structuring and integration – skills that searchers can leverage to accelerate value creation.
- Exit planning: "PE always thinks from the end. Search fund entrepreneurs should too, because if there's no exit market, your

valuation will suffer."

Fuelling the next wave of ETA and search funds

As more capital enters and more individuals pursue ETA as a career path, it's harder to identify which investors will be true value-adding partners and which entrepreneurs are genuinely committed.

Although the search fund market functions as a matching system, outcomes will likely become more polarised. Strong investor-entrepreneur matches will continue to deliver outstanding returns. Poor matches will not. This only reinforces the need for thoughtful, strategic alignment on both sides.

To support this growing need, INSEAD has launched the **ETA and Search Funds Hub** to connect entrepreneurs, investors, board members and business sellers. The Hub leverages INSEAD's global network to advance education, research and value creation in ETA.

As more investors and MBA graduates discover this model, and as **succession challenges** create urgent demand, search funds are poised to grow even further. For aspiring entrepreneurs with the right mindset and skills, search funds and ETA offer the autonomy and upside of entrepreneurship, coupled with reduced risk and a structured path to success. For investors, this is a timely opportunity to back entrepreneurial talent while generating attractive, risk-adjusted returns.

Find article at
https://knowledge.insead.edu/entrepreneurship/search-funds-rising-asset-class-outperforming-pe-and-vc

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About the author(s)

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