# SEEK AND YOU SHALL FUND: QUICK OVERVIEW OF SEARCH FUNDS

With **Michael E. Reid** and **Yara Nijm** (Articled Student)

**What Is a Search Fund?**

A search fund (or acquisition fund) is a specialized investment vehicle through which one or more entrepreneurs, often referred to as the "searcher(s)", raise capital from a group of investors in order to search for, acquire, and run a privately held company. Typically, target companies are stable, legacy-style businesses whose owners are seeking to retire or transition out. Rather than founding a startup from scratch, searchers leverage the search fund model to take immediate control of an existing operation, serving as owner-operators, usually installing themselves in leadership roles such as CEO or president.

While this model has existed for decades in the United States and has been increasingly gaining traction in Canada, there is a current upswing in popularity. It offers entrepreneurs who may lack a novel startup idea or extensive operating track record a practical route to "Entrepreneurship Through Acquisition". At the same time, it provides investors the chance to invest in a focused, single-company deal that can yield attractive returns if managed effectively. And finally, it provides an attractive exit for the current wave of existing business owners looking for a retirement exit.

### How Search Funds Differ from Other Investment Models

- Search Funds vs. Publicly Traded SPACs

A SPAC ("Special Purpose Acquisition Company") also raises capital for the purpose of acquiring or merging with a private company, but it does so via the public markets. Shares or units of the SPAC are listed and traded, and retail or institutional investors can buy in. By contrast, a search fund raises equity privately, from a small network of investors, often successful entrepreneurs, high-net-worth individuals, or family offices. Because a search fund's capital is privately raised, its searchers have a more intimate, often mentor-mentee relationship with investors, who typically offer guidance alongside their financial commitments.

- Search Funds vs. Traditional Private Equity

Although search funds fall under the broader category of private equity, since they invest in privately held companies, they differ significantly from traditional private equity ("PE") firms:

- **Portfolio Composition:** PE firms spread capital across multiple companies. A search fund tends to focus on just one. As a result, the search fund's success hinges entirely on the performance of the single acquired business.

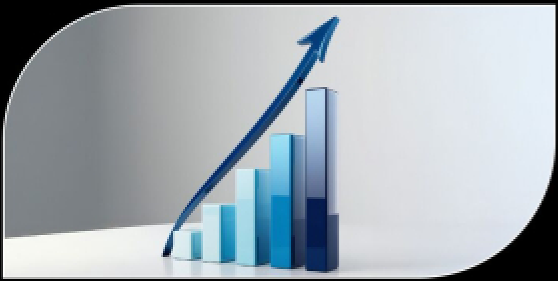
- **Role of the Fund Manager:** Traditional PE fund managers oversee a portfolio and rely on outside executives to run the day-to-day operations of each company. Search fund entrepreneurs, by contrast, install themselves as owner-operators and serve in those executive roles.

- **Investment Timeline:** While PE firms often plan exits in three to five years, a search fund may hold the business for five to ten years or longer.

- **Shareholder Activism:** In many search funds, key investors take board seats in the acquired company, offering strategic guidance and mentorship to the searcher(s), but the company is run by the entrepreneur. Traditional PE firms exercise oversight and direct control, whether in connection with the original entrepreneurs or subsequently appointed executives.

## Why Search Funds Are Gaining Momentum

Search funds have become an attractive alternative for entrepreneurs who want the autonomy of building a business but prefer acquiring an established operation with proven revenue and a solid customer base.



Some key advantages include:

- **Reduced Startup Risk:** Rather than building a company from zero, searchers inherit existing operations, customer relationships, and brand recognition.
- **Significant Growth Upside:** By improving management practices, introducing new products or services, and tapping into untapped markets, entrepreneurs can scale the existing business to boost the enterprise value resulting in a significant upside upon exit.
- **Robust Returns:** Historically, search funds have generated investor returns exceeding 30%, which often surpasses the returns of traditional private equity by 10-15%.
- **Shareholder Activism:** Many investors prefer the hands-on nature of search funds, which allows them to offer real-time advice and mentorship.
- **Aging population:** There has been a large and steady stream of retiring business owners in established industries seeking a successor to whom they can transition leadership, creating ample deal flow for small to medium enterprises.

## Typical Life Cycle of a Search Fund

Though every search fund has its nuances, the life cycle generally spans several phases:

- <u>**Initial Capital Raising (2–6 months)**</u>

At launch, the searcher(s) often incorporate a limited partnership company and draft a private placement or offering memorandum with which to approach shortlisted investors. Formal capital is then raised in two staged phases: (1) the funding required to finance the search ("search capital"); and (2) the funding required to acquire the target once it has been identified ("acquisition capital").

Investors are often seasoned entrepreneurs, industry experts, or high-net-worth individuals. These investors contribute capital based on their belief in the searcher's ability to locate a suitable acquisition target and grow the business successfully. Search funds are generally smaller than typical private equity funds, often ranging from a few hundred thousand dollars to a few million. In addition to funding, investors often provide mentorship and strategic advice. This dynamic can be critical, especially since many searchers are MBA graduates or individuals with limited operating experience.

- **Searching for a Target (1–2 years)**

Once a search fund is established, the entrepreneur embarks on what's known as the search phase. It's not uncommon for the searcher to spend significant time, often one to two years or more, searching for and conducting due diligence on potential businesses. This phase can be intensive and time-consuming.

Searchers tap into personal networks, consult with business brokers, and leverage various professional platforms to find promising businesses. As soon as a potential target is identified, the entrepreneur works alongside legal, financial, and industry experts to analyze the company's financial health, market position, leadership needs, and overall growth prospects. Most search funds aim for stable businesses with strong financial performance, solid revenues, healthy cash flow, and a track record of growth. Oftentimes, owners of such businesses are looking to retire or otherwise exit their companies, creating an opportunity for a new leader.

Since the entire future of the search fund hinges on this single acquisition, the search and due diligence process often involves extensive negotiation, financial modeling, and market research.

- **Acquisition (60–90 days)**

After months, or sometimes years, of research, the searcher negotiates the purchase terms with the target's current owners.

At this point, decisions must be made as to how much equity the searcher will hold versus the outside investors, how the acquisition will be financed (e.g., a combination of debt and equity), and any earn-outs or performance incentives for the company's former owners. Once terms are set, the legal and financial teams finalize documents, ensuring all parties are protected and in agreement on the path forward.

- **Managing and Growing the Company (3–7 years)**

What sets search funds apart from many private equity models is the hands-on role of the searcher. From day one, the searcher(s) in their new role as the executive leaders of the business focus on implementing strategies to enhance the company's performance, whether that's introducing new product lines, expanding into new markets, restructuring debt, or refining operations. While traditional private equity often aims for a three- to five-year turnaround, many search funds hold their investments much longer, somewhere between five and ten years or even more. Some may not seek an exit, but rather repayment of investors through profits as the entrepreneur settles in as a long-term business owner-operator.

### Potential Drawbacks

While there are clear advantages to search funds as outlined, there are also potential drawbacks which make search funds not for everybody:

- **Concentrated Risk:** As the fund invests in only one company, there is little diversification. A single failed deal can lead to a total loss for investors.

- **High Barrier to Entry:** Compared to starting a small business from scratch and then growing, an acquisition may require a substantial amount of capital right away. This often means entrepreneurs need a solid network of potential investors or personal capital to set up the fund, which can be a barrier to entry.

- **Longer Timelines:** The process of finding and acquiring a company can be lengthy, and once the deal is done, it can take many more years to optimize operations and build value. Investors who want quicker liquidity may find these multi-year timelines challenging.

### Conclusion

For aspiring entrepreneurs who value hands-on management but prefer a proven operating platform over a startup, search funds present a compelling path to ownership. Investors, meanwhile, gain exposure to a single-company deal that can produce strong returns, bolstered by the searcher's full-time dedication to improving and scaling the business. As the model gains further momentum in both Canada and the United States, search funds continue to attract entrepreneurs seeking a turn-key business opportunity and investors drawn to returns that can exceed those in traditional private equity.

## About Mike Reid

Mike Reid is a partner and co-chair of the Emerging Growth and Venture Capital group at DLA Piper (Canada) LLP. He is a corporate/commercial lawyer working across a variety of sectors, from software to e-commerce, gaming to productivity tools, artificial intelligence to VR/AR, healthtech, fintech, consumer goods, food and beverage, life sciences and plenty of categories in between. Mike's practice includes all stages of a company's life cycle from startup, through growth, to exit., and he has a particular penchant for M&A work. He regularly works with entrepreneurs, founders, and investors, enjoying life on both sides of the table.

## About Yara Nijm

Yara Nijm is an Articled Student with DLA Piper (Canada) LLP, with particular interests in real estate law, financial services, and emerging companies