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Search Funds Characteristics of a New Group of Investors in Poland for Family Businesses Facing the Lack of Succession

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Abstract

Purpose: To analyze search funds as a new group of investment vehicles in Poland that constitutes a group of potential investors for family companies facing the lack of succession.

Methodology: The theoretical part presents family businesses, considers the problem of succession in Poland, and analyzes the literature on available forms of divestment of a family business owner. Moreover, the article presents the roots of search funds creation and their characteristics, which reveals these investment vehicles as theoretically perfect for family businesses without successors. The empirical part presents a study into the sale of a Polish family business to a search fund, which was the first and only search fund deal in Poland until the end of 2020.

Findings: The study revealed that the sale of a family business to a search fund should be included in the catalog of possible forms of divestment of a family business owner facing the lack of successors.

Originality: The article fills a gap in the literature on family entrepreneurship in the context of selling a business to a search fund in Poland, which has not yet been indicated as one of the methods for owners to exit a business.

Keywords: search fund, family business, succession.

JEL: G32, L26, D490

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Introduction

Family businesses are the foundation of the Polish economy. These enterprises account for approximately 40% of the Polish GDP and provide over 3 million jobs. There are almost 1.7 million family businesses, and only 8.1% of these companies have a successor in the family circle. Considering the importance of family businesses for the Polish economy and the massive problem of no successors, we must learn all the possible forms for the divestment of a family business owner facing this lack of succession. Divestment in this case means the process of the owner's exit from the family business, understood as a complete severance of previous ownership ties with the company and the cessation of any managerial functions in the company (Koładkiewicz and Wojtyra, 2016, p. 90).

In the Polish literature on family businesses, the catalog of possible forms of divestment includes such methods as the sale of the business to an industry or financial investor or the sale of the company through the stock exchange in an IPO transaction. However, the studies provide no mention of such a form of divestment as the sale of the company to a search fund. Therefore, I pose the following research question: Is the sale to a search fund of a family business facing the lack of succession a viable form of owner's divestment?

The article will analyze search funds to show whether the sale of a family business to a search fund should be considered one of the key forms of divestment of a family business owner facing a lack of succession. Based on the literature review and the knowledge of both family businesses and search founds, I posed the following research hypothesis:

> The sale of a family business to a search fund is a viable form of owner's divestment in the absence of family succession.

Because the Polish search fund market is relatively young and small – and there is no Polish literature dedicated to this topic – I will only follow foreign literature and statistics on search funds activity abroad to characterize search funds. Notably, I will use the terms "family business," "family enterprise," and "family company" as synonyms in this article (cf. Winnicka-Popczyk, 2016, p. 9).

The article consists of three sections. The first two sections will include the theoretical section, while the third section – empirical research. Section one will present the roots and scale of the problem of the lack of succession in Poland, as well as forms of divestment available to family business owners who face the issue. The second section will consider search funds as a new form of divestment from family businesses, their distinguishing features, and their activity on the Polish market. Section three will describe a case study of the sale of a Polish family business to a search fund. Conclusions will present the study findings.

The Roots and Issues of the Lack of Succession among Polish Family Businesses

Reflections on family businesses and the problem of lacking succession possibilities should begin with taking note that there is no single established definition of a family business. Simplifying, a family business can be defined as a business entity run by family members (Bernard, 1975, p. 42), or one in which a family member is a CEO (McConaughy *et al.*, 1998, pp. 1–19). Some researchers consider a family business to be the one that believes it is a family business (Frishkoff, 1995). There are many more elaborate definitions in which authors include several additional criteria for selecting a family business, such as the criterion of ownership, management, or family involvement in running the business on the daily basis (Davis, 1983, p. 47; Stem, 1986, p. 21; Handler, 1989, pp. 257–276; Klein, 2000, pp. 157–181; Jeżak *et al.*, 2004, p. 19; PWC and Family Business Institute, 2016, p. 28; Kowalewska, 2009, p. 19; Klimek, 2016, p. 3).

As presented above, defining a family business has been a research problem for the last few decades. This problem mostly results from the fact that these entities are not a homogeneous group of enterprises but one significantly different in size, legal form, ownership structure, business purpose, culture, and historical background in individual countries (Dźwigoł-Barosz, 2018, p. 34). In turn, the definitional discrepancies lead to significant statistical discrepancies between studies conducted by different authors. Depending on the adopted criteria and the selected definition, some studies state that only 15% of all enterprises in the world are family businesses (Kayser and Wallau, 2002, pp. 111–115) while other studies indicate that these companies constitute as much as 79% of all enterprises (Chrisman *et al.*, 2004, pp. 335–354). In Poland, we also notice differences in this regard. Some sources state that as many as 828,000 enterprises operating in Poland declare they are family companies. This constitutes 36% of all enterprises operating in Poland. These companies bring as much as PLN 322 billion annually to the economy, accounting for 18% of the GDP (Lewandowska *et al.*, 2016, p. 27). According to Statistics Poland, there are more than 2 million family businesses in Poland, which generate 63–72% of the GDP and 8 million jobs. Other studies indicate that in Poland there are about 1.8 million companies in the SME sector, of which about

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80% are family businesses. This sector accounts for over 50% of the GDP and 60% of jobs (Zajkowski, 2018, p. 40). Still, other statistics state that there are 3.5 million registered companies in Poland, of which 1.7 million are active businesses, of which over 1 million are family businesses (Andrzejewski, 2011, pp. 27–25). According to data from the Polska Agencja Rozwoju Przedsiębiorczości 2020 report, the number of enterprises in Poland is 2.15 million. Of these, 99.8% are companies from the SME sector. Skowrońska and Zakrzewski (2020, pp. 5–6) argue that companies in the SME sector account for about 49.1% of Poland's GDP and employ 3.9 million people while estimating that 80% of all SMEs are family businesses. Therefore, we may assume that family companies constitute about 1.7 million enterprises, accounting for about 40% of GDP and employing about 3.1 million people. Mindful of the above statistics, we should acknowledge that family companies play a key role in the Polish economy. Regardless of the adopted definitions and statistical data, the share of family companies in the total number of enterprises, the number of jobs created by family companies, and the share of these companies in the GDP of Poland are significant, and no one questions the importance of family companies in the Polish economy.

Many of the family businesses in Poland were established during the political transition in the early 1990s. According to research conducted for the Family Business Foundation by the Bisnode agency, around 60% of private companies founded in 1989 have successfully continued operations in 2019 (Fundacja Firmy Rodzinne, 2019, p. 3). Today, many owners of these companies must naturally decide to whom and how they will transfer ownership and power in their companies. Therefore, a rich body of research and literature has emerged on internal/family succession in Polish family businesses, understood as the transfer of ownership of and power over the business by the founders (elders, seniors) to their children (successors). On the other hand, the literature pays much less attention to possible forms of divestment of a family business owner in the absence of viable family succession. Meanwhile, this matter concerns almost all family businesses in Poland. First, some family businesses do not have a successor at all (e.g. owners have no children). Second, according to statistics, only 8.1% of potential successors express interest in taking over businesses after their parents (Lewandowska and Tylczyński, 2017, p. 20). Finally, out of this group, part of the potential successors may be perceived by the owner as unsuitable to inheriting their family business, or internal succession processes themselves may end in failure. The above means that the other forms of owners' exit than internal succession concern more family businesses than the topic of internal succession. Therefore, these other forms of exit are an extremely important subject both for all family enterprises in Poland and for the whole economy, which now experiences a period of mass succession and ownership changes among family enterprises. Considering the statistics provided by Polska Agencja Rozwoju Przedsiębiorczości that there are about 1.7 million family businesses in Poland and the statistics of the Family Business Institute that only 8.1% of successors want to take over the family business, we may estimate that only about 137.7 thousand family businesses in Poland have a successor interested in running the family business, while over 1.5 million family businesses do not have a successor. Therefore, the scale of the problem of lacking succession is enormous, and so it is extremely important to better understand other forms of owners' possible exit strategies than the internal succession.

Unfortunately, due to owners' reluctance to raise the subject of succession among the family and its constant deferral, about 40% of Polish entrepreneurs over 65 years old continue planning the succession yet without any specific strategy underway. Around the world, as many as 70% of family businesses do not have an implemented succession plan, 53% of family business owners plan to retire only between the ages of 61 and 70, and as many as 27% want to retire only after the age of 70 (Calabro and Valentino, 2019, p. 12). Such an approach to the matter often results in the fact that family succession is implemented too late or simply cannot be implemented due to the lack of successors. Therefore, almost 66% of family businesses are closed or sold by their founders due to the impossibility of implementing family succession (The Wendel International Centre for Family Enterprise, 2020, p. 34).

Some authors who deal with the broad topic of family businesses and internal succession indicate various forms of exit from the family business in the absence of succession (Bednarski, 2018, p. 6; Bilicka *et al.*, 2018, pp. 398–399; Filipczak, 2018, p. 183; Lewandowska *et al.*, 2017; p. 156, Lipman, 2018, p. 19; DeTienne and Cardon, 2012, p. 355; Safin and Koładkiewicz, 2019; Pinkovetskaia *et al.*, 2020, pp. 370–371), which can be cataloged into the following set:

1) sale of the company as part of an initial public offering (IPO) on the Warsaw Stock Exchange (WSE),
2) sale of the company to an industry investor,
3) sale of the company to a financial investor,
4) sale of the company to managerial staff/employees,
5) company liquidation.

The above forms of divestment are used also by other capital market participants, such as private equity funds (Szelągowska, 2012, p. 197; Sosnowski, 2014, p. 237). However, the mentioned studies indicate no such form of divestment as the sale of a business to a search fund. Search funds are investment vehicles usually created by one or two young entrepreneurs to search, acquire, manage, and develop only one company. Moreover, there is still no research devoted to search funds in the Polish literature, probably because the Polish search fund market is relatively young and small. Considering the cooperation with search funds in Poland so far, the growing number of these entities, and their characteristics, this article will present search funds as one of the possibilities of divestment for family business owners who face no succession in their families.

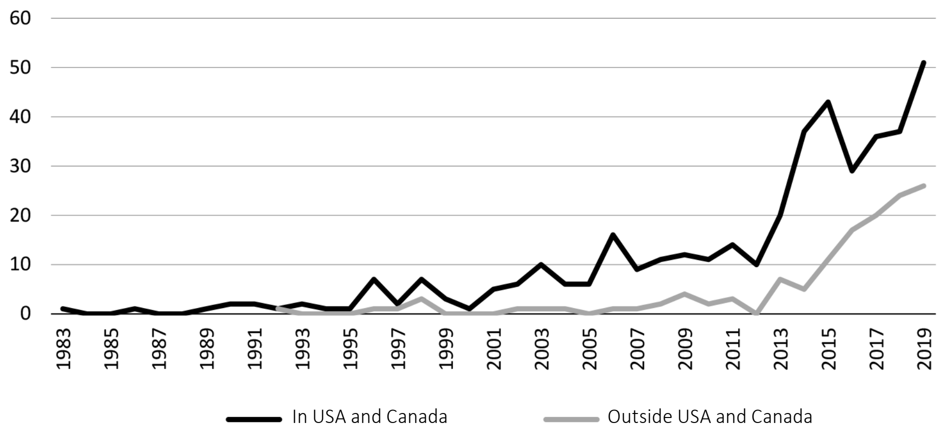
Search Funds as a New Form of Divestment

Characteristics of Search Funds and Their Activity

A search fund is an investment vehicle run by one or two managers (hereafter: Managers) who partner with a small group of affiliated investors and mentors to search for, acquire completely, and operate a business of their choice for a period of six to ten years, until divestment (Stanford Graduate School of Business, 2013, p. 1). Unlike private equity funds, after acquiring the chosen business Managers personally manage it on a day-to-day basis and generally move with their families to the vicinity of the acquired company's headquarter. For the Managers, this is the only transaction and the only company they manage and develop for several years after the transaction. A successful investment in the search fund model is an opportunity for the Managers to become owner-managers, provides chances for attractive returns on investment for both investors and Managers, and enables further development of the company and its professionalization (Kelly and Heston, 2020, p. 3).

The cradle and most developed search fund market are the USA and Canada, where search funds emerged as an answer to the lack of succession in American markets. In the USA and Canada, many companies were established after the Second World War, so after about 30 years, many family businesses faced the problem of lacking succession possibilities. Moreover, these companies needed managers who could skillfully implement the new technologies emerging in the markets in the 1980s and 1990s. These circumstances attracted the interest of MBA students from the Stanford Graduate School of Business, who began to look for opportunities to take over businesses struggling with the problem of lacking succession, so as to then buy these companies from their founders with funds raised from private investors. This was the search fund model developed in 1983 by Irving Grousbeck, then a professor at Harvard Business School. Irving Grousbeck helped young entrepreneurs acquire and run small businesses (Stanford Graduate School of Business, 2020, p. 2). One of the first recognized examples of a search fund is Nova Capital, founded by Jim Southern in 1984 (Dennis and Laseca, 2016, p. 2.) The search fund model was popularized at the Stanford Graduate School of Business in the 1980s and 1990s and has subsequently become a popular model with many entrepreneurs and at many business schools around the world, although still mainly in the USA and Canada. In these markets, research on search fund investments is conducted by the Stanford Graduate School of Business, which publishes study results every two years on the school's website.[2] Search fund investment research outside the USA and Canada is conducted by the IESE Business School in cooperation with Stanford Graduate School of Business, and the results are also published every two years on the IESE Business School website.[3] As we may see in Figure 1, the first search fund in the US market was established as early as in 1983 and in a non-US market – in 1991. The dynamic development of the search fund market outside the USA and Canada and the increased search fund activity have only started in 2013. This was the first year in which the number of newly established search funds exceeded five, while in the US market such a situation already took place in 1996.

Figure 1. Number of new search funds established between 1983 and 2019



Note: no data available for 2020.

Source: own elaboration based on Kelly & Heston (2020, p. 5); Kolarova *et al*. (2020, p. 5).

On the other hand, the Polish search fund market is relatively young and small, although developing steadily. The first search fund in Poland was Nextline, established in 2018. Also in 2018, there appeared a publication on *Puls Biznesu* website with the cooperation of Nextline, entitled "Search Fund rozwiązuje problem sukcesji" (Search Fund Solves

2 https://www.gsb.stanford.edu/faculty-research/centers-initiatives/ces/research/search-funds (accessed: 12.11.2021).

3 https://www.iese.edu/entrepreneurship/search-funds/ (accessed: 12.11.2021).

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the Problem of Succession).[4] The aim of the publication was to reach a wider audience and present search funds as new investment entities in the Polish capital market. Nextline has already acquired a company in 2020, and I will present Nextline's profile and the transaction itself below. At the end of December 2020, there were three more search funds operating in Poland:

1) MWI,
2) KCP,
3) Stability Capital.

MWI[5] is a fund operating in the search fund model, which was founded in 2019 by M. Wrzos and supported by a group of 15 investors from Poland, Germany, Spain, the UK, and the USA. The fund has a capital of up to EUR 10 million. The aim of MWI is to acquire 70–100% of the shares of just one medium-sized company based in Poland, which has a unique product or service, generates recurring revenue, and has a loyal group of customers. The key investments criteria are:

1) between PLN 4 million and PLN 10 million EBITDA results,
2) any industry, with a preference for specialized business services or niche production,
3) low need for capital expenditures and working capital investments,
4) the high share of recurring revenues and low customer concentration,
5) the company must not be at an early stage of development or in need of restructuring.

KCP[6] was founded in 2020 by M. Kołata. KCP's investors are a group of more than a dozen entrepreneurs, managers, and investors from Poland, Germany, Switzerland, the USA, Canada, and Spain, such as Istria Capital, Vonzeo Capital, or AI Global. Notably, Istria Capital was the first investment vehicle in the European Union to invest in search funds around the world. KCP's objective is to acquire, manage, and build the value of one selected company in Poland. KCP is looking for a financially stable company with operations in Poland, which:

1) has a clear competitive advantage and potential for growth,
2) has a diversified customer base and a high proportion of recurring revenues,

4 https://www.pb.pl/search-fund-rozwiazuje-problem-sukcesji-940544 (accessed: 12.11.2021).

5 https://mwi.com.pl/pl/index.html (accessed: 12.11.2021).

6 https://www.kcapital.pl/ (accessed: 12.11.2021).

3) operates in a prospective industry in terms of structural and demographic trends,
4) generates an EBITDA result of between PLN 3 million and PLN 16 million and an EBITDA margin of no less than 10%.

Stability Capital[7] was founded in 2020 by P. Malon and M. Jakubów. The fund was established at the end of 2020 and is currently looking for one company to acquire so that the founders of the fund will take over its management. The fund's investment criteria are:

1) business revenue scale of PLN 30 to 200 million,
2) operating profit of more than PLN 10 million,
3) operating profitability of more than 10%,
4) a growing industry with low cyclicality and high barriers to entry,
5) a business model incorporating recurring revenues from a stable group of clients and low capital expenditure.

We may expect further growth in the number of search funds in Poland to the increasing supply of family businesses potentially for sale due to a lack of succession and thanks to the growing awareness of the search fund model in Europe, which in turn translates into easier access to capital for Managers.

At this point, we should consider statistics of search funds activity around the world, which I present in Figure 2. A total of 533 search funds have been established since the start of this model until December 31, 2019 (2020 data yet unavailable), including 401 in the USA and Canada and 132 in non-US markets. As of December 31, 2019, 140 search funds were still in the process of finding a company to acquire, while 379 search funds had already closed. In the group of closed entities, 119 search funds have ceased operations without an investment, while 260 have bought a company. Of the 260 search funds that have made acquisitions, 146 of them are developing the company, 76 have made divestments with positive returns, and 38 of them have made divestments with negative returns.

The development of search funds in Poland and their status as of December 31, 2020, is presented in Table 1. Apart from Nextline, the three other search funds were in the process of searching for a company to acquire.

7 https://www.stability.pl/ (accessed: 12.11.2021).

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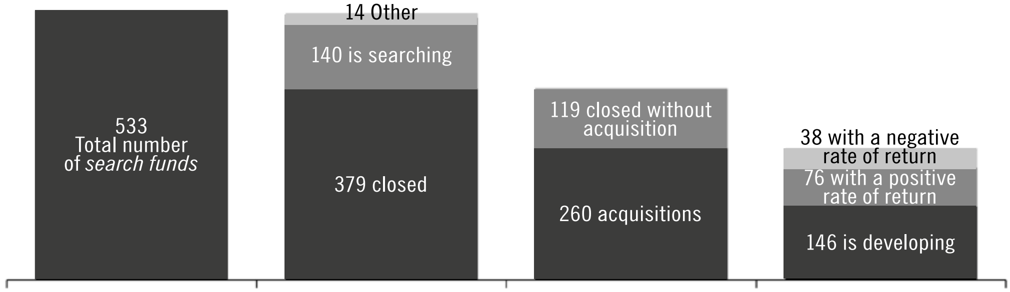
Figure 2. Search fund status globally as of December 31, 2019



Source: own elaboration based on Kelly and Heston (2020, p. 5), and Kolarova et al. (2020, p. 5).

Table 1. Search fund status in Poland as of December 31, 2020

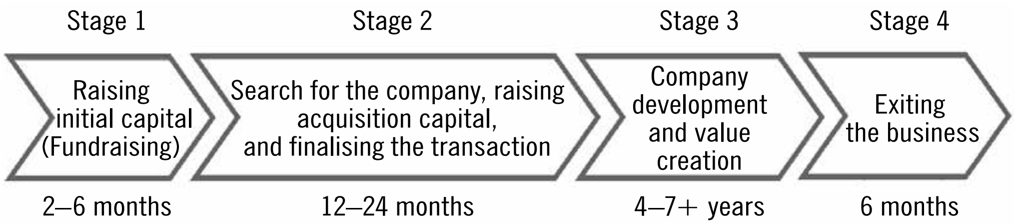
Search fund	Year of establishment	Status	Portfolio company
Nextline	2018	Develops the company	VFX Motion
MWI	2019	At the search stage	–
KCP	2020	At the search stage	–
Stability	2020	At the search stage	–

Source: own elaboration based on market analysis.

Search Funds' Investment Process

To understand the different statuses of search funds presented in Table 1 and Figure 2 – including non-acquisition closing, which is very rare among private equity funds – I will present the characteristic of search funds' investment process. As Figure 3 shows, the search fund investment process consists of several stages that begin with fundraising and end with the exit from the previously acquired business (Keil, 2021, p. 4).

Figure 3. Search fund investment process



Source: own elaboration based on Kelly et al. (2018, p. 3); Stanford Graduate School of Business (2013, p. 1).

The first stage is *fundraising*. Many search fund representatives, especially outside the USA, consider this to be the most difficult stage of the entire investment process (Kolarova *et al*., 2020, p. 28). First, capital is necessary for search funds in the process of searching for a company to be acquired (hereinafter: search capital). The search capital is used over a period of several months to several years to cover Managers' salaries, administrative costs associated with running the office, or costs of meeting with potential companies for acquisition. To begin the process of soliciting search fund investors, the Managers prepare a formal *private placement memorandum*, which is provided to potential investors to present the investment opportunity, and which is designed to interest potential investors in working with the Managers. This document typically contains several sections such as the summary of key information about the search fund, a description of the search fund model, a description of how to find a company to be acquired, and a profile of the potential company to be acquired, a detailed budget for the use of search capital, proposed forms of investment of the acquisition capital, a financial model showing potential returns on the investment, an outline of potential divestment methods, a summary of the search fund founders' personal experiences, and a breakdown of future responsibilities (Dodson *et al*., 2013, p. 3).

At this point, we should note that the Managers not only must present their experience and skills well, but they often must also convince investors to the search fund model in the first place. In this respect, there are significant differences between US and non-US markets. With more than 35 years of search fund activity in the USA and Canada, Managers have access to search-fund-focused investor databases, growing amounts of search-fund-focused institutional capital, and lists of successful search fund Managers. The above positively impacts the time required to raise search capital. In the US market, in 2018–2019 the median number of months that a search fund raised search capital was three.

In the non-US and Canadian markets, search fund Managers must contend with much more limited financial resources dedicated to this funding model, much less understanding of the search fund model, and differences between search fund and private equity among potential investors. For example, in India, one Manager decided to close his search fund without acquiring any company because he concluded that local investors only sought investment in the venture capital model (Kolarova *et al*., 2013, p. 11). The manager who raised the first search fund in Spain described that it took him over 11 months to raise capital, despite having a top-tier US MBA and having done a search fund internship in the USA (Kolarova *et al*., 2016, p. 19). Investors from the USA were unfamiliar with investing in Spain, so the Manager had to hold more than 100 meetings with local and international investors, albeit mostly with European

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ones. In many cases, the potential investors did not understand what for the search capital was needed and indicated that the Manager would already come back to them with a concrete investment proposal when he needed acquisition capital. Moreover, the potential investors did not understand how the search fund model differed from traditional private equity. This scenario was common among search fund Managers outside the USA and Canada, who described having to spend far more time convincing investors to the search fund model itself rather than convincing them of their qualifications and experience. The median number of months it took a search fund to raise search capital in a non-US market was five months in 2018–2019. However, in recent years there has been an increase in investors with a particular focus on search fund investments. Funds investing in search funds have emerged in recent years in Germany, Spain, and the UK, among other countries, making it easier for Managers to raise capital.

In practice, Managers typically need to draw on a wide network of potential investors to raise search capital. Often, the funds for this come from their resources and are raised from friends and family, colleagues, business school lecturers, owners, and managers of companies with whom they have previously worked, and individual and institutional investors. In return for the search capital, each investor receives:

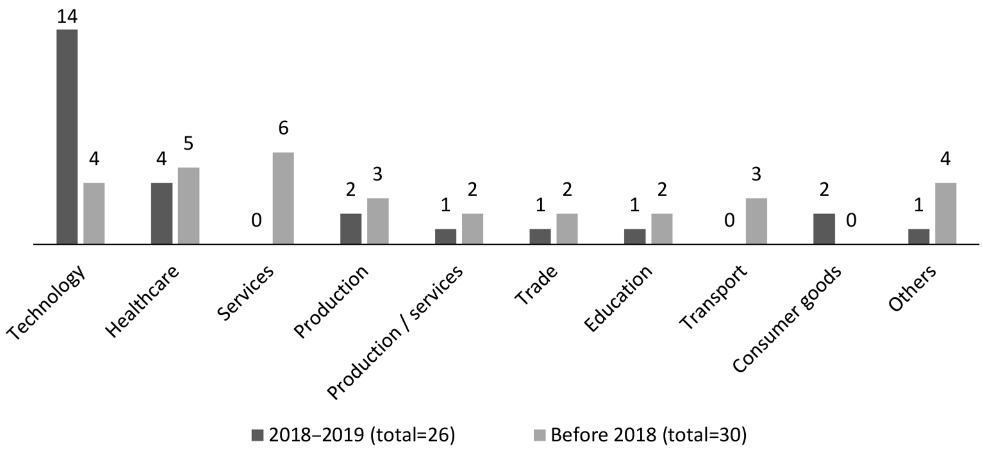
1) the right – but not the obligation – to partake in the search fund acquisition capital in proportion to the share invested in the search capital,
2) the conversion of search capital into acquisition capital.

Most Managers seek investors who can also serve as quality advisors. Ideal investors can offer expert guidance and advice on evaluating and executing deals, managing businesses, supporting entrepreneurs during the ups and downs of the search process, and helping them to identify companies to acquire. In many cases, investors are attracted not only by the potential financial returns from a search fund but also by the psychological benefits of engaging with a young entrepreneur.

Stage two is the *search for the company to be acquired, raising acquisition capital, and finalizing the transaction*. At this stage, the Managers must obtain financing to purchase the company (hereinafter: acquisition capital). Notably, compared to the first stage of the investment process, finding an acquisition target, and finalizing the transaction is typically more time-consuming, as it usually takes a median of 19 months. This duration is significantly influenced by the economic environment, industry characteristics, business owners' willingness to sell, and regulatory issues. European search funds indicate that it is much more difficult to find a suitable company in national European markets than in the USA due to the size of the latter economy and the number of business entities in local markets (Kolarova *et al.*, 2018, p. 29). A high level of involvement in the process of finding a company to acquire is extremely important. Unlike private equity funds, a search fund invests in only one company. Therefore, there is no question of portfolio risk diversification as in the case of private equity funds. Moreover, there are no cost or sales synergies that could help the acquired company grow rapidly as in the case of industry investors. To mitigate operational and investment risks, search funds tend to focus on companies with a stable market position with opportunities for further growth and with stable cash flows that will guarantee an adequate level of cash for business development and repayment of possible debt after the transaction (Center for Private Equity and Entrepreneurship, 2005, p. 4). A high diversification of customers and suppliers also adds to these guidelines. A key parameter for a search fund to select a company is the high level of recurring revenues too (Kelly *et al.*, 2013, pp. 16–17).

At this point, we should consider which industries are most interesting to search funds in non-American markets, which is also a reference point for the Polish market. As shown in Figure 4, the most popular in non-US markets is the technology industry. In 2018–2019, over 60% of search fund transactions happened in this market. Moreover, the first ever and – so far – the only search fund transaction on the Polish market happened in the technology sector, which I will describe in the following section of the article.

Figure 4. Main industries in which search funds invested outside the USA and Canada in 2018–2019 and before 2018



Source: own elaboration based on Kolarova et al. (2020, p. 10).

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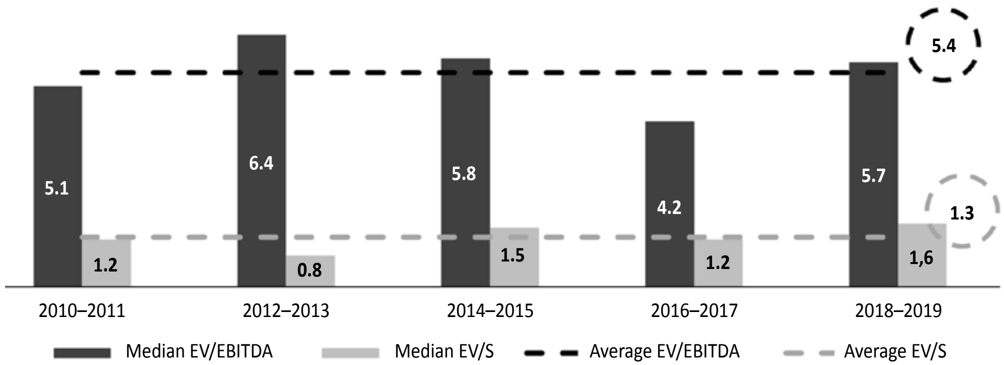
Notably, in 2018–2019 there were 26 search fund transactions outside the USA and Canada, while before 2018, there were only 30. This shows a significant growth of the search fund market in non-US countries in recent years.

A key issue from the perspective of both search funds and sellers considering a transaction with a search fund is the transaction valuation proposed by search funds. Based on the statistics of transactions conducted by search funds outside of the USA and Canada in the period of 2010–2019, we may conclude that the average median EV/EBITDA multiplier of search fund transactions in the analyzed period was 5.4, while the EV/S multiplier was 1.3, as presented in Figure 5. Notably, the value of EV/EBITDA multiplier was thus much lower than the average EV/EBITDA multiplier on the mergers and acquisitions (M&A) market in Poland in 2010–2020, which amounted to about 8.9. On the other hand, the value of EV/S multiplier was higher than the average EV/S multiplier on the M&A market in Poland in 2010–2020, which amounted to 1.0. However, the above conclusions greatly simplify the complicated image, as the data of the Polish market is compared with foreign markets due to the lack of proper statistical data concerning search fund transactions in Poland.

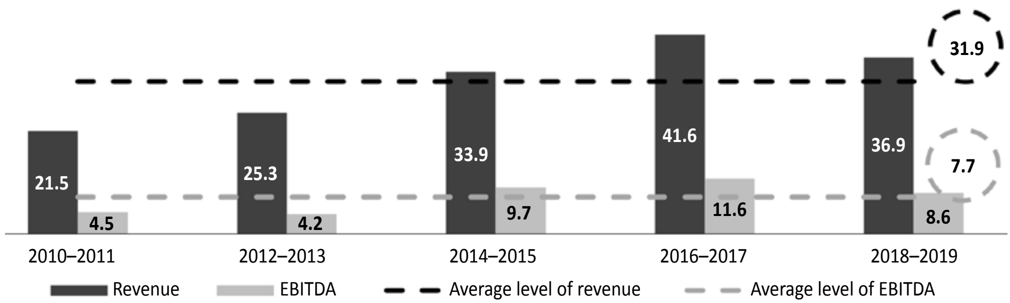
Figure 5. Median EV/EBITDA and EV/S multiples in M&A search fund transactions outside the USA and Canada from 2010 to 2019



Source: own elaboration based on Kolarova et al. (2020, p. 25).

However, the most used multiplier in transactional valuations is the EV/EBITDA multiplier, and at the level of this multiplier, we may notice value disproportions in the valuations of businesses by search funds and other investors. First, private equity and industry investors have much more experience in M&A transactions and can much more easily raise acquisition capital in the form of e.g. bank loans. Second, industry investors often have a better understanding of the growth prospects of a business and can pay a higher price due to, among other things, operational and cost synergies. The larger the company and the higher the expected valuation, the more likely it is to be sold through an auction process, in which price is the main parameter for investor selection and which makes it difficult for search funds to compete with private equity funds or industry investors (Stanford Graduate School of Business, 2013, p. 35). Third, search funds are ready to accept the lack of management professionalization, the absence of an extensive organizational structure, or the lack of experienced management staff. This factor also significantly affects the lower valuation of businesses due to the valuation of human capital in the company. Often, private equity funds and industry investors will not be interested at all in acquiring a company with the lack of human resources and gaps in the organizational structure. Finally, the lower valuations proposed by search funds result from the lower value of capital available to search funds compared to private equity or industry investors. Hence, the size criterion of the acquired company is insignificant for search funds. We should employ in this case two frequently used financial parameters: revenue and EBITDA. The average level of revenue and EBITDA of a company acquired by a search fund outside the USA and Canada is shown in Figure 6.

Figure 6. Average level of revenues and EBITDA of a company acquired by a search fund outside the USA and Canada in 2010-2019 (PLN million)



Source: own elaboration based on Kolarova et al. (2020, p. 25).

First, we should remember that the funds raised by search funds are typically insufficient for activities in billion-dollar deals. The average median revenue of companies acquired by search funds between 2010 and 2019 was USD 9.1m, while the EBITDA level was USD 2.2m. Considering the average USD/PLN exchange rates in the analyzed period, the above means that non-US search funds were interested in entities with revenues of approximately PLN 31.9m and PLN 7.7m EBITDA. However, we may conclude that search funds are interested mainly in small entities, while family businesses in Poland are mainly small and medium-sized enterprises.

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Once a target is identified, a search fund should take a number of subsequent steps to complete the transaction, including making an initial offer, company due diligence, arranging debt financing from third parties (e.g. banks) if the transaction will be debt co-financed, negotiating an acquisition capital structure with search fund investors, finalizing the acquisition capital structure including contributions from the Managers and investors, setting a closing date, and having the Managers take over management of the company. Once all the above steps are completed, the transaction is finalized. Notably, the seller may remain with the acquired company for some time, e.g. as an advisor to the Managers (Archer and Elkins, 2018, p. 5).

The third stage is *company development and value creation*. This is theoretically the longest stage of the entire investment process, which can take up to 10 years. Once the acquisition is completed, the Managers close the search fund and form a new management team in the acquired company. They also often move with their families to the vicinity of the acquired company's headquarters. During the first six to 18 months after the acquisition, the Managers usually do not make significant changes to the existing company but, instead, focus on getting to know its internal mechanisms and operational details. Only after gaining a thorough understanding of the company's day-to-day operations, the new management tries to introduce various types of optimizations. Typically, Managers create a growth strategy for the company by working toward revenue growth, improving operational efficiency, financial controlling, appropriate use of financial leverage, organic growth, growth through further acquisitions, investing in existing infrastructure, using existing international contacts to scale the business, professionalizing the management and organizational structure of the company, and professionalizing the finance departments. Once the growth strategy is successfully implemented and the company developed, the Managers can start the divestment process.

The final stage is to *exit the business*. Most search funds are established with the long-term perspective, generally longer than three years, and often even a ten-year-long perspective. Nevertheless, investors and Managers want to take profits at some point. Consequently, Managers should consider the range of divestment forms available. First, the entire business may be sold to an industry investor or financial investor. Second, the Managers may wish to buy out the investors' shares and become sole owners of the business. The company can also be floated on the stock exchange, in which e.g. only shares of investors will be sold in an IPO, while Managers will keep their stake. There are many possibilities, but Managers should have a concept for exiting the business already at the stage of preliminary talks with the prospective companies to be acquired. Notably, returns on search fund investments are typically high. Search funds have historically achieved an ROI of 2.8x and an IRR above 33% (Kolarova *et al.*, 2016, p. 9).

Search Funds Versus Other Types of Investors

As indicated above, Managers and search funds have a unique journey to follow from raising search capital to exiting the business. In presenting search funds, we should also highlight the characteristics of these entities that distinguish search funds from other groups of investors active in the M&A markets. These characteristics are presented in Table 2.

Table 2. Comparison of search fund to other investor groups

Area	Search fund	Industry investor	Private equity
Value creation	Increasing business value and operational improvement	Integration and synergies, including cost synergies	Financial engineering and strategic oversight
Focusing on	Development and value creation	Acquisition of assets and market share	Maximizing the rate of return
Investment horizon	Long-term (no specific date for exiting the business, but up to about 10 years)	Varies	3–5 years
Source of financing	Individual and institutional investors specializing in small and medium-sized business development	Own and public funds	Institutional investors
Commitment	The only investment: full commitment to business management	One of many business units	One of many portfolio companies
Business management	Directly by the founders of the search fund	Expected management in the target company and their staying in the business after the transaction or recruitment of external managers	Expected management in the target company and their staying in the business after the transaction or recruitment of external managers
Transaction structure	Flexible depending on owner's expectations (100% preferred)	Structure for hedging investor risk and future activity	Dependent on fund structure and leverage
Time factor	Focusing on closing a single transaction as quickly as possible	Necessary approval of investment committees and boards of directors	Resources involved in multiple transactions and necessary to obtain investment committee approval

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Employee retention	Critical aspect of business development strategy	Varies	Varies
Keep brand/ company operating	Yes	It depends	Yes
Owner's role after the sale	Flexible: can be an advisor to managers or full exit	Same or none	Same with increased accountability and reporting requirements

Source: own elaboration based on https://www.hahnbeck.com/blog/2017/7/12/what-is-a-search-fund and own analyses.

The family business owner who is considering a search fund as a potential investor in their business should note a few specific characteristics that significantly distinguish search funds from other investors that make search funds even more actively seek out family businesses. These characteristics are:

1) Further development of the business directly by the owner: Managers become owners of the acquired business. It is their only business and their only job. Therefore, Managers are highly motivated to keep the business stable after the acquisition and grow it in the future. This may comfort the seller that after the transaction, their business will not be a small part of a large corporation but will be the most important business for the new owners. The managers will be both owners and key managers of the acquired company, which is often consistent with the situation in family businesses, in which the owner is also the main manager.
2) Management takeover by Managers after the transaction: the Managers usually move to a location close to the business so as to actively manage the company on a daily basis. This allows for the previous owner to exit the business and means that the search fund has no expectations of a professionalized business management and an extensive organizational structure prior to the transaction. The professionalization and operational optimization measures will be implemented by the Managers after the transaction in preparation for the company for the subsequent divestment.
3) Interest in acquiring 100% of the business: as a rule, a search fund acquires 100% of the business, so it allows owners a one-step exit from the business.
4) Creating value: a search fund builds business value not only by improving financial performance and investment but also by professionalizing internal processes, developing human capital, and other activities that develop the company organization.
5) Employee retention: family business owners are often members of the local community, which in turn is often the main workforce in the family business.

For family business owners, it is very often extremely important that employees keep their jobs after the transaction. For the search fund Managers, it is also extremely important to retain employees after the transaction and to grow the business together with them.

6) Brand maintenance: from the perspective of a family business owner who has built a brand over many years, it is often very important to maintain the brand after the sale of the business. For a search fund, brand recognition is also often very important in order to further develop the business, namely building on its existing recognition and increasing it further.

Based on the above analyses, we may conclude that search funds are a type of investor that is not only able to accept the specific characteristics of family businesses but even actively seek them out. Moreover, search funds as investors can meet a number of expectations of a family business owner who wants to sell the business due to the lack of succession possibilities. As a result, the sale of a family business to a search fund can be classified as a theoretically viable form of divestment for family business owners facing a lack of succession.

Case Study: Family Business MotionVFX Sale to the Nextline Search Fund

As indicated in the previous section, the first search funds were created to address the lack of family succession in the USA in the 1980s. However, the first search fund in Poland was only established in 2018, and the first search fund transaction did not happen in Poland until 2020, when a search fund called Nextline acquired MotionVFX. Until the preparation of this article in mid-August 2022, this transaction remained the only search fund transaction in Poland. Keeping that in mind, I analyzed this transaction using publicly available data and an interview with Nextline. According to the information I obtained, MotionVFX was a family-owned business. Therefore, the following section will present this transaction as an example in the case study of a family business sale to a search fund in order to prove it a viable form of divestment, which was previously never mentioned in the literature on the Polish market.

MotionVFX's Profile

MotionVFX is a company that develops plugins and templates for Apple macOS video editing software. As reported by Mergermarket in June 2020, the company was founded in 2010 and had been generating approximately USD 5 million in revenue with high

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EBITDA margins in recent years. The company had 26 employees and was 100% owned by Szymon Masiak. The owner's wife also worked in the company, so MotionVFX was classified as a family business. In 2020, MotionVFX began seeking an investor.

Nextline Profile

Nextline was founded by Andrzej Basiukiewicz and Wojciech Korpal in 2018. Nextline was interested in acquiring a financially stable company in the manufacturing or B2B (business-to-business) services industry. The profile of the ideal company described by Nextline included the following parameters:

1) a company whose owner is looking to exit the business and/or step away from day-to-day responsibilities,
2) a company operating in a growing and profitable industry with little struggle between competitors, with preferred industries being advanced manufacturing of industrial or consumer goods, B2B services, or specialized niche technologies,
3) leading position on the market, diversification of clients, possibilities for further development,
4) from PLN 20 to 100 million revenue and from PLN 6 to 12 million EBITDA.

Transaction Details

Information that MotionVFX was looking for an investor appeared on Mergermarket in June 2020. The seller's advisor was an investment bank specializing in M&A transactions. Thus, the information about the possible acquisition of MotionVFX reached a wide range of investors.

In December 2020, MotionVFX was acquired by Nextline from its current owner. This means that Nextline had been looking for a company to be acquired for almost three years, since the beginning of 2018. The value and terms of the transaction were not disclosed. The most important aspect of this transaction – from this article's perspective – is that the previous owner's expectations fitted perfectly with the search fund's approach: the owner of a family firm wanted to sell the business and immediately withdraw from active management of the company, which was problematic for other investor groups. As a search fund, Nextline was able to meet those expectations.

Interview with Nextline

With the permission of Nextline's founders, below I indicate some additional information about their business and transactions that are otherwise publicly unavailable:

1) Nextline's capital-raising process took approximately three months;
2) the initial investors were previous employers of Nextline's founders, and in the final group of investors, about one-third of all investors came from Poland, another one-third from European investors – mainly Germany and Spain – and the same proportion from the USA;
3) in December 2020, Nextline invested in MotionVFX by acquiring the organized part of the company from the company's founder. The founder's expectations fitted perfectly with the search fund approach as the owner wanted to sell the business and immediately withdraw from active management of the company, which was problematic for private equity funds;
4) search funds generally seek family companies in which the founder/owner's low management skills make it difficult to grow the business, so the owner's withdrawal and gaining control by the search fund can unlock the business's growth potential;
5) Nextline's founders' experiences in interviewing family business owners were consistent with theoretical studies regarding the lack of succession:
    a. for family business owners, entering conversations about selling their business was an extremely difficult and emotional task,
    b. there was a noticeable greater openness to discussing the sale among the children of the founders who were involved in the business,
    c. the owner of the family business was usually in control of the entire business, and the children involved in the business were often not independent, meaning decisions were made by the seniors,
    d. family businesses are often a reflection of the personality and character of the business owner/founder.

The characteristics of search funds presented in this chapter and the case study confirmed that a form of divestment previously unmentioned in the literature about the Polish market – the sale of a family business to a search fund – is possible in practice.

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Conclusion

Undoubtedly, family businesses hugely impact the Polish economy. They are responsible for about 40% of the Polish GDP and provide over 3 million workplaces. There are about 1.7 million such entities, and only 8.1% of these companies have a successor from the family circle. Considering the importance of family businesses for the Polish economy and the massive problem with succession, it is extremely important to know and understand all possible forms of divestment of a family business owner in the face of the lack of succession.

The characteristics of search funds presented in the second section, allow us to conclude that – theoretically – search funds are made for the Polish family businesses that face the lack of family succession. In turn, the above case study example – in which the first and only search fund transaction in Poland in 2020 consisted of the acquisition of a family business – further confirms in practice that search funds should be classified as a group of investors interested in Polish family businesses and that the sale of a family business to a search fund should be permanently included in the catalog of possible forms of divestment of a family business owner who faces no succession possibilities. This information is important both for owners of family businesses and researchers who deal with family businesses, succession matters, or capital market issues.

Therefore, this article has provided owners of family businesses in Poland information about a new practical method of divestment, namely company sale to a search fund. As described in section 2.3, a search fund may be a more attractive investor for a family business compared to an industry investor or a private equity fund.

Second, the research has supplemented the literature on family businesses and succession processes in Poland. This article is the first to raise the issue of search funds in Poland, and one that connects the growing search fund market with the issue of succession in Poland. Therefore, the study can serve as the basis for further study by researchers dealing with family businesses or search fund issues, e.g. by further analyzing search fund transactions in Poland as this market develops.

Moreover, the above analyses have shown that search funds offer significantly lower transaction valuations based on the most popular EV/EBITDA multiplier compared to the average levels of this multiplier on the market. On the other hand, this group of investors accepts certain parameters of the target company, which are not accepted by other investor groups, e.g. the lack of professional management. Search funds are simultaneously interested in acquiring 100% of a selected business, by which search fund Managers become owners of the acquired company so that it becomes their only job and business that they seek to develop. This provides comfort to the seller that – after the transaction – their business will not become a small part of a large corporation or competitor, but instead, it will be the most important business for the new owners.

Nevertheless, the research has certain limitations, especially the fact that the case study was based on a single example and data from abroad for comparison. However, I believe that the conducted study was sufficient to achieve the purpose of the article, and future analyses could be continued.

Although the search fund market in Poland is still young and small, given the scale of the issue of the lack of succession in Poland, the market has significant potential for further growth. From the perspective of further research on the search fund market in Poland, it seems interesting to conduct analyses similar to those made by foreign authors, which would focus on the number of search funds in Poland, their sources of financing, and sectors in which they invest, including from the perspective of acquisitions of family businesses, transaction valuations, and implemented forms of divestments in the future.

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