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The University of Pennsylvania
The Wharton School
Management Department

Venture Capital and Entrepreneurial Management

MGMT 2640 – Fall 2022
MW 1:45 pm – 3:15 pm
Room: JMHH 260

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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 supports¹ 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.

¹ 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 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 States². 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 nine principal areas relevant to privately held, high-growth-potential start-ups. These include:

²There 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.

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 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 incentives 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
- Elements of compensation, both cash and equity, that are common to venture-backed companies in the technology sector
- Managing the exit
- 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. 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/1657337>
- 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 with any issues regarding the reading materials. You may also contact customerservice@study.net outside of normal business hours regarding the Study.net materials.

Readings: 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 are three HBS case studies that are assigned along with five 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 5 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 **September 12th, 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:

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|--|------------|
| • Classroom participation | 20% |
| • Case memos and other assignments | 20% |
| • Negotiation submissions & presentation | 30% |
| • Late mid-term 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 “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. There will be assigned seating in the class: During the second-class meeting on **September 7th, 2022** you will be asked to choose your seat. A seating chart will be displayed before the beginning of each class meeting. There

will be assigned seating in the class: You are asked to sit in your assigned seat and 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 that class session. (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 and before the start of class, your study-group team is asked to 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. 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 instruction of the exercise will be distributed during the course. At the end of class 16 on **Wednesday, October 26th, 2022**, I 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, December 5th and Wednesday December 7th, 2022**, Founders teams and VC teams will be required 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 assignment onto Canvas no later than 5:00 PM EST on Sunday, December 4th, 2022**. All team members are required to actively participate in preparing and presenting the results of the negotiations assignment. 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.

Quiz (30%): Will be held on **Wednesday, November 2, 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 electronically to you. Specifically, at the end of the class you will be evaluated by each of your team members based on your contribution to each category of group assignments, namely caselette/problem-set memos and the negotiation assignment. 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 review 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 and Excused Absence Policy

Consistent with the Wharton Resource Guide students are expected to adhere to “concert rules,” alluding to the environment one ordinarily finds at an orchestral performance. By labeling them as such, they become an intuitively understood set of expectations which include:

- 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 may apply grade penalties for violations of these learning-environment guidelines.

Academic engagement requires a commitment to class preparation and attendance. The School recognizes, however, that there are occasions where classroom attendance is not possible due to personal circumstances. The following fit the criteria of excused absences: Illness; Death in the family; Grave personal circumstances; Religious observance. Students in these situations can, with appropriate documentation, request that their absences be accommodated. Note that the following would be considered unexcused absences: Recruitment; Travel.

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 that is scheduled for Monday between 3:30-5:00 PM, or set up an appointment with the instructor.

Course Outline At-A-Glance MGMT 2640 Fall 2022³				
Session #	Date	Topic	Case/activity	Submissions Due
1	W 8/31/22	Course Introduction and Overview		
2	W 9/7/22	The VC Industry Today – An Industry in Transition		
3	M 9/12/22	VC Firm Structure and Activities		
4	W 9/14/22	Evaluating Opportunities - Overview		
5	M 9/19/22	Evaluating Opportunities II: Validating Assumptions	HBS Case Study #812077 (2011, rev. 2012) <i>Rent the Runway</i>	Study group teams may be asked to present their analysis
6	W 9/21/22	The Business Model – Overview		
7	M 9/26/22	Evaluating Opportunities III: Business Model Innovations	HBS Case Study #W19506 (Ivey, 2019) <i>NIO: Developing a Business Model in China</i>	Study group teams may be asked to present their analysis
8	W 9/28/22	Formation of a Start-up I: Organizational Issues	Caselette #1	Caselette #1
9	M 10/3/22	Formation of a Start-up II	Caselette #2	Caselette #2
10	W 10/5/22	Formation of a Start-up III: Initial Capitalization and Founder Team Challenges	Caselette #3 & govWorks Video Case	Caselette #3
11	M 10/10/22	The Fundraising Landscape - Overview		
12	W 10/12/22	Valuation Methodologies		
13	M 10/17/22	Valuation Methodologies (continued)	HBS Problem Set (# N9-396-090)	Questions 1-5
14	W 10/19/22	Negotiating Term Sheets		
15	M 10/24/22	Liquidation Preferences and Price Protection Anti-Dilution	Caselette #4	Caselette #4
16	W 10/26/22	Analysis of a Term Sheet (Hand out negotiation materials)	Caselette #5	Caselette #5

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

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17	M 10/31/22	Review Session		
18	W 11/2/2022	Quiz		
19	M 11/7/2022	Compensation Practices in a VC Backed Start-up		
20	W 11/9/2022	Guest Speaker: David Spiro, Principal, Insight Ventures https://www.insightpartners.com/team/david-spiro		
21	M 11/14/2022	Managing the Exit		
22	W 11/16/2022	VC Negotiation Team Meetings with the Instructor	Sign-up schedule will be posted on Canvas	
23	M 11/21/2022	VC Negotiation Team Meetings with the Instructor	Sign-up schedule will be posted on Canvas	
24	M 11/28/2022	Corporate Governance – The role and composition of the BOD in a venture-backed firm	Class discussion of the Alantec handout	
25	W 11/30/2022	Selected Second Round VC Negotiation Team Meetings with the Instructor	Signup schedule will be posted on Canvas	Meetings are held in the classroom
26	M 12/5/2022	Term Sheet Debriefings		All Presentations are due NO LATER than Sunday, December 4, 2022 at 5:00 PM (Late submissions will not be accepted)
27	W 12/7/2022	Term Sheet Debriefings, Benchmarking the Results, and Course Summary		

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 31, 2022**Session 1: Course Introduction and Overview**

- Course introduction
- Study group formation
- The role of the 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
- “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)
- “Demystifying Venture Capital Economics, Part I,” by Andy Rachleff (June 19, 2014)
- “Demystifying Venture Capital Economics, Part II,” by Andy Rachleff (September 24, 2014)
- “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 7, 2022**Session 2: The VC Industry Today – An Industry in Transition**

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

Required Reading:

- “A Note on the Venture Capital Industry,” Harvard Business School (HBS # 9-295-065, July 12, 2001)

Supplementary 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)
- “Behind the Scenes at a VC Fund, Part 3: Fund Structure, Fundraising, Investor

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- 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)
- “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)

Monday, September 12, 2022**Session 3: VC Firm 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 Readings:

- “How Venture Capital Works,” by B. Zider, Harvard Business Review (Nov-Dec 1998)
- “The Venture Capital Funnel,” CB Insights (April 7, 2014)
- “The Evolving Relationship between LP and GPs,” by A. Leamon, J. Lerner & S. 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 14, 2022**Session 4: Evaluating Opportunities - Overview**

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

Supplementary Readings:

- “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)
- “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 19, 2022**Session 5: Evaluating Opportunities II: Validating Assumptions****Required Reading:**

- HBS Case Study #812077 (2011, rev. 2012)
Rent the Runway

Case Discussion Questions (please prepare PPT slides for presentation to the class):

1. What is the business opportunity that the founders have identified?
2. Are the backgrounds and experiences of the co-founder team

- suitable for the business opportunity?
3. Create a timeline of actions taken by **Rent the Runway (RTR)**. Do you agree with their decisions to capture the business opportunity? Which actions were important in validating their assumptions and refining the concepts?
 4. As the case ends in January 2010, the cofounders are considering whether to: (1) stick with their original plan to pursue operational improvements in 2010 before raising more capital in 2011; or (2) accelerate fundraising in order to expand inventory and product range, enabling RTR to serve a broader set of customer segments and usage occasions. What would you have done about this decision?

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 21, 2022

Session 6: The Business Model - Overview

Required Readings:

- BUSINESS MODEL INNOVATION STRATEGY: Transformational Concepts and Tools for Entrepreneurial Leaders

By: Raphael Amit and Christoph Zott
John Wiley & Sons Inc. 2021
Hoboken, NJ

Chapter 1: Why Do Business Models Matter? The “What, How, Who, and Why” Framework for Understanding Any Business Model

Chapter 2: How Business Models Create Value in New Ways – Case Studies and Theory

Monday, September 26, 2022

Session 7: Evaluating Opportunities III: Business Model Innovations

Required Reading:

- HBS Case Study #W19506 (Ivey, 2019)
NIO: Developing a Business Model in China

Case Discussion Questions (please prepare PPT slides for presentation to the class):

Discussion Questions:

1. Describe the industry environment when NIO was founded. What factors contributed to the establishment and development of NIO?
2. Describe the NIO business model in terms of the 4 dimensions and plot the activity map.
3. What were the innovations in NIO’s business model?
4. Why did NIO choose a “charging and replacing” system as part of its business model?
5. Faced with a fiercely competitive market, what adjustments would you recommend for NIO’s business model?

Course Syllabus

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 28, 2022**Session 8: Formation of a Start-up I: Organizational Issues**

- Building a start-up team
- Forming the company and creating a capital structure in preparation for venture funding
- Basic building blocks involved in equity financings with venture investors
- Corporate structures to support financing

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 Readings:

- “The Process of Forming the Company.” Chapter 3 of High tech startup: the complete handbook for creating successful new high tech companies, by J. Nesheim (2000)
- “Founder’s guide to allocating co-founder equity,” by Long Term Stock Exchange (LTSE) (no date)
- “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 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,” Paul Graham (March 5, 2005)
- “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)

Monday, October 3, 2022**Session 9: Formation of a Start-up II**

- Initial capitalization: design the equity and capital structure

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.

Supplementary Readings:

- “Cap Tables, Share Structures, Valuations, Oh My! A Case Study of

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- Early Stage Funding,” by Jason Rowley (September 26, 2017)
- “Startup Equity Calculator: How to Split Fairly Among Founders,” Embroker (September 2, 2021)
- “How to Split Equity Among Co-Founders,” by Michael Seibel, Y-Combinator (June 6, 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)

- What did they do well?
 - What mistakes were made?
- Human Resource lessons:
- What did they do well?
 - What mistakes were made?
- Financial lessons:
- What did they do well?
 - What mistakes were made?
- Marketing lessons:
- What did they do well?
 - What mistakes were made?
- Operational:
- What did they do well?
 - What mistakes were made?
- Technical/R&D:
- What did they do well?
 - What mistakes were made?

Wednesday, October 5, 2022**Session 10: Formation of a Start-up III: Initial 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.

- **govWorks Video case**
Video Case: govWorks.com

<https://www.youtube.com/watch?v=ibuiUXOTE4M>

While watching the video during your study group meeting, please note the lessons learned in the following areas of the business:

Strategy lessons:

Be prepared to discuss the following 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?

Monday, October 10, 2022**Session 11: The Fundraising Landscape - Overview**

- Sources of capital
- Alternative forms of fundraising

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- Evaluating funding options
- Convertible note financing
- Fundraising process and fallacies

Required Readings:

- "Financing New Ventures " (HBS #N9-811-093, March 28, 2011)
- "Convertible Notes in Seed Financings," Harvard Business School (HBS # 9-813-017, September 23, 2016)

Supplementary 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)
- "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)
- "What Is a Startup Accelerator? Research on Top Startup Accelerators

- 2020," by Taras Tymoshchuck (June 1, 2020)
- "Is a Startup Accelerator Right for You?", by Jess Bardo, Silicon Valley Bank (no date)
- "What is Pre-Seed Funding?" by Jaclyn Robinson, Crunchbase (March 17, 2022)
- "What's the Difference between Pre-Seed and Seed Funding Rounds?" by Matthew Lynley (July 9, 2019)
- "Seed Funding: A Guide for Starting Up with Seed Fundraising," MacDonald Ventures (September 20, 2021)
- "How Biotech Startup Funding Will Change in the Next 10 Years," by Jared Friedman, Y-Combinator (no date)
- "How to Do Crowdfunding in 2021: With Expert Tips and Examples from Successful Campaigns," by Desirae Odjick (July 23, 2021)
- "How Crowd-Funding Is Changing Everything and What That Means for Your Startup" by First Round Capital (2017)
- "Equity Crowdfunding: The Future of Financing," by Neil Patel (May 25, 2020)
- "Blockchain, Bitcoin, Cryptocurrency and ICOs—All You Need to Know in 10 Minutes," by Bernard Marr (September 15, 2017)
- "Bitcoin and Cryptocurrencies—What Digital Money Really Means for Our Future," by Alex Hern (January 29, 2018)
- "Bitcoin Is the Greatest Scam in History," by Bill Harris (April 24, 2018)
- "The Top 5 Trends Defining Crypto in Late 2020," by Gregory Klumov (August 9, 2020)
- "Angels: Foundational Investors to VC," Pitchbook (June 2020)
- "Corporate VC Firms Buck "Tourist" Reputation with Pandemic Dealmaking," James Thorne, Pitchbook (September 28, 2020)

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- Terms for Series Seed Preferred Stock, Cooley Law Firm form (October 2017)
- “Bad Notes on Venture Capital,” by Mark Suster, Upfront Ventures (September 17, 2014)
- “Frequently Asked Questions: Convertible Debt,” by Peter Werner of Cooley Law Firm
- “What is a Valuation Cap?” by Adam Lieb and Joe Wallin, Startup Law Blog (February 21, 2014)
- “Pros and Cons of Raising Seed Financing via Convertible Notes vs. Preferred Stock,” by Sundance Banks, WSGR Entrepreneurs Report (Q3 2013)
- “SAFE Financing Documents,” by Carolynn Levy, Y-Combinator (September 2018)
- Simple Agreement for Future Equity [SAFE] (post-money valuation cap with discount), Y-Combinator form (September 2018)
- Form of Convertible Note Term Sheet, Cooley Law Firm (October 2020)
- Convertible Note Financing Summary of Terms (valuation cap and discount), WSGR form (October 2017)
- Term Sheet for Convertible Promissory Note Financing (valuation cap and discount), Cooley Law Firm form (October 2017)

Wednesday, October 12, 2022**Session 12: Valuation Methodologies**

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

Required Readings:

- “A Note on Valuation in Private Equity Settings,” (HBS # 9-297-050, April 2002)
- “A Method for Valuing High-Risk, Long-Term Investments,” (HBS # 9-288-006, October 1, 2009)
- “Ownership, Dilution, Negotiation, and Valuation,” Chapter 7 in High tech startup: the complete handbook for creating successful new high-tech companies, by J. Nesheim (2000)

Supplementary Reading:

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

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- “Want to Know How VC’s Calculate Valuation Differently from Founders?” by Mark Suster (July 22, 2010)

Monday, October 17, 2022**Session 13: Valuation Methodologies (continued)****Required Reading:**

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

Upload Questions 1-5. Please post your write-up before the beginning of the class session.

Wednesday, October 19, 2022**Session 14: Negotiating Term Sheets**

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

Required 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)

Supplementary Reading:

- “Negotiating Term Sheets: Focus on What’s Important,” by Matthew Bartus, Cooley Godward (no date)
- “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)
- “VC Negotiation Tricks: Simplified Term Sheets and Post-Money Valuations,” by Elad Gil, Elad Blog (September 17, 2017)
- “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)

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- “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)
- Series A Preferred Memorandum of Terms, WSGR template (October 2017)
- “Term Sheet for Series A Preferred Stock Financing,” NVCA Model Documents

Monday, October 24, 2022**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 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

Wednesday, October 26, 2022**Session 16: Analysis of a Term Sheet****Required Reading:**

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

Please bring a hard copy of this caselette to our class meeting

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

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 Founders team will get term sheets which reflect initial offers from the two different VC Investor teams. You will also get a “backgrounder” document which provides relevant

information for the assignment.

In Session 26 on Monday (December 5, 2022) and Session 27 on Wednesday (December 7, 2022), 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 content of the deliverables that are due on **Sunday, December 4th, 2022 by 5:00 PM** will be outlined in the materials which will be distributed to you.

Monday, October 31, 2022

Session 17: Review Session

Wednesday, November 2, 2022

Session 18: Quiz

- Bring your calculator.
- Open books
- Open notes
- Open minds...

Monday, November 7, 2022

Session 19: Compensation Practices in a VC Backed Start-up

- Compensation elements
- Founders' stock and equity incentive arrangements
- ISOs and NSOs

Required Reading

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

Supplementary Readings:

- "A Counterintuitive System for Startup Compensation," by First Round Capital (November 2014)
- "Demystifying 409A Valuations," Parts 1 and 2, by Shri Bhashyam (November 2015)
- "Employee Equity: How Much?" by Fred Wilson (November 22, 2010)
- "Five Compensation-Related Mistakes Startups Make (And Should Avoid)," by Caine Moss of WSGR, Venture Beat (February 9, 2010)
- "How We Explain Stock Options to Team Members & How Much Money They Would Make," by Leo Widrich (November 3, 2015)
- "The Do's and Don'ts of Compensation for Early-Stage Company Employees," by Kristen Garcia Dumont and Jennifer Martinez, WSGR Entrepreneurs Report (Fall 2008)
- Model Equity Incentive Plan (January 2014)
- "Making Sense Out of Cents: Determining Employee Compensation," by Sharon Wienbar, Entrepreneur (March 14, 2014)
- "Recommendations for Startup Employee Option Plans," by Scott Kupor of Andreessen Horowitz (July 26, 2016)

Wednesday, November 9, 2022

Session 20: Guest Speaker: David Spiro, Principal, Insight Ventures

<https://www.insightpartners.com/team/david-spiro>

Monday, November 14, 2022**Session 21: Managing the Exit**

- IPO and alternative exit strategies

Supplementary Readings:

- “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
- “Considering an IPO? First, Understand the Costs,” PWC (no date)
- “A New Breed of Tech IPOs May Give the Stock Market Reason to Party Like It’s 1999,” by Lina Saigol, MarketWatch (August 27, 2020)
- “Biotech IPOs Are on a Tear,” by Joanna Glasner, Crunchbase (August 19, 2020)

Wednesday, November 16, 2022**Session 22: VC Negotiation Team Meetings with the Instructor**

Sign-up schedule will be posted on Canvas

Monday, November 21, 2022**Session 23: VC Negotiation Team Meetings with the Instructor**

Sign-up schedule will be posted on Canvas

Monday, November 28, 2022**Session 24: Corporate Governance – The role and composition of the BOD in a venture-backed firm****Alantec case handout****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)
- “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)
- “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 Fiduciary Duties of Founders,” by Silicon Hills Lawyer (January 13, 2016)
- “The Board Works for the Common Stock,” by Silicon Hills Lawyer (February 7, 2018)

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- “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)

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 to you
- VC investors must provide the details of their valuation calculation

All team members are required to actively participate in preparing and presenting the results of the negotiations assignment.

Wednesday, November 30, 2022

Session 25: Selected Second Round VC Negotiation Team Meetings with the Instructor

Sign-up schedule will be posted on Canvas

Wednesday, December 7, 2022

Session 27: Term Sheet Debriefings, Benchmarking the Results, and Course Summary

Monday, December 5, 2022

Session 26: Term Sheet Debriefings

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 5:00 PM on Sunday, December 4, 2022.

- Each investor team and each founders team to prepare a PowerPoint presentation, which includes the final proposed valuations as well as commentary on the process of the negotiations, on