

The First 10 Questions for Would-be Searchers

Question 1. What is a Search Fund?

The Basic Search Fund Structure

Search Funds are a niche asset class that has historically been focused on the U.S. market. These investment vehicles enable high-potential and entrepreneurially minded individuals or partnerships to locate, acquire, manage and grow privately held companies.⁽¹⁾ For many prospective entrepreneurs, search funds offer a rare opportunity: The possibility of becoming an equity-owning business manager early in their career. This process is described in detail by the Stanford CES Search Fund Primer⁽¹⁾ and falls into four distinct stages.

Stage 1 – Raising the Search Fund

In this stage, the entrepreneur(s) raise search capital for their search fund. The purpose of this capital is to pay the searcher(s) a salary for approximately two years and to cover search-related expenses (such as overhead, due diligence on potential acquisitions, etc.). Typically, the initial search fund consists of 10 to 20 units, at a price of \$20,000 to \$30,000 per unit.¹ According to the most recent study on search funds,⁽²⁾ the total search capital raised is typically between \$290,000 and \$450,000.²

¹ At an exchange rate of €1.40/USD, \$20,000 to \$30,000 equates to €14,285 to €21,428.

² At an exchange rate of €1.40/USD, \$290,000 to \$450,000 equates to €207,143 to €321,429.

This technical note was prepared by Ian Nieboer, MBA 2012, and Mathieu Carenzo, EIC Manager, under the supervision of Professor Antonio Dávila. September 2011.

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Stage 2 – Search and Acquisition

In this stage, the entrepreneur(s) identify potential acquisition targets and, if a suitable target is found, attempt an acquisition. Potential acquisition targets should fall within a specific set of criteria defined by the searcher(s) and agreed upon by Stage 1 investors. Several common criteria include geographic location, industry, EBITDA margin, and Enterprise Value. Before making an acquisition, a typical search fund will have identified over 300 potential targets.⁽²⁾ However, the strictness of the search criteria, the due diligence process and negotiations results in a demanding acquisition funnel. Once the due diligence is complete and the deal has been negotiated, the final acquisition is funded through equity (usually from the original investors, though sometimes supplemented by other investors) and debt (usually a combination of bank and seller debt).

Stage 3 – Operation and Value Creation

In this stage, the entrepreneur(s) take on a key operational role within the acquired company. This role is typically at the CEO or equivalent level and the entrepreneur(s) is generally expected to remain in this role until an exit is achieved. During this stage, the entrepreneur(s) executes their plan to grow the business and create value.

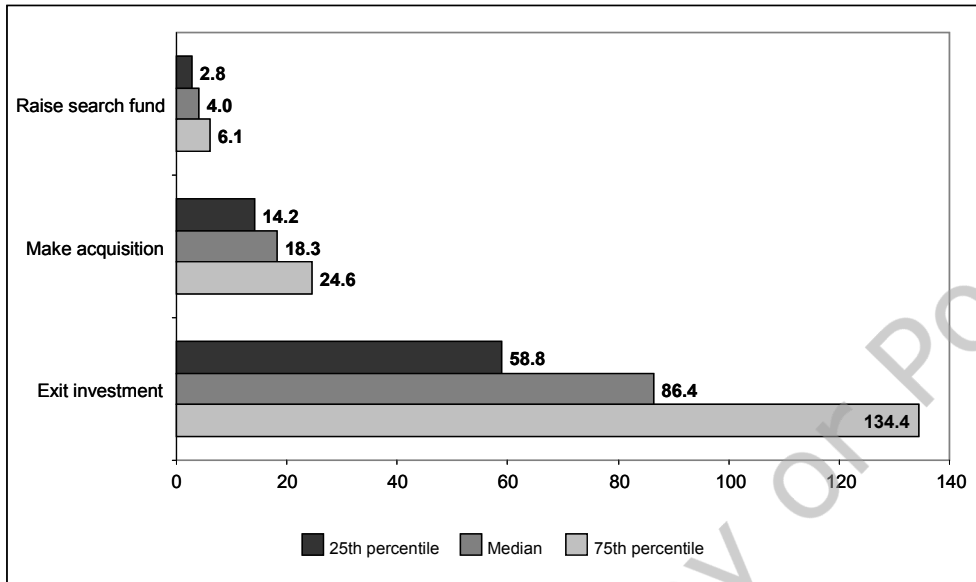
Stage 4 – Exit

In Stage 4, the entrepreneur(s) provides investors with a liquidity event. This may take the form of an IPO, sale to a strategic buyer, etc.

Duration of a Search Fund

The median life cycle of a search fund is over eight years⁽²⁾ (see Figure 1 for the historical durations of each stage) and demands a large commitment from the searcher(s). Prospective searchers should be aware that, once committed, there are limited opportunities to exit the search fund and should consider how this commitment will impact their personal and professional lives in the years to come.

Figure 1
Duration of search fund stages in months



Source: "Search Funds – 2009: Selected Observations," CASE: E-386 (Palo Alto, California: Stanford Graduate School of Business, 2010), <http://www.gsb.stanford.edu/ces/resources/documents/SearchFunds-2009SelectedObservationsFINAL-revised7.21.10.pdf>.⁽²⁾

Characteristics of Target Industries and Businesses

Most Search Funds have been raised by MBAs (either newly minted, or with a few years of post-MBA experience). As such, they tend to be high-potential, but relatively inexperienced operators. In addition, investors expect high returns on their investment (usually in the 30% IRR range). In order to increase the odds of success and to achieve the expected returns, search funds target businesses that meet very strict criteria. Some of the most common criteria are described in Appendix 1.

Additional Resources

"Global Entrepreneurship Week," Simon Webster and Mark Egan, December 15, 2008, video file, IESE Business School, <http://www.youtube.com/watch?v=100uRsa03v0>.

Hurley, James. "Business Angels Put MBA Graduates on the Fast-Track to Becoming Chief Executives," *The Telegraph*, August 15, 2010. <http://bit.ly/csPwsp>

GrowthBusiness.co.uk, "The Secret of Search Funds," October 20, 2009. <http://www.growthbusiness.co.uk/email/channels/entrepreneurs/achieving-growth/1084157/the-secret-of-search-funds.thtml>.

Moules, Jonathan. "An Alternative Source of Funding," *The Financial Times*, October 14, 2009. <http://www.ft.com/cms/s/0/6861fc84-b858-11de-8ca9-00144feab49a.html>.

Bowers, Brent. "Paying Entrepreneurs to Find the Right Business," *The New York Times*, http://www.nytimes.com/2009/03/12/business/smallbusiness/12hunt.html?_r=1&ref=business.