MOT 6XXX, Venture Financing
Sample Syllabus

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"The entrepreneur casts aside his assurance of 40-hour weeks, leaves the safe cover of tenure and security, and charges across the perilous fields of change and opportunity. If he succeeds, his profits will come not from what he takes from his fellow citizens, but from the value they freely place on the gift of his imagination." George Gilder

"Good judgment comes from experience. Experience comes from bad judgment." Walter Wriston

Objectives:

This is a course with two fundamental objectives. The first is to teach current and future managers and entrepreneurs to use financial perspective in the value creation and enhancement process. The second objective is to teach effective entrepreneurial practice from the perspectives of users and suppliers of capital and other stakeholders. By the end of the course students will have developed an understanding of:

- the sources and nature of capital available to early stage ventures
- the venture capital process
- the typical structure of venture financing at various stages of venture development
- the valuation process for new ventures
- capitalization tables
- term sheets

Course Structure and Contents:

Valuation

In this module, we will discuss different valuation techniques. There are several approaches to valuation. The easiest way to value an early-stage firm is to examine the valuation of another early-stage firm. It could be a difficult task given that it is hard to find valuations of privately held firms. The other methods are i) The Net Present Value Method, ii) Adjusted Present Value Method iii) Comparable Firm Analysis, iv) Option analysis, and v) The "Venture Capital Method." We will discuss the strengths and weaknesses of the above techniques through several examples.

Financing the Entrepreneurial Firm

This section discusses questions such as who are the suppliers of necessary financial resources, what type of deals should be struck with each of these resource suppliers. The other issues addressed are the criteria these sources utilize and evaluate fund raising proposals, and the legal process involved in raising outside risk capital.

There are four primary factors that influence the source of funds. **Uncertainty** exists about whether the research program or new product will succeed. This in turn affects the willingness of outsiders to contribute capital, the desire of suppliers to extend credit among other things. This often times results in the investor staging the capital. **Asymmetric information** may also affect project-financing decisions. Typically, an entrepreneur will know more about the company's prospects than investors, suppliers, or strategic partners. This may result in an entrepreneur pursuing a risky investment strategy or shirking work. The third factor that influences the source of financing is the **nature of the assets**. Firms with more tangible assets will find it easier to raise external capital. Lastly, **market conditions** often play a very important role in terms of the ability of the firm to raise capital. The supply of capital dramatically varies over time. Currently, it is a lot harder for an internet firm to raise capital.

The type of financing (i.e. debt, equity, or convertible security) used often times mitigates some of the potential conflicts. Monitoring and evaluation by investors play a critical role in minimizing these conflicts. Some of the techniques used in this regard include having an active and qualified board of directors. The notes used in this course will provide a useful framework understand the above issues.

Harvesting

Harvesting can take several forms. We will explore modes such as initial public offerings (IPOs) and acquisitions. Successful exits by providers of capital are critical to insuring attractive returns for investors and, in turn, to raising additional conflict. But private equity investors' concerns about exiting investment can sometimes to lead severe problem for entrepreneurs. We will discuss the pros and cons of going public. We will explore the IPO Amazon.Com through a case.

Venture Financing Tools

Ventures often develop for long periods of time (2 to 3 years or more) before operations provide enough free cash flow to support the continued growth of the venture. The goal of this module is to help students understand the sources, strategies and trade-offs associated with the various forms of financing available to early stage ventures as well as how typical financing deals over the life of the venture are structured. Additionally, a range of tools necessary to the process (valuations, term sheets, capitalization tables, etc.), are reviewed as part of this module.

Sample Project:

Each team will be provided with copies of three business plans from ventures currently seeking funding. Teams will take the role of managers of a $100 million venture capital fund (fund parameters will be provided as part of the project).

Each team will select one (and only one) of the ventures for investment and will defend their investment decision before a panel of venture finance experts. In order to accomplish this each team will complete the following:

1) Due diligence research on each business plan (to include technology due diligence, market and competitor due diligence, etc.)
2) a completed term sheet for the proposed financing of the selected business
3) a one-page term sheet summary outlining the key provisions of the term sheet
4) a one-page executive summary providing the reasons for investing in the chosen venture as well as the reasons for not investing in the ventures not chosen
5) An 8 minute verbal presentation with slides defending the teams' investment decision (the judging panel will have up to 10 minutes for Q&A after the presentation).

Grading:

Your grade for this course will be based on your contribution to the classroom discussion (50%) and your team project (50%).

Module: **Valuation**

Module Objectives:

Different techniques of valuation are presented. The methods addressed include a) NPV, b)Adjusted Present Value, c) Comparable firms, d) Option analysis, e) The “Venture Capital Method.”

Student’s Preparations:

Read the following handout.

Student’s Materials:

A note on valuation in private equity settings HBS 9-297-050

Student’s After-Class Assignment:

None

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Module: **Obtaining Risk Capital**

Module Objectives:

This module focuses on different sources of risk capital. A detailed discussion about angels, venture capitalists, SBA and SBIC is provided.

Student’s Preparations:

Before class, read the material.

Student’s Materials:

Course Notes

Student’s After-Class Assignment:

None

Module: **IPO and other exit strategies**

Module Objectives:

Different exit strategies such as IPOs, acquisitions are discussed. We discuss the typical issues an investment banker brings up in taking a firm public.

Student's Preparations:

Before class, read course notes

Student's Materials:

Course notes

Student's After-Class Assignment:

None

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Module: **Amazon.Com - Case**

Module Objectives:

The case is used to illustrate the exit strategy

Student's Preparations:

Please be ready for the discussion in the class.

1. What is the business model for Amazon.com? How does their business model differ from that of Barnes and Noble or Borders? How would you value Amazon.com?
2. Should Amazon.com go public? Why or why not?
3. What are the plausible scenarios for the period leading up to a final pricing meeting, which typically takes place the night before an IPO? How should management respond to these scenarios (e.g., is there a price below which Amazon.com should not go public)?
4. What should Joy Covey, the CFO, do?

Student's Materials:

HBS - 9-899-003

Student's After-Class Assignment:

None

Module: **Venture Financing Tools**

Module Objectives:

Help students understand the sources, strategies and trade-offs associated with the various forms of financing available to early stage ventures as well as how typical financing deals over the life of the venture are structured.

Student's Preparations:

Read materials below and be prepared to discuss: valuations, capitalization tables, researching comparables, preparing and understanding term sheets, putting the financing deal together.

Student's Materials:

Valuation, Financing and Capitalization Tables in the New Venture Context, by Michael J. Roberts
eSurg (B): Second Round Financing, by Anthony Massaro

Student's After-Class Assignment:

None