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IN THE HUNT

Paying Entrepreneurs to Find the Right Business

By [BRENT BOWERS](#)

JIM ELLIS and Kevin Taweel used a search fund to acquire a \$6 million roadside assistance company with 45 employees that they built into the nation's largest provider of insurance products to cellphone companies.

Jim Southern, a Boston investor, said his search funds had generated 14 times the capital he placed in 20 companies over an average holding period of eight years, while Dave Carver, the co-founder of Search Fund Partners in Menlo Park, Calif., said his company was also achieving strong results with the same investment model.

While most people have never heard of them, search funds are attracting increasing attention as a way for small businesses to beat the usual odds of success, even in the midst of a deepening recession.

This is the way a search fund typically works: One or two ambitious graduates of a top-tier business school, who want to run their own business but recognize they lack practical experience, offer themselves as fledgling entrepreneurs who can make some tough-minded investors a lot of money.

These investors put up about half a million dollars for the pair to spend up to two years scouring the marketplace for a promising business with \$10 million to \$30 million in revenue. If satisfied with the choice, the investors help finance the acquisition of the business, join its board and give their young partners a crash course in hands-on management. If all works out, the venture grows and makes everybody richer.

H. Irving Grousbeck, co-founder of Continental [Cablevision](#) (later Media One) and now a consulting professor of business at [Stanford University](#), helped originate the business model a quarter of a century ago and has been studying it ever since.

Mr. Grousbeck says studies by the Center for Entrepreneurial Studies at Stanford, which he co-directs, show average annual returns by search funds to their original investors of well over 30 percent.

The results are skewed by the big winners, which constitute about a fourth of the total. Another fourth fold without making a purchase, a fourth lose money for their investors and a fourth provide a middling return, according to Mr. Southern, the Boston investor. Still, taken as a whole, search funds can be a winning proposition.

The funds do have drawbacks, of course. The same recession that has attracted search fund buyers has scared off sellers, for example, Mr. Grousbeck said.

Moreover, major successes are rare.

One was Road Rescue Inc., a Houston venture that Mr. Ellis and Mr. Taweel acquired in 1995 for \$8 million and built into the insurance giant Asurion Inc. In that case, the original investors in Road Rescue

received more than a 100-fold return on their stakes.

Asurion provides a case study of the power of the search fund model in the right circumstances. The founders, who had studied under Mr. Grousbeck at Stanford, said they liked Roadside Rescue because it was not a towing company. Instead, it sold roadside assistance insurance through local wireless carriers to their users. The venture grew by 50 to 100 percent a year in its first four years.

Then the two men had an epiphany: they were not in the roadside-assistance business; they were in the cellphone services business. In 1999 they expanded into insurance for loss or damage to cellphones. After making three major acquisitions in recent years, Asurion, based in San Mateo, Calif., has grown into a \$2.5 billion company with 10,000 employees, more than 70 million wireless customers and a growing presence in Asia.

Mr. Ellis, who stepped away from an active role in the company several years ago (though he still sits on its board as a nonvoting director), now divides his time between lecturing at Stanford and investing in small and medium-size businesses.

He acknowledged that he and Mr. Taweel had the good fortune of choosing an industry on the cusp of an explosion in consumer demand. "If we had grown more slowly than we did, we would have been losing ground," he said. Still, he said, the leap to \$2.5 billion in revenue, from \$6 million, in 13 years "is the biggest multiple any search fund company has had."

Mr. Southern, the Boston investor, made a small fortune in a niche printing business that he acquired in 1984. Through dividends and the sale of the company 10 years later, his investment returned 35 times the original capital, for an average annual yield of 60 percent.

"For years, I was the most successful search fund entrepreneur," he said. "But Asurion knocked the cover off the ball." He has put money behind more than 40 search funds, with results that he said have been "better than those in the Stanford study."

"The reaction I get when I tell a business owner or an investor about search funds is, 'I wish I had thought of that,'" he said. For aspiring entrepreneurs who embrace the search fund model, he said, the likelihood of a big payoff is much greater than "the gamble of trying to do a start-up."

Mr. Southern says more business school graduates are being drawn to search funds, in part because of Asurion's success and in part because the recession has diminished prospects on Wall Street and in corporate America. Nearly 25 would-be search fund entrepreneurs have approached him since November alone, he said, compared with fewer than 10 in a full year in the past. He plans to back nine funds this year, the same as in 2008 and 2007 but significantly more than the one or two a year he helped finance before that.

Mr. Carver, co-founder of Search Fund Partners, has noticed a similar trend, with 14 candidates approaching him in the first five weeks of 2009, double the number in previous years. He says he has also seen "a strong increase in investor interest in them," he said.

He and his business partner, Rich Kelley, a former Utah Jazz basketball player, founded Search Fund Partners five years ago. He describes it as the only private equity firm to invest exclusively in search funds.

So far, the firm has raised close to \$25 million from individuals and invested in 22 search funds, half of which have acquired companies. "We've never had any shortage of terrific entrepreneurs to invest in," he said. He would not divulge specifics, but said all the capital invested in the firm's initial round of six

investments was paid back by just one of them.

Mr. Grousbeck, the Stanford professor who nurtured the first fund in 1984 when he was teaching at Harvard, says the business model has spread to Europe, Latin America, Asia and even South Africa, if only by a trickle.

Still, search funds occupy a tiny niche of the investment world. Mr. Southern estimates that only 160 or so have been created, all looking for companies with less than \$50 million in revenue. He estimated that about 60 search fund companies were active today.

Even so, Mr. Grousbeck said, investors who back a portfolio of search funds stand a good chance of beating the returns in other markets. "I can't tell you how many investors have asked me, 'Why should I pay somebody to hunt for a company when entrepreneurs are knocking on my door all the time to invest in theirs?'" he said. "I tell them, 'You'd be taking a very small risk for the chance to ride the coattails of some very bright and talented people.'"

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