

FINANCING THE ENTREPRENEURIAL BUSINESS

Administrative Details

Course	Finance 374S – Entrepreneurial Finance
Semester	Spring 2015
Classroom	PAR 201
Time	M, W 11:00 am – 12:30 pm
Instructor	Mark Jansen
Office	CBA 5.334AA
Office Phone	(512) 887-2114
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Office Hours	M, W 9:30 – 10:30 am and by appointment
Teaching Assistant	Antonio Fazio, antoniofazio@gmail.com , office hours by appointment
Prerequisites	Finance 374S is a Restricted Course for students who are currently enrolled in the College of Business Administration. Prior completion of Finance 357 or Finance 357 H (grade=>B) is required.

Course Objectives

This course intends to improve student understanding of how to value unlisted companies, how transactions can be financed, and how the financial valuation and deal structure can affect the development of the business, the management team and the shareholders. The course will provide a perspective of the financing process and the elements of deal making, including financial forecasting, and valuation methods. Students will develop a familiarity with various financing issues which must be addressed when starting or buying a business, from the points of view of both investor and entrepreneur.

The course combines lectures, cases, and guest speakers. Class discussions and assignments will engage, energize, and challenge students. While the instructor leads the process, students discover, articulate and develop most critical insights.

Teaching Approach and Case Preparation

Individuals who value and finance unlisted firms frequently encounter ambiguity. There is an opportunity to learn from each deal and gradually build experience in the subject matter using case studies. To properly prepare, students will need to spend three to six hours of reading and preparation, including discussions with classmates. We will use the case method – a student-centered approach whereby students will drive the discussion of the case by identifying the problems and issues faced by the managers and formulating alternatives for solution backed by case facts and assumptions.

The case method will accelerate this process by exposing the student to a variety of deals. Students will analyze the situation, identify the key issues, and become more proficient at thinking through the possibilities and pitfalls of different financing and valuation methodologies. In some sessions, multiple cases will be discussed to contrast different approaches. Students should prepare and discuss all cases.

Much of the discussion will center on the question “why?” Good arguments will be supported with good facts, logic and analysis. Simply restating case facts like “the company’s revenues were \$100 million and profits were \$5 million” is not of value and uses precious airtime. We can assume everyone has read the case. A discussion of sales trends and explanations or solutions for these trends moves the class forward. By the same token, just throwing out an answer such as “I believe the company is worth \$10 million” is of little use without first telling which method you used, what adjustments and assumptions you made, and why you believe this to be a reasonable value.

Students who skim the reading right before class will not realize the benefits of the course. Students will learn by wrestling with the valuation and financing issues before class and developing a course of action. This experience, combined with the course discussion, will create the conditions necessary for students to move up the learning curve in the deal process. Working through and discussing the cases with your team is highly encouraged!

Course Policies

Class Contribution

Prepare each case thoroughly, and be prepared to initiate class discussion and to defend your conclusions. I will act as the moderator of the discussion. Do not look to me for “the answer”. Address your questions and answers to your fellow students, not to me. Hold up your hand and wait to be called on – do not blurt out a response. I monitor the participation throughout the semester and if you are not called on when you have your hand up, do not get discouraged as I may have reasons for directing the discussion to other students.

Rules of Engagement for Class Discussion:

- There is mutual respect between instructor and students, and among the students.
- Instructor and students come to class well-prepared
- Arrive on time and be prepared to participate.
- Electronic devices are closed and put away.
- Contribute ideas, assumptions, analysis, and personal experiences instead of simply presenting case facts.
- Participate and listen actively throughout class discussions.
- Speak concisely. Airtime is a scarce resource, do not ramble.
- Direct your comments to your classmates, not the professor.
- Respectfully challenge or support the arguments being made.
- Build on each other’s comments and critique and debate different points of view.

Some of the points that I will use to grade class discussion are:

- Was the problem or issue clearly defined?
- Did you take a firm stand and back it with evidence?
- Did you outline your assumptions?
- Did you use the frameworks, valuation models and notes discussed in class?
- Did you explore the pros and cons of the strategic alternatives?
- Did you perform both qualitative and quantitative analysis?
- Was a plan of action presented along with implementation steps, timing and costs?
- How did you respond to your peer’s questions about your solution?

A good question can be worth as much as a good answer. Feel free to experiment with unorthodox solutions, which will be rewarded if you can defend them with logic and evidence.

Feedback

I encourage students to offer suggestions on how to improve the course both for the existing semester and future ones. My goal is to optimize your learning experience so that you understand the important topics of the semester. Any suggestions for improvements are appreciated.

University Policies

Policy on Scholastic Dishonesty

The McCombs School of Business has no tolerance for acts of scholastic dishonesty. The responsibilities of both students and faculty with regard to scholastic dishonesty are described in detail in the BBA Program's Statement on Scholastic Dishonesty at <http://www.mcombs.utexas.edu/BBA/Code-of-Ethics.aspx>. By teaching this course, I have agreed to observe all faculty responsibilities described in that document. By enrolling in this class, you have agreed to observe all student responsibilities described in that document. If the application of the Statement on Scholastic Dishonesty to this class or its assignments is unclear in any way, it is your responsibility to ask me for clarification. Students who violate University rules on scholastic dishonesty are subject to disciplinary penalties, including the possibility of failure in the course and/or dismissal from the University. Since dishonesty harms the individual, all students, the integrity of the University, and the value of our academic brand, policies on scholastic dishonesty will be strictly enforced. You should refer to the Student Judicial Services website at <http://deanofstudents.utexas.edu/sjs/> to access the official University policies and procedures on scholastic dishonesty as well as further elaboration on what constitutes scholastic dishonesty

Students with Disabilities

Students with disabilities may request appropriate academic accommodations from the Division of Diversity and Community Engagement, Services for Students with Disabilities, 512-471-6259, <http://www.utexas.edu/diversity/ddce/ssd/>.

Religious Holy Days

By UT Austin policy, you must notify me of your pending absence at least fourteen days prior to the date of observance of a religious holy day. If you must miss a class, an examination, a work assignment, or a project in order to observe a religious holy day, you will be given an opportunity to complete the missed work within a reasonable time after the absence.

Campus Safety

Please note the following recommendations regarding emergency evacuation, provided by the Office of Campus Safety and Security, 512-471-5767, <http://www.utexas.edu/safety>:

- Occupants of buildings on The University of Texas at Austin campus are required to evacuate buildings when a fire alarm is activated. Alarm activation or announcement requires exiting and assembling outside.
- Familiarize yourself with all exit doors of each classroom and building you may occupy. Remember that the nearest exit door may not be the one you used when entering the building.
- Students requiring assistance in evacuation should inform the instructor in writing during the first week of class.
- In the event of an evacuation, follow the instruction of faculty or class instructors.
- Do not re-enter a building unless given instructions by the following: Austin Fire Department, The University of Texas at Austin Police Department, or Fire Prevention Services office.
- Behavior Concerns Advice Line (BCAL): 512-232-5050
- Further information regarding emergency evacuation routes and emergency procedures can be found at: <http://www.utexas.edu/emergency>.

Course Materials

It will be assumed that students have, prior to the first class session, obtained at least a basic understanding of the financing instruments covered in the finance core courses. The notes covered in the course should be read and used as reference throughout the course. The readings are essential to preparing the written assignments.

Required reading:

- HBR Course Park is available for download at: <https://cb.hbsp.harvard.edu/cbmp/access/32082556>
- Entrepreneurial Finance, 2011, Janet Smith, Richard Smith, & Richard Bliss, Stanford University Press, ISBN: 978-0-8047-7091-0.¹
- How to Buy a Business. <http://www.entrepreneur.com/article/79638>

Other suggested reading:

- Management Buy-outs (Director's Guides), Institute of Directors
<http://www.amazon.com/Management-Buy-outs-Directors-Guides-Institute/dp/0900939699>
- Smarter Ventures: A Survivor's Guide to Venture Capital Through the New Cycle, Katherine Campbell
<http://www.amazon.com/Smarter-Ventures-Survivors-Venture-Financial/dp/0273654039>
A useful perspective on the relationship between entrepreneurs and their investors
- Guerrilla Financing, Blackman and Levinson
<http://www.amazon.com/Guerrilla-Financing-Marketing-Bruce-Blechman/dp/0395522641>
- Valuing A Business: The Analysis and Appraisal of Closely Held Companies, Shannon Pratt
<http://www.amazon.com/Valuing-Business-5th-Edition-McGraw-Hill/dp/0071441808>
- The New Business Road Test: What entrepreneurs and executives should do before writing a business plan, John Mullins
<http://www.amazon.com/The-Business-Road-Test-entrepreneurs/dp/027373279X>
Provides a framework for assessing and shaping entrepreneurial opportunities
- Boulevard of Broken Dreams: Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed – and What to Do About It, Josh Lerner
<http://www.amazon.com/Boulevard-Broken-Dreams-Entrepreneurship-Failed/dp/0691154538>

Evaluation

Individual Assignments 15%

The individual assignments will familiarize students with the valuation methodology. Each individual (and group) assignment will be graded with checks. Most assignments receive a score of 2 to 3 points.

- 0 point: assignment was not handed in
- Check minus (1 point): Poor analyses.
- Check (2 points): Fair analyses and recommendations.
- Check plus (3 points): Good analyses and recommendations.
- Check star (4 points): Excellent analyses and recommendations.

Group Assignments 30%

You will be assigned to a team of 4 students after the 12th day of class. More details on the assignments will be provided during the semester. Your grade on the assignments will be computed in two parts. I will assign a grade to the team as a whole that represents my assessment of the team's overall performance across the semester based on the group assignments which includes the same scoring methodology as the individual assignments. In addition, each student will be given a budget of 12 points that can be used to reward team members for their contribution to the case write-ups. If someone from the team drops the course, the points from the individual that dropped are reallocated amongst the remaining team members. The sum of the team grade and the average of each individual's team member scores will be the student's grade for this component.

Most of the assignments will be case study write ups which will require you to render a valuation (or value range) of the firm. The cases generally deal with privately held companies with no secondary market for their debt or equity. This lack of liquidity and marketability generally decreases the value of private firms relative to public companies.

¹ Digital copy may be available at the UT library.

Adjustments will also have to be made if the interest being valued is a minority or majority interest. Since many private firms manage the company to minimize taxes rather than maximize profits, earnings normalization may have to be made for excessive salaries, excess cash, and non-recurring income or expenses. Therefore, many assumptions will have to be made in your analysis and will probably lead you to the conclusion that valuation is as much art as science. If you are looking for "the number" you will get frustrated. We are trying to narrow the range of darkness by using different valuation models and hope to get some convergent validity and triangulation from these models to give a valuation range.

Attendance and Case Discussion 25%

Making good decisions with limited data in the face of uncertainty is the hallmark of a successful entrepreneur. The classroom is an ideal setting in which you test your ability to convince your peers of the value of your ideas. If you are not prepared to actively contribute to the course, you should be prepared for a below average grade in this class.

I expect students to participate in each session's discussion, and will grade each student's contribution to others' learning after each and every session. To assist me in this process, please display a name card at every session. If your name card is not displayed, I will assume you expect no credit for contributing to the session. If you are by nature a quiet person, please come talk to me and I'll help bring you into our class discussions. Please note that the quality of what you contribute to these discussions (whether a thoughtful question, some astute analysis, or some other meaningful contribution) will count far more than the quantity of your remarks. More 'noise' does not necessarily equal a higher score.

Each student team (see group assignments) will select a (different) speaker for each case discussion. The pool of speakers (for each session) will be "cold called" to open and close each class. The student should take the point of view of the protagonist in the case. A good opening would begin by taking a firm stand on the solution to the problem and defending it with logic and numerical analysis. Openings should include: (1) defining the problem; (2) answering the questions; (3) developing strategic alternatives; (4) presenting a solution; and (5) providing an action plan for implementation. An opening can take anywhere from five to fifteen minutes. This is where the discussion begins and others are encouraged to support or challenge the assumptions and conclusions your classmates are making. Openings and closings have a disproportionate weighting and since there are more students than openings and closings, you must remain fully engaged and participate in each case discussion. The grade of the group leader will reflect on the team.

Individual Case Exam 30%

You will have two exams. The first will be an in-class exam (10%). You will receive a case study at the end of class and will have time to prepare notes and other materials for the exam. The exam questions will be distributed to you in class. You will submit your solutions to the questions plus any four single-side pages of supporting analysis that you did on the case. This will be individual work without collaboration or discussion. The second exam will be worth 20%. The exam work will be individual work without collaboration or discussion.

Grading

Submissions will be graded on a curve. Once all submissions are in at the end of the term and the grades, including class contribution grades, have been totaled, letter grades will be assigned by ranking students from the top to the bottom of the class. Grades of A and A- will be given to not more than 50% of the class. Student work will be graded by assessing the quality of the work to determine the number and proportion of B, C, D, and F grades given. There is no required distribution for the bottom half of the grades, though generally the combined proportion of C, D and F grades will not exceed 20% of the class.

Date	Topic	Reading	Description	Assignment
1/21 1/26	Introduction	Ch. Preface, 1, 2 HBR: Introductory Note on the Case Method	Course Intro & New venture finance – Types of entrepreneurship, stages of venture development, business plans, sources of finance, term sheets	Parallel 6
1/28 2/2	Financial Modeling	Ch. 6	Revenue Forecasting for new & established firms, fundamental analysis, incorporating uncertainty	6.3, 6.7, 6.9 Dayva
2/4 2/9	Cash Flow Modeling	Ch. 7	Cash Flow Forecasting: Cash conversion cycle, working capital, assumptions, financial modeling for start-ups, incorporating uncertainty Deal Valuation Exercise – R Wine	7.1, 7.5, 7.9
2/11 2/16	Invest Assessment	Ch. 8	Assessing Financial Needs – Sustainable growth, Break-even analysis	8.1, 8.4, 8.7
2/18	** No class **		Case method work session (to be scheduled).	
2/23 2/25	Invest Assessment		Assess Financial Needs – Rapid growth, scenarios, staged investing Guest Speaker: Jeff Zeigler	
2/23 2/25	Valuation I	Ch. 9; HBR: Small Company Finance: What the Books Don't Say	New Venture Valuation – Myths, discounted cash flow, RADR, CEQ, relative value, venture capital method, rates of return	Wind Zero 1
3/2	Valuation II	Ch. 10 HBR: Valuation Techniques	Valuation in Practice – Continuing value, multiples, estimating R_f , market risk premium & β , applying RADR & CEQ	
3/4	Valuation III	Ch. 11	Valuation Review. Deal Valuation Exercise	
3/9	Valuation III	HBR: Note on Valuing Private Businesses	The Entrepreneur's Perspective on Value – Undiversified investors, partial-commitments, valuing partial commitment with RADR & CEQ	Central Circuit Breaker
3/11	Deal Structure	Ch. 12	Deal Structure – Outside investors, contracts, risk sharing, asymmetric risk & return, subsidized investors, active investors, informational issues Guest Speaker: Yuen Yung	Wind Zero 2
SPRING BREAK				
3/23	Venture Capital	Ch. 3; HBR: Note on Valuation of VC Deals; How VC's Evaluate Potential venture opportunities	Venture Capital: Types of PE funds, fund structure, raising PE funds, how funds work, calculating carry, private equity returns, fund of funds Guest Speaker: Michael Falcon	HBR: How VCs Evaluate Potential venture opportunities
3/25	Rollups	HBR: Consolidation of Highly Fragmented Service Industries		HBR: Project DialTone
3/30	** No class **		Exam Preparation	
4/1	In Class Exam			
4/6	Real Options	Ch 4, 5.8, 5.9	New Venture Strategy - Strategic planning, financial strategy, real vs. financial options, expansion & abandonment options, decision trees	
4/8	Choice of Financing	Ch. 14 HBR: Note on Angel Financing	Choice of Financing: Financing alternatives, financial decision process, cumulative financing needs, organizational structure, & financial distress.	
4/13	Bootstrap Finance	HBR: Bootstrap Finance: The Art of Startups HBR: Why Entrepreneurs Don't Scale	Founders Choices Guest Speaker: Sam Decker	HBR: Lather, Rinse, repeat: FeedBurner's Serial Founding
4/15	M&A		Investor and Entrepreneur decisions	Jaaks
4/20	Management Buy-Outs	Entrepreneur: How to Buy a Business	Management Buy-Outs Guest: Matt Stuart	HBR: Brazos Partner the Comark LBO
4/22	Franchising	HBR: Note on Franchising; Note on Buying a Franchise	Guest Speaker: Randy Murphy	HBR: World Wrapps
4/27	Exit	Ch. 15; HBR: Company Sale Process; Note on the IPO Process	Harvesting - Liquidation events, IPO's, underwriting, trade sales, valuing private transactions, MBO's, ESOP's, harvest decision, Break-up value	HBR: Interco
4/29	Debt vs. Equity		Debt vs. Equity In class exercise: Terrell Road	HBR: Clarion Optical
5/4	Review		Guest Speaker: Brett Hurt	
5/6	In Class Exam			