

Succession Planning: The Joy of Search Funds

By Stever Robbins

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It's the American Dream to build and run your own business. But for many entrepreneurs, the time comes to leave. Perhaps for retirement, perhaps just because it's time to move on. But what to do with the business? Give it to the kids? Sell to private equity investors? Sell to or merge with a competitor? There are many choices, and no clear path through.

Darren Torrence founded VRI in 1989. A company that provided medical alerts and senior monitoring, VRI was a good business financially and in terms of its impact on the world. Darren grew the business happily for eighteen years but with almost 30,000 customers and 50 employees he felt like the time was right to look for a partner to grow the business.

Decide if you really want to sell.

Especially on bad days, you may think you want to sell your business. But make sure you're serious before you start looking. If you have some hazy idea that "life will be better" without the business, bring that hazy idea into focus. How will you spend a typical day without the business? Perhaps you plan to sail around the world, become involved in charity, or start something new. If a business has been the center of your life for years or decades, however, you could risk feeling lost or directionless without it. Until you have a new life you're moving towards, leaving your old one behind may be unwise.

If you really want to sell the business, decide what's important to you about the sale. Presumably you want money from the sale, but there may be other factors. The timing of the money—tradeoffs between cash now versus potential upside in a continued position in the company—may be a factor. If you've had stable, loyal employees, you may care how they're treated and what happens to them next. If your company is your major life legacy, you might want it to grow and thrive, even when you're no longer personally involved.

Your goals with the sale will determine the buyers that most make sense for you.

Darren realized that VRI was doing well, but getting large enough that it needed senior managers who could take it to the next phase of growth. Darren was in a different stage of life than when he started the company. He wasn't excited about hiring a new management team and continuing to be general manager of a growing firm. His love was sales, marketing, and the customer relationships. He still enjoyed that part of his job, and wanted to take some money out of the company so he could enjoy what he had built over the years.

His broker brought him many different buyers. None seemed quite the right fit. Then the broker introduced him to Chris and Andy.

The Buyers

Chris and Andy had known each other for several years, having been roommates together in business school at Stanford University. Chris came from a private equity background in addition to some experience with a technology startup. Andy's family owned a small business. They immediately recognized they had one thing in common: they knew they wanted to run a business.

Neither was interested in starting from the ground up. Nor were they interested in being passive financial owners. They wanted to *work!* They decided to buy an existing business and created a search fund in September 2006.

The Search

With a search fund, would-be business owners raise capital from friends, family, and angel investors (often former search funders themselves) to fund their search for a business to buy. When they find a business, the investors in the fund are given the chance to participate in the purchase. They are then repaid through dividends and stock buybacks.

Chris and Andy narrowed a list of several *hundred* industries down to 25 candidates that were a good fit for their skills, personalities, and business criteria. It had to have growth potential, to provide an economic return, and it had to be a cultural fit, since they planned to run the business going forward. They were introduced to VRI in April 2007 and it fit the bill: it addressed health care in an aging population, with real growth opportunities.

Everyone wins

After about six months of negotiations, Darren sold Chris and Andy a majority interest in the business. Although he had originally imagined leaving after an acquisition, Darren elected to stay and concentrate solely on sales, marketing, and customer relationships.

Chris and Andy run the company on an ongoing basis, and Darren expects the ownership he has retained to be worth a handsome sum as a result of Chris and Andy's leadership.

Darren, Chris, and Andy are all quite happy with the arrangement. Darren has been able to turn his hard work into cash, while still sharing in the company's future growth. He can now concentrate solely on the areas of the business he most enjoys, and has two partners who greatly value his experience and knowledge. Chris and Andy are living their dream of owning and running their own company. They have already nearly doubled the size of the business, and are looking forward to many years at VRI.

If Darren's only concern in selling his business was making money, it may have made sense to sell to a private equity firm. They would pay good money. Then they typically cut costs or reorganize the business, and look for a way to flip it at a profit. While they may hire in operational managers, private equity funds are rarely committed to building an ongoing concern. If you simply want to turn your business into cash and walk away, private equity buyers make a lot of sense.

Similarly, selling to a competitor or someone who wants to expand into your market can be a good idea if you don't care what happens to the company afterwards. Culture clashes often cause mergers to fail, and acquisitions risk exposing employees to layoffs. In Darren's case, he wanted to ensure that the company that he spent nearly the last two decades building would continue to employ the people and values that made VRI a leader in its industry.

Search funded entrepreneurs can be attractive buyers

With search funds, your buyers plan to work in the business, not just own it. It gives you a chance to sell, but to sell to owners who have a stake in running the business a certain way. If you care about your legacy, you can do due diligence on your search fund entrepreneurs to make sure they'll run the business with the same values as yours. If you want to stay involved and want partners who will have skin in the game and bring the skills to take the company to the next level, a search fund maybe just the thing.

In many closely held and family businesses, ownership is shared among several owners. As an alternative to forcing the sale of the whole company because of a few disgruntled members, carefully chosen search fund entrepreneurs can step in to replace owners who want out. Family businesses can be emotional minefields; you would want very careful due diligence to insure the new owners would mesh well with the remaining family members .

Search fund investors are also a special breed. Unlike traditional private equity, where investors are merely looking for a return, search fund investors are often motivated by a desire to help the specific entrepreneurs succeed. They don't expect to buy and flip the businesses, their concern is growing a thriving business. As a result, they generally let

the buyers run the business for the long-term, rather than playing short-term games for quick cash.

You can find search funds through business brokers, searching the Internet, and connecting with business schools that have strong entrepreneurship programs. Babson College, the world's #1 school for entrepreneurship for the last 16 years, has a course in acquisitions where students can actually purchase a business while they are still in school.

The course has also spawned search funds like Knob Hill Partners, where founders Scott Noll and Charlie Burckmyer are currently in the midst of searching for their perfect company. Similar to Chris and Andy, but with a more sales-focused heritage, Scott and Charlie want to invest in the expansion of the business and take advantage of new market opportunities. Their search has focused on business service companies in the healthcare, financial, IT, and energy efficiency sectors.

In short, if you're just in it for the money, a traditional harvest of selling to a buyer whose motivations are purely financial may be the best bet. But if you want flexible ownership arrangements, an ongoing relationship with the business, or new owners who will help preserve and grow your legacy, a search fund could be your best solution.