

## The Secret of Search Funds

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UK-based search funder Ritz Steytler

**There can't be many asset classes that boast an average IRR of 52 per cent. Search funds, in which an inexperienced entrepreneur is backed by angel investors to search for and acquire a business, have this enviable distinction, according to a Stanford University study from 2007.**

Like a lot of financial models from across the Atlantic, search funds have been slow to catch on in the UK and Europe. The first one was raised in the US in 1984, while the UK had to wait until 1992.

'The UK is somewhat behind the curve when it comes to angel investing,' says Ritz Steytler, a London Business School MBA graduate who has spent the last nine months raising the money for a search fund. 'There's also a more entrepreneurial attitude in the US: people are prepared to take a punt.'

Simon Webster, who raised the UK's first search fund in 1992 and achieved an IRR of 20 per cent for his investors, agrees. 'It's a hard sell [to raise money] because you're selling a concept rather than something tangible. When I did it there were few examples of successful search funds to point to, even in the US. It took me seven months.'

The concept is that a would-be entrepreneur, usually with an MBA and limited experience, persuades around a dozen investors to support him (almost all principals are men, according to the Stanford study) to search for a suitable company to acquire. Steytler, for example, is raising £300,000 in 12 units of £25,000 and is now only one unit short.

Once a target is located, the "dragons" are offered the chance to invest in the acquisition itself (bank debt or vendors' loan notes may also be used). The principal then takes over the company with the object of exiting for a good return, as per the usual management buy-in (MBI) model. He may be assisted by his investors, although not all of them are likely to want hands-on involvement.

The Stanford research shows that since 2005 an average of \$385,000 (£235,000) has been raised in the first round, which typically takes three months. Acquired

<http://www.growthbusiness.co.uk/channels/entrepreneurs/achieving-growth/1084157/the-secret-of-search-funds.shtml>

companies have a median turnover of \$9.1 million and earnings before tax, depreciation, interest and amortisation (EBIDTA) of \$2 million, while the typical purchase price is \$9.4 million.

‘One of my frustrations is the small number of people [in Europe] who have followed this path,’ says Webster. ‘A lot of people on MBAs want to be equity investors in a business but don’t have a big idea – well here’s a route to do it.’

That said, this is not for the completely green. Webster was with IBM for six years before he raised his search fund, while father-of-four Steytler has 17 years’ experience in the IT sector, which is where he plans to make his acquisition.

‘There are three [search fund principals] raising money in the UK at the moment, all of us at a similar age,’ says Steytler. ‘There is no sense of “because you’re cheap I’ll take a punt on you”.’

‘It’s a hard sell raising money for a concept’

Nevertheless, that is more or less how the model has worked in the US. The median age of post-2005 search fund principals is 31, with the youngest only 27. ‘If you’re a busy business angel and you can get an MBA working for you for £10,000 a year sourcing deals full-time, that’s a very strong argument,’ explains Steytler. The low income of the principal, who seeks financial upside mainly from the exit, boosts IRR compared to a typical MBI where good managers attract big salaries as well as equity in the company.

But doesn’t the concept imply that a bright young thing with little more than an MBA and confidence can run a business better than its founders? ‘Not really,’ says Steytler. ‘What you’re really doing is going after a business that’s just slightly dusty – the founder’s been running it for 25 years and in the last ten years they haven’t really been taking risks with it.’

‘It’s about taking that business and combining the talent, enthusiasm and hunger of someone out of business school with 10 or 12 dragons.’

It’s true that Stanford’s next study may not show such an impressive IRR; after all, there has been a credit crunch and global recession since then. However, the UK’s serial entrepreneurs may well find search funds of interest, whether they approach them as an investor or a principal.

‘It’s a really interesting model where a young business professional can both raise money and become an equity-owning manager very quickly,’ concludes Webster.

## Interesting links

- [British Search Fund Association](#)