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Graduates hunt for 'search fund' success

By Camilla Hall in New York

Baker Library at Harvard Business School

Over wine and canapés in the Meredith Room, a small banquet hall at Harvard Business School, more than 100 students gathered this month to consider a career in finance that is luring a growing number of America's bright young things.

On April 2 Harvard hosted its inaugural conference dedicated to "search funds", crudely described as one-person-one-company private equity funds, which are becoming a hot career choice for business school graduates.

A search fund can be set up by one or two people who raise money from friends, family, business associates or other investors, to fund the cost of looking for a small company to acquire. Investors buy in before the target company is identified, covering a modest salary for the "searcher", the costs of administration and deal-related expenses.

Alex Gelman, a 29-year-old searcher who graduated from Stanford Business School last year and raised money for his search fund Poplar Partners, has been looking for the right company to acquire for seven months. "I have a giant calendar on my wall and I cross off a day every day," he said. "It's a ticking clock."

After jobs at McKinsey, the consultancy, and Kohlberg Kravis Roberts, the private equity group, Mr Gelman decided: "I wanted to be the one making decisions."

Typically in their late twenties or early thirties, searchers try to buy a small company, expand it and, when the time is right, sell it.

"We're seeing a huge interest in search funds," said Kristen Fitzpatrick, managing director at the MBA career development team at Harvard Business School. "More people are going down this road."

While a search fund may sound simple, the structure of these entities has been defined in a primer written by Irving Grousbeck, a professor of management at Stanford University, which has become the gospel of the fledgling investment community that he pioneered in 1984.

Investors buy units of the fund at about $35,000 to $50,000 each, with the fund offering around 10 units to finance a search. About 200 such funds exist, up from 46 in 2001, Professor Grousbeck says.

The typical lifespan of a search fund, structured as a limited liability company, includes two to six months to raise capital, a one to 30-month stage to search for the acquisition and six months to raise acquisition capital and complete the transaction.

The fund then has four to seven years to create value at the company. Finally, it starts the exit process – such as through a sale or initial public offering, which is estimated to take another six months.

"Students have decided they're able to take a little more risk," said Mr Grousbeck. "The failure rates are pretty high, but the returns from the successes have more than counterbalanced." Mr Grousbeck estimates that one in five search funds fails to find a company.

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Jim Southern, a search fund veteran who is a partner at Pacific Lake Partners, which invests in as many as 20 search funds at a time, said: "It's all about the company: an average manager can do well if he/she buys a good company."

Bringing in more experienced investors can help search funders by acting as “a canary in a coal mine”, and stopping poor acquisition choices.

than counterbalanced

- Irving Grousbeck, professor of management at Stanford University

The model appeals at a time when investors are looking to put money to work and young business graduates are searching for more entrepreneurial paths.

Ashwin Grover, 30, who graduated from Harvard in 2010, teamed up with a friend who graduated from Insead last year and is on the hunt for a small company in the UK.

“I liked the idea of entering through acquisition,” said Mr Grover, who worked at Amazon and came from a history of family businesses. “So many companies go bust in their first year.”

Some would-be searchers have shunned the idea, believing that having all their eggs in one basket could be a riskier option than working for a more diversified small-cap private equity fund.

However, for ambitious young graduates the thrill seems to be worth it.

“You’re in your mid-to-late twenties and you’re buying a business and taking it over with employees and their families looking to you to make the right decision,” said Michael Goy, 28, who set up search fund MPG Equity Partners after he left the University of Chicago Booth Business School.

“I want to make a difference now. I don’t want to wait 15 years.”

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