

Over the past month, I've been looking for a digital business to buy and run. Here are some things I've learned.

1. Self-funded vs traditional

There are two kinds of searches: self funded and traditional. Both camps kinda don't like each other, just like anything humans do that have a teeny tiny difference between them.

Self funded is when the searcher pays for search costs (living expenses, diligence, etc.) on their own. Typically, it's funded with a combination of the searchers own capital, an SBA 7(a) loan and additional equity partners. The thing that makes this interesting is the SBA loan. You can finance up to 90% of a transaction (<\$10m) with a 6% interest rate loan if the business has the right cash flow profile. Searches often grant preferred equity to outside investors and end up owning a majority of the common shares. However, structures vary greatly in this model.

Traditional search funds are when the searcher raises around half a million dollars and spends two to three years searching for an opportunity, using the capital to pay for search expenses. The investors who provide that capital have pro-rata rights to invest in the deal. Oftentimes traditional searches are looking for larger deals than self funded searchers. They are financed primarily with equity rather than debt. Capital is sourced through high net worth individuals and funds that explicitly invest in this asset class. Oftentimes traditional searchers are former MBAs (this model was popularized at Stanford GSB). Investors are often also mentors: typically they either are industry experts or have already gone through the traditional search fund model. Searchers often own 30% of the common shares at the end of the deal.

The former has more flexibility, the latter has more stability & security.

The kinds of things you look for are very different. In the self funded, it's more of 'don't screw it up' while the traditional model is looking for growth. This matches the capital structure of each. Self funded is levered, traditional is not.

Big money can be made from both models.

2. The bottleneck is finding a company, and metrics should be optimized around talking to entrepreneurs

There are three categories of people I've been talking to: lenders, equity investors, and entrepreneurs.

Lenders are picky — I talked to several who don't touch anything that doesn't involve hard assets. However, I've spoken with one who does underwriting for digital companies, and my personal financial profile doesn't set off any red flags for him. Basically, the debt capital is on standby for the right deal.

Equity investors aren't hard to come by. I've spoken with several high net worth individuals who might put money in. I've also spoken with a few funds who would be interested. In any environment, capital tends to flow to good deals. In a 0% interest rate environment, capital tends to beg for good deals.

Which leads me to the entrepreneur bucket. There are lots of ways to find people selling their company. There are at least a dozen online business brokers that have deals I'm interested in looking at. These are good because the entrepreneur already wants to sell, which is often the hardest part.

Developing proprietary sourcing through cold outreach is a good idea, but takes a lot more work. I've done a bit of this, but the hit rate is very low.

Regardless of how I find deals, the quantity and quality of conversations with owners is the metric I need to be optimizing. There's the obvious reason I'm optimizing around this: I'll have more options to evaluate. And then there's the less obvious reason that you get calibrated a lot better after seriously taking a look at more deals.

I've looked at hundreds of companies already, have spoken with maybe 8-10 and have come pretty close to submitting an offer on two. But I still haven't gotten an LOI signed.

"How to be a good investor in any asset class: evaluate 100 deals. After that, the winners will be obvious." - Unknown

3. There are two categories of consideration: investment and personal

Searching to buy and run a business is a lot of fun because you get to exercise both your investment brain and your operating brain. Most other jobs make you pick between one or the other.

However, the downside is that the deal has to fit even more criteria.

First, it has to be a good investment. Which is no easy feat in the lower middle market. While every business I'm looking at is cash flow positive, the reliability of those cash flows varies a lot. There are lots of businesses that have platform risk (ie a significant / all of their revenue attributed to Google traffic or Amazon searches). There are other businesses with customers that churn or where the product needs a lot of work. Or other ones that are just barely holding on because the market they chose is small enough to not attract any competition.

And while pretty much every lower middle market deal has hair on it, there are certainly some good ones out there. It's just a matter of getting in front of enough quality companies.

Then there's the personal side. Not only does the deal have to be a good investment, but it also has to match up with me as an operator. Do the needs of the business match my skill set? Is it in an industry that I could be interested in for the next three, five, seven years? What do I want my day to day to look like? Does it meet my financial goals? Does it require 60 hours a week from me to grow, or only 20 hours a week?

I'm buying a job, and so it matters that all these personal questions get answered too. At the beginning, I had a pretty wide investment criteria. Slowly, that is getting narrower and narrower.

4. Feelings fluctuate, but the north star doesn't

I would be lying if I told you I didn't have lots of personal anxiety about this process. It's especially easy to feel imposter syndrome. I've only had a few years of operating experience and I don't have that much capital. Who am I to tell a 41 year old entrepreneur that I can run their business better than them?

There's also the undeniable feeling that this is a cop out. I feel this way because most other people become wealthy through other paths. Either they start their own company, work as an investor or have a high enough salary at a BigCo. Do I really want to skip "the hard part" where I have to rough it as a founder without income and search for product-market fit?

Additionally, there's the identity issue. I wouldn't want to think of myself as a finance person. A lot of finance people are squares. They are risk averse and not creative. It would destroy my ego to think of myself as those things. But pursuing a business acquisition isn't about my ego and identity. It's about making money so that I can spend time on things that I care about (that may or may not make money).

I've learned that it's not necessarily good to have my work fulfill my identity. In fact, I'm beginning to think that I'm much happier when work is about making money, and not work is about having fun with the homies. All of this 'follow your passion' and 'creator economy' stuff kinda sucks, honestly.

Throughout the process, I must remember that even though my feelings fluctuate a lot, almost all of the things that actually matter don't fluctuate. I'm doing this primarily to achieve financial independence with low risk. An established business — even a small one — has already gotten over the biggest challenge it's probably ever going to face. Plus, I can take capital out of the business from day one. It's lower risk all around.

Basically, as long as 1) multiples don't get out of hand, and 2) I can still raise the capital, my feelings shouldn't impact my actions.

5. Try to sign a deal this month. If you can't, reevaluate

This is just advice to myself.

I've been at this search for about four weeks now (with a few days off as I was running around Texas during that storm). The plan is to try and sign an LOI sometime in March. Hit it hard and fish out as many quality deals as I can.

A strange thing about this model is that the worst outcome isn't not finding a deal, but rather investing in a bad deal. Not investing at all is a mediocre outcome, but it comes with a lot of learning and just a couple months expenses for costs. But investing in a deal that stays flat (or, God forbid, drops in value) hurts capital partners and also burns a few prime earning years of my career.

With all these boxes to check, I could be searching for a deal for months or years. I don't want to be doing that because I'm going to run out of money. At some point if I don't find something, I should change course. And so I'm giving myself to April to find a company to buy and run. If I don't sign one by then, I'll change my plans to start a company, get a real job again, or go for one more month.