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

**Venture Capital and Entrepreneurial Management**

**MGMT 8040, Q1 – Fall 2022  
MW 10:15 AM – 11:45 AM  
Room: JMHH 350**

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**Setting the Stage for our Class**

In the world of venture capital and startups, 2021 was a year for the record books. In 2022, it is beginning to look as if the wave has crested. But as of the end of the second quarter, it is too soon to know whether the year is in full blown retreat from the records set last year, or is just a modest industry recalibration.

Venture capital and the technology sector that it supports<sup>1</sup> have continued to evolve, impacted by major macroeconomic events over the years. Since it first emerged in the 1970s, the United States venture capital and startup sector has always been dynamic, buffeted and shaped by dramatic technological and economic forces. Some of the more compelling technological changes include the development and proliferation of the internet, the semiconductor chip, the laptop computer, mobile communication, e-commerce, social media, and more recently, the emergence of artificial intelligence, autonomous technologies, advancing battery technologies, vaccine capabilities, blockchain and related technologies, gene therapy and gene editing and personalized medicine, to name only a few. Where once venture capital was almost exclusively dedicated to electronic technologies and software, today it has expanded to embrace almost all areas of innovation.

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<sup>1</sup> For 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, mobile, food and agtech, fintech, etc.), biotech companies (medical device, pharmaceutical, life science, digital health and health care, etc.), clean and green tech companies (fuel cell, solar, wind, battery storage, conservation technologies, etc.), homeland security companies, and consumer companies (social media, e-commerce, gaming, web 2.0, etc.).

Economically, the U.S. venture capital/startup community has endured the upheaval of two major financial crises—the dot.com bust of 2000-01, and the great recession of 2008. With the advent of the pandemic in March 2020, it was feared that the economic restrictions of the pandemic in 2020-2021 would precipitate another down cycle—but instead the pandemic has been witness to a record-setting explosion in economic activity.

As we all know, venture investment in the entrepreneurial community is all about cycles. Almost as soon as 2021 was being heralded as the harbinger of a transformative new era in the business of innovation, some degree of cyclical slowing from the highs of last year were expected. But 2022 seems to be setting the stage for a more significant industry recalibration at the least, or perhaps even a down cycle in the world economy that presages a financial recession. The economic forces driving this change are well known and do not seem likely to end soon—high inflation rates, changes in monetary policy by the Fed, ongoing disruptions to the global supply chain, the impact on commodity prices, such as oil and gas, of the war between Russia and Ukraine, and climate change, to name a few.

Although the severity of the down slope in this current cycle is still unknown, the headwinds that have emerged are affecting all aspects of venture capital activity and the formation and operations of early stage companies. Interestingly, there are many founders, managers and investors who have entered the community only after the recession of 2008 and have never been required to navigate through a down cycle in the economy.

Based on the experiences of the 2000-01 dot.com bust and the 2008 great recession, elements from the current negative outlook are mostly predictable and are pervasive throughout the startup ecosystem. Likely trends for 2022 include:

- **A decline in venture funding and tougher term sheets.** A general decline in available venture funding is expected, with all that that entails. Valuations already are becoming more conservative; the number and size of venture deals in general are expected to diminish across all levels of the startup ecosystem; and term sheets are beginning to reflect terms more favorable to the investor. It is expected that 2022 will see more “down rounds,” “flat rounds,” and convertible note or SAFE financings for both seed and later rounds. Valuation declines are expected to particularly impact companies at “unicorn” levels of valuation.
- **More selectivity by investors.** Investors are becoming more selective in the companies that they choose to invest in, and it is expected that the pace of venture investments correspondingly will slow. A bellwether among major investment funds with over 400 portfolio companies, SoftBank announced in May that it is substantially cutting back its investment activities for 2022, perhaps by even as much as 75%.

- **“De-risking” of VC portfolios and emphasis on company profitability.** In general, VC firms are beginning to “de-risk” their company portfolios by withdrawing support from companies that cannot control cash burn or fail to demonstrate positive cash flow and/or profitability within the near term. As part of the de-risking process, VC firms are expected to focus more on later stage companies with proven business models, at the expense of high risk, early stage companies. The emphasis on growth over profit in the last decade or so will change.
- **“Flight to quality” by limited partners and fundraising challenges.** The IPO market has shut down—as of mid-June of 2022, more than 140 VC-backed companies that went public in the U.S. since 2020 have market capitalizations that are less than the amount of venture funding they raised. In addition, SPAC exits are also expected to decline in 2022. Based on this and the notable sell-off in the public equity markets, historical patterns indicate that limited partners, placing a premium on experience and success, will engage in a “flight to quality” to the most successful VC firms. Fundraising for first-time or less successful firms will likely take longer and become more difficult.
- **Changes in employee hiring trends.** Although the pandemic has demonstrated that companies can successfully recruit and retain employees who reside in distant locations outside of the traditional centers of startup activity (e.g., the San Francisco Bay Area, New York City, Los Angeles, Seattle, Austin, and so on), it is expected that hiring will continue to be a challenge—particularly as companies restrain headcount growth in the service of expense reduction. In addition, the ease with which employees can “jump across” to take on jobs at competing companies is likely to change as the job environment changes.
- **Startups to prepare for hard times.** Startups will lean out as founders and CEOs take steps to extend their runway in the face of challenging business conditions. Some companies have already initiated layoffs; growth and cost containment strategies to produce a faster route to positive cash flow and profitability are under scrutiny; and some managers are seeking to optimize employee compensation practices to true up with the emerging market environment. Increasingly, experienced venture investors including the likes of Sequoia Capital and Lightspeed Venture Partners are instructing their portfolio companies to prepare for adverse conditions and to take all necessary steps to remain viable.

Two countertrends are important to note, however, as they may soften the angle of industry decline. Based on the record-shattering activities of 2021, many VC firms and startup companies alike are flush with cash, enabling them to stay with their fundamental investment and growth strategies without too much dislocation in the short term. Additionally, there are both investors and founders in the entrepreneurial community who did live through and survive the contortions of the 2000-01 dot.com bust and the 2008 recession, and who bring that experience with them into the current volatile environment.

## Course Overview and Design

Our class will cover many of the traditional conventions in the industry that have historically shaped investor and company behaviors, and the various industry dynamics that are affecting the current state of play.

This elective course focuses on venture capital and the typical venture-backed start-up company, based on conventions and practices in the United States<sup>2</sup>. 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 and corporate governance.

The entrepreneur's perspective addresses the challenges in organizing and financing the venture. 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. Insights gained from these class discussions will be valuable for students considering a career in venture capital, while also providing essential information for entrepreneurs. As we explore the venture capitalist's perspective, we will address several aspects of the investment process including current financing trends in both early and late stage companies, the term sheet content and structure in a typical VC financing (both convertible debt and equity), 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.

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 six areas relevant to the formation and funding of privately held, high-growth-potential start-ups. These include:

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<sup>2</sup>There are many business structures for early stage companies, including companies that are sole proprietorships, general partnerships, limited partnerships, and limited liability corporations. The focus of this course is on early stage corporations, typically incorporated as Subchapter C corporations, that are predominantly supported by venture investors in the technology sector. Thus, companies that are family-owned, closely held or outside the profile of the typical venture-backed company are outside the purview of this course.

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Course Syllabus

- 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 criteria.
- 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.
- The challenges of fundraising, due diligence, and financing strategies.
- Valuation methodologies that form the basis of the negotiation between the entrepreneur and the venture capitalist in anticipation of a venture investment.
- 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.

**Canvas Site:** There is a dedicated Canvas site for our course. Lecture notes, caselettes, and course materials as well as periodic announcements will be posted on this Canvas site.

- The Canvas URL is: <https://canvas.upenn.edu/courses/1657340>
- Students will be able to access copyrighted reading materials through Canvas, via the "Study.net Materials" and the “Course Materials @ Penn Libraries” Tabs on the Canvas site. Please email [courseware@wharton.upenn.edu](mailto:courseware@wharton.upenn.edu) with any issues regarding the reading materials. You may also contact [customerservice@study.net](mailto:customerservice@study.net) outside of normal business hours regarding the Study.net.

**Readings:** 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 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 can be found on Canvas.

**Case Studies:** There is one HBS problem set along with four short case studies, or caselettes, which will be used in this course. These caselettes are based on actual occurrences (with some degree of poetic license as appropriate) and are substantially shorter than traditional case studies. 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 case study and caselette, specific study questions have been assigned. In most class sessions, we will consider these questions in addition to the material in the case.

**Study Groups:** Students are asked to form study group teams of up to 6 students per team. Study groups are expected to meet to discuss and prepare each assignment. Choose your teammates carefully—changes will not be allowed once your study-group team has been formed. **The deadline for team formation is Wednesday, August 31, 2022. Note: students who have not signed up for a study group by the above deadline will be assigned to a study group by the TA.**

### Requirements and Evaluation

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

- Classroom participation **20%**
- Case memos and other assignments **20%**
- Negotiation submissions & presentation **30%**
- Quiz **30%**

**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 “Learning Agreement” (<https://mba-inside.wharton.upenn.edu/mba-learning-agreement/>) any other use of electronics such as cell phones 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. There will be assigned seating in the class: During the second class meeting on **August 31<sup>st</sup> 2022** you will be asked to choose your seat. A seating chart will be displayed before the

beginning of each class meeting. You are required to display your Wharton-issued name tent in each class to facilitate teacher/student interaction. **Note:** Failure to sit in your assigned seat or 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. (If you do not have a Wharton-issued name tent, we will provide you with a name tent.)

**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 intent is to motivate the class discussion. Please do not be concerned by the fact that you may not know the exact answer because there may not be a single answer. These are normally qualitative issues that reflect the assessments and views of the stakeholders. The material required for all quantitative assignments will be discussed in class before the assignment is due.

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 be integrated into a single file. **The names of the students in the study team must appear on the 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 that have been posted online on the Canvas site for our class before the beginning of the class session to which the caselette is assigned and that are visible on the due date and time. No credit will be given for write-ups which are posted late or not posted.

**Negotiation Exercise (30%):** A critical component of the course is the negotiation exercise, which enables students to apply and integrate their learnings. The detailed instructions of the exercise will be distributed during the course. At the end of Class 7 on **Wednesday, September 21, 2022**, we will confirm with you the pairing of the negotiation teams. Each team will be designated as either Founders or as VCs. We will pair two VC teams against a single Founders team. Each Founders team will get the term sheets that reflect initial offers from the two different VC teams along with “backgrounder” documents that provide details about the VC investors. Each investor team will get copies of the initial term sheet that they gave to the Founders along with a backgrounder.

During the classes on **Monday, October 3<sup>rd</sup>** and **Wednesday, October 5<sup>th</sup>, 2022**, Founders teams and VC teams will be asked to summarize and present to the class the results of the term sheet negotiation. Detailed schedules will be distributed in class and posted on Canvas.

**Each negotiation team is required to upload the deliverables of the negotiation exercise onto Canvas no later than 5:00 PM EDT on Sunday, October 2, 2022.** All team members are required to actively participate

in preparing and presenting the results of the negotiations assignment. More information about the exercise will be made available during the course.

The exact details of the negotiation process and the presentations that are due will be outlined in the materials that will be distributed to you electronically.

**Quiz (30%):** Will be held on **Monday, October 10, 2022** during class time. This is an open-book, open-notes quiz. Students must bring a calculator to the quiz.

**Peer Evaluation:** Since 50% 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 and made available online. 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.

#### **Lecture Notes:**

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

#### **Learning Environment and Excused Absence Policy:**

Consistent with the **Wharton Learning Agreement**, which depicts the Students and Instructor standards, please note that:

- Class starts and ends exactly on time. Students and faculty are expected to be prompt.
- Students sit according to a seating chart.
- 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.*

As well, we will adhere to the **Wharton Excused Absence Policy** (<https://mba-inside.wharton.upenn.edu/academic-performance/excused-absence-policy/>).

#### **Feedback and Questions**

I 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 course-related issues you would like to discuss, please feel free to contact me via email, come to the office hour that is scheduled for Monday between 3:30-5:00PM, or set up an appointment with me.



Course Syllabus				
<b>Course Outline At-a-Glance</b>				
<b>MGMT 8040 Q1 Fall 2022<sup>3</sup></b>				
<b>Session Number</b>	<b>Date</b>	<b>Topic</b>	<b>Case/Activity</b>	<b>Submissions Due</b>
1	Monday, August 29, 2022	Course Introduction; The VC Industry Today	Study group formation	
2	Wednesday, August 31, 2022	VC Firm Structure and Activities; Evaluating Opportunities		
3	Wednesday, September 7, 2022	Organizational Issues and Initial Capitalization in the Formation of a Start-Up	Caselette #2: Considerations in Establishing the Initial Capitalization of the Start-Up	Upload Case Memo #2 (Note: There is no Caselette #1)
4	Monday, September 12, 2022	The Fundraising Landscape	Caselette #3: Issues Encountered in Connection with a First Round Financing	Upload Case Memo #3
5	Wednesday, September 14, 2022	Lecture on, and examples of, the VC Valuation Method		
6	Monday, September 19, 2022	Applying the VC Valuation Method Negotiating the Term Sheet	HBS Problem Set (HBS Case # N9-396-090)	Upload Questions 1-5 before class

<sup>3</sup> Note: The session outline is subject to change in order to accommodate the pace and content of class discussions

## Course Syllabus

7	<b>Wednesday, September 21, 2022</b>	Term Sheets (Continued)	Caselette #4: Liquidation Preferences and Anti-Dilution Formulas	Upload Case Memo #4 Distribute negotiation materials
8	<b>Monday, September 26, 2022</b>	Analysis of a Term Sheet Corporate Governance	Caselette #5: Analysis of a Term Sheet Class discussion of the Alantec handout	Upload Case Memo #5
9	<b>Wednesday, September 28, 2022</b>	Guest Speaker, TBA		
10	<b>Monday, October 3, 2022</b>	Class Presentations on Term-Sheet Negotiations		See details of deliverables <b>Submissions must be uploaded onto Canvas no later than: Sunday, October 2, 2022 at 5:00 PM</b>
11	<b>Wednesday, October 5, 2022</b>	Class Presentations on Term-Sheet Negotiations		
12	<b>Monday, October 10, 2022</b>	Quiz		

## Detailed Course Outline

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

**Monday, August 29, 2022**

### Session 1: Course Introduction; The VC Industry Today

- An overview and brief history of the venture capital industry and its role in fostering the growth of firms
- Fundamentals of VC investments
- Current industry trends

#### Session 1: Required Readings

- “A Note on the Venture Capital Industry,” Harvard Business School (HBS # 9-295-065, July 12, 2001)
- “So Really, What is Venture Capital?” Chapter 2 of “Secrets of Sand Hill Road—Venture Capital and How to Get It,” by Scott Kupor, Andreessen Horowitz (2019)

#### Session 1: Supplemental Readings

- “What comes after the easy money era ends for cash-burning companies in Silicon Valley,” by Eric Rosenbaum, CNBC Disruptor 50 (May 18, 2022)
- “Need advice on navigating a tough startup market? Start here,” by Alex Wilhelm, Natash Mascarenhas and Miranda Halpern (May 6, 2022)
- “The upside of a downturn,” Lightspeed Venture Partners (May 16, 2022)
- “How far will high-flying tech investors fall?” by James Thorne, Pitchbook (May 27, 2022)
- “Where is Venture Capital Headed in 2022?” by Suzanne Fletcher, Forbes (March 10, 2022)
- “Reckoning looms for past VC excesses as market forces valuation reset,” by Marina Temkin, Pitchbook (May 20, 2022)
- “The Great VC Pullback of 2022,” by Matt Turck (April 28, 2022)
- “Nontraditional Investors React to Current Market Headwinds,” by Kyle Stanford, Pitchbook (May 31, 2022)
- “Demystifying Venture Capital Economics, Part I,” by Andy Rachleff (June 19, 2014)
- “Demystifying Venture Capital Economics, Part II,” by Andy Rachleff (September 24, 2014)
- “Behind the Scenes at a VC Fund, Part 3: Fund Structure, Fundraising, Investor Relations and FAQs,” by Leo Polovets, Susa Ventures (March 2017)
- “How Venture Capitalists Make Decisions,” by Paul Gompers, Will Gornall, Steven Kaplan and Ilya Strebulaev, Harvard Business Review (March-April 2021)

**Wednesday, August 31, 2022****Session 2: VC Firm Structure and Activities; Evaluating Opportunities**

- VC firm structures and activities
- Opportunity definition and recognition
- Evaluating opportunities

**Session 2: Supplemental Readings**

- “Does Venture Capital Foster the Most Promising Entrepreneurial Firms?” by R. Amit, L. Glosten & E. Muller, *California Management Review*, 32 (3): 102-111, 1990
- “Coronavirus: The Black Swan of 2020,” Sequoia Capital (March 5, 2020)
- “The Tech Start-Up Economy Is Broken,” by Mark Lemley and Andrew McCreary (September 12, 2020)
- “In Search of the Next Big Thing,” *Harvard Business Review* (May 2013)
- “How Venture Capitalists Evaluate Potential Venture Opportunities,” *Harvard Business School* (HBS # 9-805-019, December 1, 2004)
- “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)

**Wednesday, September 7, 2022****Session 3: Organizational Issues and Initial Capitalization in the Formation of a Start-Up**  
***Submission Due: Case Memo #2***

- Forming the company and creating a capital structure in preparation for venture funding
- Founders’ stock and foundations of equity incentive arrangements
- Basic building blocks involved in equity financings with venture investors
- Corporate structures to support financing
- ***Prepare Caselette #2:*** Considerations in Establishing the Initial Capitalization of the Start-Up (**Post before the beginning of class**)  
*\*Note: There is no Caselette #1*

**Session 3: Supplemental Readings**

- “The Legal Forms of Organization,” Harvard Business School (HBS # 9-898-245, 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)
- “How to Start a Startup,” [based on the eponymous essay by Paul Graham] by Anna Vital (May 13, 2013)
- “How to Choose a Co-Founder,” by Elad Gil (February 27, 2012)
- “Cap Tables, Share Structures, Valuations, Oh My! A Case Study of Early Stage Funding,” by Jason Rowley (September 26, 2017)
- “How to Split Equity Among Co-Founders,” by Michael Seibel, Y-Combinator (June 6, 2019)
- “Founder’s guide to allocating co-founder equity,” by Long Term Stock Exchange (LTSE) (no date)
- “Startup Equity Calculator: How to Split Fairly Among Founders,” Embroker (September 2, 2021)
- “What is an Employee Option Pool?” by AngelList Venture (no date)
- “How to Decide the Size of Your Employee Option Pool,” by Jenna Lee, Carta (June 9, 2021)
- “9 of the Biggest Mistakes Startup Entrepreneurs Make,” by Donna Finn, Business Insider (August 27, 2019)
- “The Very First Mistake Most Startup Founders Make,” by Noam Wasserman and Thomas Hellman (February 23, 2016)
- “Dividing Equity Between Founders,” by Chris Dixon (August 23, 2009)
- “Selecting and Protecting a Company Name,” by Aaron Hendelman, WSGR Entrepreneurs Report (Summer 2008)

**Monday, September 12, 2022****Session 4: The Fundraising Landscape*****Submission due: Case Memo #3***

- Sources of capital
- Alternative forms of fundraising
- Convertible note financing
- Fundraising process and fallacies
- ***Prepare Caselette #3: Issues Encountered in Connection with a First Round Financing (Post before the beginning of class)***

**Session 4: Required Readings**

- "Financing New Ventures" (HBS #9-811-093, March 28, 2011)
- "Convertible Notes in Seed Financings" (HBS #9-813-017, September 23, 2016)

**Session 4: Supplemental Readings**

- "The Rise of Alternative Venture Capital," by Tristan Pollack, Entrepreneur (March 24, 2020)
- "How to Manage Equity Dilution as an Early-Stage Startup," by Jenna Lee, Carta (June 9, 2021)
- "SPACs: What You Need to Know," by Max Bazerman and Parish Patel, Harvard Business Review (July-August 2021)
- "How Special Purpose Acquisition Companies (SPACs) Work," PWC (no date)
- "Considering an IPO? First, Understand the Costs," PWC (no date)
- "Raising Money for Your Startup? Here Are 6 Things You Absolutely Must Do," by Mark Suster (May 9, 2018)
- "A Guide to Seed Fundraising," by Geoff Ralston, Y-Combinator (no date)
- "How Much Should You Raise in Your VC Round? And What Is a VC Looking at in Your Model?" by Mark Suster (May 28, 2018)
- "How to Raise Money," by Paul Graham (September 2013)
- "How do startup accelerators work?" by James Wilson, Silicon Valley Bank (no date)
- "6 Pros and Cons of Joining a Startup Accelerator," by Karthik Sridharan, Wharton (February 25, 2016)
- "Is a Startup Accelerator Right for You?" by Jess Bardo, Silicon Valley Bank (no date)
- "How to Do Crowdfunding in 2021: With Expert Tips and Examples from Successful Campaigns," by Desirae Odjick (July 23, 2021)
- "What's the Difference between Pre-Seed and Seed Funding Rounds?" by Matthew Lynley (July 9, 2019)
- "What is Pre-Seed Funding?" by Jaclyn Robinson, Crunchbase (March 17, 2022)
- "Seed Funding: A Guide for Starting Up with Seed Fundraising," MacDonald Ventures (September 20, 2021)
- "Pros and Cons of Raising Seed Financing via Convertible Notes vs. Preferred Stock," by Sundance Banks, WSGR Entrepreneurs Report (Q3 2013)
- "Understanding Convertible Notes," FundersClub (no date)
- "Frequently Asked Questions: Convertible Debt," by Peter Werner of Cooley Law Firm
- "Quick Start Guide," Y-Combinator (no date)
- Simple Agreement for Future Equity [SAFE] (post-money valuation cap with discount), Y-Combinator form (March 2021)
- Form of Series Seed Term Sheet, Cooley Law Firm (October 2021)
- Form of Convertible Note Term Sheet, Cooley Law Firm (October 2021)

**Wednesday, September 14, 2022**

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**Session 5: Lecture on, and examples of, the VC Valuation Method**

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

**Session 5: Required Readings**

- “A Note on Valuation in Private Equity Settings,” Harvard Business School (HBS # 9-297-050, April 2002)
- “Ownership, Dilution, Negotiation, and Valuation,” Chapter 7 in High tech start-up: the complete handbook for creating successful new high tech companies, by J. Nesheim (2000)

**Session 5: Supplemental Readings**

- “How to Talk About Valuation When a VC Asks,” by Mark Suster (May 29, 2018)
- “Startup Valuation—The Ultimate Guide to Value Startups 2021,” Pro Business Plans (March 30, 2021)
- “What Most People Don’t Understand About How Startup Companies Are Valued,” by Mark Suster of Upfront Ventures (February 24, 2016)
- “How Do VC’s and Angels Value a Company?” by Jeff Carter (August 8, 2014)
- “How Does an Early Stage Investor Value a Startup?” by Carlos Eduardo (undated)
- “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)
- “What’s My Company Worth?” by Herb Fockler, WSGR Entrepreneurs Report (Fall 2007)
- “Want to Know How VC’s Calculate Valuation Differently from Founders?” by Mark Suster (July 22, 2010)

**Monday, September 19, 2022**

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**Session 6: Applying the VC Valuation Method; Negotiating the Term Sheet**  
**Submission Due: HBS Problem Set (HBS Case # N9-396-090)**

- **Case Discussion:** The Venture Capital Method—Valuation Problem Set (HBS Case # 9-396-090, October 5, 1995)

**Upload Questions 1 – 5 before the beginning of class.**

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

**Session 6: Supplemental Readings**

- 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
- “Investor-protective deal terms may keep down rounds at bay,” by Priyamvada Mathur, Pitchbook (May 20, 2022)
- “Cram downs are a character test for VCs and founders” by Steve Blank (April 18, 2022)
- “The case for down rounds,” by Connie Loizos, TechCrunch (June 9, 2022)
- “Liquidation Preference in Startup Deals,” Startup Valuation School (August 3, 2020)

**Wednesday September 21, 2022**

**Session 7: Term Sheets (Continued)**  
**Submission Due: Case Memo #4**

- Review and discuss caselette regarding term sheets
- **Prepare Caselette #4:** Liquidation Preferences and Anti-dilution Formulas (**Post before the beginning of class**)



**Session 7: Required Readings**

- “The Impact of Dilution,” by Andy Rachleff (August 26, 2014)
- “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)

**Session 7: Supplemental Readings**

- “Negotiating Term Sheets: Focus on What’s Important,” by Matthew Bartus, Cooley Godward (no date)
- “How to Negotiate a Term Sheet in the Covid-19 Era,” by Russ Wilcox, Pillar VC (August 11, 2020)
- “Control: The Critical Issue in Negotiating Financing Terms,” by Caine Moss, WSGR Entrepreneurs Report (Fall 2008)
- “VC Negotiation Tricks: Simplified Term Sheets and Post-Money Valuations,” by Elad Gil, Elad Blog (September 17, 2017)
- “6 Investment Term Sheet Mistakes Founders Make,” by RubiconLaw (December 5, 2017)
- “What Is It Like to Negotiate a VC Round?” by Mark Suster (June 5, 2015)
- “Dual-Class Stock: A Founder Favorite Faces Growing Investor Disapproval,” by Lianna Whittleton of Wilson Sonsini Goodrich & Rosati, Entrepreneurs Report (1H 2016)
- “Limit Dual-Class Structures Rather Than Shun Them,” by Scott Kupor (November 20, 2018)
- “Super Voting Stock: The Advantages and Pitfalls,” by Stradling law firm (October 3, 2018)
- “Price and Preference—Participating v. Non-Participating Preferred,” by Herb Fockler of Wilson Sonsini Goodrich & Rosati, Entrepreneurs Report (Q1 2015)
- “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)
- “The Toxic Term Sheet: Founders Beware!” by John Backus (October 6, 2015)
- “On the Road to Recap: Why the Unicorn Financing Market Just Became Dangerous...for All Involved,” by Bill Gurley (April 21, 2016)
- Series A Preferred Memorandum of Terms, WSGR template (October 2017)

**Term Sheet Negotiation Assignment**

- Materials explained

*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 VCs.*

We will pair two VC teams against a single Founders team. Each Founders team will get term sheets that reflect initial offers from the two different VC teams. You will get a “backgrounder” document that provides background information for the assignment.

Details of the process and content of this assignment will be distributed to you electronically.

During the classes on **Monday, October 3, 2022** and **Wednesday, October 5, 2022** each team will be required to summarize and present the results of the term sheet negotiation.

**The group presentations must be uploaded onto Canvas by Sunday, October 2, 2022 no later than 5:00 PM.**

### Monday, September 26, 2022

#### Session 8: Analysis of a Term Sheet; Corporate Governance

##### *Submission Due: Case Memo #5*

**Handout:** Alantec case – handed out in class

- Board members’ duty to stockholders
- Composition and roles of the board of directors in the private company
- **Prepare Caselette #5:** Analysis of a Venture Capital Term Sheet (**Post before the beginning of class**)
- **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.
- **Please bring a hard copy of Caselette #5 to this class meeting**

#### Session 8 Supplemental Readings

- “Board Members and the Good Housekeeping Seal of Approval,” Chapter 12 of “Secrets of Sand Hill Road—Venture Capital and How to Get It,” by Scott Kupor, Andreessen Horowitz (2019)

## Course Syllabus

- “The Fiduciary Duties of Founders,” by Silicon Hills Lawyer (January 13, 2016)
- “What You Need to Know About Startup Boards,” by Samer Hamadeh and Adam Dinow (November 2016)
- “How to Prepare for a Board Meeting to Make Sure You Crush It,” by Mark Suster (February 27, 2019)
- “What You Need to Know about Board Compensation,” Matt Blumberg, Bolster (May 4, 2021)
- “Board Compensation: 3 Charts on How Companies Pay Non-Investor Directors,” by Dana Olsen of Pitchbook (June 22, 2017)
- “3 Considerations for Advisory Board Compensation,” by Tony Lettich (June 28, 2017)
- “The Basic Responsibilities of VC-Backed Company Directors,” by Working Group on Director Accountability and Board Effectiveness (January 2007)
- “Corporate Governance and Disclosure Practices of Venture-Backed Companies in U.S. Initial Public Offerings,” Wilson Sonsini Goodrich & Rosati (July 2011-June 2012)
- “The Board Works for the Common Stock,” by Silicon Hills Lawyer (February 7, 2018)
- “11 Quick Tips to Get More Value Out of Your Board,” by Mark Suster (August 15, 2017)
- “Pre-Series A Startup Boards,” by Jose Ancer, Silicon Hills Lawyer (May 17, 2017)
- “How Do You Compensate Directors of Startup Companies?” by Paul Jones (March 7, 2013)
- “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)

**Wednesday, September 28, 2022****Session 9: Guest Speaker, TBA****Monday, October 3, 2022**

**Session 10: Class Presentations on Term-Sheet Negotiations**

During this session, teams will present their negotiated term sheets and discuss the issues they ran into during the negotiation. Each team has been allocated **10 minutes** for its presentation.

**Submissions are due by Sunday, October 2, 2022 no later than 5:00 PM EDT.**

- Each of the investor teams and founders teams will prepare a PowerPoint presentation, which includes the final proposed valuations as well as detailed commentary on the content and process of the term sheet negotiations.
- Founders teams additionally provide a detailed summary of the final agreement using the format outlined in the Negotiation Instruction handout that will be distributed.
- Investor teams additionally provide detailed valuation calculations.

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**Wednesday, October 5, 2022****Session 11: Class Presentations on Term-Sheet Negotiations**

During this session, teams will present their negotiated term sheets and discuss the issues they ran into during the negotiation. Each team has been allocated **10 minutes** for its presentation.

**Submissions are due by Sunday, October 2, 2022 no later than 5:00 PM EDT.**

- Each of the investor teams and founders teams will prepare a PowerPoint presentation, which includes the final proposed valuations as well as detailed commentary on the content and process of the term sheet negotiations.
- Founders teams additionally provide a detailed summary of the final agreement using the format outlined in the Negotiation Instruction handout that will be distributed.
- Investor teams additionally provide detailed valuation calculations.

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**Monday, October 10, 2022****Session 12: Quiz**

**QUIZ (open books; open notes; tablets and laptops in airplane mode; muted communication)**

- Bring your calculator.