

The University of Pennsylvania  
The Wharton School  
Management Department

# Venture Capital and Entrepreneurial Management

MGMT 804 - Q4 Spring 2008

SUBJECT TO CHANGE

ALL CLASSES ARE ON TUESDAYS FROM 12:00-3:00PM

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## Course Overview and Design

This elective course focuses on venture capital management issues in the context of a high-growth potential start-up company. The course is motivated by rapid increases in both the supply of and demand for private equity over the past two decades. On the supply side, the amount of private equity under management has increased from under \$5 billion in 1980 to over \$400 billion –for venture capital and buyouts --at the beginning of 2005.<sup>1</sup> The downturn in private equity fundraising and investment activity that occurred following the burst of the technology bubble in 2002 has largely reversed with an emphasis towards deal of more maturity. These trends are, of course, good news and bad news for entrepreneurs -- capital is plentiful but highly selective for earlier stage companies. Moreover, as many other post-industrial societies and emerging markets witness a dramatic resurgence of entrepreneurship, the supply side of the equation is growing to meet the demand side..

The course addresses this topic from two distinct perspectives: issues that relate to the demand for private equity and venture capital (the entrepreneur's perspective) on the one hand, and issues that relate to the supply of capital (the investor's perspective) on the other. As well, we will address management issues that relate to how the VC and the entrepreneur work together once an investment has been made.

"The Entrepreneur's Perspective" deals with the entrepreneur's challenge to understand the financial implications of the business plan including its business model, development and marketing strategy, and capitalization plans. Moreover, this point of view describes the basis on which entrepreneurs must understand the context and mechanics of valuing the business. Together, these matters help define the financing requirements of the business and suggest the approach for where and how to raise capital, and thereafter manage the relationship with investors.

The second point of view is "The Venture Capitalist's Perspective." This perspective explores the context of the private equity asset classes and how the history and current environment of the asset class affects the decision-making process and behavior of venture capital professionals. Insights gained from this underlying theme will be valuable for students considering a future in venture capital, as well as provide essential knowledge for those who wish to pursue an entrepreneurial career. As we explore the venture capitalist's perspective, we will address several aspects of the investment process, including the term sheet content, structure, and negotiation, valuation methods, and the impact of successive rounds of financing. The nature

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and tenor of this aforesaid process sets the stage for the relationship between management and investors, the governance of the company, and the management of the exit process.

The course is fundamentally pragmatic in its orientation and will attempt to expose students to both perspectives simultaneously. It will cover six principal areas relevant to the privately held high-growth-potential start-up. These include:

- Commentary on the venture capital industry generally, as well as a discussion of the typical venture partnership structure, management objectives and investment strategies
- Common organizational issues encountered in the formation of a venture-backed start-up, including issues relating to initial capitalization, intellectual property and early stage equity arrangements
- Valuation methodologies that form the basis of the negotiation between the entrepreneur and the venture capitalist in anticipation of a venture investment. Managerial and financial issues in an insider-led, “down round” financing
- The challenges of fundraising, financing strategies and the importance of the business plan and presentation
- Typical investment terms found in the term sheet and the dynamics of negotiation between the entrepreneur and the venture capitalist
- Corporate governance in the context of a venture-backed start-up company and the typical dynamics that play out between VCs and entrepreneurs in the ongoing management of the venture backed company.

The course is designed principally to address the interests of students who either expect to embark on an entrepreneurial career, those who expect to assume a managerial role with a venture-backed start-up company, or students who wish to pursue a career in venture capital. The course will touch upon a range of fields including management, finance, accounting, strategy, and legal and attempt to identify mainstream “best practices” in the area of high growth potential start-ups, with the objective of ensuring that students completing the course will have a solid understanding of the questions and issues that face the typical start-up.

### **Other course features and resources**

There will be a dedicated Web Care for our course. Lecture notes along with periodic announcements will be posted on this site.

As well, I seek your feedback on an ongoing basis. During the first class meeting, I expect the class to elect 2-3 students who will communicate frequently with the instructor - providing feedback and suggestions as part of the Quality Circles program at the School.

### **Students Requirements and Evaluation**

The assigned readings in the course are in the range of moderate to heavy, particularly at the beginning of the course. This syllabus, the assignments, and the Bulkpack have been organized so that students can manage the requirements efficiently. As in all courses, the lectures and discussions in the classroom will be much more meaningful if the required readings have been studied in advance. From time to time, mid-course changes in presentations or materials may be made to achieve academic objectives.

The Bulkpack is divided into two components: Required Readings and Supplemental Materials. The Required Readings are generally comprised of secondary source materials provided for background. The Supplemental Materials consist of examples of legal or business documents included for the purpose of illustrating the themes discussed in class.

The course is primarily in a term “simulation” and discussion format, supplemented by lectures. For each class there will be a submission of a portion of the simulation. During the class, two student teams will present their analysis and conclusions for the relevant portion of the simulation – one from the VC point of view, the other from the entrepreneurial point of view. It is expected that all students come to class fully prepared: namely, having read the assigned readings for the session and fully ready to respond to the questions outlined in the simulation.

Depending on enrollment Students are asked to form simulation teams of **four to six** members at the beginning of the course. Choose your team-mates carefully – changes will not be allowed once your study group team has been formed. Study groups are expected to meet and develop each part of the simulation. .

**Note: the deadline for the formation of study groups is by:**

**Thursday, March 19, 2009**

All students are expected to participate in class discussions; Students should expect to be cold called.

### **Student Grades**

The Wharton grading practices will be used. The final course grade will be computed as follows:

- Four simulation memo submissions (teams) (40%)
- Emerging market case memo submission (10%)
- Team presentation of assigned portion of simulation or emerging market case (10%)
- Class contribution (10%)
- Quiz, open notes/open book (30%)

**Note: The instructor will take great care to grade as fairly as possible and will strictly adhere to Wharton MBA program grading policies. Grades will NOT be discussed at the end of the course.**

### **Lecture Notes**

PDF files with the PowerPoint slides used in class will be posted onto the Web Cafe prior to class.

### **Required Texts**

Course Bulk-pack: MGMT 804 Venture Capital and Entrepreneurial Management, Spring 2009 edition, compiled by Raffi Amit and Steve Sammut

### **Class Cancellation and Make-up Days:**

In the unlikely event that a class must be canceled, students will be contacted by e-mail. Generally, if a make-up class can be scheduled, it will be held on the preceding or following Friday in the AM. Make-up classes will be video recorded and posted.

### **Communicating with the Instructor**

The best way to contact me is by e-mail. If you want to see me in person you I keep an appointment sheet outside my office at on the fourth floor of Vance Hall. Office hours are generally on Mondays from 10:30 to 1:00 PM, or by special appointment. The instructor prides himself in availability to students and welcomes opportunities to get to know students.

If for any reason you are unable to attend class, please notify me in advance.

**Please bring your name card to each class.**

## About the instructor

Mr. Sammut is Senior Fellow, Wharton Health Care Systems and Entrepreneurship, and Venture Partner, Burrill & Company, a San Francisco based life science venture capital fund and merchant bank. At Burrill & Company, Mr. Sammut focuses on Asian and Middle Eastern venture activity, with a special focus on global health venturing.

At the Wharton School, (and periodically in the University of Pennsylvania School of Applied Science and Engineering, School of Law and School of Medicine), he teaches venture capital management, corporate development, mergers and acquisitions, biotechnology entrepreneurship, intellectual property strategy, and private equity in emerging markets, and a special seminar on private sector participation in international health. He works actively with a student-alumni organization called the Wharton Health International Volunteer Program that provides *pro bono* consulting services to public health services and clinics in the developing world.

Mr. Sammut is also Founder and Chair of the International Institute for Biotechnology Entrepreneurship, a non-profit organization offering intensive training programs throughout the world for managers of biotechnology companies. He actively conducts research under a grant from the Bill & Melinda Gates Foundation, in collaboration with the McGlaughlin-Rotman Center for Global Health at the University of Toronto on the capability of emerging market countries in the biotechnology and pharmaceutical industries. He is also on the faculty of the World Intellectual Property Organization/UN executive education program.

Mr. Sammut has been involved in the creation or funding of nearly 40 biotechnology, Internet, and information technology companies globally. He is on numerous Boards of Directors and Advisory Boards including Doctors of the World USA, Mitsubishi Corporation Life Sciences Business Group, the Royal Bank of Canada Technology Venture Fund, the Cornell University Research Foundation, Combinent BioMedical Systems, Dynamis Pharmaceuticals, Gentis, Biowizard.com, the International Finance Corporation Bioethics Advisory Board (World Bank), the Center for Medicine in the Public Interest, Red Diamond Capital (a mid-market buyout fund), the Asia-Alpha Venture Fund, and several other organizations. He is also on the editorial board of the European Venture Capital Association Publications, The Private Equity Review, the Journal of Commercial Biotechnology and the Biotechnology Business and Law Journal.

Mr. Sammut previously held the positions of Vice President of Development of Teleflex Incorporated where he created and managed acquisitions and alliances, and at S.R. One, Ltd., GlaxoSmithKline's venture capital fund. He was also Managing Director of Access Partners, a venture fund focused on formation of companies around university technologies and capitalized by corporate strategic investors.

Earlier in his career, he was Managing Director of the Center for Technology Transfer at the University of Pennsylvania, where he spun out over one dozen companies over a two-year period. He held a similar position at Jefferson Medical College. He is also co-founder and former CEO of the Philadelphia Organ Transplant Program, the largest transplant organ bank in the United States. He holds degrees in biology and humanities from Villanova University, attended Hahnemann Medical College for two years and holds an MBA from the Wharton School of the University of Pennsylvania.

**Management 804 Course Outline At-A-Glance Quarter 4**

<b>Session Number</b>	<b>Date</b>	<b>Topic</b>	<b>In class Case/activity</b>	<b>Submissions Due Midnight before class</b>
1	<b>Tu</b> March 17, 2008	Course introduction : The VC industry today- an industry in transition; VC firm structure, and activities; company formation		TEAMS MUST BE FORMED BY THURSDAY MARCH 19 AND POSTED ON WEBCAFE.
2	<b>Tu</b> March 24, 2008	Part 1 of Class: Lecture on Due Diligence Part 2 of Class: Two assigned teams to present company formation section of simulation	Presentation by two teams and discussion of Simulation Case Part 1: Company Formation	Posting of Part 1 of simulation by all teams by 11:59 PM, Sunday, March 22
3	<b>Tu</b> March 31, 2008	Part 1 of Class: Lecture on Capitalization Tables and Valuation Part 2 of Class: Two assigned teams to present due diligence section of simulation	Presentation by two teams and discussion of Simulation Case Part 2: Due Diligence	Posting of Part 2 of simulation by all teams by 11:59 PM, Sunday, March 29
4	<b>Tu</b> , April 7, 2008	Part 1 of Class: Lecture on Term Sheets Part 2 of Class: Two assigned teams to present cap table and valuation section of simulation	Presentation by two teams and discussion of Simulation Case Part 3: Capitalization Tables	Posting of Part 3 of simulation by all teams by 11:59 PM, Sunday, April 5
5	<b>Tu</b> , April 14, 2008	Part 1 of Class: Lecture on Governance, Value Add and Exits; Part 2 of Class: Two assigned teams to present term sheet section of simulation	Presentation by two teams and discussion of Simulation Case Part 4: Term Sheet Negotiation	Posting of Part 4 of simulation by all teams by 11:59 PM, Sunday, April 12
6	<b>Tu</b> , April 21, 2008	Part 1 of Class: Summation and Quiz Review Part 2 of Class: Two assigned teams to present Emerging Markey VC Cases	Presentation by two teams on Emerging Market Cases	Posting of Emerging Market Case by 11:59 PM, Sunday April 19, 2007
Quiz	<b>Tu, April 28, 2008</b>	Quiz		

## Assignments:

See Course at a Glance Tables above for Corresponding Dates

Session 1 Preparation: The Venture Capital Industry; Organizational Issues and Financing considerations of the venture backed start-up Company

### Reading Materials:

- "A Note on the Venture Capital Industry." P. Gompers, Harvard Business School
- "How Venture Capital Works." B. Zider, Harvard Business Review
- "Why Venture Funds Don't Want your Cash,": The NY Times, July 8, 2004
- "Extreme Makeover." Institutional Investor (July 2004)
- "Venture Capitalists," Chapter 9, Hi-Tech Start-up by J. Nesheim
- "The Economics of the Private Equity Market." by Fenn, Liang & Prowse (December 1995, The Board of Governors of the Federal Reserve System)
- "The Legal Forms of Organization." M. Roberts, Harvard Business School
- "The Legal Protection of Intellectual Property." M. Roberts, Harvard Business School
- "How to Build an Organization." Author unknown.

### Supplemental Materials:

- "Does Venture Capital Foster the Most Promising Entrepreneurial Firms?" by R. Amit, L. Glosten & E. Miller, California Management Review, 32 (3): 102-111, 1990
- Summary of Principal Terms: Sample Venture Capital Fund I, L.P.

Session 2 Preparation: Principles of Due Diligence

Assigned Teams: Simulation Case 1

Presentation

All other teams: Simulation Case 1

Memo

- **Preparation and submission of Simulation Part 1: Company Formation; two teams will be selected to present**
- **PREPARATION AND POSTING OF SIMULATION PART 1: COMPANY FORMATION; TWO TEAMS WILL BE SELECTED TO PRESENT**
- See Webcafe for "Due Diligence Module and Simulation"

Session 3 Preparation: Capitalization Tables and Valuation

Assigned Teams: Simulation Case 2

Presentation

All other teams: Simulation Case 2

Memo

- "Ownership, Dilution, Negotiation, and Valuation," Chapter 7, Hi-Tech Start-Up by J. Nesheim
- "Valuation: What it's Worth." VentureEdge 2001
- A Note on Valuation in Private Equity Settings (HBS, 9-297-050 Rev April 8, 2002)
- **PREPARATION AND POSTING OF SIMULATION PART 2: DUE DILIGENCE; TWO TEAMS WILL BE SELECTED TO PRESENT**

Session 4 Preparation: Term Sheets;  
Assigned Teams: Simulation Case 3  
Presentation  
All other teams: Simulation Case 3  
memo

**Reading Materials:**

- "Bootstrap Finance: The Art of Start-ups." A. Bhide, [Harvard Business Review](#), Nov-Dec 1992
- "How to Write a Great Business Plan." W. Sahlman, [Harvard Business Review](#), July-Aug 1997
- "How to Choose and Approach a Venture Capitalist." G. Tankersley, Jr.
- "Meeting with the Venture Capitalist." W. Kingsley
- **PREPARATION AND POSTING OF SIMULATION PART 3: CAPITALIZATION TABLES; TWO TEAMS WILL BE SELECTED TO PRESENT**

Session 5 Preparation : Lecture on  
Governance, Value Add and Exits;  
Assigned Teams: Simulation Case Part  
4: Term Sheet Negotiation  
All other teams: Simulation Case 4  
memo

**Reading Materials:**

- "Venture Capital Negotiations": VC versus Entrepreneur." N. Wasserman, HBS
- "It May Be Time to Hit the Reset Button on Liquidation Preferences." R.Chiruvolu. [Venture Capital Journal](#), July 2002
- "How to Find the Right Investors for Your Business." Author unknown.
- "Non-Traditional Financing Resources." G. Sneddon and J. Turner.
- Practical Guidelines for Insider-Led, Down Round Financings

**PREPARATION AND POSTING OF SIMULATION CASE PART 4: TERM SHEETS; TWO TEAMS WILL BE SELECTED TO PRESENT**

Session 6: Governance and Value-add  
Assigned Teams: Emerging Market  
Case Presentation  
All other teams: Emerging market case  
memo  
Quiz Review

**PREPARATION AND POSTING OF Emerging Market Case Memo ; TWO TEAMS WILL BE SELECTED TO PRESENT**

Session 7: In class quiz  
Full session  
Open book and open notes