

GSBA 524
New Venture Finance
Spring, 2008

Dr. Dennis Zocco
Professor of Finance and Investments
School of Business Administration
University of San Diego
Office: 214 Olin Hall
Phone: 260-4848
email: dzocco@san Diego.edu
Office Hours:
TTH 3:00 P.M. - 5:30 P.M.

I. Course Description

This course presents the fundamental process of funding a new venture. The course is centered on developing the critical skills of evaluating a start-up business idea, constructing a business plan to implement that idea, identifying an appropriate funding source, presenting the business idea to a funding source, and negotiating a funding term sheet.

II. Course Objectives

This course is designed, through a series of class lectures, cases, and practical experience to provide you with an understanding of:

- 1) the process by which an entrepreneur takes a business idea to a successful new venture,
- 2) the manner in which entrepreneurs deal with venture capitalists and the requirements placed on entrepreneurs by venture capitalists,
- 3) valid business valuation techniques,
- 4) techniques of "deal structuring".

The course is specifically designed to develop your skills in:

- 1) being a socially responsible entrepreneur
- 2) recognizing business venture opportunities,
- 3) developing a business plan,
- 4) identifying alternative sources of financing and committing those resources to create and finance new business ventures,
- 5) developing and presenting a business plan,
- 6) negotiating a term sheet.

III. Student Materials

Books:

Raising Entrepreneurial Capital (REC) by Vinturella and Erickson
Term Sheets and Valuations (TSV) by Alex Wilmerding
Founders at Work (FW) by Livingston

Research Papers:

New Venture Financing

(The following research papers can be accessed in the Course Content section of GSBA 524 WebCT.)

Baum, J. R., & Locke, E. A. (2004). The relationship of entrepreneurial traits, skill, and motivation to subsequent venture growth. *Journal of Applied Psychology, 89*(4), 587-598.

Berg-Utby, T., Sørheim, R., & Widding, L. Ø. (2007). Venture capital funds: Do they meet the expectations of portfolio firms? *Venture Capital, 9*(1), 23-41.

Campbell II, T. L., & Frye, M. B. (2006). Venture capitalist involvement and the long-run performance of IPOs. *Journal of Private Equity, 10*(1), 7-17.

Kogut, B., Urso, P., & Walker, G. (2007). Emergent properties of a new financial market: American venture capital syndication, 1960-2005. *Management Science, 53*(7), 1181-1198.

Seshadri, D. V. R. (2007). Understanding new venture failure due to entrepreneur-organization goal dissonance. *Vikalpa: The Journal for Decision Makers, 32*(1), 55-74.

Sørensen, M. (2007). How smart is smart money? A two-sided matching model of venture capital. *Journal of Finance, 62*(6), 2725-2762.

Wang, C. (2006). Key success factors and career risks for junior-level personnel in venture capital. *Journal of Private Equity, 10*(1), 73-79.

International New Venture Financing

(The following research papers can be accessed in the Course Content section of GSBA 524 WebCT.)

Mudambi, R., & Zahra, S. A. (2007). The survival of international new ventures. *Journal of International Business Studies, 38*(2), 333-352.

Zacharakis, A. L., McMullen, J. S., & Shepherd, D. A. (2007). Venture capitalists' decision policies across three countries: An institutional theory perspective. *Journal of International Business Studies, 38*(5), 691-708.

Socially Responsible Entrepreneurship (SER) and New Venture Finance

Although there is a growing desire to practice socially responsible entrepreneurship, there are no clear guidelines for successfully accomplishing this goal, either as an entrepreneur or a capital provider. The following interview and research papers extend the thinking in this area and hopefully will provide you with direction in developing and/or funding new ventures that have an element of social responsibility in the business model.

(The following interview can be accessed in the WebLinks section of GSBA 524 WebCT.)

Article: *The Past, Present, and Future of Social Entrepreneurship: A Conversation with Greg Dees*, Faculty Director, Center for Advancement of Social Entrepreneurship, Duke University, Fuqua School of Business <http://www.fuqua.duke.edu/centers/case/articles/0506/casecorner.htm>

(The following research papers can be accessed in the Course Content section of GSBA 524 WebCT.)

Dorado, S. (2006). Social entrepreneurial ventures:: Different values so different process of creation, no? *Journal of Developmental Entrepreneurship*, 11(4), 319-343.

Harjula, L. (2006). Tensions between venture capitalists' and business-social entrepreneurs' goals. *Greener Management International*, (51), 79-87.

Isaak, R. (2002). The making of the ecopreneur. *Greener Management International*, (38), 81.

Prentice, R. A. (2007). Ethical decision making: More needed than good intentions. *Financial Analysts Journal*, 63(6), 17-30.

Schaper, M. (2002). The essence of ecopreneurship. *Greener Management International*, (38), 26.

IV. Course Requirements

The course has two segments. The initial segment, covering the first nine weeks of the course, is instructional. The second segment, covering the remaining five weeks, is a practicum designed to give you experience in the new venture funding process from both sides of the table – the entrepreneur seeking funding and the venture capitalist providing funding.

For the practicum, you will be organized in teams of four students per team. Each team will have two roles:

Role 1: as a team of entrepreneurs initiating a new venture and seeking and negotiating new venture financing from a team of venture capitalists, and

Role 2: as a team of venture capitalists providing new venture financing to new ventures of your choice. Your venture fund has \$5 million available for funding ventures. You must invest at least \$4.5 million but not more than \$5 million in one or more ventures.

Therefore, you will be both a new venture attempting to attract venture funding from one or more teams of your fellow students acting in their role of venture capitalists and also a team of venture capitalists evaluating the attractiveness of financing your fellow students' new venture companies.

In this process, you will have the responsibilities described below. Some of the material your team is responsible for must be uploaded onto the course section of WebCT.

1) Developing a business plan for a new venture. Your team is required to develop a viable business idea and a plan to create a business model and company based on that idea. The viability of your idea will be tested by the degree of interest you generate from the venture capitalist groups in the class. You can have your company positioned at any of the early stages of venture development. Be reasonable in your financial projections, as unreasonable projections presented for the purpose of attracting funding will be rejected by me and result in a grade penalty. Projections must be within reason and justified by the ventures business model.

Your business plan should demonstrate some element of Socially Responsible Entrepreneurship, which means enhancing the positive contribution of your company to society while minimizing negative impacts on people and the environment. Socially-responsible Entrepreneurship is a way of adding value to both the business and society. It denotes voluntary business strategies to achieve sustainable development and is fully in line with the notion of corporate social responsibility. Socially responsible entrepreneurs are those who start and grow companies which take effective measures to address environmental issues including emissions, climate change and renewable energy as well as practice ethical and responsible corporate governance.

2) Presenting your business idea in a pitch to a group of venture capitalists. Pitch classes will be organized in 20 minute intervals. Your 20 minute time slot for your pitch includes setup, so be prepared. Hopefully, as a result of your pitch, you will be contacted by one or more venture capital groups for further information. This contact can be via phone, email, or in-person meetings outside of class.

3) Negotiating the terms of venture capital financing. In the negotiations part of the course, you will be negotiating from both sides of the table, both as an entrepreneur and as a venture capitalist. We will devote an entire class to the technique of negotiating term sheets. In the role of an entrepreneur, you are to negotiate the best terms available from the venture capital firm or firms who have contacted you. You can choose to negotiate with only one or several firms. Your objective is to get funding on the best terms you can negotiate. You have the alternative to finance from other sources (self, family, friends) if you cannot agree on a term sheet with a venture capital firm, but that will slow your growth. It is an alternative, however. You may contact venture firms to explore their interest in your venture. In your role as a venture capitalist, you will have \$5 million to invest. After seeing the venture pitches, you will contact one or more ventures to explore the possibility of an investment from your firm. When interest is mutual, initiate negotiations with the entrepreneurs on the terms of the term sheet. Your objective in the negotiations is to get the best terms possible. Investors have put money into your VC firm, so they expect you to invest that money into promising ventures on favorable terms. Negotiations will take place mostly in the two class sessions reserved for negotiations, but can also partially take place outside of class.

4) Evaluating a term sheet. An important part of the funding process is the evaluation of the terms of the term sheet. It is your responsibility as an entrepreneur to completely understand the terms and to attempt to secure favorable terms. The first term sheet offered to you by the

venture capitalist will have to be closely evaluated to determine whether terms are acceptable and tradeoffs/concessions are feasible.

5) Writing a formal term sheet identifying the financing terms. The final stage of negotiations require you to write a term sheet that is acceptable to both parties and that achieves your objectives, and that will serve as a formal agreement in the cash for equity (funding) transaction. The term sheet is to be signed by all parties and turned in during the final class period by the venture capital firm.

Although the primary objective of the course is to provide you with a comprehensive knowledge of the financing process for new ventures, the course also provides you with valuable and practical knowledge and experience in two skills that will require a high level of proficiency throughout your business career - presenting and negotiating skills.

There are no exams in the course. Your course requirements are to be active in the class discussions and to be enthusiastic and industrious in your preparation and involvement in the development of your team's business plan, presentation, and negotiations. Your written requirements are the following:

1. [Entrepreneur Group] Entrepreneur Business Plan (Post on WebCT as attachment to message for "Business Plan" Discussion thread with the name of your company on the subject line). Write your company's business plan. Each team member is to identify the section of the business plan they are primarily responsible for. If one member wrote a segment of the plan and another member revised that section, please note that at the end of the segment. Page requirements on the business plan: not to exceed 20 pages.
2. [Entrepreneur Group] Entrepreneur Pitch (Entrepreneurial Team, (Post on WebCT as attachment to the "Entrepreneur Pitch" assignment). Develop the visuals (Powerpoint or other medium) to support your entrepreneurial pitch in front of the class. This should be a compelling pitch as you are trying to obtain venture funds from the venture teams listening to your pitch.
3. [Venture Capital Group] Venture Capital Firm Prospectus (Venture Capital Team; Post on WebCT as an attachment to a message for "Venture Capital Firm Prospectus" Discussion thread with the name of your VC firm on the subject line). Write a prospectus for your venture capital firm based upon the characteristics you want to emphasize about your firm to new ventures in the market for funding. Possible characteristics are: funding amount size, industry specialization, partners' backgrounds, prior investments, stage of development of venture, non-monetary benefits to venture company. See the Pratt's Venture Capital Directory at the library for guidance.
4. [Group] Term Sheet (Venture Capital Team; Post on WebCT; attach your term sheet(s) to a post to this message identifying your VC firm in the subject line. One post only per VC group. No need for the entrepreneur group to post the term sheet.). After you have identified one or more ventures in which you want to invest, draft the term sheet(s) and all revisions to the terms sheet(s) to arrive at the final agreement. Include all correspondence that took place between the entrepreneurial and venture capital team. Your term sheet(s) in both your venture capital role and your entrepreneur role will be evaluated on the terms you negotiated with respect to the "investor favorable", "middle of

the road”, and “company favorable” terms as shown in the Term Sheets & Valuations book. It is likely that you will not be able to negotiate a terms sheet that is comprised entirely of terms favorable to your position. However, use the negotiating strategy discussed in class to develop a series of tradeoffs that will result in a term sheet of value to you whether you are in your role of an entrepreneur or venture capitalist.

5. [Individual] Entrepreneur Negotiation Report and Venture Capitalist Negotiation Report Post on WebCT each as an attachment to the “Entrepreneur Negotiation Report” Assignment and the “Venture Capitalist Negotiation Report” Assignment. Write two descriptive reports (3-5 pages for each) of the negotiation process, including your strategy, techniques, critical moments, tradeoffs and concessions, and breakthroughs that led to the final term sheet agreement. Identify your counterparts in the negotiation, that is, if you were the entrepreneur, which venture capitalists were you negotiating with or, if you were the venture capitalist, which entrepreneurs were you negotiating with.
6. [both Venture Capital Group and Entrepreneur Group] Funding Report (Post on WebCT as attachment to the “Funding Report” assignment). Using the form attached to this course outline as a format guideline, complete a form for (Venture Capital Group) each company in which your venture capital team has invested and (Entrepreneur Group) each venture capital group who invested in your company.
7. [Individual] Personal Experience Report; Post on WebCT as attachment to the “Personal Experience Report” Assignment. Write a 2-4 page personal account of your experience throughout the process, including what your preconceptions were of the financing process, what critical pieces of knowledge you acquired about the process and about yourself through the process, and how your perceptions of the process changed.

(All written reports should be formatted with one-inch margins on all sides, double-spaced, Times New Roman, and 12-Point Font.)

The team approach to this process requires each team member to contribute on an equal basis to the effort. Team dynamics are important. If the team dynamics are failing or if a team member is not contributing their fair share to the effort, it is the responsibility of the team members to resolve their problems. If the intra-team efforts at resolving the problem are not successful, then it is the responsibility of team members to send me an email explaining the problem. All team members’ emails will be confidential. I will address the problem maintaining that confidentiality. Also, I will be asking each team at some time during the semester about whether their team dynamics are working. If I detect a team member not contributing to the team effort, I will also address it. Your grade will suffer if you do not contribute your share to the team effort. If I am not notified of a team problem prior to the last class of the semester, I will assume that the effort of each team member was satisfactory to all members.

Class Participation: You are expected to actively participate during classes in the following ways by:

- 1) participating in class and case discussions,
- 2) asking pertinent questions and offering insightful viewpoints and opinions during class,
- 3) participating on an equal basis with your team members in all practicum activities.

Class Attendance: Class attendance is critical in the course, as you will be gaining valuable information each class about the activities you will be engaging in during the practicum segment of the course. Also, you will be working in teams, and team members depend on each other for participation and contribution to the team effort. Therefore, unless you have a medical excuse, class attendance is mandatory. Each missed class will contribute to a reduction in your course grade.

Grade Composition:

Class Participation	10%
Entrepreneur Pitch.....	15%
Business Plan	25%
Venture Capital Firm Prospectus.....	5%
Term Sheet Negotiations.....	15%
Term Sheet Agreement.....	10%
Negotiation Reports.....	10%
Personal Experience Reports.....	10%

V. Course Schedule

Date	Reading Assignments and Class Activity	Course Learning Objectives	Topic(s)
1/31	Introduction to course	1	Introduction
2/7	Guest Speaker: Rick Hudson, VP, 1 st Pacific Bank; REC: Chapter 1, 2, 3	1, 2	Monetization, Bank Financing
2/14	REC: Chapter 4; FW: 1, 2, 4	2	Business Plan Creation
2/21	Distance Learning Class; TSV: 1, 2, 3; Research Papers: Baum, Seshadri, Dorado, Isaak, Schaper, Prentice	2, 3	VC Industry and Operations
2/28	REC: Chapter 5; TSV: 4; FW: 6, 11, 14;	2, 3	Structuring the Term Sheet
3/6	Guest Speaker: Peter Arrowsmith, General Partner, JMI Equity; REC: Chapter 6; Research Papers: Berg-Utby, Campbell, Kogut, Sørensen, Harjula	2	VC Analysis Model
3/13	REC: Chapter 7; FW: 15, 16, 17,	3, 4	Liquidity Stage
3/20	Spring Break		
3/27	TSV: 5; FW: 18, 19, 20, 22, 23, 28; Discussion of pitches and negotiation strategy; read links on The Entrepreneur Pitch in the “Web Links” section of WebCT	3, 4	Entrepreneur Pitch Creation and Term Sheet Negotiation Strategy
4/3	New Venture Pitches (20 minute intervals)	2, 4	Entrepreneur Pitches
4/10	New Venture Pitches (20 minute intervals)	2, 4	Entrepreneur Pitches
4/17	Negotiations (In-Class)	4	Entrepreneur/VC Negotiations
4/24	Negotiations(In-Class)	4	Entrepreneur/VC Negotiations
5/1	Finalize Negotiations and Crafting of Final Term Sheets	4	Entrepreneur/VC Negotiations
5/8	Presentation of Term Sheets by Entrepreneur Teams (10 minute intervals); Research Paper: Wang	1, 2, 3, 4	Summary of Learning

VI. Academic Integrity

As stated in the Graduate Bulletin, the University of San Diego is predicated on the principles of scholastic honesty. Academic dishonesty in any form is taken very seriously.

Specifically, unless Dr. Zocco indicates that work can or should be done on a group basis, all course assignments must be done on an individual basis. When group work is allowed, participation in work assignments within the group must be done on an equal basis. Any deviation from this norm should be reported to Dr. Zocco.

Any reference materials used in the preparation of an assignment, whether quoted or paraphrased, must be explicitly cited

In taking examinations or quizzes (in-class or take-home), unless Dr. Zocco gives explicit prior instructions to the contrary, students' academic integrity dictates that students are required to do their work individually and without assistance from any person. Reference to any books or notes or electronic devices is allowed only with explicit permission from Dr. Zocco. Any attempt to give assistance to any other student contrary to the provisions above is in violation of academic integrity. Other violations of academic integrity include, but are not limited to, claiming as your own work done by another person whether gratis or for hire, tampering with a graded exam, using electronic or wireless means to access information during an exam that otherwise would not be allowed in hard copy.

If there are any questions before, during, or after the course, please consult Dr. Zocco immediately.

Complete details regarding USD's policy on academic integrity are available in the Graduate Bulletin.

Venture Capital Firm Prospectus

VENTURE CAPITAL FIRM NAME _____

PARTNERS NAMES _____

FUNDING AMOUNT SIZE _____

INDUSTRY SPECIALIZATION _____

PARTNERS' BACKGROUNDS _____

PRIOR INVESTMENTS _____

PREFERRED STAGE OF DEVELOPMENT OF VENTURE _____

NON-MONETARY BENEFITS TO VENTURE COMPANY _____
