

Update: August 22, 2012

The University of Pennsylvania  
The Wharton School  
Management Department

## Venture Capital and Entrepreneurial Management

MGMT 264 - Fall 2012  
260 JMMH 1:30 pm – 3:00 pm

**Raffi Amit**

Robert B. Goergen Professor of Entrepreneurship

Phone: (215) 898.7731

Fax: (215) 573.7189

Email: [amit@wharton.upenn.edu](mailto:amit@wharton.upenn.edu)

<http://www.wharton.upenn.edu/faculty/amit.html>

TA: Dr. Xu (Henry) Han, [hanxu@wharton.upenn.edu](mailto:hanxu@wharton.upenn.edu)

### Course Overview and Design

This elective course focuses on venture capital and the typical venture-backed start-up company, based on conventions and practices in the United States.

Venture capital and the technology sector that it supports<sup>1</sup>, continue to evolve structurally. This evolution traces to the dot.com bubble of 1998-2000; the dramatic economic upheaval in 2008/2009; the explosive growth of companies with an Internet-based business model; the globalization of business in general; the expansive adoption of consumer-based technologies, products and services; and other influential changes. Our class will cover traditional conventions in the industry that have historically shaped investor and company behaviors, as well as the structural changes that we are witnessing now.

Among the many factors that are currently impacting the industry:

- Venture capital funds typically have a ten-year life. The dot.com bubble of 1998-2000 that lifted the financial performance of and produced positive returns for so many venture firms has become a distant event and fallen off the horizon for return calculations. As a result, venture capital as an asset class is not performing at the traditional norms of 15-20% ROI. Many funds today are showing negative returns to their limited partners. As a result, traditional LPs are engaged in a “flight to quality”, reinforcing the dominance of the established top-tier VC firms at the expense of lesser-known firms. It is widely acknowledged that the VC industry is in a state of contraction. With the inflow of new funds to VC firms diminishing and as the VC community consolidates, what effect will this have on innovation and growth in the technology sector?

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<sup>1</sup> For purposes of our class, the technology sector includes companies in a wide range of industries that look to venture capital as a principal financing resource. These industries include traditional technology companies (software, internet, semiconductor, electronic hardware, etc.), biotech companies (medical device, pharmaceutical, healthcare, etc.), clean and green tech companies (fuel cell, solar panel, wind, battery storage, conservation technologies, etc.), homeland security companies, and consumer companies.

- The average investment horizon for a venture-backed startup to achieve an “exit” through an IPO has continued to exceed historical norms—over 9 years on average in 2010, in contrast with an average horizon of a little over 4 years in 1999. Venture firms are therefore required to support the capital requirements of their portfolio companies over a longer period as these companies wait for an opportune exit, and hence adversely affecting realized returns. Has venture capital as an asset class been permanently impaired?
- The IPO market has traditionally been a mainspring addressing the liquidity and capital formation requirements of the technology sector. But the last decade has witnessed a marked decline in the number of venture-backed technology IPOs, from an annual average of around 500 IPOs during 1990-1999 to fewer than 100 IPOs during 2000-2010, with a low of only 6 venture-backed IPOs in 2008. Following the economic meltdown in late 2008, the IPO market in 2008-2009 was the worst experienced in over 40 years. Should we expect that the IPO market will ever be restored to the level of significance that we witnessed during the 1990's?
- The angel community is exploding in terms of activity levels, number of individual angels/angel groups, and significance to the industry, in response to the dramatic increase in the number of consumer internet and social media startups and other companies structured around an online business model. These companies require extremely modest amounts of capital—in some cases less than \$50,000—to demonstrate proof of concept, and their all-in equity capital requirements are significantly less than traditional “brick and mortar” companies. Individual angels, angel organizations and now “superangels” have rushed into the breach, with astounding success. However, is there a dark lining to this phenomenon? The traditional venture capital community is in a state of contraction, and VC fundraising levels are at about half of their levels in 2007. As these angel-funded companies grow and begin looking for their first round of institutional capital, will the traditional venture capital community be there to take these companies to the next level of growth? If they have limited investment dollars to spend, as was the case in 2008, we should expect that current portfolio companies will take priority over new investments. If this marks the beginning of a trend, should we expect a massive “culling” of these online startups that cannot attract institutional capital? What might we expect from the M&A market in respect of companies unable to secure additional funding? What impact on company valuation?
- The emergence of private secondary market exchanges, through companies that include SharePost and SecondMarket, has offered an alternative to the traditional “exits” found in an IPO or a sale or merger. Investors and employees in private companies with substantial valuations such as Facebook, Groupon and Zynga (before their IPOs) have achieved limited liquidity through these exchanges. Compounding the availability of some degree of liquidity through these private exchanges is the growing belief of many CEOs and their investors that “going public” has become too complicated, too costly, and too aggravating. If the luster of the technology company IPO has dimmed, for whatever reason, what structural impact will this have on the VC industry that traditionally favored an exit through an IPO to capture the “valuation premium” that the public market favors? Absent a vibrant IPO market for startups, are the exit opportunities available through M&A alone compelling enough to draw LP interest in VC as an asset class over the long term?

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. As well, I will address

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management issues regarding the working relationship between the VC and the entrepreneur, corporate governance, and executive compensation.

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 venture capitalist's perspective, 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, I will address several aspects of the investment process including the term sheet content and structure, 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 pragmatic in its orientation. I will attempt to expose students to both perspectives simultaneously. It will cover eight principal areas relevant to the privately held high-growth-potential start-up.

These include:

- 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
- Evaluating investment opportunities
- Common organizational issues encountered in the formation of a venture-backed start-up, including matters relating to initial capitalization, intellectual property, and more
- Valuation methodologies that form the basis of the negotiation between the entrepreneur and the venture capitalist in anticipation of a venture investment
- The challenges of fundraising, due diligence, financing strategies and the importance of the business plan and presentation
- 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
- Corporate governance in the context of a venture-backed start-up company and the typical dynamics that play out between VC and the entrepreneur in the post-financing phase

The course is designed principally to address the interests of students who expect to embark on an entrepreneurial career, expect to assume a managerial role with a venture-backed start-up

company, or wish to pursue a career in venture capital. In light of the time constraints associated with this course, the curriculum is confined to key fundamentals in the area of venture capital and start-up companies. The course will touch upon a range of fields including finance, accounting, executive compensation, 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.

### **Other course features and resources**

- There will be a dedicated Canvas eRoom for our course. Lecture notes, Caselettes, course materials that are not copyrighted by a third party and periodic announcements will be posted on this Canvas site. The Canvas URL is:

<https://wharton.instructure.com/courses/663668>

- You will be able to access Study.net through Canvas. All third party copyrighted readings are found on Study.net (you should receive an email with logon information from Study.net at the beginning of the semester). Please contact [customerservice@study.net](mailto:customerservice@study.net) with any logon issues.

[http://www.study.net/r\\_mat.asp?crs\\_id=30025945](http://www.study.net/r_mat.asp?crs_id=30025945)

### **Requirements and Evaluation**

The assigned readings in the course are in the range of moderate to heavy, particularly at the beginning of the course. This syllabus, the assignments, and the readings have been organized so that students can manage the requirements efficiently. As in all courses, the lectures and discussions in the classroom will be much more meaningful if the required readings have been studied in advance. From time to time, mid-course changes in presentations or materials may be made to achieve academic objectives.

The class readings have been split between two sites: Study.net and Canvas. All third party copyrighted materials are found on Study.net, all other readings are found on the Canvas. This is meant to minimize the cost of students obtaining reading materials. There is a link to the Study.net site from Canvas. Please note that the readings are further divided between Required and Supplemental readings. 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.

The short case studies, or Caselettes, which will be used in this course are based on actual occurrences (with some degree of poetic license, as appropriate) and are substantially shorter than the traditional case study. Each Caselette has been prepared with the objective of highlighting “best practices”, conventions in the industry, or issues that are commonly encountered. The Caselettes will be posted on Canvas and are part of the required readings. The classes generally will involve both lecture and case discussions, with interaction and dialogue with the instructor strongly encouraged.

For each Caselette, specific study questions have been assigned. In most class sessions, we will consider these questions and the material in the case.

Students are asked to form study group teams of up to 5 students per team. Study groups are expected to meet to discuss each Caselette; in addition, every effort will be made to maintain these teams in the term sheet negotiation assignment to be handed out in **Session 16**. Choose your teammates carefully – changes will not be allowed once your study group team has been formed. You are encouraged to form your study group before our first session.

### Student Grades

The final course grade will be computed as follows:

- Classroom Participation 15%
- Case Problem Set Memos 25%
- Negotiation Submissions & Presentation 15%
- Quiz 45%

**Individual class participation:** Active class participation is very important for this course. Both quantity and quality of your comments count. Because so much of the learning in this course occurs in the classroom, it is important that you attend every class. If you have to miss class, for one reason or another, 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 cold called. You are required to **display your name card in each class to facilitate teacher/student interaction**. Note: Failure to display your name card may result in not getting any credit for the class session in which your name card was not displayed.

**Case write-ups and other assignments:** For each of the assigned Caselettes or problem set, the study group team will turn in, **before** the start of class by uploading to Canvas, a write-up in which the study questions are addressed. The instructor recognizes the challenges of responding to the study questions of each Caselette given the pace of the course.

The write-up should be double-spaced, font size 11, and as a guideline should be limited to 4 pages in length. The 4-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 front page of the memo. Write these as if you were writing a recommendation to the major decision-maker in the case.

Write-ups of the Caselettes and problem sets will not be accepted after the class has started. **Credit will only be given to write-ups which are uploaded to Canvas before the start of the class to which the Caselette was assigned. No credit will be given for write-ups which are handed in late or not handed in.**

**You are required to upload the deliverables of the negotiation exercise before 11:59 pm the evening before the date of the term sheet negotiation debriefing class meeting. As well, all team members are required to participate in the assigned presentation.**

**QUIZ: Will be held during Session 21, November 19, 2012 during class time.** It may be taken on an open book/open notes basis. You must bring a calculator to the quiz. No laptops are allowed.

**Note:**

**The instructor will take great care to grade as fairly as possible and will NOT discuss grades at the end of the course.**

**Lecture Notes**

PDF files with the PowerPoint slides used in class will be posted onto Canvas prior to class.

**Learning Environment**

Students are expected to strictly adhere to **Concert Rules**, including:

- Class starts and ends exactly on time. Students are expected to be prompt.
- Students remain in attendance for the duration of the class, except in an emergency. Students who leave the class while it is in session will be not be readmitted.
- Students display their nameplates.
- All phones and electronic communication devices are turned off.

Note: The instructor, at his sole discretion, will apply grade penalties for any and all violations of these **Concert Rules**.

**Class Cancellation and Make-up Days:**

In the unlikely event that a class must be canceled, students will be contacted by e-mail. Generally, if a make-up class can be scheduled, it will be held on the preceding or following Friday in the AM. Make-up classes will be video recorded and posted.

**Communicating with the Instructor**

The best way to contact me is by e-mail. I will make every effort to respond promptly. If you want to see me in person you will find it most efficient to coordinate a meeting with me. Alternatively, you may also come to my office (SH-DH 2012) during my office hours which are on Monday 3:00 - 4:00 pm throughout the semester.

<b>VI. Course Outline At-A-Glance MGMT 264 Fall 2012</b>				
<b>Session Number</b>	<b>Date</b>	<b>Topic</b>	<b>Case/activity</b>	<b>Submissions Due</b>
1	W 9/5/2012	Course Introduction and Overview		
2	M 9/10/2012	The VC Industry Today - An Industry in Transition		
3	W 9/12/2012	VC Firm Structure and Activities		
4	M 9/17/2012	Evaluating Investment Opportunities	Chemdex	Prepare case
5	<b>T 9/18/2012 4:30pm to 6pm</b>	<b>SPECIAL SESSION, JMHH 265</b> Evaluating Investment Opportunities --Case Analysis	Chemdex	Post PowerPoint slides
6	M 9/24/2012	Evaluating Investment Opportunity – The Business Plan	IBAS Case	Read the IBAS plan. Be prepared to evaluate it in class
7	W 9/26/2012	Organizational Issues in the Formation of a Startup	Caselette # 1	Case Memo
8	M 10/1/2012	Initial Capitalization in the Formation of a Startup	Caselette # 2	Case Memo
9	W 10/3/2012	<b>Guest Speaker</b> – Stephan Jacob, Kembrel, Inc.		
10	M 10/8/2012	Valuation Methodologies	HBS Problem set case # N9-396-090	Prepare Questions 1 - 2
11	W 10/10/2012	Valuation Methodologies (continued)	HBS Problem set case # N9-396-090 (continued)	Prepare Questions 3 - 6
12	M 10/15/2012	Fundraising Challenges: The Entrepreneur's Perspective	Caselette # 3	Case Memo
13	W 10/17/2012	Lecture on Term Sheets		
	M 10/22/2012	<b>NO CLASS: Fall Break</b>		
14	W 10/24/2012	Liquidation Preferences and Price Protection Anti Dilution	Caselette # 4	Case Memo
15	M 10/29/2012	<b>Guest Speaker</b> – Michael Kopelman, Edison Ventures		
16	W 10/31/2012	Analysis of a Term Sheet <b>Hand out materials for negotiation session</b>	Caselette # 5	Case Memo
17	M 11/5/2012	Integrating Valuation with Term Sheet Structure – Apex A	Apex A	Case Memo

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18	W 11/7/2012	Apex A continued	Apex A	
19	M 11/12/2012	Formal Review Session with the TA		
20	W 11/14/2012	Optional Review Session with TA		
21	M 11/19/2012	<b>QUIZ</b>		
	W 11/21/2012	<b>NO CLASS</b>		
22	M 11/26/2012	Compensation Practices in Venture-Backed Companies		
23	W 11/28/2012	Corporate Governance - The role and composition of the BOD in a venture-backed firm		
24	M 12/3/2012	<b>Term Sheet Debriefing Session</b>	Teams must be ready to present their negotiated term sheet	See negotiation instructions for the content and timing of your deliverables
25	W 12/5/2012	Course Summary		

**Detailed Course Outline**

***Note: The session outline below is subject to change in order to accommodate the pace of class discussions and guest speakers' schedules***

**Wednesday, September 5, 2012****Session 1: Course Introduction and Overview**

- Course introduction
- Student introduction and team formation
- An overview of the venture capital industry and its role in fostering the growth firms

**Required Reading**

- "The VC Shakeout" by Joseph Ghalbouni and Dominique Rouziès, Harvard Business Review (Jul/Aug 2010)

**Monday, September 10, 2012****Session 2: The VC Industry Today – An Industry in Transition**

- Venture Capital objectives and investment strategies; role of the general partners
- Current industry trends

**Required Reading**

- "A Note on the Venture Capital Industry" Harvard Business School (HBS# 9-295-065 July 21, 2001)
- "How Venture Capital Works" by B. Zider, Harvard Business Review (Nov-Dec 1998)
- "Market Structure Is Causing the IPO Crisis" by David Weild and Edward Kim of Grant Thornton LLC (October 2009)

**Supplemental Reading**

- "Venture Capital Fund-Raising Tumbles in Third Quarter," by Evelyn M. Rusli, The New York Times (October 10, 2011)

- "Lack of Exits Impacts Q3 Fundraising," by Lawrence Aragon, Venture Capital Journal (October 2011)
- "IPOs Matter," by Mark Jensen, Venture Capital Journal (July 2011)
- "The New IPO Calculus," by Mark Boslet, Venture Capital Journal (October 2011)
- "Step Into The Spotlight," by Joanna Glasner, Venture Capital Journal (2011)
- "A Tale of Two Markets," by Paul Maeder, Venture Capital Journal (September 2011)
- "LPs Speak out on Terms, Quartile Rankings," by Joanna Glasner, Venture Capital Journal (July 2011)
- "Exchanges Democratizing Venture Capital," by Mark Boslet, Venture Capital Journal (February 2011)
- "Report: Venture capital funding fell in third quarter of 2011," Mercury News (November 13, 2011)

**Wednesday, September 12, 2012****Session 3: VC Firm Structure and Activities**

- Venture Capital Funds: Structure, activities and practices

**Required Reading**

- Chapters 1 & 2. "The Economics of the Private Equity Market," by Fenn, Liang & Prowse (December 1995, The Board of Governors of the Federal Reserve System)
- "Does Venture Capital Foster the Most Promising Entrepreneurial Firms?" by R. Amit, L. Glosten & E. Muller, California Management Review, 32 (3): 102-111, 1990

**Monday, September 17, 2012****Session 4: Evaluating Investment Opportunities****Required Reading**

- Chemdex.com (HBS Case 9-898-076, revised: June 22, 1999)
- "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)

**Chemdex Case preparation question:**

1. How would you describe the opportunity that David Perry identified? **(Due before start of class.)**

**SPECIAL SESSION: Tuesday, September 18, 2012, 4:30pm to 6pm, JMHH 265****Session 5: Evaluating Investment Opportunities – Case Analysis****Required Reading**

- Chemdex.com (HBS Case 9-898-076, revised: June 22, 1999)

**Chemdex Case preparation questions:**

1. Which criteria would you use in general for assessing an entrepreneurial opportunity? What would you – as an entrepreneur and as an investor - look for in a start-up business? **Please post your PowerPoint slide on our Canvas site in the Assignment Folder.**
2. Imagine you are considering an investment in Chemdex in 1997. How would you evaluate this specific opportunity? **Please post your PowerPoint slides on our Canvas site in the Assignment Folder.**  
**(due before start of class)**

**Monday, September 24, 2012****Session 6: Evaluating Investment Opportunities—The Business Plan**

- **IBAS Case — see case assignment on the Canvas eRoom (due before start of class)**

**Required Reading**

- "How to Write a Great Business Plan" by W. Sahlman, *Harvard Business Review*, July-Aug 1997

**Wednesday, September 26, 2012****Session 7: Organizational Issues in the Formation of a Start-Up**

- Forming the company; creating a capital structure in preparation for a venture financing
- Intellectual property: the importance of getting it right
- Founders' stock and basic equity incentive arrangements

***Prepare Caselette # 1: Organizational Issues in the Formation of a Start-Up (due before start of class)*****Required Reading:**

- "The Legal Forms of Organization" Harvard Business School (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)
- "Venture Capitalists" Chapter 9 in High tech start-up: the complete handbook for creating successful new high tech companies, by J. Nesheim (2000)

***Supplemental Materials***

- "Guide to Trademark Issues for a New Company," WSGR Entrepreneurs Report (2005)
- "Selecting and Protecting a Company Name" by Aaron Hendelman, WSGR Entrepreneurs Report (Summer 2008)

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- “Top 10 Intellectual Property Tips for Early-Stage Companies,” by Peter Eng, WSGR Entrepreneurs Report (Summer 2008)
- “Startup Companies and Financing Basics,” by Yoichiro Taku, WSGR Entrepreneurs Report (Fall 2007)
- “Vesting of Founders’ Stock: Beyond the Basics,” by Doug Collom, WSGR Entrepreneurs Report (Spring 2008)
- “Starting Up: Sizing the Stock Option Pool,” by Doug Collom, WSGR Entrepreneurs Report (Summer 2008)
- “Avoiding Trouble: Provisions in Previous Employment Documents that Every Start-up Company Founder Needs to Review,” by Yokum Taku, WSGR Entrepreneurs Report (Winter 2008)
- **Case Discussion: The Venture Capital Method – Valuation Problem Set (HBS case # N9-396-090, October 5, 1995)**  
Prepare Questions 1 & 2  
**(due before start of class)**

**Required Reading**

- “A Note on Valuation in Private Equity Settings” (HBS # 9-297-050, April 2002)
- “Valuation: What It’s Worth”  
VentureEdge 2001

**Supplemental Materials**

- “What’s My Company Worth?” by Herb Fockler, WSGR Entrepreneurs Report (Fall 2007)

**Monday, October 1, 2012****Session 8: Initial Capitalization in the Formation of a Startup**

**Prepare Caselette #2: Considerations in establishing the initial capitalization of the start-up**

**(due before start of class)**

**Required Reading**

- “Angel Investors Spread Their Wings” by Scott Duke Harris, Mercury News (August 31, 2010)

**Wednesday, October 3, 2012****Session 9: Guest Speaker – Stephan Jacob, Kembrel, Inc.**

**GUEST SPEAKER:** Stephan Jacob, Kembrel, Inc.

**Monday, October 8, 2012****Session 10: Valuation Methodologies**

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

**Wednesday, October 10, 2012****Session 11: Valuation Methodologies (continued)**

- **Case Discussion: The Venture Capital Method – Valuation Problem Set (HBS case # N9-396-090)**  
**continued**

Prepare Questions 3 – 6

**(due before start of class)**

**Required reading**

- “Ownership, Dilution, Negotiation, and Valuation” Chapter 7 in High tech start-up: the complete handbook for creating successful new high tech companies, by J. Nesheim (2000)

**Monday, October 15, 2012****Session 12: Fundraising Challenges – The Entrepreneur’s Perspective**

- Raising Capital; the role of the business plan; fundraising strategies
- Due diligence: content and process

**Prepare Caselette #3: Issues encountered in connection with First Round Financing (due before start of class)**

**Required Reading**

- “Non-Traditional Financing Sources” by G. Sneddon and J. Turner in Pratt’s Guide to Private Equity Sources, by Thomson Venture Economics (2003)
- “Meeting with the Venture Capitalist” by W. Kingsley in Pratt’s Guide to Venture Capital Sources, Stanley Pratt & Jane Morris (2004)
- “New Venture Financing” Harvard Business School (HBS note # N9-802-131, Aug. 1, 2006)
- “Strategic Investors in the Early-Stage Company” by Allison Spinner, WSGR Entrepreneurs Report (Winter 2007)
- “Structuring the Financing,” by Stanley C. Golder in Pratt’s Guide to Private Equity Sources, by Thomson Venture Economics (2004)
- “VC ‘Super Angels’: Filling a Funding Gap or Killing ‘The Next Google?’”, Knowledge@Wharton (September 1, 2010)
- “Venture Capital Negotiations: VC versus Entrepreneur.” Harvard Business School (HBS# 9-800-170, March 2, 2000)

**Supplemental Materials**

- “Fundraising Workshop,” Deloitte & Touche
- “More Angels Pile Into Deals,” by Constance Loizos, Venture Capital Journal (June 2011)
- “Is Crowd-Funding on the Horizon?” by Cydney Posner, Cooley LLP (September 14, 2011)
- “Record Amount of IPOs Pulled As Volatility Spooks Companies,” by John Melloy, CNBC.com (September 15, 2011)
- “Hatching Startups,” by Mark Boslet, Venture Capital Journal (April 2011)
- “Seed is the New Series A for VCs,” by Caine Moss of WSGR, VentureBeat (August 24, 2009)

- “‘Super Angels’ Fly In to Aid Start-Ups” by Pui-Wing Tam and Spencer E. Ante, Wall Street Journal (August 16, 2010)
- “Left Out,” Venture Capital Journal (July 2009)
- “Perfecting Your Pitch,” by Brad Feld, WSGR Entrepreneurs Report (Winter 2008)
- “The Fundraising Process: Best Practices for Entrepreneurs and Directors,” by Robert Housley and Evan Kastner, WSGR Entrepreneurs Report (Summer 2009)

**Wednesday, October 17, 2012****Session 13: Lecture on 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)

**Supplemental Materials**

- “Control: The Critical Issue in Negotiating Financing Terms,” by Caine Moss, WSGR Entrepreneurs Report (Fall 2008)
- “Navigating Down-Round and Dilutive Financings,” by Yokum Taku, WSGR Entrepreneurs Report (Fall 2008)
- “The Nuts and Bolts of Recaps and Pay-To-Play Financings,” by Timothy Harris, Venture Capital Journal (May 2010)
- Memorandum of Terms for Preferred Stock (non-negotiated company favorable)
- Memorandum of Terms for Preferred Stock (non-negotiated investor favorable)

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- Memorandum of Terms for Preferred Stock (negotiated)
- Terms for Private Placement of Series Seed Preferred Stock
- TheFunded Founder Institute: "Plain Preferred Term Sheet"
- NVCA Model Documents: "Term Sheet for Series A Preferred Stock Financing..."
- WSGR Term Sheet Generator: "Memorandum of Terms"
- "Founders Now Take the Money and Maintain Control," by Evelyn M. Rusli, The New York Times (April 7, 2011)

**Monday, October 22, 2012****NO CLASS, Fall Break****Wednesday, October 24, 2012****Session 14: Liquidation Preferences and Price Protection Anti Dilution**

**Prepare Caselette # 4: Liquidation Preferences and Anti-dilution Formulas (due before start of class)**

**Monday, October 29, 2012****Session 15: Guest Speaker – Michael Kopelman, Edison Ventures**

**GUEST SPEAKER:** Michael Kopelman, Edison Ventures

**Wednesday, October 31, 2012****Session 16: Analysis of a Term Sheet**

**Prepare Caselette #5: Analysis of a Typical Venture Capital Term Sheet (due before start of class)**

- **Hand out materials for negotiation session**

**Term Sheet Negotiation Assignment**

- Materials explained
- Selection of negotiating teams

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 Entrepreneurs or as VCs.

We will pair two VC teams with a single Entrepreneur team. Each Entrepreneur team will get term sheets which reflect initial offers from the two different VC teams. Everyone will get a "backgrounder" document which explains the assignment in great detail.

For **Session 24 on Monday, December 3, 2012**, 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 presentations that are due on **Monday, December 3, 2012**, will be outlined in the materials which will be handed out to you.

**Monday, November 5, 2012****Session 17: Integrating Valuation with Term Sheet Structure**

- **Case Study: Prepare the Apex Investment Partners (A): April 1995 (HBS # 9-296-028, Nov. 17, 1997)**
- **Case preparation questions:**
  1. How has AccessLine financed itself to date? Why have they chosen this strategy? What have been the implications for the firm?
  2. Why does Dan Kranzler regard Apex Investment Partners as an attractive source of venture capital? Why does Apex find AccessLine to be an attractive investment?
  3. How attractive are the terms that AccessLine has proposed to Apex for the Series B financing? What are the key differences from those in Series A financing round? What issues, if any, should concern Apex?
  4. What is an appropriate valuation for AccessLine? Do analyses using the comparable method, discounted cash flow method, and the "venture capital"

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method. Do these methods suggest similar or different values for AccessLine?

**Case memo due before start of class.**

- Be prepared to be called upon to do the valuation.

**Wednesday November 7, 2012****Session 18: Apex A continued****Monday, November 12, 2012****Session 19: Formal Review Session with TA****Wednesday, November 14, 2012****Session 20: Optional Review Session with TA****Monday, November 19, 2012****Session 21: QUIZ****QUIZ**

- Bring your calculator. (No laptops allowed.)
- Open books
- Open notes
- Open minds...

**Wednesday, November 21, 2012****NO CLASS****Monday, November 26, 2012****Session 22: Compensation Practices in Venture-Backed Companies**

- Compensation Elements
- ISOs and NSOs
- The impact of 123R on Incentive compensation in the high growth potential company
- Implications of IRC section 409A

- Alternative forms of Incentive compensation

**Required Reading**

- “New Rules on Option Pricing for Private Companies” by Craig Sherman & Scott McCall, WSGR Entrepreneurs Report (Fall 2007)
- “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)

**Supplemental Reading**

- 2010 Equity Incentive Plan
- 2010 Stock Option Agreement
- Equity Compensation Overview Memorandum (WSGR)
- “Interesting Approaches to Unique Problems: Partial Cash-Out of Founders’ Stock” by Doug Collom, WSGR Entrepreneurs Report (Fall 2007)

**Wednesday, November 28, 2012****Session 23: Corporate Governance – The Role and Composition of the BOD in a Venture-Backed Firm**

- The roles and composition of the BOD
- Overcoming difficult times

**Required Reading**

- “After The Term Sheet” by Dennis T. Jaffe and Pascal N. Levensohn (November 2003)
- “Rites Of Passage” by Pascal N. Levensohn (January 2006)

**Supplemental Reading**

- “A Brave New Board Era” Venture Capital Journal (March 2006)
- “How to Turn A ‘Bored’ Meeting Into A Real Board Meeting” Venture Capital Journal (August 2006)

## Course Syllabus

- “The Basic Responsibilities of VC-Backed Company Directors” by working group on Director Accountability and Board Effectiveness (January 2007)
- “Venture-Backed Boards More Active, Better Aligned Amidst Financial Crisis” Dow Jones VentureSource (November 10, 2009)
- “VCs Take CEO and Board Relationships to the Next Level” by Ben Holzemer, Venture Capital Journal (July 2010)
- Five Compensation-Related Mistakes Startups Make (And Should Avoid)

**Monday, December 3, 2012****Session 24: Term Sheet Debriefing**

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 11:59 pm the night before you present in class.**

- Each investor team and the founder to prepare a PowerPoint presentation, which includes the final proposed valuations as well as commentary on the key terms that were critical in the negotiation of the term sheet.
- Founders additionally provide a detailed summary of the final agreement using the format outlined in the Negotiation Instruction handout which will be distributed in class.

**Wednesday, December 5, 2012****Session 25: Course Summary**