Elgar Encyclopedia of Entrepreneurship and Digitalization

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3. Entrepreneurial exits

Kaushik Gala and Manjot S. Bhussar

Introduction

A significant milestone in most founders' entrepreneurial journeys is the decision to exit the venture by selling their businesses. Such entrepreneurial exits are extremely common, amounting to tens of billions of dollars annually in the US alone (Statista, 2024). The transaction size of these sales ranges from as little as a few hundred thousand dollars to more than hundreds of millions of dollars for a highly successful venture (BizBuySell, 2024). Together, these exits total tens of billions of dollars each year (NVCA, 2024).

While most of the exit decisions are voluntary, founders also may decide to exit a venture due to economic considerations such as financial distress or monetary harvest, non-economic considerations such as co-founder conflict or sickness, or some combination of these (DeTienne, 2010). They may also sell a business to pursue a more attractive opportunity elsewhere.

In some cases, however, entrepreneurial exits may be involuntary. For example, investors may seek to recoup their capital by 'forcing' founders to sell a venture. Indeed, the extent of business success or failure is often a critical determinant of how and when an entrepreneurial exit is undertaken (Wennberg et al., 2010).

Exit routes

Founders can exit their companies employing one of several routes, depending on business, founder, and other factors. When a venture is underperforming vis-à-vis its stakeholders' expectations, for example, founders are likely to exit it via a liquidation, especially when they lack the financial resources to continue operating. Such ventures are sometimes auctioned off, with the winning bidder seeking to monetize the tangible and intangible assets thus acquired. In the worst case, founders may simply shut down a failing venture.

Conversely, when an entrepreneurial firm performs well, its founders can choose one of many exit routes, including financial harvest, stewardship, and voluntary cessation (DeTienne et al., 2015). Often the most lucrative – but also the least likely – route for an entrepreneurial exit is an initial public offering (IPO), wherein the public is offered equity ownership in the business. On average, IPOs account for less than five percent of exits each year (NVCA, 2024). This exit route typically involves high-growth ventures operating in fast-growing or large markets, with venture-funded technology startups as the prototypical examples. However, the much more likely exit route is a 'trade sale', wherein a relatively larger firm typically acquires a smaller, successful venture (Wennberg & DeTienne, 2014). In such cases, founders may sell some or all of their ownership to the buyer and may choose to join the latter in an executive capacity. Alternatively, some founders may choose to pursue a new opportunity by starting another venture, thus turning into serial entrepreneurs (Dabić et al., 2023).

An increasingly prevalent exit route is an 'acquihire', where a venture is acquired primarily for human capital, possibly accompanied by valuable intellectual property (Ng & Stuart, 2019; Polsky & Coyle, 2013). The most common acquihires involve technology startups with fewer than a few dozen employees (TechCrunch, 2024). Acquihiring, thus, allows not only founders but also employees with some form of equity ownership in the venture to exit relatively early, potentially recoup their opportunity costs (i.e., the effort, money, and time spent building the business instead of working a salaried job) as well as pursue other professional or personal endeavors.

Exit timing

The timing of an entrepreneurial exit depends on many factors. For example, while the degree of venture success is a critical determinant of when founders choose to exit, factors such as market size, product maturity, and team capability also play an influential role (Arora et al., 2021). When ventures grow using external capital, the possibility of being replaced as the CEO may motivate a founder to exit early rather than cede control to an 'outsider' (Graebner & Eisenhardt, 2004). Further, personal factors (e.g., employment burnout or a death in the family) and external factors (e.g., a pandemic or a recession) may accelerate the timing of an exit. Conversely, some founders may intentionally delay the sale of their ventures until they are assured of both the financial and professional security of their employees (DeTienne et al., 2015).

Post-exit considerations

When entrepreneurial exits occur via the acquisition of a venture by another firm, post-acquisition considerations play a significant role in the eventual success of this exit route (Ng & Stuart, 2019). In all likelihood, sellers and buyers likely differ along multiple dimensions, ranging from the managerial autonomy and dynamic capabilities to organizational structure and work culture (Graebner et al., 2017). Therefore, substantial effort has to be devoted to ensure structural, functional, socio-ocultural, and financial integration during the post-acquisition phase. A lack of alignment in one or more of these dimensions can result in turnover of the acquired teams, especially the founders and key employees. This concern is particularly salient for 'acquihiring', whose primary purpose is to gain human capital, the loss of which largely erodes the economic value expected from an acquisition (Gala & Mueller, 2024). Therefore, a broad and deep integration of the venture being sold into the buying firm is crucial in the post-acquihire phase of such entrepreneurial exits.

Additionally, when entrepreneurial exits occur via IPOs, the potential replacement or voluntary departure of the founder-CEO is often an important consideration for the top management team, board of directors, and shareholders. Some founder-CEOs may relish the opportunity to continue leading the now-public company, whereas others may chafe under newly imposed corporate constraints and/or prefer to continue the entrepreneurial journey by starting a new venture.

Literature review

Scholarly research on business exits has emerged in two primary streams. One body of literature was begun by economists, who seek to understand when and why individuals choose entrepreneurship over a salaried job, how entrepreneurs perceive risk, and how they manage business uncertainty (e.g., Hall & Woodward, 2010). Researchers in this field has also examined entrepreneurial exits from specific markets, industries, and geographies. Given their interest in socioeconomic outcomes, economics researchers often evaluate various exit routes, from bankruptcy and voluntary liquidation to mergers, acquisitions, and initial public offerings (Cefis et al., 2022).

The second stream of research features management and entrepreneurship scholars, who initially sought to expand the buyer-focused literature on mergers and acquisitions to include sellers' perspectives (Graebner & Eisenhardt, 2004). This work has increasingly focused on the 'process' of entrepreneurial exits (DeTienne, 2010; Wennberg et al., 2010). For example, researchers have examined entrepreneurial exit intentions, motivations, strategies, and post-exit decisions (DeTienne et al., 2015; Wennberg & DeTienne, 2014).

Scholars have highlighted the unique challenges faced by family firms, where considerations of socioemotional wealth play a pivotal role in shaping the nature and timing of exits, overshadowing purely financial considerations (DeTienne & Chirico, 2013). Complexities of succession and control in family firms, coupled with the threshold of performance required for business survival, are thought to trigger the following three exit strategies:

1. stewardship-based exits involve transferring ownership to a family member primarily focusing on business continuity and care.
2. business sales are pursued where owners prioritize maximizing financial returns over retaining control within the family.
3. cessation-based exits occur when the business is liquidated not due to poor performance but rather due to a loss of interest or a need to redirect resources toward other priorities.

Recent research has also explored how the uncertainty inherent in entrepreneurial endeavors may adversely impact the mental health of entrepreneurs and, consequently, influence the timing and nature of entrepreneurial exits (Hessels et al., 2018). Other scholars have begun to examine how the process of entrepreneurial exits may differ for socially focused (e.g., non-profit) ventures, family firms, and those in emerging economies. Because the entrepreneurial journey does not necessarily end with an (advantageous) exit, researchers have also investigated when and why some founders choose to become serial entrepreneurs. Surprisingly, as many as 50 percent of all entrepreneurs create more than one venture, even though the vast majority of ventures fail to survive or meet their stated objectives (Dabić et al., 2023).

Impact on entrepreneurship

Entrepreneurial exits represent a crucial component of the journey from the creation of a new venture to the creation of economic and non-economic value at the individual, team, firm, and societal levels (DeTienne et al., 2015). Without the possibility of exiting their ventures via acquisitions, mergers, or public listings, entrepreneurial ecosystems would experience a significant drop in entrepreneurial intent and new venture formation. Conversely, successful entrepreneurial exits can attract budding and nascent entrepreneurs in greater numbers; they can also fuel serial entrepreneurship and generate resources for environmental and social good (Dabić et al., 2023).

The distribution of proceeds from entrepreneurial exits also carries important implications. For example, when employees who own equity in a technology startup acquire newfound wealth after a successful acquisition of their venture, they may turn into first-time entrepreneurs, who have not only the experience of working in an early-stage venture but also the financial wherewithal to survive the risks that invariably arise in entrepreneurship (Arora et al., 2021). Similarly, angel investors who earn substantial returns on their investments that are acquired may expand their portfolio, thus increasing the risk capital available for new ventures. The success of Silicon Valley, for example, is often attributed to successful exits from pioneering firms like Fairchild Semiconductor Corporation that helped launch local venture capital firms like Kleiner Perkins and Sequoia Capital (Laws, 2016).

Entrepreneurial exits also carry significant implications for founders, their families, and their friends. Bankruptcies and forced liquidations can affect not only their physical and mental health but also their personal and social relationships (Hessels et al., 2018). Conversely, lucrative exits can transform the quality of life for founders' families, many of whom may have borne years of hardship during the early years of a new venture. Because families and friends also tend to be a common source of capital for many new ventures, the financial outcome from an entrepreneurial exit can help justify the confidence shown and the risks taken by these early supporters.

Implications of digitalization

Like most aspects of entrepreneurship, entrepreneurial exits are meaningfully impacted by the rapid digital transformation of most sectors of the economy. First, the rise of digital platform entrepreneurship, wherein sellers connect with buyers through global e-commerce platforms, such as Amazon.com, allows entrepreneurs to continue operating individually or as small teams without necessarily raising large amounts of capital and hiring numerous employees for scaling production and distribution (Nambisan, 2017). Digital contexts fundamentally alter entrepreneurial exits, which can manifest as ongoing cash inflows for the individual entrepreneur instead of one-time proceeds from the sale of an incorporated firm with multiple stakeholders.

Second, the increasing importance of digital assets vis-à-vis physical assets makes it easier for entrepreneurs to scale quickly and exit early because most of the economic value in the venture is embedded in assets such as data and algorithms instead of factories and machinery (Hartmann & Henkel, 2020). Digital assets are relatively easy to transfer from a seller to a buyer and lend themselves to quicker post-acquisition integration than physical assets. Thus, entrepreneurial exits can be executed faster, at lower costs, and with lower risk due to digitalization. These operational benefits of digitalization for entrepreneurial exits are particularly salient for acquihires, which can now transcend industry boundaries and involve buyers from traditional industries being disrupted by digitalized outsiders (Gala & Mueller, 2024; TechCrunch, 2024).

Finally, digitalization enables a more efficient marketplace for connecting potential buyers with sellers. Instead of relying only on their personal or professional networks, founders can use digital marketplaces to find and engage with interested buyers worldwide (BizBuySell, 2024). This mode of lead generation not only increases the odds of consummating an entrepreneurial exit but can also enhance the exit valuation for the selling firm due to interest from multiple bidders and the ability to engage multiple intermediaries (i.e., brokers). Moreover, digitalization enables founders to use electronically secured datarooms to share confidential information with buyers during due diligence. Such Internet-based mechanisms can further increase the

likelihood of success for an entrepreneurial exit.

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