

MGMT 811 – Entrepreneurship Through Acquisition

Wharton Fall 2020 Q1

INSTRUCTOR

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COURSE OBJECTIVES

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



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 also examine 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 pragmatic 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.
4. As a result of COVID-19 some paradigms have changed.

COURSE REQUIREMENTS

The way this class is taught makes it difficult to catch up later by reviewing the readings and handouts. If you just miss one of our sessions, you will miss a significant amount of course material.

Since class discussions are an important aspect of the learning process, you should not register for this course unless you are prepared to be vigilant about attending the class sessions either in a synchronous mode or promptly thereafter in an asynchronous mode. Students will be expected to apply both their academic training and prior business experience to the class.

The class will be conducted over Zoom. Prior to each class session I will post the Zoom link in an announcement and advise you when I have posted the slide deck and any other materials on Canvas. You should have these materials accessible at the commencement of each session.

TEXT AND READINGS

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

- *How to Buy a Business* by Robert J. Chalfin (“CHALFIN”) This is a draft manuscript that I have prepared on many of the salient topics that will be covered in our course. It will be posted on Canvas.
- All of the assigned readings are available on study.net or Canvas
- Additional reading materials including 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- 20%
Your contributions will be evaluated after each class.

Assuming you are in a time zone that makes it conducive, I expect you to attend class and be prepared for each session. I will make every effort to start each session on time. If you cannot attend class on a synchronous basis, you should promptly listen to the recordings. In addition to calling on you during the sessions, your class participation grade will consist of two other items that are described below.

1.) Answering a few short, typically 1-2 question, surveys that will be due at 10 p.m., the night before each 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 Quizzes section of Canvas.

2.) Due to the unique circumstances this quarter, which includes that some of you will be attending the class on an asynchronous basis, you will be requested to submit a one-page paper with your reflections on a topic or topics that we discussed in any one of our classes. There is no preset format for this submission.

- Homework- 30%

The first homework assignment, which is posted in the Quizzes Section of Canvas, requests that you confirm that you have read the course syllabus. Although this assignment is a requirement of the course, no points will be awarded for this.

Homework assignments 2 through 5 are short caselets. The homework is designed to encourage you to think about the readings and facilitate active participation in class. Just like what is encountered in actual deal-making, there is not always one correct answer to the homework problems. However, I will provide you with a proposed solution to each assignment.

Homework assignments 2 through 5 will be graded as follows:

- approximately 10% will receive a grade of a check plus or 5 points,
- approximately 85% will receive a grade of a check or 4 points, and
- approximately 5% will receive a grade of a check minus or 3 points.

- Final Project- 50%

The final project will be a case study that will be distributed prior to the last class. The project may be prepared individually or in a group of up to 3 students. It will be due on November 1, 2020.

ASSIGNMENT SCHEDULE

<u>Assignment</u>	<u>Due Date</u>
Homework Assignment 1	September 1, 2020
Homework Assignment 2	September 22, 2020
Homework Assignment 3	September 29, 2020
Reflections Paper	October 2, 2020
Homework Assignment 4	October 6, 2020
Homework Assignment 5	October 20, 2020
Final Project	November 1, 2020

All assignments are due at 10:00 p.m. on the dates listed above and should be submitted via the Course Canvas site.

Although we are all facing many challenges this term, please make every effort to submit your assignments on time. If there are unique circumstances that prevent you from doing this, please let me know.

ACCESSIBILITY

Although we will not be meeting on campus, I am available to meet and can be reached via email and telephone to assist you. I will have platform hours after each class. You are always welcome to call or email me.

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.

Week 1 Sessions 1 and 2 September 2 and 9, 2020
Overview of the Acquisition Process and Identifying Acquisition Targets

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.

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

Required Readings:

CHALFIN: Manuscript Part A

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.

Week 2 Sessions 3 and 4 September 14 and 16, 2020
Evaluating Acquisition Opportunities and Conducting Due Diligence

This class will discuss the strategic and operational criteria used to evaluate acquisition opportunities as well as the responsibilities and obligations of the parties to maintain the confidentiality of information that is exchanged. During this session we will discuss the art and science of evaluating and analyzing financial and legal due diligence material.

We will cover the data, metrics, 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.

The implications of the Tax Cut and Jobs Act of 2017 and The CARES Act on small business acquisitions will be reviewed.

Required Readings:

Chalfin: Manuscript Part B

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

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.

"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

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

Week 3 Sessions 5 and 6 September 21 and 23, 2020
Structuring the Acquisition – Legal, Financial, and Tax Considerations

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.

The design and structure of an acquisition along with the organizational, legal, and tax ramifications will be reviewed.

Required Readings:

CHALFIN: Manuscript Part C

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).

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

Homework Assignment:

Homework Assignment #2, which will be posted on Canvas, is due at 10:00 p.m. the night before class.

Week 4 Sessions 7 and 8 September 29 and 30, 2020
WE WILL NOT BE MEETING ON SEPTEMBER 28, 2020. WE WILL MEET ON SEPTEMBER 29, 2020 AT 6:00 p.m.

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 these entities. Empirical data will be utilized to validate the underlying assumptions for these calculations.

Required Readings:

CHALFIN: Manuscript Part D

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:

Homework Assignment #3, which will be posted on Canvas, is due at 10:00 p.m. on September 22, 2020.

Week 5 Sessions 9 and 10 October 5 and 7, 2020

Raising Capital

This class will explore the sources, processes, requirements, and obligations 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:

CHALFIN: Manuscript Part E page 1 to 21

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

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

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

Week 6 Session 11 and 12 October 12 and 14, 2020 **Search Funds, Fundless Deal Sponsor Models, and The Letter of Intent**

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 analyzed.

The letter of intent will be discussed 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.

Required Readings

CHALFIN :Manuscript Part E pages 22 to 25
Manuscript Part F.1

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

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: Selected Observations." *Stanford Graduate School of Business*, Case E662, September 24, 2018.

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 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 # 4 which will be posted on Canvas, is due on October 13, 2020 at 10:00 p.m.

Week 7 Sessions 13 and 14 October 19 and 21 Contract, Closing the Transaction, and Post Closing Integration

Vital components and considerations when negotiating the contract will be examined.

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. Students should be prepared to discuss in class five suggestions to improve the business that is discussed in the Zeswitz case, which is listed below.

Required Readings:

CHALFIN: Manuscript Part F.2
Manuscript Part G

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.

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:

Homework Assignment #5, which will be posted on Canvas, is due at 10:00 p.m. on October 20, 2020.

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