

Update: August 17, 2017

**The University of Pennsylvania  
The Wharton School  
Management Department**

## **Venture Capital and Entrepreneurial Management**

**MGMT 264 – Fall 2017  
MW 1:30 pm – 3:00 pm  
JMHH F90**

### **Raffi Amit**

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### **Course Overview and Design**

This elective course focuses on venture capital and the typical venture-backed start-up company, based on conventions and practices in the United States.

Venture capital and the technology sector that it supports<sup>1</sup> continue to evolve structurally. This evolution traces from the dot-com bubble of 1998-2000; the dramatic economic upheaval in 2008-2009; the explosive growth of companies with an Internet-based business model; the globalization of business in general; the expansive adoption of consumer-based technologies, products, and services; and other influential changes. Our class will cover traditional conventions in the industry that have historically shaped investor and company behaviors, as well as the structural changes that we are witnessing now.

The course will take all of these factors into consideration from the different and distinct perspectives of both the entrepreneur and the venture capital investor (including the angel and early-stage professional investor). As well, we will address management issues regarding the working relationship between the VC and the entrepreneur, corporate governance, and executive compensation.

The entrepreneur's perspective addresses the challenges in organizing and financing the venture. The examination of this perspective reveals how entrepreneurs gain an understanding of 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.

Complementing, and sometimes in counterpoint to, the entrepreneur's outlook is the perspective of the professional investor, which explores issues of concern to investors in evaluating, structuring, and pricing venture capital investments. As we explore the venture capitalist's perspective, we will address several aspects of the investment process including the term sheet content and structure, term sheet negotiation, valuation methods, and the impact of successive rounds of financing on capitalization and ownership. All of these factors set the stage for the relationship between management and investors, as well as the governance of the company.

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<sup>1</sup> For the purposes of our class, the technology sector includes companies in a wide range of industries that look to venture capital as a principal financing resource. These industries include traditional technology companies (software, internet, semiconductor, electronic hardware, etc.), biotech companies (medical device, pharmaceutical, healthcare, etc.), clean and green tech companies (fuel cell, solar panel, wind, battery storage, conservation technologies, etc.), homeland security companies, and consumer companies (social media, e-commerce, gaming, Web 2.0, etc.).

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**Course Syllabus**

The course is designed to achieve three main objectives:

1. Introduce you to basic concepts and topics in venture capital and the typical venture-backed start-up
2. Help you to understand the issues in organizing and financing a VC-backed start-up company
3. Expose you to methods and perspectives on valuing and structuring venture capital investments

The course is pragmatic in its orientation and will cover eight principal areas relevant to privately held, high-growth-potential start-ups. These include:

- A brief overview of the venture capital industry today, as well as a discussion of the typical venture fund structure and related venture capital objectives and investment strategies
- Opportunity evaluation
- Common organizational issues encountered in the formation of a venture-backed start-up, including matters relating to initial capitalization, intellectual property, and early stage equity incentive and compensation arrangements
- Valuation methodologies that form the basis of the negotiation between the entrepreneur and the venture capitalist in anticipation of a venture investment
- The challenges of fundraising, due diligence, and financing strategies
- Elements of compensation, both cash and equity, that are common to venture-backed companies in the technology sector
- 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 VC and the entrepreneur in the post-financing phase

The course is designed principally to address the interests of students who expect to embark on an entrepreneurial career, expect to assume a managerial role with a venture-backed start-up company, or wish to pursue a career in venture capital. In light of the time constraints associated with a half-unit course, the curriculum is confined to key fundamentals in the area of venture capital and start-up companies. The course will touch upon a range of fields including finance, accounting, strategy and corporate law and will attempt to identify mainstream “best practices” in the area of high growth potential start-ups. Students completing the course will have a solid understanding of the questions and issues that face the typical start-up.

There is a dedicated Canvas site for our course. Lecture notes, caselettes, and course materials that are not copyrighted by a third party as well as periodic announcements will be posted on this Canvas site. The Canvas URL is: <https://canvas.upenn.edu/courses/1360057>

- You will be able to access [Study.net](#) through Canvas. All third party copyrighted readings are found on Study.net. You should receive an email with log-in information from Study.net at the beginning of the semester. Please contact [customerservice@study.net](mailto:customerservice@study.net) with any logon issues.

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 readings have been organized so that students can manage the requirements

## Course Syllabus

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.

The readings are 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 optional reading materials and examples of legal or business documents included for the purpose of illustrating the themes discussed in class. All required readings and supplemental readings, organized by session, can be found on Canvas or in the Study.net window found on the Canvas website.

The short case studies, or caselettes, which will be used in this course are based on actual occurrences (with some degree of poetic license as appropriate) and are substantially shorter than the traditional case study. Each caselette has been prepared with the objective of highlighting “best practices,” conventions in the industry, or issues that are commonly encountered. The caselettes can be found on Canvas, and are part of the required readings. The classes generally will involve both lecture and case discussions. Interaction and dialogue with the instructor are strongly encouraged.

For each caselette, specific study questions have been assigned. In most class sessions, we will consider these questions in addition to the material in the case.

Students are asked to form study group teams of up to 5 students per team. Study groups are expected to meet to discuss each caselette. Choose your teammates carefully—changes will not be allowed once your study-group team has been formed.

### Requirements and Evaluation

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

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|--|-----|
| • Classroom participation                | 20% |
| • Case memos and other assignments       | 20% |
| • Negotiation submissions & presentation | 20% |
| • Quiz                                   | 40% |

**Individual class participation (20%):** Active class participation is very important for this course. The quality of your comments counts as much as your participation activity level. Because so much of the learning in this course occurs in the classroom, it is important that you attend every class. You may use tablets for note-taking only. As a common courtesy to other students and the instructor, and consistent with Wharton’s “concert rules,” any other use of electronics such as cell phones, tablets, or laptops is not permitted in the classroom. If you have to miss class, please notify the instructor and the TA in advance by e-mail. All students are expected to participate in class discussions. Students should expect to be called upon. If you are unprepared for the class session, please inform the instructor before the beginning of the class and you will not be called upon. You are required to display your Wharton-issued name tent in each class to facilitate teacher/student interaction. **Note:** Failure to display your Wharton-issued name tent may result in not getting any credit for the class session in which your Wharton-issued name tent was not displayed.

**Case memos and other assignments (20%):** For each of the assigned caselettes or cases, before the start of class each study-group team will submit online, into a designated folder on Canvas, the write-up in which the study questions are addressed. The instructor recognizes the challenges of responding to the study questions of each caselette in advance of the class discussion of each topic.

The write-up should be double-spaced, in 11-point font, and as a guideline should be limited to four pages in length. The four-page limit is for text only. You may attach as many numerical calculations as you wish—**BUT** your submission must

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**Course Syllabus**

be integrated into a single file. **The names of the students in the study team must appear on front page of each memo.** Write these as if you were writing a recommendation to the major decision-maker in the case.

Write-ups will not be accepted after the class has met. Credit will only be given to write-ups which are posted online before the **beginning** of the class session to which the caselette is assigned. No credit will be given for write-ups which are posted late or not posted.

**Negotiation Exercise (20%):** A critical component of the course is the negotiation exercise which enables students to apply and integrate their learning. The detailed instruction of the exercise will be handed out during the course. Each negotiation team is required to upload the deliverables of the negotiation exercise to Canvas before the deadline specified in the instruction (to be handed out in class). All team members are required to participate in the assigned presentation. More information about the exercise will be made available during the course.

**Quiz (40%):** Will be held on **Wednesday, November 15<sup>th</sup> 2017** during class time. This is an open-book, open-notes quiz. Students must bring a calculator to the quiz.

**Peer Evaluation:** Since 40% of your course grade depends on group work, you will be asked to evaluate the contributions of each of your study group members using a form that will be distributed in class. Specifically, at the end of the class you will be evaluated (on a 0-100 scale) by each of your team members based on your contribution to each category of group assignments, namely caselette/problem-set memos and the negotiation exercise. The average of the evaluation by all of your team members will be used to adjust your individual grade in each group-assignment category. Submission of this form in a timely manner is a requirement of this course.

*Note: The instructor will take great care to grade as fairly as possible and will not discuss grades at the end of the course. Students wishing to discuss their quiz are asked to make an appointment with the TA to do so.*

**Lecture Notes**

PDF files of the PowerPoint slides used in class will be posted to Canvas prior to each class session.

**Learning Environment**

Consistent with the MBA Resource Guide students are expected to strictly adhere to “concert rules,” including:

- Class starts and ends exactly on time. Students and faculty are expected to be prompt.
- Students are to remain in attendance for the duration of the class, except in an emergency.
- Students display their Wharton-issued name tents at every session.
- All mobile phones are turned off.

*Note: The instructor reserves the right to apply grade penalties for any and all violations of these learning-environment guidelines.*

**Feedback and Questions**

The instructor will do everything possible to provide you with a valuable and interesting learning experience. You are encouraged to provide feedback and suggestions at any time. For any course-related issues you would like to discuss, please feel free to contact the instructor via email, come to the office hour which is scheduled for Monday between 3-4 PM, or set up an appointment with the instructor.

**Course Outline At-A-Glance MGMT 264 Fall 2017**

<i>Session Number</i>	<i>Date</i>	<i>Topic</i>	<i>Case/activity</i>	<i>Submissions Due</i>
1	W 8/30/2017	Course Introduction and Overview		
2	W 9/6/2017	The VC Industry Today – An Industry in Transition		
3	M 9/11/2017	VC Firm Structure and Activities		
4	W 9/13/2017	Evaluating Opportunities I		
5	M 9/18/2017	Evaluating Opportunities II: Market Places	Chemdex case	Case memo
6	W 9/20/2017	Evaluating Opportunities III : Business Models	CredEx Case	
7	M 9/25/2017	Formation of a Startup I: Organizational issues	Caselette #1	Caselette #1
8	W 9/27/2017	Formation of a Startup II: Compensation	Caselette #2	
9	M 10/2/2017	Formation of a Startup III: Initial Capitalization and Founder Team Challenges	Caselette #3 & GovWorks Video Case	Caselette #3
10	W 10/4/2017	The Fundraising Landscape		
11	M 10/9/2017	Angel Investing	Blink	
12	W 10/11/2017	Valuation Methodologies		
13	M 10/16/2017	Valuation Methodologies (continued)	HBS Problem Set	HBS Problem Set
14	W 10/18/2017	Negotiating Term Sheets		
15	M 10/23/2017	Liquidation Preferences and Price Protection Anti- Dilution	Caselette #4	Caselette #4
16	W 10/25/2017	Analysis of a Term Sheet (Hand out materials for negotiation session)	Caselette #5	Caselette #5
17	M 10/30/2017	Integrating Valuation with Term Sheet Structure	APEX Case	
18	W 11/1/2017	Managing the Exit		
19	M 11/6/2017	Integrating Valuation with Term Sheet Structure	LuckyPai Case	
20	W 11/8/2017	Corporate Governance – The role and composition of the BOD in a venture-backed firm	Class discussion of the Alantec handout	
21	M 11/13/2017	Review session and Q&A (Optional session)		
22	W 11/15/2017	Quiz	Quiz	

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<b>Session Number</b>	<b>Date</b>	<b>Topic</b>	<b>Case/Activity</b>	<b>Submission Due</b>
23	M 11/20/2017	Guest Speaker		
	W 11/22/2017	Thanksgiving – NO CLASS		
24	M 11/27/2017	Term Sheet Debriefings	Presentations	All Presentations are due NO LATER than NOON on Monday 11/27/2017 (Late submissions will not be accepted)
25	W 11/29/2017	Term Sheet Debriefings and Course Summary	Presentations	

Detailed Course Outline

**Note: The session outline below is subject to change in order to accommodate the pace and content of class discussions.**

Wednesday, August 30, 2017**Session 1: Course Introduction and Overview**

- Course introduction
- Study group formation
- The role of venture capital industry in the economy

**Supplementary Readings:**

- “Venture Impact: The Economic Importance of Venture Capital-Backed Companies to the U.S. Economy”, by IHS Global Insights and National Venture Capital Association (NVCA), 2011
- “Does Venture Capital Foster the Most Promising Entrepreneurial Firms?” by R. Amit, L. Glosten & E. Muller, California Management Review, 32 (3): 102-111, 1990

Wednesday, September 6, 2017**Session 2: The VC Industry Today – An Industry in Transition**

- An overview on the trend of global venture capital industry
- Current industry trends in US

**Required readings:**

- “16 Definitions on the Economics of VC,” by Scott Kupor, Andreessen Horowitz (September 2016)

**Supplementary Reading:**

- “10 Growing Trends in Venture Capital for 2016,” by Lisa Calhoun (January 25, 2016)
- “How Much Does Venture Capital Drive the U.S. Economy?” by Ilya Strebulaev and Will Gornall (October 21, 2015)
- “The State of U.S. Venture Valuations and Other Notable Trends in 10 Charts,” by Pitchbook (April 5, 2016)
- “The Silicon Valley Standoff in Three Charts,” by Louis Basenese (May 12, 2016)
- “Are Venture Capitalists Becoming Less Important for US Tech Startups?” by CBInsights (March 7, 2015)
- “As Private Valuations Increase, Returns Shrink, Study Finds,” by Rolfe Winkler (November 2, 2015)
- “The Changing Structure of the VC Industry” by Mark Suster (July 22, 2014)
- “The Other Problem with Venture Capital: Management Fees,” by Chris Dixon (August 26, 2009)
- “The Private IPO Phenomenon,” by Josh Kopelman (April 8, 2015)
- “Venture Outlook 2016,” by Mark Suster (October 18, 2015)
- “What to Expect When You’re Expecting Venture Capital Returns,” by Charlie O’Donnell (July 30, 2015)
- “Why the Structural Changes to the VC Industry Matter” by Scott Kupor (July 30, 2014)
- “Demystifying Venture Capital Economics, Part I,” by Andy Rachleff (June 19, 2014)
- “Demystifying Venture Capital Economics, Part II,” by Andy Rachleff (September 24, 2014)
- “The New Reality of Venture Capital” by Joey Dwyer (February 25, 2014)

**Monday, September 11, 2017****Session 3: VC Firms: Structure and Activities**

- Venture Capital objectives and investment strategies
- Venture Capital firms activities
- The structure of VC firms
- The relationship between limited partners and general partners
- Fundamental Issues in Venture Capital Investments

**Supplementary Reading:**

- “A Note on the Venture Capital Industry” Harvard Business School (HBS# 9-295-065 July 21, 2001)
- “How Venture Capital Works” by B. Zider, Harvard Business Review (Nov-Dec 1998)
- “The Venture Capital Funnel” CB Insight (April 7, 2014)
- “The Evolving Relationship between LP and GPs” by Ann Leamon, Josh Lerner and Susana Garcia-Robles (September 5, 2012)
- “The Structure and Governance of Venture-Capital Organizations” by William Sahlman, Journal of Financial Economics, 27:473-521, 1990
- “A Day in the life of a Venture Capitalist” (Stanford Case -44, January 28 2013)

**Wednesday, September 13, 2017****Session 4: Evaluating Opportunities I**

- Opportunity definition and recognition
- The MMM Framework for evaluating opportunities

**Supplementary Reading:**

- “How Venture Capitalists Evaluate Potential Venture Opportunities”, (HBS Note 9-805-019, December 1, 2004)
- “In Search of the Next Big Thing”, Harvard Business Review (May 2013)
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- “Criteria used by venture capitalists to evaluate business plans” by I. MacMillan, R. Siegel, and P. Subba Narashima. Journal of Business Venturing 1, 119-128 (1985)

**Monday, September 18, 2017****Session 5: Evaluating Opportunities II: Market Places and the Chemdex case****Required Reading:**

- Chemdex.com (HBS Case 9-898-076, revised: June 22, 1999)

**Case Discussion Questions:**

1. How would you describe the opportunity that David Perry identified?
2. Imagine you are considering an investment in Chemdex in 1997. How would you evaluate this specific opportunity?

Please post your PowerPoint slides on our Canvas site in the Assignment Folder before the beginning of the class session and be prepared to present them in class.

**Wednesday, September 20, 2017****Session 6: Evaluating Opportunities III: Business Models and the CredEx case****Required Reading:**

- CredEx case (A) (Wharton Case-90, revised January 2016)
- “Business models” (C. Zott & R. Amit) in J.D. Wright (Ed.), *International Encyclopedia of the Social & Behavioral Sciences*, 2nd Edition, Volume 3, Oxford: Elsevier, pp. 33-36, 2015.
- “Creating value through business model innovation” (r. Amit & C. Zott), *Sloan Management Review*, Volume 53(3), pp. 41-49, Spring 2012.

**Case Discussion Questions:**

1. What is the entrepreneurial market opportunity identified by the founders? What are the factors that make this opportunity attractive or unattractive?



2. What is the targeted customer group of CredEx? Why did they target this group of customers?
3. What was the initial business model of CredEx? How does it compare with the traditional business model in the industry? 4. What is the current business model of CredEx? How does this compare with its initial business model? What do you think enabled the business model transformation?
5. In your view, what are the challenges CredEx faces in executing its expansion plan?
6. In your view, what are the challenges CredEx faces in its attempt to raise money from professional venture capitalists (VCs)?

**Note:** Be prepared to be called upon to address in class any of the above questions.

**Monday, September 25, 2017**

**Session 7: Formation of A Start-up I: Organizational Issues**

- Building a startup team
- Forming the company: legal forms
- Intellectual property: the importance of getting it right

**Required Reading:**

- **Caselette #1:** Organizational Issues in the Formation of a Start-Up

Please post your write-up before the beginning of the class session.

**Supplementary Reading:**

- “The Legal Forms of Organization” Harvard Business School (February 19, 2004)
- “The Legal Protection of Intellectual Property” Harvard Business School (HBS# 9-898-230 April 17, 1998)
- “The Process of Forming the Company.” Chapter 3 of High tech start-up: the complete handbook for creating successful new high tech companies, by J. Nesheim (2000)

**Wednesday, September 27, 2017**

**Session 8: Formation of A Start-up II: Compensation**

- Initial capitalization: design the equity and capital structure
- Compensation elements
- Founders’ stock and equity incentive arrangements

**Required Reading:**

- **Caselette #2:** Considerations in establishing the initial capitalization of the start-up

Please post your write-up before the beginning of the class session.

- “Equity Compensation in Startup Ventures,” (HBS Note 9-815-074, March 2, 2015)

**Supplementary Reading:**

- “Vesting of Founders’ Stock: Beyond the Basics,” by Doug Collom, WSGR Entrepreneurs Report (Spring 2008)
- “Dividing Equity Between Founders,” by Chris Dixon (August 23, 2009)
- “Five Compensation-Related Mistakes Startups Make (And Should Avoid),” by Caine Moss of WSGR, Venture Beat (February 9, 2010)
- “A Counterintuitive System for Startup Compensation” by First Round Capital, First Round Capital (November 2014)
- “Making Sense Out of Cents: Determining Employee Compensation” by Sharon Wienbar, Entrepreneur (March 14, 2014)
- Dream Teams: The Characteristics of Billion-Dollar Startup Founders,” by Tomasz Tunguz, Red Point (October 29, 2013)
- “The Dos and Don’ts of Compensation for Early-Stage Company Employees” by Kristen Garcia Dumont and Jennifer Martinez, WSGR Entrepreneurs Report (Fall 2008)

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- “Starting Up: Sizing the Stock Option Pool,” by Doug Collom, WSGR Entrepreneurs Report (Summer 2008)

**Monday, October 2, 2017****Session 9: Formation of Start-up III: Initial VC Capitalization and founder team challenges****Required Reading:**

- **Caselette #3:** Issues encountered in connection with First Round Financing

Please post your write-up before the beginning of the class session.

**Video Case:**

- Video Case: GovWorks

**Discussion questions:**

1. What caused the failure of govWorks.com?
2. Could the failure of the company have been avoided? If so, how?
3. What general lessons can be learned from the govWorks.com experience?
4. Have Kaleil and Tom failed as entrepreneurs? What should they do next?
5. What is your definition of, and your attitude towards failure? How did watching the movie affect your appetite for entrepreneurship?

**Wednesday, October 4, 2017****Session 10: The Fundraising Landscape**

- Sources of capital
- Alternative forms of fundraising
- Fundraising process and fallacies

**Required Reading:**

- "New Venture Financing" Harvard Business School (HBS note # N9-802-131, Aug. 1, 2006)
- "Financing New Venture" (HBS Note N9-811-093, March 28, 2011)

**Supplementary Reading:**

- “Strategic Investors in the Early-Stage Company” by Allison Spinner, WSGR Entrepreneurs Report (Winter 2007)
- “Best Practices for Raising a VC Round,” by Chris Dixon (May 4, 2011)
- “How Crowd-Funding Is Changing Everything and What That means for Your Startup,” First Round Review
- Convertible Note Financing (Summary of Terms)
- “6 Questions Entrepreneurs Should Ask During an Investor Meeting” By Bhavin Parikh & Aaron Schwartz (October 15, 2014)
- “A VC’s Tips on Securing Seed and Series A Financing” by Carl Showalter, Entrepreneur Guest Post (February 12, 2010)
- “Due Diligence Reveals All,” AlwaysOn: The Insider’s Network (October 21, 2008)
- “How to Prepare for a Presentation to a VC,” by Carl Showalter, Opus Capital
- “How to Raise Money,” by Paul Graham (September 2013)
- “In Defense of the Deck,” by Bill Gurley (July 7, 2015)
- “Why Raising Too Much Money Can Harm Your Startup,” by Mark Suster (June 30, 2016)
- A Guide to Seed Fundraising,” Geoff Ralson (January 7, 2016)
- “How Crowd-Funding Is Changing Everything and What That means for Your Startup”, First Round Review
- Sample executive summaries

**Monday, October 9, 2017****Session 11: Angel Investing**

- Evaluating Funding options
- Convertible note financing

**Required Reading:**

- The Blink Case

**Discussion questions:**

1. Assuming you were an angel investor and Jimmy pitched this idea to you, would you make an investment? Why or why not?
2. Assuming you were Jimmy and were facing the financing options below, which one would you choose and why?
  - A. \$100K from a well-known angel investor (and mentor) in exchange for 7% of Blink's equity
  - B. \$100K funding from DreamIt Ventures (a prominent Philadelphia-based accelerator) in exchange for 10% of Blink's equity
  - C. \$100K crowdfunded through Angellist Syndicate in exchange for 3% of Blink's equity
  - D. \$100K from GroupMe in exchange for 5% of Blink's equity
  - E. \$100K from seed fund of Sequoia Capital in exchange for 20% of Blink's equity
3. If you are an angel investor and consider to make an investment in the company, how would you like to structure your \$100,000 (e.g., in debt? Equity? Or convertible note)? Why?

**Note:** be prepared to be called upon to address in class any of the above questions.

- “Convertible Notes in Angel Financing.” Harvard Business School (HBS# 9-813-017, September 11, 2012)

**Supplementary Reading:**

- “VC ‘Super Angels’: Filling a Funding Gap or Killing ‘The Next Google?’”, Knowledge@Wharton (September 1, 2010)

**Wednesday, October 11, 2017****Session 12: Valuation Methodologies**

- Financial valuation methodologies; the art and the science of valuation
- Financing strategies and the impact of dilution

**Required Reading:**

- “A Note on Valuation in Private Equity Settings” (HBS # 9-297-050, April 2002)
- “A Method for Valuing High-Risk, Long-Term Investments” (HBS Note 9-288-006, July 24 2009)

**Supplementary Reading:**

- “What’s My Company Worth?” by Herb Fockler, WSGR Entrepreneurs Report (Fall 2007)
- “How Do VC’s and Angels Value a Company?” by Jeff Carter (August 8, 2014)
- “How Funding Rounds Differ: Seed, Series A, Series B, and C…” Elad Blog (March 15, 2011)
- “Series A Dynamics – Ownership, Timing, and Valuation” by Rob Go, NextView Ventures (May 20, 2014)
- “The Series A Round is the New Series B Round” by Jeff Jordan (June 18, 2013)
- “The Top 20 Reasons Startups Fail” CB Insight
- “The Impact of Dilution,” by Andy Rachleff (August 26, 2014)
- “When Seed Funding is Better Than Series A” by Carl Showalter (October 9, 2007)

**Monday, October 16, 2017****Session 13: Valuation Methodologies (continued)****Required Reading:**

- The Venture Capital Method – Valuation Problem Set (HBS case # N9-396-090)

Please post your write-up before the beginning of the class session.

**Wednesday, October 18, 2016****Session 14: Negotiating Term Sheets**

- Environmental factors surrounding term sheets
- Selected critical elements in venture term sheets

**Required Reading:**

- “Venture Capital Negotiations: VC versus Entrepreneur.” Harvard Business School (HBS# 9-800-170, March 2, 2000)

**Supplementary Reading:**

- “Control: The Critical Issue in Negotiating Financing Terms,” by Caine Moss, WSGR Entrepreneurs Report (Fall 2008)
- “Navigating Down-Round and Dilutive Financings,” by Yokum Taku, WSGR Entrepreneurs Report (Fall 2008)
- “Mark Suster: The Authoritative Guide to Pro-Rata Rights” by Mark Suster, Venture Capital (October 13, 2014)
- How to Build a Unicorn from Scratch—and Walk Away with Nothing,” by Heidi Roizen (May 11, 2015)
- “Protections for Late Investors Can Inflate Start-Up Valuations,” by Randall Smith, New York Times (June 7, 2015)
- “Startup Accelerator Anti-Dilution Provisions; The Fine Print,” by Jose Ancer (June 21, 2015)
- “The Entrepreneurs Report: Private Company Financing Trends for 3Q 2016” Wilson Sonsini Goodrich & Rosati
- “The Toxic Term Sheet: Founders Beware!” by John Backus (October 6, 2015)
- “Unicorns and Other High Valuation Deals,” by Ben Hance and Calise Cheng (November 10, 2015)
- “On the Road to Recap: Why the Unicorn Financing Market Just Became Dangerous...for All Involved,” by Bill Gurley (April 21, 2016)

- “Worst Case Scenario: What if None of the Unicorns Live Up to Their Valuations?” by Dan Primack (November 2, 2015)

**Monday, October 23, 2017****Session 15: Liquidation Preferences and Price Protection Anti-Dilution****Required Reading:**

- **Caselette #4:** Liquidation Preferences and Anti-Dilution Formulas

Please post your write-up before the beginning of the class session.

**Supplementary Reading:**

- “Anti-Dilution Protection: What You Need to Know” by Mark Baudler, WSGR Entrepreneurs Report (Spring 2008)
- “Liquidation Preferences: What They Really Do” by Craig Sherman, WSGR Entrepreneurs Report (Winter 2007)
- Memorandum of Terms for Preferred Stock (negotiated)
- Memorandum of Terms for Preferred Stock (non-negotiated company favorable)
- Memorandum of Terms for Preferred Stock (non-negotiated investor favorable)
- Terms for Private Placement of Series Seed Preferred Stock
- “Memorandum of Terms,” WSGR Term Sheet Generator
- “Plain Preferred Term Sheet,” The Funded Founder Institute
- “Term Sheet for Series A Preferred Stock Financing,” NVCA Model Documents

**Wednesday, October 25, 2017****Session 16: Analysis of a Term Sheet****Required Reading:**

- **Caselette #5:** Analysis of a Typical Venture Capital Term Sheet

Please post your write-up before the beginning of the class session.

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**Your assignment:** The purpose of this caselette is issue spotting. The Summary of Terms depicted in the caselette is conventional in most respects, and as is true of most legal documents, the wording is precise. However, a number of terms have been deliberately revised in ways that would create serious issues either for the Company or the Investors – there are a number of “traps for the unwary” that have been dropped into this term sheet. To assist in this exercise, sections of the term sheet that have **not** been planted with any “traps” have been *italicized* and marked with [brackets]. Your assignment is to identify each of the 20 or so traps.

**Note:** At the end of this class session we will confirm with you the pairing of the negotiation teams. Each team will be designated as either Founders or as VC Investors.

We will pair two VC Investor teams with a single Founders team. Each Founder team will get term sheets which reflect initial offers from the two different VC Investor teams. Everyone will get a “backgrounder” document which explains the assignment in great detail.

**In Session 24 on Monday (November 27, 2017) and Session 25 on Wednesday (November 29, 2017),** each team will be required to summarize and present to the class the results of the term sheet negotiation.

The exact details of the negotiation process and the presentations that are due on **Monday November 27, 2017 by 12:00 Noon** will be outlined in the materials which will be handed out to you.

### Monday, October 30, 2017

#### Session 17: Integrating Valuation with Term Sheet: The Apex Case

#### Required Reading:

- Apex Investment Partners (A): April 1995 (HBS # 9-296-028, Nov. 17, 1997)

#### APEX Case Discussion Questions:

1. Do you think AccessLine is an attractive investment opportunity (regardless of valuation)? Why and why not?
2. What is the proposed valuation for AccessLine in Series B financing?
3. How has AccessLine financed itself to date? Why have they chosen this strategy? What have been the implications for the firm?
4. Why does Dan Kranzler regard Apex Investment Partners as an attractive source of venture capital?
5. How attractive are the terms that AccessLine has proposed to Apex for the Series B financing? What are the key differences from those in Series A financing round? What issues, if any, should concern Apex?

**Note:** be prepared to be called upon to address in class any of the above questions.

### Wednesday, November 1, 2017

#### Session 18: Managing the Exit

- IPO and alternative exit strategies

#### Supplementary Reading:

- “A Note on the Initial Public Offering Process,” (HBS note # 9-200-018, July 20, 2007)
- “SpeedSim: Made to Exit!” by Naeem Zafar and Victoria Chang, California Management Review, 54(4): 143-155, 2012

### Monday, November 6, 2017

#### Session 19: Integrating Valuation with Term Sheet: The LuckyPai case

#### Required Reading:

- An Early-Stage VC Investment: D’T Capital Financing of LuckyPai (Wharton Case-88, July 31, 2014)

#### Case Preparation Questions:

## Course Syllabus

1. If you were an investor, would you make an investment in LuckyPai Group Limited (LuckyPai)? How would you evaluate this investment opportunity? What criteria would you use? What risks have you identified?
2. What is your pre-money valuation for LuckyPai based on different valuation methodologies [e.g., comparable, discounted cash flow (DCF), and venture capital (VC)]? (Notes: (1) According to the prospectus of Acorn International Inc., its IPO price was US\$15.5, which implies a price-to-earnings ratio (P/E) of 96.9 and a price-to-sales ratio (P/S) of 1.4 at IPO. By the end of 2011, the stock price of Acorn International Inc. had stumbled down to US\$4.08/share, which suggested a P/E of 24 and a P/S of 0.34; (2) the 10-Year-Treasury Bond in January 2006 had a yield of 4.4 percent)
3. If you were the founder of LuckyPai, how would you assess DT Capital Partners (DT Capital) as a potential investor? How would you evaluate the proposed syndication structure?
4. If you were the founder of LuckyPai and the two options below were available to you along with the proposed deal of DT Capital, which one would you choose?
  - a. Option 1: Acorn International Inc. proposes a US\$15 million investment at a much higher pre-money valuation for the company.  
Option 2: An angel investor proposes a US\$3.6 million investment in the form of a convertible note which would cover your spending in the first 6 months with much more amiable terms than DT Capital proposed.
5. If you were the founder of LuckyPai, how would you negotiate the proposed term sheet from DT Capital?

**Note:** be prepared to be called upon to address in class any of the above questions.

**Wednesday, November 8, 2017**

**Session 20: Corporate Governance – The Role and Composition of the BOD in a Venture-Backed Firm**

**Handout:** Alantec case

- Board members' duty to stockholders
- Composition and roles of the board of directors in the private company
- Sarbanes Oxley and the private company

**Required Reading:**

- “After The Term Sheet” by Dennis T. Jaffe and Pascal N. Levensohn (November 2003)
- “Rites Of Passage,” by Pascal N. Levensohn (January 2006)

**Supplemental Reading:**

- “The Basic Responsibilities of VC-Backed Company Directors” by working group on Director Accountability and Board Effectiveness (January 2007)
- “Venture-Backed Boards More Active, Better Aligned Amidst Financial Crisis” Dow Jones VentureSource (November 10, 2009)
- “CEO Playbook for Early Stage Board Meetings,” by Geoff Yang, Red Point (August 2, 2013)
- “The Secret to Making Board Meetings Suck Less,” First Round Review (October 18, 2013)
- Corporate Governance and Disclosure Practices of Venture-Backed Companies in U.S. Initial Public Offerings,” Wilson Sonsini Goodrich & Rosati (July 2011-June 2012)
- “The Basic Responsibilities of VC-Backed Company Directors,” by Working group on Director Accountability and Board Effectiveness (January 2007)

**Monday, November 13, 2017**



Wednesday, November 15, 2017**Session 22: QUIZ**

- Bring your calculator. (No laptops allowed.)
- Open books
- Open notes
- Open minds...

Monday, November 20, 2017**Session 23: Guest Speaker**Monday, November 27, 2017**Session 24: Term Sheet Debriefing**

During this session, teams will present their negotiated term sheets and discuss the issues they ran into during the negotiation.

**Submissions Due: Please upload your deliverables to Canvas before 12:00 Noon on Monday, November 27, 2017.**

- Each investor team and the founder to prepare a PowerPoint presentation, which includes the final proposed valuations as well as commentary on the process of the negotiations, on the key terms that were critical in the negotiation of the term sheet, and on lessons learned
- Founders additionally provide a detailed summary of the final agreement using the format outlined in the Negotiation Instruction handout which will be distributed in class
- VC investors must provide the details of their valuation calculations

Wednesday, November 29, 2017**Session 25: Term Sheet Debriefing (continued) and Course Summary**