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Considerations for Entrepreneurial Acquisitions

Introduction

For many aspiring entrepreneurs, identifying and developing a business idea for a start-up is a daunting and seemingly insurmountable task. Moreover, few are aware of the opportunity to begin an entrepreneurial career through an entrepreneurial acquisition – the process of acquiring an opportunity as opposed to inventing one.

There are many types of opportunities that a prospective entrepreneur can look to acquire (a technology, a franchise, a healthy firm, a turnaround opportunity, etc.), and they exist in a broad range of geographies and industries. What all entrepreneurial acquisitions have in common is that they are fundamentally composed of four phases: *searching* for an entrepreneurial opportunity, *acquiring* the opportunity, *executing* on the opportunity and *exiting* the opportunity.

Entrepreneurial activities inherently lack resources, and entrepreneurial acquisitions are no exception. Moreover, entrepreneurs pursuing an entrepreneurial acquisition will expend significant time and resources finding and acquiring an opportunity. These phases do not add value.[1] – Until entrepreneurs don't own the rights to the opportunity they cannot capture value from it. This note therefore focuses on streamlining the search and acquisition phases of an entrepreneurial acquisition.

The considerations that follow are a synthesis of the experiences encountered by entrepreneurs and investors from around the world. Each has years of experience identifying, evaluating, acquiring and managing entrepreneurial ventures, and their combined wisdom will help entrepreneurs through the early phases of their entrepreneurial acquisition. In particular, these

[1] It could be argued that the entrepreneur creates value during these phases by indentifying the best opportunity possible. However, unless entrepreneurs have the rights to the opportunity, they do not have the ability to capture value from it. In this sense, activities prior to the acquisition date serve only to generate costs and not to add value.

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considerations will help the entrepreneur in two ways. First, they will help entrepreneurs to systematically review and define the assumptions of their search. Second, suggestions and recommended practices for undertaking a search will be presented. A careful consideration of these assumptions and practices will help entrepreneurs streamline their search and make a first-class acquisition.

How this Note is Structured

The note focuses on entrepreneurial acquisitions in a general sense and is composed of four parts. Part 1, Preliminary Discussion and Clarifications, provides a definition of entrepreneurial acquisitions and Search Funds, clarifying some terminology used commonly throughout the text. Part 2, The Search Domain, addresses issues that should be considered while defining a Search Domain. Part 3, Undertaking a Search, discusses the many considerations associated with the search itself. Finally, Part 4, Putting it All Together, summarizes the key considerations for the search and acquisition phases of an entrepreneurial acquisition.

For the practicing entrepreneur, recommended practices are highlighted throughout the note. Similarly, real-life examples are included at the conclusion of many sections to enrich the reader's understanding. A Glossary of the many terms used in the discussions has also been included at the end of the note. Additional data and resources are available at:

http://www.iese.edu/en/Research/CentersandChairs/centers1011/eic/BusquedaDeFondos/Bsqu edadefondos.asp

Part 1. Preliminary Discussion and Clarifications

The Entrepreneurial Acquisition Process

For the purposes of this note, an entrepreneurial acquisition (EA) is defined as follows:

> "An entrepreneurial acquisition is the deliberate and systematic process of sourcing and acquiring an entrepreneurial opportunity."

This definition of an EA allows for the acquisition of many types of entrepreneurial opportunities, including deliberately looking for a new venture opportunity.

The EA process can be broken down into four distinct phases. Each phase is highly influenced by the preceding one, emphasizing the importance of good decisions throughout the process.

The Search Phase

During this period the entrepreneur makes many decisions surrounding their financial goals, the type of opportunity that they will seek (a technology, a franchise, a healthy firm, a turnaround opportunity, etc.), the type and timing of the financing they intend to employ, the Search Domain they will focus on (their chosen geography and target industries), and the type of Search Vehicle they will use. These decisions are interrelated and have a significant impact on where and how the entrepreneur will source opportunities, how opportunities are evaluated and the type of exit they will pursue.

The Acquisition Phase

The focus of this phase is on execution: Have the entrepreneurs found a compelling opportunity? Have they convinced the owner to sell? Can they convince investors and banks to finance the acquisition? How should the acquisition be structured? If the search phase has been executed with due diligence, entrepreneurs will find executing this phase much easier. In particular, a well evaluated and clear set of acquisition criteria will allow the entrepreneur to identify compelling opportunities, demonstrate the merits of the opportunity to sellers and financiers and make informed decisions on the financial structure of the acquisition.

The Opportunity Execution Phase

This phase focuses on the entrepreneur's ability to create value as a manager and operator. However, the likelihood of success in this phase is highly dependent on the search and acquisition phase. A good opportunity, in a strong industry and/or with an appropriate capital structure, can compensate for many management errors. Conversely, a poor opportunity, in a weak industry and/or with an inappropriate capital structure, is likely to overwhelm even the most talented manager.

Exit

The final phase is the exit. This typically takes the form of an IPO, selling to a strategic buyer, an asset sale or a shutdown. The choices available for exit will be determined by the decisions and results of the preceding phases.

Search Funds

Search Funds are a formal EA model and in recent years have become an increasingly popular vehicle for undertaking an EA. While this note deals with the EA process in a general sense, it may be particularly appropriate for Search Fund entrepreneurs. These entrepreneurs are frequently newly/recently minted MBAs and typically have limited operational experience. This note will offer them many lessons – each drawn from the experience of others – that would be costly and time-consuming to discover on their own. Secondly, Search Funds take a deliberate and focused approach to the EA process, an approach that is presented and promoted by this note.

The Search Fund Model

This model, originally conceived in 1984, was intended as a vehicle in which investors financially support an entrepreneur's efforts to locate, acquire, manage and grow a privately