MERGERS & ACQUISITIONS

M&A INSIGHTS INDEPENDENT SPONSORS

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The Rise of Independent Sponsors in Middle-Market M&A

Companies seeking funding or an outright sale should consider independent sponsors as a serious option.

Gerhard Anderson
Seward & Kissel

Nick Katsanos
Seward & Kissel

THE INDEPENDENT sponsor model is an emerging force in middle-market M&A, having the potential to reshape traditional private equity deal-making. Once considered a niche approach, independent sponsors are increasingly competing with conventional PE firms, in part driven by structural changes in the investment landscape. Several key factors have fueled this trend, including the evolving investment preferences of family offices and institutional backers, career ambitions of seasoned PE team leaders, and the increasing preferences of large investors for direct investments instead of indirect investments through blind pool funds.

Companies who are considering an investment or sale should treat independent sponsors as serious options, and there are a number of techniques that can be deployed by these companies to minimize friction and uncertainty in negotiating and executing an independent sponsor-led transaction.

Driving Factors

One of the most compelling aspects of the independent sponsor model is its singular focus on a particular investment. Unlike traditional private equity firms that often raise funds with an open-ended mandate limited only by an investment focus (industry, geography, etc.), independent sponsors identify specific opportunities first and then secure backing on a deal-by-deal basis. This means independent sponsors tend to focus exclusively on their most promising investment ideas, effectively creating a "best ideas" approach to private equity investing.

A growing number of independent sponsors originate from established private equity firms. These sponsors seek greater autonomy over deal selection and structure, as well as full economic upside in the fruits of their efforts. These professionals leverage their experience, networks and industry knowledge to pursue high-quality transactions without the constraints of a large fund's investment parameters.

At the same time, family offices and other large investors that historically have backed traditional private equity firms have moved towards professionalizing their own direct investment capabilities. As these investors grow more sophisticated, they are increasingly comfortable evaluating and underwriting individual deals rather than gaining investment exposure to the private equity asset class only by investing in blind-pool funds. This shift allows them to maintain discretion over their investments, ensuring targeted exposure to high-conviction opportunities that align with their strategic goals.

Gaining Credibility

Independent sponsors have earned their place as credible bidders in M&A processes. The traditional view that sponsors without committed capital pose higher execution risks is being re-evaluated as more independent sponsor-led deals are being completed. Further, acquisition targets, which benefit from more bidders in competitive processes, welcome the upward pressure on valuations driven by independent sponsors swelling the ranks of participants.

While independent sponsors may not be backed by committed funds in the conventional sense, they often cultivate strong relationships with a network of backers who repeatedly invest in their deals. Independent sponsors who have a strong following from institutional investors (often including existing private equity funds) and/or have a demonstrated history of closing investments using the independent sponsor model, have gained significant credibility in dealmaking, even if not on parity with traditional private equity.

Execution Risks

Despite the general acceptance of independent sponsors in the middle-market M&A ecosystem, these structures do present unique challenges in deal execution. Unlike traditional PE firms that have a committed fund and discretionary capital, independent sponsors must ultimately secure deal-specific funding from their backers. While this structure does create some uncertainty, it is not entirely dissimilar from the approval process within a traditional PE firm, where deals must gain final investment committee approval before closing, particularly where the sponsor has a demonstrated history of closing transactions.

However, there are some key areas that companies should consider when negotiating a deal with an independent sponsor:

1. Understanding the Sponsor's Backers

• One of the most critical factors in assessing execution risk is understanding who the sponsor's financial backers are.

• Ideally, the backers should have prior experience working with independent sponsors, particularly with the same sponsor leading the current deal.

• If a sponsor has a reliable group of backers that have successfully closed deals together in the past, it significantly reduces execution risk.

2. Involving Lead Backers Early

• A strong strategy to de-risk execution is to have one or more of the lead backers co-sign the term sheet.

• This demonstrates commitment from the backers and reduces the likelihood that they will attempt to renegotiate terms later in the process.

• The earlier a lead backer is involved, the more stability the deal structure will have, improving certainty for all parties.

3. Expense Sharing

• If a sponsor's backers are willing to bear a significant portion of the deal's expenses, it signals a high level of commitment.

• Because pursuing an acquisition involves material due diligence costs, backers that are financially invested in these expenses are less likely to walk away.

• This factor can be particularly important for target companies evaluating multiple independent sponsors, as it distinguishes those with committed financial partners from those still seeking firm backing.

4. Ensuring Alignment

• If a sponsor does not have a lead backer secured at the time of signing a term sheet, it is crucial to ensure alignment once a lead backer is identified.

• The target company should confirm that the lead backer fully agrees with the existing term sheet terms, or, if not, quickly negotiate the full set of updated terms with the target, as otherwise the company risks the backer proposing a series of incremental renegotiations that could delay or jeopardize the transaction.

• The best practice is to have the lead backer formally execute an updated term sheet, ensuring clarity and reducing the risk of shifting expectations.

5. Setting a Realistic Transaction Cadence

• Independent sponsors often have to coordinate multiple backers, each with different views on due diligence, quality of earnings, and deal documentation.

• Unlike traditional PE firms with standardized internal processes, independent sponsors must manage various stakeholders, which can extend timelines.

• Target companies should factor this into their deal planning to avoid unrealistic expectations on timing and execution speed.

• That being said, having the sponsor commit to a timeline with agreed upon milestones, including tangible engagement by the lead backers, allows the target to better evaluate whether execution risk is more or less of an issue.

6. Navigating Exclusivity

• Independent sponsors often seek extended exclusivity periods, not only to complete due diligence, but also to prevent their backers from bypassing them.

• A reasonable compromise is to agree to a standard-length exclusivity period for the transaction itself but also include a separate non-circumvention clause.

• This ensures that the target company cannot directly engage with the sponsor's backers outside the independent sponsor structure, providing necessary protection while keeping the deal moving forward.

The rise of independent sponsors represents a significant evolution in middle-market private equity. Their focused, high-conviction approach to dealmaking, combined with the increasing sophistication of family offices and institutional investors that back them, has positioned them as legitimate competitors in M&A. **M&A**

Advanced Dealmaking Techniques

Dealmaking continues to evolve rapidly with an increasing number of M&A professionals making AI part of their workflows. Gone are the days of physical data rooms and laborious due diligence processes. Now, AI can help with everything from transcribing meetings to spitting out potential target lists. So what does it mean to be a dealmaker now if AI is subsuming the role and where do things go from here? We spoke to dealmakers, with almost a combined 130 years of experience, about the future of the dealmaking process. Here's the highlights of our interviews.

How has dealmaking changed over your career?

Jaime Forsyth, Partner, Head of Investment Team, Monomoy Capital Partners (Years of dealmaking experience: 18)
Monomoy has shifted from running a traditional recession case to a more nuanced cycle case. This shift pushes us to assess the impacts of an evolving macroeconomy and evaluate how the risks specific to any given business might impact earnings, cash flow and key credit metrics in a contractionary period.

Henry Frankievich, Managing Director, Insight Partners (Years of dealmaking experience: 12)
When I started investing in technology 12 years ago, software was not a sector many established firms cared much about. Now, software investing is more competitive and specialized than it's ever been, and the outcomes can be enormous.

Nick Katsanos, Partner, Seward & Kissel (Years of dealmaking experience: 26)
Deals move much faster now. This is largely due to the effects of technology, which have made dealmaking more efficient. For example, e-mails vs. FedEx or virtual data rooms vs. physical data rooms, but it also altered the timing expectations of buyers and sellers. Clients just expect much faster deal processes and turnaround times. As a result, there is also much less in-person interaction than there used to be. Negotiating a deal in person, or even attending a closing dinner, is a rare occurrence now.

Wayne Kawarabayashi, Head of M&A, Union Square Advisors (Years of dealmaking experience: 29)
The arrival of AI. The information can be researched and packaged more efficiently and effectively to answer questions people are seeking with AI. As a result, the continuous need to provide proprietary deal opportunities or differentiated ideas becomes even more critical. You can't call a client and have nothing new to add such as a target company or buyer they already know of or a transaction structure that is boiler plate.

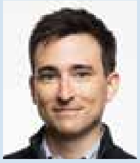
What's the hardest part of your job?

Forsyth: As head of the investment team, I find managing high-performing people to be a greater challenge with less predictability in some regards. We have incredible talent on my team that comes with a range of strengths, interests and motivating factors. Providing the feedback, training, mentorship and support to guide deal leads towards making good investment decisions while achieving their personal and professional goals is very nuanced.

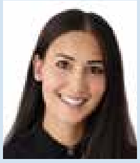
Charles Yoon, Partner, Brightstar Capital Partners (Years of dealmaking experience: 30)
Evaluating and recruiting C-level talent is one of the most difficult parts of my job. While the candidates are always talented individuals with deep industry experience, different people fit different organizations and cultures, and oftentimes the only way to find out if they fit your organization is to have them become a part of it.

Advanced Dealmaking Techniques

What do you consider the most important skills needed to be successful at dealmaking today?



Frankievich: In today's crowded landscape, I believe investors need to specialize. Insight Partners specializes in software. We aim to find, fund and partner with software companies that are experiencing remarkable growth and driving transformative changes in their industries. When you spend a significant amount of time in the software ecosystem, you can gain more relevant experience, build important relationships, and develop nuanced points of view that you can bring to the table. This is particularly valuable post-investment around scaling go-to-market and product teams.



Forsyth: The best dealmakers learn from prior experiences and know when to push forward and when to walk away if it's the right call for their investors and stakeholders. By combining these skills with a strong commitment to your investment strategy and process, you'll be positioned to achieve successful outcomes.

Erik Johnson, Managing Director, TSG Consumer Partners (Years of dealmaking experience: 13)
Successful dealmaking at TSG Consumer hinges on a deep understanding of consumer behavior and broader consumer market dynamics. Our team excels in identifying emerging trends and aligning them with investment opportunities. Strong collaborative skills and high EQ are essential, as we work closely with innovative founders and management teams. We're focused on long-term growth, so creativity, brand-building expertise and a deep appreciation for what makes a consumer brand truly resonate in the market are critical to building enduring, valuable companies.

Katsanos: Having a sense of urgency is crucial. Deals tend to falter when they lose momentum. Understanding both sides of an argument and being willing to find reasonable middle grounds, paying attention to what the other side is saying, being level-headed and not allowing emotion to hijack a negotiation, and being able to communicate clearly are all very important skills as well.

Yoon: In dealmaking, it's crucial to remember that it's not so much about how you feel about your counterparty or how they feel about you – it's ultimately about how they feel about themselves after interacting with you. Can they walk away feeling proud about the deal that was struck or the compromises made?

How is AI part of your deal process today?

Johnson: AI is becoming a really useful tool in our investment process, especially when it comes to analyzing reports and large amounts of data. I love using the deep research function on ChatGPT. It's great for digesting materials quickly and pulling out key insights. By asking the right questions and feeding in relevant data or articles, we can get a well-rounded perspective on a business, an industry trend, or a competitive landscape in a fraction of the time it would normally take.

Kawarabayashi: As AI technologies advance, it has the potential to more effectively help identify business prospects, buyers and investors for client transactions, identify trends and current market standards in deal terms. I still believe for a long time there will need to be bankers. AI won't completely replace us, but some of the more menial tasks could be supplemented and augmented with technologies. However, I still feel you need a human in the loop to address the nuances of dealmaking and structuring.

Advanced Dealmaking Techniques

What modern tools do you incorporate in your job that you find most helpful?

Forsyth: We use tools like Alteryx and Tableau to analyze transaction-level data, distill and draw conclusions from large amounts of inputs and help our management teams drive live decision making at our portfolio companies.

Johnson: As a sector-focused fund, we rely on deep consumer insights and data analytics to identify and support high-growth brands. We deploy advanced market intelligence tools to track evolving consumer behavior, category trends, and competitive dynamics. These insights help us refine our investment thesis, assess brand momentum, and make data-driven decisions that drive long-term value creation. By leveraging proprietary research, social sentiment analysis, and point-of-sale data, we gain a nuanced understanding of how consumers interact with brands. This allows us to not only identify breakout companies but also provide strategic guidance that accelerates growth and strengthens brand equity.

Yoon: Perplexity AI, LinkedIn, and Salesforce. Perplexity AI enables our team to leverage GenAI to streamline intelligence and tasks and optimize organizational processes. LinkedIn and Salesforce are two tools that enable us to stay in front of stakeholders digitally. We use both tools to amplify key company messages, contact existing and prospective investors, and keep our LP and stakeholder bases organized.

What changes do you see happing in the dealmaking process in the future?

Johnson: I think the pace and speed of dealmaking will continue to accelerate as private equity firms are able to better leverage technology to evaluate opportunities more efficiently. Advanced data analytics, AI-driven insights, and automation are streamlining diligence, allowing us to assess market opportunities, consumer sentiment, and financial performance faster than ever. At the same time, we're seeing companies scale more quickly than before, as digital platforms, e-commerce, and social media reduce traditional barriers to growth. The pace of innovation will also accelerate, with new business models and consumer trends emerging at a faster rate. In this environment, private equity firms will need to be more agile, proactive, and strategic in identifying and supporting high-growth brands.

Katsanos: Everyone is expecting AI to eventually have a significant impact on dealmaking, obvious examples being the automation of tasks like diligence and document drafting, which will make lawyers much more productive with their time. While many commentators speculate this will result in a loss of jobs for young attorneys, it is just as likely that AI could free up those same attorneys to take on new roles or tasks we have not yet envisioned.

Yoon: I think the due diligence process will be much faster and more efficient as AI becomes increasingly prolific in private equity. Areas of optimization include:

• Information Gathering: Important information that would have taken days to gather and analyze can be available in seconds.

• Meetings: Dealmakers will be provided with automated and instantaneous summaries of meetings and calls, which can accelerate the dealmaking process and empower parties with more knowledge.

• Documentation: AI will analyze and summarize critical documents, such as a CIM, at the click of a button. This shortening of "speed-to-knowledge" can be an efficiency driver throughout our industry. **M&A**