

## MGMT 811 – Entrepreneurship Through Acquisition Spring 2020 Q3

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### INSTRUCTOR

Robert J. Chalfin CPA, Esq.

The Chalfin Group

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Office Hours:

Mondays/Wednesdays 1:30 p.m.-3:00 p.m. and by appointment

### COURSE OBJECTIVES

The objective of this course is to study the process of entrepreneurship through the acquisition of existing operating businesses. We will study this process through a series of lectures, assigned readings, case studies, and a final project which will follow the acquisition process.



We will discuss sourcing and identifying acquisition opportunities, strategic, operational, legal, and financial operational due diligence, valuation, tax considerations, raising capital, structuring and closing transactions, post-closing integration, as well as managing and exiting the acquisition. We will examine other prototypes for pursuing acquisitions including search fund models and fundless deal sponsor models.

When determining whether to enroll in this course, please keep the following in mind:

1. No two deals or acquisition processes are the same.
2. This course is designed to provide a comprehensive strategy on how to acquire a business and to provide you with the tools to decide if this is the path for you. We will discuss some alternative methods and a common-sense approach to the process.
3. While there are many similarities between the process of acquiring a small business and the protocols followed by a private equity fund buyout or a large M&A transaction, the world of small business is highly entrepreneurial, fragmented, and nuanced. There will be differences between what is discussed in class and the private equity process.

### COURSE REQUIREMENTS

You are expected to attend all course sessions. Failure to attend the first session will result in being automatically dropped from the course with no further right to admission.

Since class discussions are an important aspect of the learning process, you should not register for this course unless you are prepared to attend and actively participate in each class. To encourage open conversations in each session, you should not record any of the lectures. Students will be expected to apply both their academic training and prior business experience to the class.

When class begins, all electronic devices should be turned off and put away. If you need to use a device for a language or disability issue, or there is an emergent matter, please advise me before class.

### **TEXT AND READINGS**

The course has several types of reading materials including books, articles, and case studies.

- Required: Ruback, Richard S., and Royce Yudkoff. *Buying a Small Business*. Boston, MA: Harvard Business Review Press, 2017. (“RUBACK”)
- All of the other assigned readings, except for RUBACK, are available on study.net.
- Additional reading materials along with sample agreements, documents, and spreadsheets will be posted on Canvas during the course

### **GRADING/ASSIGNMENTS AND EXAM**

The course submission requirements, deadlines, and grade composition are as follows:

- Class Participation- 25%  
Your contributions will be evaluated after each class. One component of class participation will be a few short, typically 1-2 question, surveys that will be due at 10 p.m., the night before several of our classes. These surveys, which do not always have one correct answer, will provide a prelude to the material that we will be discussing in class and will be posted in the Quiz section of Canvas.
- Homework- 25%  
The homework assignments, which are short caselets, will be due at 10 p.m. the night before the designated classes, as indicated on the course schedule that follows. All homework assignments must be submitted through the course Canvas site. The homework is designed to encourage you to think about the readings and facilitate active participation in class. In many cases, just like in real-world deal making, there is no single correct answer to the homework problems. However, I will provide you with a proposed solution to each assignment.
- Final Project- 50%  
The final project will be a case study that will be distributed prior to the last class. As an alternative to the final project, subject to my prior review and approval, you may prepare an acquisition analysis of an existing business. The requirements for the acquisition analysis are posted on Canvas and will be discussed in the first class. Either project may be prepared individually or in a group of up to 3 students. Regardless of whether you choose to do the final or alternative project, they are both due by 11:59 p.m. on March 17, 2020.

All assignments must be submitted through the course Canvas site. If an assignment is submitted late, your grade will be affected.

### **ACCESSIBILITY**

All students are encouraged to meet with me during office hours, after class, or for a meal during the course. I can also be reached via email and telephone.

## CONCERT RULES

- Class will start and end on time. Please be prompt.
- Students should sit according to the seating chart.
- Students should remain in attendance for the duration of class, except in an emergency.
- Students should display name tents.

## ETHICS AND USE OF PRIOR MATERIALS

Members of the Wharton community are expected to uphold the highest ethical standards. The MBA student body has articulated [guidelines](#), approved by vote in the Spring of 1989, amended by vote in the Spring of 2005.

## COURSE SESSION OUTLINE

<u>Session</u>	<u>Date</u>	<u>Topic</u>
1	January 15, 2020	Overview of the Acquisition Process
2	January 22, 2020	Identifying Acquisition Targets
3	January 27, 2020	Evaluating Acquisition Opportunities
4	January 29, 2020	Conducting Due Diligence
5	February 3, 2020	Financial Due Diligence
6	February 5, 2020	Structuring The Business Being Acquired
7	February 10, 2020	Legal, Financial, and Tax Structuring of the Acquisition
8	February 12, 2020	Target Valuation Methodologies
9	February 17, 2020	Raising Capital
10	February 19, 2020	Search Fund and Fundless Deal Sponsor Models
11	February 26, 2020	The Letter of Intent and Other Alternatives
12	February 28, 2020	The Purchase Agreement
13	March 2, 2020	Closing the Transaction and Post Closing Integration
14	March 4, 2020	Acquisition Growth Strategies – Transitioning and Exiting the Business

## COURSE OUTLINE

Session 1 January 15, 2020

### Overview of the Acquisition Process

In the first session we will discuss the path of entrepreneurship through acquisition including the advantages and disadvantages of entrepreneurship through acquisition versus entrepreneurship through start-up.

### Required Readings:

RUBACK: The Opportunity: Entrepreneurship Through Acquisition (Chapter 1)  
Is Entrepreneurship Through Acquisition for You? (Chapter 2)  
The Acquisition Process (Chapter 3)

Ruback, R. and Yudkoff R. “Buying Your Way into Entrepreneurship” *Harvard Business Review* January 1, 2017.

Ruback, R. and Yudkoff R. “Which MBAs Make More: Consultants or Small-business Owners.” *Harvard Business Review*, June 28, 2016.

### Optional Reading:

Glazer, Emily and Das, Anupretta. "Family Businesses Welcome Outside Buyers." *The Wall Street Journal*, August 20, 2015.

## **Session 2 –January 22, 2020**

### **Identifying Acquisition Targets**

This session will discuss the process of identifying acquisition opportunities and the preparation required prior to contacting the prospective target.

#### **Required Readings:**

RUBACK: Identifying the Characteristics You Want in a Business (Chapter 6)  
Managing Your Search Effectively (Chapter 7)  
Sourcing Prospects Using Brokers (Chapter 8)  
Sourcing Directly (Chapter 9)

## **Session 3 – January 27, 2020**

### **Evaluating Acquisition Opportunities**

This class will discuss the strategic and operational criteria used to evaluate acquisition opportunities plus the responsibilities and obligations of the parties to maintain the confidentiality of information that is exchanged.

#### **Required Readings:**

RUBACK: Filtering for the Owner's Commitment to Sell (Chapter 12)

G. Cullinan, J. Le Roux, and R. Weddigen. "When to Walk Away from a Deal." *Harvard Business Review*, April 2004.

#### **Optional Readings:**

Ansberry, Clare. "When Family Business Owners Don't Want to Retire." *The Wall Street Journal* April 30, 2017

Upadhyaya, V. "Why Due Diligence is Important for Entrepreneurs." *Entrepreneur* February 6, 2016.

**There will be a survey due at 10 p.m. the night before this class.**

## **Session 4 – January 29, 2020**

### **Conducting Due Diligence**

During this session we will discuss the art and science of evaluating and analyzing financial and legal due diligence material.

#### **Required Readings:**

RUBACK: Preliminary Due Diligence (Chapter 13)

**Homework Assignment:** Students will be requested to prepare components of a due diligence list for a hypothetical business provided by the instructor.

Homework Assignment # 1 is due at 10:00 p.m. the night before class.

## **Session 5 – February 3, 2020**

### **Financial Due Diligence**

In this class we will cover the metrics, indicators, and algorithms used in evaluating a business. This will include the assessment and evaluation of data to determine the quality of earnings, valuation of assets and liabilities, analysis of the target's future prospects, and any synergies that could be obtained subsequent to the acquisition.

#### **Required Readings:**

RUBACK: Enduringly Profitable Small Businesses (Chapter 10)  
Using Financial Information to Gauge Enduring Profitability (Chapter 11)  
Confirmatory Due Diligence (Chapter 17)

#### **Optional Readings:**

“What is the Difference Between a Compilation, a Review and an Audit? A Comparative Overview”  
American Institute of Certified Public Accountants

Shumsky, Tatyana. “Companies Invent Their Own Performance Benchmarks.” *The Wall Street Journal*, March 29, 2016

Bensinger, Greg. “Startups Scramble to Define ‘Employee’.” *The Wall Street Journal* June 30, 2015

## **Session 6 – February 5, 2020**

### **Structuring the Business Being Acquired**

This class will discuss guidelines, considerations, and misconceptions of organizational and legal structures that should be devised and implemented when acquiring and operating an entrepreneurial business. During this session we will briefly review the “Dollar General Bids for Family Dollar” case study for purposes of discussing fiduciary responsibilities of a business's board of directors and analyzing of the target business's strategy and results by comparing it to its peers.

#### **Required Readings:**

Davis, J (2006). “Reminders for Owner-Managers Regarding the Board of Directors of Private Companies.” *Harvard Business School Background Notes*, 9-805-154 June 2005.

Roberts, M., Sahlman, W., and Novakovich, S. “How Serial Entrepreneurs Build and Manage a Board of Directors in a Venture-Backed Start Up.” Harvard Business School Case 808-163, June 2008 (Revised July 2008).

“Dollar General Bids for Family Dollar.” *Harvard Business School* 9-116-007 October 15, 2017.

**There will be a survey due at 10 p.m. the night before this class.**

## **Session 7 – February 10, 2020**

### **Legal, Financial, and Tax Structuring of the Acquisition and Fiduciary Responsibility of the Board of Directors and Competitive Analysis**

The design and structure of an acquisition along with the organizational, legal, and tax ramifications will be reviewed. The Implications of the Tax Cut and Jobs Act of 2017 on small business acquisitions will be examined.

**Required Readings:**

RUBACK: Deal Terms (Chapter 15)  
The Offer (Chapter 16)  
Negotiating the Purchase Agreement (Chapter 20)

*Estate of Cohen, ex rel. Perelman v. Booth Computers, et al.* 412 N.J. Super. 134 (2011)

**Optional Reading:**

Nitti, Tony. "Understanding the New Sec. 199A Business Income Deduction." *The Tax Advisor* April 1, 2018.

**Session 8 – February 12, 2020**

**Target Valuation Methodologies**

This class session will address some common methods to value entrepreneurial businesses along with the applicability of various discounts and premiums as they relate to entrepreneurial businesses. Empirical data will be utilized to validate the underlying assumptions for these calculations.

**Required Readings:**

RUBACK: How Much Should You Pay for a Small Business? (Chapter 14)

McCarthy, Daniel and Fader, Peter. "Subscription Businesses are Booming, Here's How to Value Them." *Harvard Business Review* December 19, 2017.

Cannella, M. "Technical Note on LBO Valuation and Modeling." *Columbia Business School, Case Works* CU413, April 10, 2015

Hitchner, James R. *Financial Valuation*, (2017, John Wiley and Sons, Inc.) Chapter 1.

**Optional Reading:**

Crane, Dwight B. "Note on Valuing Private Businesses." *Harvard Business School Note*, 9-201-060, February 2001 (Revised April 2001)

Homework Assignment # 2 is due at 10:00 p.m. the night before class.

**Session 9 – February 17, 2020**

**Raising Capital**

This class will explore the sources and processes to raise both debt and equity to purchase a business. The metrics and benchmarks utilized by the funding sources to select and approve various investment options will be discussed.

**Required Readings:**

RUBACK: Raising Debt (Chapter 18)  
Raising Acquisition Equity (Chapter 19)



Herman, Peter. "A Meeting of the Minds." *New Jersey Lawyer* October 2010

Fuerst, Steven, et. al. "Earn-Outs: Bridge the Gap, With Caution." *Mergers and Acquisition Law Report BNA* June 15, 2009

**There will be a survey due at 10 p.m. the night before this class.**

### **Session 10 – February 19, 2020**

#### **Search Fund and Fundless Deal Sponsor Models**

The advantages and disadvantages of the search fund and fundless deal sponsor models from the perspective of both searchers and investors will be evaluated. Published data on the performance of search funds will be discussed.

#### **Required Readings:**

RUBACK: Anticipating the Cost of Your Search (Chapter 4)  
Paying for Your Search (Chapter 5)

Search Funds: Best Practices for the Search Phase, *Stanford Graduate School of Business*, November 2014.

Dennis, J. and Laseca, E. "The Evolution of Entrepreneurship through Acquisition." Chicago Booth November 2016

Stanford Graduate School of Business Case Study, Models of Entrepreneurial Acquisition (E365-PDF ENG)

#### **Optional Reading:**

Kelly, Peter, Dodson, David, Grousbeck, H. Irving, et. al. "2018 Search Fund Study." *Stanford Graduate School of Business*, Case E605, June 26, 2016.

Stevenson, Howard H., Sharpe, James M., and Roberts, Michael J. "Early Career LBOs Using the Search Fund Model." *Harvard Business School Note*, December 10, 2012 HBS Product Number 9-813-119.

#### **Homework Assignment:**

Students should review the Models of Entrepreneurial Acquisition case study, which is one of the assigned readings, and in response to questions provided by the instructor: evaluate topics such as 1.) the different approaches to entrepreneurship through acquisition, 2.) the desired characteristics of search fund investors, and 3.) the advantages and disadvantages of the search fund model.

Homework Assignment # 3 is due at 10:00 p.m. the night before class.

### **Session 11- February 24, 2020**

#### **The Letter of Intent and Other Alternative Approaches**

The letter of intent will be parsed in this lecture, including its drafting and the strategies, thought processes, and other considerations utilized when negotiating the purchase of a business will be discussed. Alternative approaches and methods, besides the letter of intent, will be explored. Vital components and considerations when negotiating the contract will be examined.

#### **Required Readings:**

RUBACK: The Offer (Chapter 16)

## Negotiating the Purchase Agreement (Chapter 20)

### **Session 12- February 26, 2020**

#### **The Purchase Agreement**

This session will discuss vital components and considerations when negotiating the contract along with key considerations.

#### **Required Readings:**

RUBACK: Negotiating the Purchase Agreement (Chapter 20)

### **Session 13 – March 2, 2020**

#### **Closing the Transaction and Post-Closing Integration**

This class will review and analyze some creative, but pragmatic, ways to integrate and improve the target business, including the development of human capital. This includes the design and use of employee equity and incentive plans (such as ESOPs) and other synergistic initiatives. The advantages and disadvantages of various forms of equity sharing plans will also be evaluated.

#### **Required Readings:**

RUBACK: The Closing Day and Beyond (Chapter 21)

Roberge, M. and Cespedes, F. “Entrepreneurial Sales and Marketing Vignettes.” *Harvard Business School*, 2016 9-817-010.

Tjan, Anthony K. “Great Businesses Don’t Start with a Plan.” *Harvard Business Review* May 16, 2012.

Marks, M., Mirvis, P. and Ashkenas, R. “Surviving M&A,” *Harvard Business Review* March-April 2017.

**There will be a survey due at 10 p.m. the night before this class.**

### **Session 14 – March 4, 2020**

#### **Acquisition Growth Strategies Transitioning and Exiting the Business**

This session will discuss some of the opportunities, alternatives, and decisions the entrepreneur will encounter after acquiring the target business including organically growing the business, acquisitions, and roll-ups. Students will be asked to prepare answers to several questions regarding the *Complex Aminos* Case, which will be used as the basis for a portion of the class discussion.

The final class will tackle some of the entrepreneur’s options and plans including transitioning out of management and exiting the acquired business. Some final thoughts on the attraction and lure of entrepreneurship will be conveyed.

#### **Required Readings:**

MacMillan, Ian C. and Selden, Larry. “The Incumbent’s Advantage.” *Harvard Business Review* October 2008

Maqubela, Kanyi. “Entrepreneurs Need a Better Way to Cash Out.” *Harvard Business Review* June 9, 2014.



Justo, Rachida. "The Different Reasons Men and Women Leave Their Startups." *Harvard Business Review* February 8, 2017 (updated February 17, 2017)

Breslin, Ned. "If You're Out to Change the World, How Do You Know When to Move On?" *Harvard Business Review* July 2, 2013

Zeswitz Music Case Study (HBS 9-215-034)

**Homework Assignment:**

In response to questions submitted by the instructor: students will be requested to prepare a succinct, but comprehensive, summary of suggested improvements to a business.

Homework Assignment #4 is due at 10:00 p.m. the night before class.

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