Entrepreneurship Through Acquisition – An Innovative Solution to Value Creation

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Novastone Capital Advisors in Switzerland has devised a program designed to help firms find a solution to the age-old problem of succession. IMAP Hungary talks to Christian Malek, Co-CEO & Managing Partner of Novastone Capital Advisors and CEO of Novastone Capital Single-Family Office, to find out more about the program's origins and how it works, as well as one of its candidates, Viktor Dimitrov, a former IMAP Hungary colleague at Oriens.

The challenge of finding a successor in the SME sector is a well-known issue globally. Novastone Capital Advisors connects talented entrepreneurs, investors, and SMEs within the framework of its *Entrepreneurship Through Acquisition* program. Program participants search for and buy an SME, and then become its CEO to operate and grow the company, not only solving succession issues while protecting the capital of investors, but also ensuring continuity and value creation following the acquisition.

What is Novastone Capital and Novastone Capital Advisors?

Novastone Capital is a single-family office, based in Switzerland. Novastone Capital Advisors ("NCA") was founded by a group of entrepreneurs from the family office community, led by Christian Malek, CEO of Novastone Capital, to initiate and manage the *Entrepreneurship Through Acquisition* program, on behalf of Novastone Capital and its program members. Program members include European single-family offices and entrepreneurs who sponsor the program participants. Think of it as a real-life post-corporate career MBA, where highly talented executives-to-be with entrepreneurial ambitions are given the framework and support to acquire and operate a private company.

The members help the executives-to-be in three stages: during the search for an SME, with financing for the acquisition and then in pro-actively growing the company. As the participants are 100% dedicated to the program, they are supported with a stipend to cover living expenses. Program members may also help make introductions to potential targets, as well as pay for training and program resources to help participants in their search. In Viktor Dimitrov's case, for example, this meant providing databases and networks specific to Hungary's SME space.

You work with the Search Fund asset class. Can you explain more about these funds and how this led to the concept of the Entrepreneurship Through Acquisition program?

A Search Fund is a process in which a group of investors back a talented individual to search, buy, grow and exit a company. The companies chosen are typically those facing a succession issue. Search Funds have existed as an asset class since the early 1980s and independent research from Stanford shows they have average Internal Rate of Return above 30%.

As CEO of Novastone Capital, we invested in our first Search Fund in 2013. It was one of the first Latin-American Search Funds launched and a highly successful investment. Following the exit, we became a Limited Partner (LP) of a Fund-of-Search Funds launched by one of the initial investment's co-investors.

Novastone Capital did in fact, previously endorse and fund a candidate to research a company to acquire, buy and run, yet our experience with Search Funds has been that sharing an investment where no one person has control and the process is collaborative and centralised through a program is the best approach and yields the best results.

Furthermore, I was also fortunate enough to meet a top-tier professional who opened my eyes. He believed the traditional approach of launching a Search Fund himself, and knocking on 12-15 different investors' doors raising 35-40 thousand Euros at a time, was not the solution. I agreed and it prompted me to devise and run an in-house program for Search Fund investing for single-family offices. Following the completion of my Executive-MBA at INSEAD in Lausanne, I launched the program, which reduces the inefficiencies of the traditional model without compromising the expected return.

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Which geographies do you cover and do you have plans to expand?

We currently operate in two regions; Europe and North America. We started with Switzerland and Germany

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and the European program has expanded to include Italy, Spain, and the UK, as well as Central and Eastern European countries such as Hungary and Poland. We expect to expand the program to France, the Nordic and Benelux countries later this year.

The European program has the capacity to take-on 12-15 participants a year. However, quality comes first; one year we might find 7, the next, we could find 20. Quality is what makes the difference and makes everything work: candidates able to attract the sponsors and convince the business owner that they are the right person to take over. There is no room for error, which is why our selection process is so rigorous. Our North American program is also live where we have our first female participant and we hope to launch in Canada very soon.

What are you looking for in an entrepreneur?

Selecting the candidates is a very challenging process. There are basic attributes such as character, being hard-working and being able to take on responsibility, that are a must. The ideal candidate would normally have a good educational background, operational experience, i.e., be running a company in a high/general manager position, and have entrepreneurial experience. In fact, many of our candidates have already co-launched a company.

The program is about trying to make a change, creating value and writing your own company story. It is not for everyone, which is why we spend a great deal of time and care selecting the participants.

Though entrepreneurs and situations differ case by case, which type of companies do your entrepreneurs look for?

In general, we have two types of candidates: those who have moved from one industry to another and are therefore, focusing on companies in 3-4 industries and others specializing in a single vertical.

The program itself is quite industry agnostic. It can work with either type of candidate. However, there are several elements in the target industry that we generally want to see. First, we want to make sure there are sufficient companies in the chosen industry. Sometimes we have a candidate who wants to buy

a hotel or a luxury brand and there are only 20-100 targets, which will not work. We want industries where there is a pool of hundreds, if not thousands of companies to search through.

Second, we favour industries that are not too capital intensive, have limited cyclicality and are growing. Of course, when it comes to the balance sheets, they should be healthy and profitable, but otherwise we are flexible.

Third, we prefer industries within geographies known to the program participant. For example, Viktor was the standout candidate during his assessment period. As his industry knowledge and expertise is focused on Hungary, we have a participant in Hungary!

Finally, candidates will usually try to solve succession issues, because it is a mandate of the program. We particularly favour companies where, within the owner's family there is no successor; where the controlling shareholder does not want to sell to a competitor or a private equity investment fund; and where there is a personal connection between the retiree and the incoming executive. As succession is a big issue in our economy, the program is not only making a dream come true for these entrepreneurs-to-be, but also solving an issue for society. As the selection process is very strict, these business owners know, that when someone representing the program is knocking at the door, that individual comes with accreditation and quality and is sponsored by the program members with capital to follow-through on the closing of the acquisition.

Where would you like to see the program 10 years from now?

Ideally, we will become a global program. After consolidating our operations in Europe and North America, the plan is to expand to emerging markets, with regional programs. Currently we have two in mind, one in Latin-America and the other in India. There are also other developed markets where this issue is quite important: Japan and Australia. Australia is a bit easier to access, as it is a smaller market and English is the national language. In Japan you definitely want to find an open partner, as cultural issues and differences are quite relevant.

Why emerging markets? We want to be able to support executive talents who have the skills to become entrepreneurs but have not had the means to acquire the right level of education or expertise. One of my personal dreams, for example, would be India and to be able to partner up with a local entrepreneurial family office and develop the partnership into what we are currently creating with top business schools in Europe. Furthermore, being able to offer scholarships through an education program to very talented individuals who do not have the financial wherewithal to enrol into a Executive/MBA program at a top business school and then segue them into our program.

What is your aspiration from a financial perspective? Are your expectations the same as those of a private equity?

It is very different. The motivation driving the performance of the asset class is business savviness and entrepreneurial thinking and acting. Our program is about giving entrepreneurs the opportunity to be successful, to create value. That is why we are different from the conventional private equity approach of doing deals, where overall it is more about financial engineering, trying to squeeze as much as possible out of the target company to increase shareholder return at the private equity capital provider level.

The compensation structure is also very different. The purpose of the program is to sponsor the participants to find companies and create value at the acquired company. Return-on-investment follows if and when value is created and this financial reward is shared and divided between shareholders of the exited company, the CEO who led the company on behalf of the equity backers from our program membership base, and NCA's professionals. This allows us to continuously fund the program and access and support talent within the program on a long-term basis. So, it sounds, feels and smells quite different from a private equity fund.

You selected Viktor, our former colleague to cover CEE. What potential did you see in him?
Almost a year before he applied, he connected with us to understand the program and find out what it was about. I had the opportunity to meet him and found him to be a very nice, well-rounded professional, so I encouraged him to apply. He went through the entire selection process, which usually takes 3 months, and he was selected. I was very happy for him and think he will be a great participant, and a great CEO once he finds a company. His experience is very diverse, he has operational experience, private equity and M&A experience and international experience. He has a good education, is a hard worker, trustworthy, and highly committed to find a company. So far, he is one of the fastest participants to have attracted sponsors from our membership base.

How is the program built and structured?
We are a turn-key operation and cover the entire SME private equity investing value-chain. Novastone Capital Advisors in a way may resemble a factory set-up: we have specialized teams managing the different processes. We have a team dedicated solely to the whole selection process: to attract, select, evaluate and admit participants. The candidate's journey then begins with preparing the personal business case, presenting it to the potential sponsors from our members, and if you will, raising their own money for the project. There is a lot of training provided throughout: for example, M&A training, or how to smartly use databases and so on. When candidates start scouting for potential acquisition targets we remain in constant contact.

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Then the due diligence and acquisition processes follow. Our Value Creation Team helps the participants to create value within the acquired company. There is also a team that manages all the program members: introductions and interviews and who reports regularly on over-all progress of the program's pool of newly endorsed candidates as executives-to-be and finally, informs them on their proprietary investment portfolios. It is a structure that took a lot of work to build, but it is exciting and rewarding to me that everyone involved becomes immediately very passionate. We are able to build on an amazing team spirit and support from our single-family office program members.

What is the Value Creation Team's role?
Its main objectives are to make sure that each company does not suffer from the change of hands, that we protect the capital of our sponsors, and that the potential of each company is maximised. The team brings top-down best practices from the SME sector to guide the candidate. It also works bottom-up to look at which courses of action the candidates as CEOs would want to implement when at the helm, from accounting, growth implementation methodologies and digitalisation, to initiating organic or add-on synergies. Additionally, it also tries to maximise the support that every portfolio company should secure from its investor Cap Table. Every company normally has around 12-15 equity entrepreneurs invested, so possibilities of market expansion and other growth initiatives can be uncovered, funded and realized. The specialist teams at Novastone Capital Advisors provide and work with a setup that aims to ensure continuity at the target company level. Our program-endorsed, incoming CEO is essential and a key value-add in that regard. ■