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A Call to Philanthropy in the Search Fund Ecosystem

It is time to move to wealth disposition in addition to wealth creation

A. J. Wasserstein[1]
Greg Geronemus[2]
David Rosner[3]
Jim Sharpe[4]
Jan Simon[5]

In 1984, when Jim Southern, Jamie Turner, and Kirk Riedinger launched the first search funds, it is doubtful they could have imagined what the search fund ecosystem would grow into. What was once a nascent – and quirky – approach to entrepreneurship has now been mainstreamed, and the model continues to flourish and spread. The search fund world has always been a community, and the sense of camaraderie continues to permeate its environment. Entrepreneurs and investors consistently help each other achieve success. As search funds enter their fifth decade, we believe it is time for our network to expand its reach from benefiting ourselves to sharing with others – through philanthropy – by replicating Warren Buffett and Bill Gates' Giving Pledge.

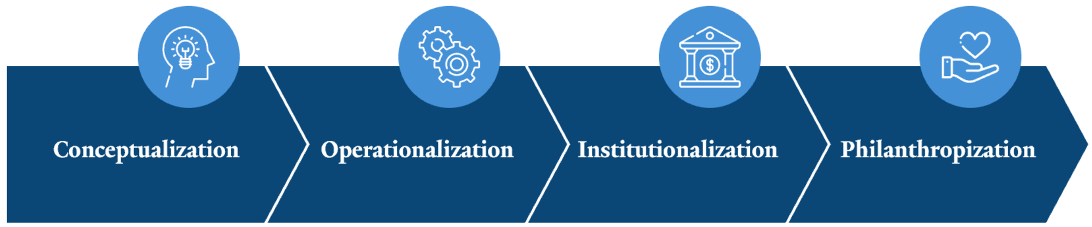
When thinking about the search fund ecosystem, we believe there have been three distinct evolutionary chapters (see **Figure 1**). First, in the early 1980s, there was *conceptualization* – establishing a new framework for talented MBA students to pursue an entrepreneurial arc by purchasing a business rather than starting one from scratch. Economic terms for entrepreneurs and investors coalesced, and a model was born.

In the second phase, the concept was *operationalized* and got traction mostly at Harvard Business School and the Stanford Graduate School of Business, with one or two intrepid pioneering students launching a search every year or two. A group of supportive and visionary investors coached and nurtured these brave entrepreneurs and established a positive culture of collaboration, learning, openness, and encouragement – values that still permeate the search ecosystem today.

The third stage of search funds has been its *institutionalization*; it has become normalized, familiar, and established as a way of pursuing entrepreneurship. More entrepreneurs from more MBA programs proliferate the space. There has been a transition from exclusively individual investors to pools of professionally managed capital. The search fund model has experienced iteration, adaption (with self-funded, accelerators, and holding companies as examples), and geographic expansion, and there has been an increase in service providers (creditors, lawyers, and accountants, to name a few) who are keenly focused on search funds and fully understand their necessities and peculiarities.

We believe that there is a fourth chapter to be written in the search fund world: *philanthropization*. Search funds have created tremendous affluence for entrepreneurs and investors, and we think there is an opportunity for them to share a small part of this accumulated wealth.

Figure 1: The four evolutionary chapters of the search fund ecosystem



When the search fund model is deconstructed, many of the core principles can be traced to the famed investor and CEO of Berkshire Hathaway, Warren Buffett, and his multi-decade partner Charlie Munger. For example, buying rather than starting an enterprise, recurring revenues, asset-light businesses, moats, reasonable entry valuations, prudent growth, long holding periods, capital allocation, decentralization, and backing talented CEOs are all pages borrowed from the Buffett–Munger playbook. We all follow many of their solid tenets and have been served well by embracing these principles.

We now propose continuing to imitate, albeit in a small way, the Oracle of Omaha by observing actions taken by Buffett regarding philanthropy and wealth disposition. In 2006, Buffett pledged to gradually donate all of his Berkshire Hathaway equity to philanthropic foundations. In 2010, he joined forces with Microsoft founder Bill and Melinda Gates to establish The Giving Pledge – a movement of billionaires cum philanthropists who commit to giving the majority of their wealth to charitable causes, either during their lifetimes or in their wills. Buffett and the Gateses conceived this as an open invitation to extremely fortunate people to use their accumulated wealth as a mechanism to make the world a better place. For Buffett's giving pledge, please see **Exhibit 1**.

We are calling on the search fund community to come together to establish a similar giving pledge for those of us who have benefited so tremendously from an economic and societal system designed for capitalists, investors, and entrepreneurs. We joke that this is the ETA community giving pledge for mere mortals compared to the billionaires Buffett is targeting. Although this is not a club or an elite group in any way (all comers are welcome), we are loosely thinking about people who have accumulated enough wealth, or those who anticipate they will, to contemplate meaningful philanthropic initiatives. Our goal is to stimulate approximately 300 people who are multi-decamillionaires to pledge a percentage of their wealth to philanthropy during their lifetime or in their wills. Although there is no need to disclose quantities of wealth, we are suggesting no less than a 5% commitment for those with less than $20 million, no less than a 7.5% commitment for those with more than $20 million and less than $50 million, and no less than a 10% commitment for those with more than $50 million. See **Figure 2** for our suggested giving commitment buckets and donor ladder.

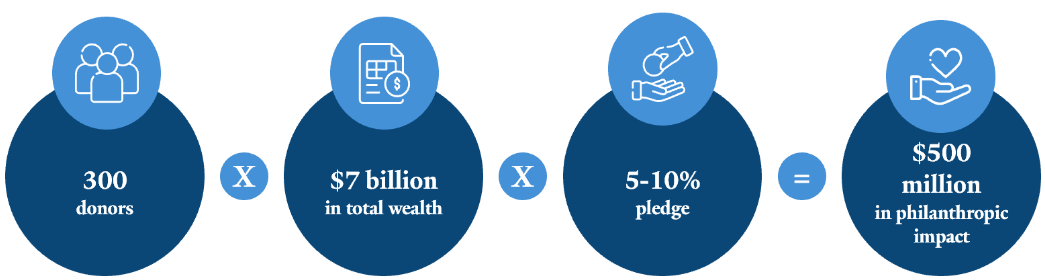
Figure 2: Suggested giving buckets and donor ladder

Wealth	Giving Pledge %
< $20M	5.0%
> $20M < $50M	7.5%
> $50M	10.0%

	Potential Donors	Average Amount	Total Wealth	Giving Pledge %	Philanthropy
	150	$10M	$1,500M	5.0%	$75M
	100	$30M	$3,000M	7.5%	$225M
	50	$50M	$2,500M	10.0%	$250M
Total	**300**		**$7,000M**		**$550M**

This would result in $500 million of philanthropic commitment and impact (**Figure 3**). We know that many people within the search fund ecosystem are already incredibly generous and philanthropic, but we hope that our giving pledge stimulates *more* activity and helps get some people off the sidelines.

Figure 3: Illustrative math for the giving pledge in action



Why are we thinking about this in the context of the search fund ecosystem? We have all enjoyed this community in innumerable ways. We have built friendships, learned immensely from each other, coinvested in numerous deals, coached and been coached by each other, and refined our business and entrepreneurial philosophies through our interactions. In short, we are all better, smarter, and wealthier due to our association. This culture and these values are hallmarks of the search fund world – a world we have had the privilege and opportunity to create and operate in. It is a unique environment that has resulted in superior entrepreneurial and investment performance. We aspire to create a similar dynamic with regard to philanthropy – and we are likely to do it better, more effectively, and more enjoyably as a community than any of us would in isolation.

To further explain this vision, this case note will explore the following:

- The size of the search fund market and its wealth creation characteristics
- Why the search fund community should consider a move towards philanthropy
- What the ETA community giving pledge is
- What the ETA community giving pledge is not
- Potential next steps

The size of the search fund market and its wealth creation characteristics

When search funds were initially conceived by Irving Grousbeck, the Stanford Graduate School of Business MBA Class of 1980 Adjunct Professor of Management, in the early 1980s, it would have been hard to imagine how the model would grow and proliferate – and how much wealth it would create. From a fledgling concept embraced by an entrepreneur every year or two, search funds have mushroomed into a bona fide post-MBA career attracting 50 to 100 participants per year and a tidal wave of investment capital. According to the 2020 Stanford University Graduate School of Business Search Fund Study Selected Observations, from 1984 through 2019, at least $1.4 billion of equity capital was invested in traditional search funds and their acquired companies, generating, in total, approximately $6.9 billion of equity value for investors and an estimated $1.8 billion for entrepreneurs so far.[6] And we believe, despite their staggering scale, that these numbers are understated, at least if they are extrapolated and applied prospectively.

The focus of the Stanford study is on U.S. and Canadian traditionally funded search funds, and it excludes international, self-funded, and accelerator-sponsored projects. The Stanford data indicates that, in 2019 (the most recent date for which we have data), 51 searches were launched that met Stanford's criteria. We do not have hard data, but we estimate that this might be approximately half of all searches when international, self-funded, and accelerator-sponsored structures are included. Let's estimate around 100 search launches per year and calculate what that implies for potential wealth creation.

The 100 searchers will likely receive approximately $45 million in search capital (100 × $450,000). Of the 100 searches, let's assume 65 will find an actionable business to acquire. If an average purchase price is $10 million and half the invested acquisition capital is equity, $325 million is invested in acquisitions per year (65 × $5 million). Adding the search capital ($45 million) and the invested capital ($325 million) yields $370 million of equity going into search transactions annually. We subtract the search equity for the 35 searches that failed to purchase a business (35 × $450,000 = $15.7 million) to net $354 million invested in acquired companies. If that $354 million grows at 3x, there is $1 billion in equity value. Subtracting the invested capital ($354 million) from the equity value ($1 billion) leaves $692 million per year in wealth creation. The math is staggering, but it gets even more stunning.

Assume that these dynamics have existed for the past five years and will exist for at least the next twenty years. If we multiply $692 million of wealth creation by twenty-five years, we reach $17.3 billion in wealth creation in search funds over a quarter-century (See **Figure 4** for the mathematical buildup). Please pause and mentally process the prodigious amount of wealth that is being manufactured in our cottage ecosystem.

If you disagree with our math, use your own estimates. Our math may not be pinpoint precise, but we think you will find it is directionally accurate.

The above calculations highlight that there are scores of multi-decamillionaires and handfuls of centimillionaires inhabiting the search fund community – and we believe this will increase. There is more than ample capacity and capability for the ETA community giving pledge to take hold.

Figure 4: Mathematical buildup of estimated wealth creation in the search fund ecosystem

Estimated annual search funds	100	A
Average search capital per fund	$450,000	B
Annual search capital invested	$45,000,000	C = A * B
Estimated annual searches buying a company	65	D
Estimated equity per transaction	$5,000,000	E
Annual investment capital	$325,000,000	F = D * E
Total capital invested annually in search	$370,000,000	G = C + F
Searches that did not acquire	35	H = A - D
Search capital for searches that did not acquire	$15,750,000	I = H *B
Value of capital in acquired companies	$354,250,000	J = G - I
Estimated multiple of invested capital	3.0x	K
Estimated equity value	$1,062,750,000	L = K * J
Wealth creation (equity value less invested capital)	$692,750,000	M = G - L
Wealth creation over the past five years	$3,463,750,000	N
Wealth creation over the next twenty years	$13,855,000,000	O
Estimated wealth creation over 25 years	**$17,318,750,000**	P = N + O

Why the search fund community should consider a move towards philanthropy

We believe there are four reasons why it is time for the search community to begin thinking about a move towards philanthropy and wealth disposition. We will examine those now.

We have done well; now, we should do good. The search fund community has benefited enormously from a unique set of circumstances facilitating unprecedented wealth creation. We were born in countries with established rule of law, systems that favored entrepreneurs and investors, an environment of relatively cheap debt, and the ability to purchase small businesses at attractive prices and benefit from multiple expansion when selling. We all received educational opportunities and somehow tripped on the marvelous search fund path as an entrepreneur or an investor. The past few decades have been a fantasy for entrepreneurial wealth creation, and we have all done well. Part of our doing well is the result of serendipitous luck. No matter how hard we have worked and how smart we are, we have enjoyed the Fates smiling upon us. As a result, we should acknowledge our good fortune and use part of our wealth to benefit others who have not been as lucky. We believe that we have a moral obligation to pay it forward. We should do good.

The incremental dollars have little to no utility . . . for you. When thinking about the ETA community giving pledge for those of us in the search world, we landed on targeting multi-decamillionaires as a benchmark because it seems to us that more wealth after that amount will have little or no utility value. Once you have a few homes, travel comfortably, know educating your progeny is not a concern, and can live without economic worries, what exactly is the value of more money? A person can only eat three meals a day and sleep in one bed at a time; more possessions can become a headache and a burden. So, when someone accumulates enough wealth for their lifetime, giving to philanthropies to help others and society is really not an imposition and will not result in a lifestyle change. It transforms wealth that has little functionality into resources with large utility.

A gift to philanthropy of five to ten percent of a large balance sheet will be replenished. Through our ETA community giving pledge, we invite people to share five to ten percent of their wealth to philanthropies during their lifetime. Search fund assets are multiplying and compounding with returns in the twenty to thirty percent range, so even a ten percent gift will quickly be replenished with new wealth. For example, if a benefactor has a $50 million balance sheet and magnanimously donates $5 million, the $45 million will rapidly pop back up to $50 million with private search fund equity returns and public equity capital appreciation. While $5 million is, of course, a large sum of money, it will barely be missed with the prestidigitation of compounding returns.

There are tax-advantageous benefits to philanthropy. Although we do not think the tax benefits of generosity should be the catalyzing motivation for helping others, they do exist. When making a charitable donation, donors can deduct the amount donated from their adjusted gross income (AGI) when making itemized deductions. According to the 2021 Internal Revenue Service Publication 526 on Charitable Contributions, before 2020, the deduction for cash contributions to qualifying organizations was limited to 60% of the donor's AGI. In 2021, if you make a qualified cash contribution, your deduction for the cash contribution is limited to 100% of your AGI minus your deduction for all other donations.[*][†]

It feels good to give and help. We are lucky to be in a position to be philanthropic; it means the basic needs in our lives are taken care of. But, more importantly, we get to enjoy the feeling of giving and helping others. Giving connects people. It generates good energy, it makes you smile bigger and stand taller, and you get to make a difference and create a legacy, maybe even leave your name on something. When engaging in philanthropy, the benefactor is, of course, helping others, but the benefactor is also rewarded by knowing they made the world a slightly better place – what could feel better than that?

What the ETA community giving pledge is

We hope this note nudges the search fund community to consider making a philanthropic pledge of between five and ten percent of the benefactor's wealth during their lifetime (the more you give and the earlier you give, the better!). If this seems remarkably similar to Buffett and Gates's pledge program – it is. We are unabashedly copying their brilliance and scaling it down to our size. As we learn and navigate this process together, our thoughts, which are currently, to some degree, inchoate, will undoubtedly continue to evolve – and you are welcome to contribute to that development. At present, this is what we envision.

[*] Publication 526 (2021), Charitable Contributions | Internal Revenue Service (irs.gov)

[†] Obligatory disclaimer: this is not tax advice and is shared for illustrative purposes only.

A pledge to donate five to ten percent of your wealth to philanthropy. The core invitation of the ETA community giving pledge is a moral commitment to donate no less than five to ten percent of your wealth to philanthropies and charities during your lifetime, including your will. The pledge is simply a letter drafted by you stating that you intend to do this. The letter is not a contract; instead, it is a public declaration of your intent. You do not need to disclose amounts or timelines.

A community of engaged individuals thinking about philanthropy. A cornerstone of our giving pledge will be a community of thoughtful and successful individuals contemplating wealth disposition issues. We do not offer answers, only questions that we hope to find solutions to together. We aspire to replicate the camaraderie and collaboration that currently exist in the search fund community and apply them to the next and fourth chapter of its evolution – philanthropization. We hope to learn, explore, develop philosophies, and challenge each other in constructive ways. Although the giving pledge we propose will not require pooled philanthropic initiatives, it would be wonderful to pursue philanthropy as we have investing and entrepreneurship – together, with all of us working towards common satisfying goals.

A venue for accountability and inspiration. If our giving pledge strikes a chord within the search community, we hope to gather pledgers and potential pledgers on a biennial to quinquennial (let's figure out the interest) basis for a one- or two-day conference. In a gathering like this, we can explore topics related to our philanthropy and hold each other accountable (positively and constructively) to our individually articulated goals. Furthermore, we can look for inspiration from our peers and celebrate those with creative and impactful approaches to their charitable initiatives. This could be very similar to the plethora of search fund conferences that currently take place.

What the ETA community giving pledge is not

While it is important to clearly define what our giving pledge is, it is equally important to articulate what it is not.

A mandate of how, when, and where to give. The mission here is exclusively to stimulate philanthropy. It is unequivocally not our aim to tell anybody how, when, or where to give. Your philanthropy is entirely your domain. Of course, we all hope to learn together, but by making a pledge, you are absolutely not signing up to give to any specific charity in any amount or on any schedule. This is not a pooled fund with any obligation to support any particular cause.

A requirement to disclose the sum of your wealth or where you give. The ETA community giving pledge does not require you to reveal the scale of your wealth. That information is as private or public as you choose to make it. Furthermore, there is no requirement to share where your philanthropic initiatives lie. That is your business and can be kept private.

A contract with any counterparty. The giving pledge is not a contract or legally binding obligation. There is no counterparty in your pledge letter, and it cannot be enforced by anybody other than yourself. The pledge is akin to a New Year's resolution in writing that you hope to stick to.

An elite or exclusive club. There is nothing exclusive or clandestine about this concept. This is an open invitation for anybody inclined to emulate the Buffett–Gates giving pledge and embrace these proposed concepts. We do not have a special list, and all are welcome to participate and be included.

Next steps

We hope this case note both circulates and resonates throughout the search fund and small business community. Although we aim to make the search fund community the initial nucleus, we hope this framework can serve as a model for more entrepreneurial-centric organizations like Young Presidents Organization, Entrepreneurs' Organization, Vistage, and Tugboat Institute. If you are interested in discussing the topics enclosed, please get in touch with any of the co-authors of this note. If the concept of an ETA community giving pledge does echo amongst our peers, perhaps a first step would be to have a video conference and talk about some of our philanthropic feelings, goals, and strategies. Remember, this is primarily about learning together as we have as entrepreneurs and investors. We hope that a video conference will morph into a gathering of some sort (we are happy to play hosts) to examine further the concept of the ETA community giving pledge.

Our goal is to harness the intellectual capacity, generosity, and wealth creation of the search fund ecosystem to loosely garner 300 decamillionaires (or those on their way to this level of wealth accumulation) who are willing to pledge five to ten percent of their wealth to drive $500 million of philanthropy. What a fantastic testament this would be for the search community.

Conclusion

If you are reading this conclusion, thank you for taking the time to peruse this note. We hope you contemplate our invitation to join our philanthropic journey by making an ETA community giving pledge. We have all benefited immensely as entrepreneurs and investors in the search fund ecosystem and have the ability and capacity to transition from doing well to doing good. The most energizing and exciting part of this notion is doing it together with friends and in a cohort – all while learning collectively and positively impacting society. We sincerely hope you join us on this journey.

Whether you are curious or plan on writing a pledge or not, we appreciate your valuable time and consideration and wish you good luck with your philanthropic endeavors!

Exhibit 1: Warren Buffett's Giving Pledge

My Philanthropic Pledge
Warren Buffett

In 2006, I made a commitment to gradually give all of my Berkshire Hathaway stock to philanthropic foundations. I couldn't be happier with that decision.

Now, Bill and Melinda Gates and I are asking hundreds of rich Americans to pledge at least 50% of their wealth to charity. So I think it is fitting that I reiterate my intentions and explain the thinking that lies behind them.

First, my pledge: More than 99% of my wealth will go to philanthropy during my lifetime or at death. Measured by dollars, this commitment is large. In a comparative sense, though, many individuals give more to others every day.

Millions of people who regularly contribute to churches, schools, and other organizations thereby relinquish the use of funds that would otherwise benefit their own families. The dollars these people drop into a collection plate or give to United Way mean forgone movies, dinners out, or other personal pleasures. In contrast, my family and I will give up nothing we need or want by fulfilling this 99% pledge.

Moreover, this pledge does not leave me contributing the most precious asset, which is *time*. Many people, including -- I'm proud to say -- my three children, give extensively of their own time and talents to help others. Gifts of this kind often prove far more valuable than money. A struggling child, befriended and nurtured by a caring mentor, receives a gift whose value far exceeds what can be bestowed by a check. My sister, Doris, extends significant person- to-person help daily. I've done little of this.

What I can do, however, is to take a pile of Berkshire Hathaway stock certificates --"claim checks" that when converted to cash can command far-ranging resources -- and commit them to benefit others who, through the luck of the draw, have received the short straws in life. To date about 20% of my shares have been distributed (including shares given by my late wife, Susan Buffett). I will continue to annually distribute about 4% of the shares I retain. At the latest, the proceeds from all of my Berkshire shares will be expended for philanthropic purposes by 10 years after my estate is settled. Nothing will go to endowments; I want the money spent on current needs.

This pledge will leave my lifestyle untouched and that of my children as well. They have already received significant sums for their personal use and will receive more in the future. They live comfortable and productive lives. And I will continue to live in a manner that gives me everything that I could possibly want in life.

Some material things make my life more enjoyable; many, however, would not. I like having an expensive private plane, but owning a half-dozen homes would be a burden. Too often, a vast collection of possessions ends up possessing its owner. The asset I most value, aside from health, is interesting, diverse, and long-standing friends.

My wealth has come from a combination of living in America, some lucky genes, and compound interest. Both my children and I won what I call the ovarian lottery. (For starters, the odds against my 1930 birth taking place in the U.S. were at least 30 to 1. My being male and white also removed huge obstacles that a majority of Americans then faced.)

My luck was accentuated by my living in a market system that sometimes produces distorted results, though overall it serves our country well. I've worked in an economy that rewards someone who saves the lives of others on a battlefield with a medal, rewards a great teacher with thank-you notes from parents, but rewards those who can detect the mispricing of securities with sums reaching into the billions. In short, fate's distribution of long straws is wildly capricious.

The reaction of my family and me to our extraordinary good fortune is not guilt, but rather gratitude. Were we to use more than 1% of my claim checks on ourselves, neither our happiness nor our well-being would be enhanced. In contrast, that remaining 99% can have a huge effect on the health and welfare of others. That reality sets an obvious course for me and my family: Keep all we can conceivably need and distribute the rest to society, for its needs. My pledge starts us down that course.

Warren E Buffett

Endnotes

[1] A. J. Wasserstein is the Eugene F. Williams, Jr. Lecturer in the Practice of Management at the Yale School of Management.

[2] Greg Geronemus is a co-founder and managing partner of Footbridge Partners, an institutional search fund investment firm.

[3] David Rosner is a co-founder and managing partner of Footbridge Partners, an institutional search fund investment firm.

[4] Jim Sharpe has been with Harvard Business School since 2009 as a senior lecturer in the MBA and Executive Education programs, an entrepreneur in residence, and now as a visiting executive.

[5] Jan Simon is Professor of the Practice of Management in Entrepreneurship at IESE and the academic director of its International Search Fund Center. He is also the founder and managing partner of Vonzeo Capital, a global institutional investor in search funds.

[6] Kelly, Peter, and Sara Heston. 2020 Search Fund Study Selected Observations. Stanford University Graduate School of Business. Case E-726.