

# 15.431: Entrepreneurial Finance

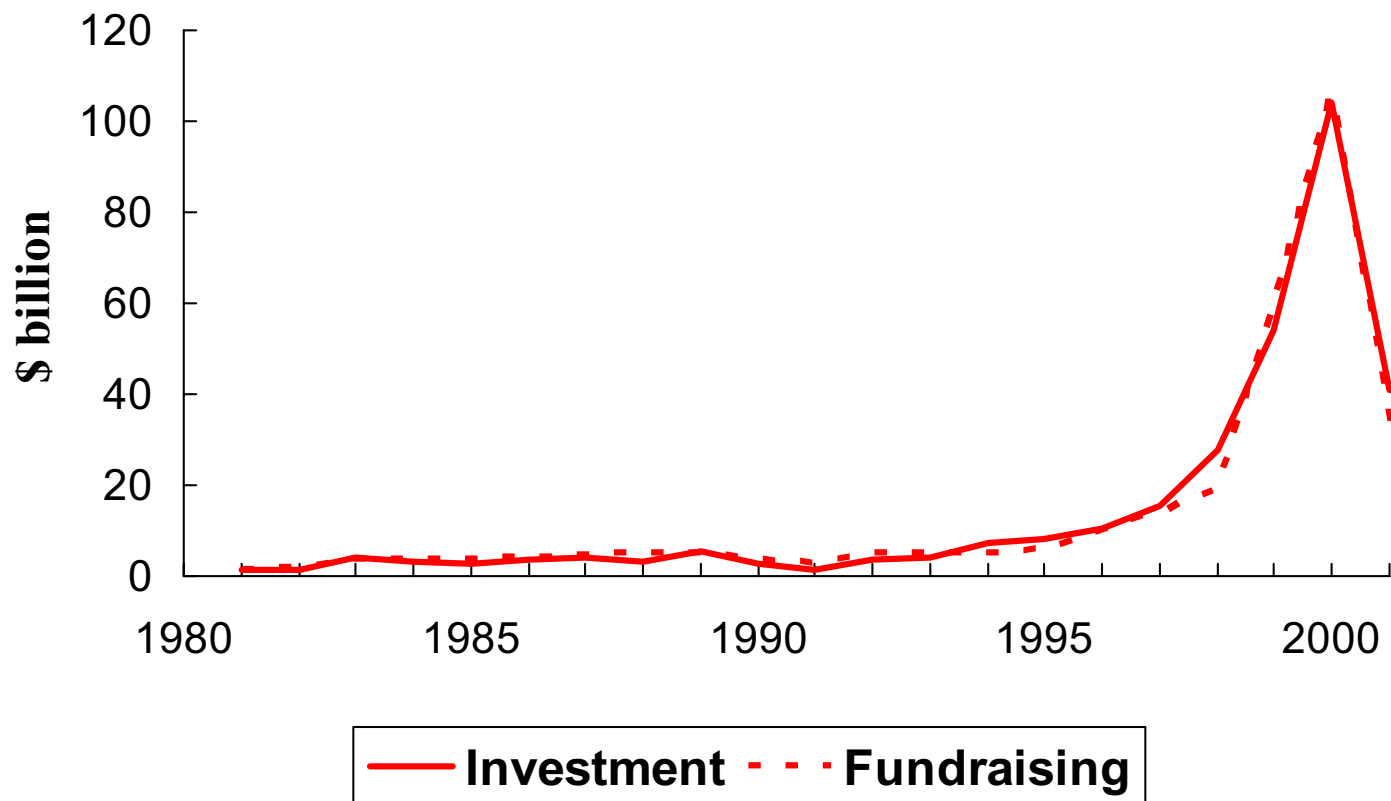
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# *Course Overview: The World of Entrepreneurial Finance*

- Large increase in supply of and demand for venture capital/private equity.
  - Record amounts raised in every year 1995-2000.
  - Even with drop in fundraising in 2001 it is about what it was in 1998 and 17x the level in 1990.
  - Likely to continue at relatively high rates, i.e. probably not just boom part of cycle.
- Does this reflect a structural shift in the way new businesses/projects are organized and financed?

# *Unprecedented Flow of Funds into Start-up Companies*



Data Source: Venture Economics

# *What Is Special About Entrepreneurial Finance?*

- Valuing New Ventures
  - Large uncertainties
  - Massive option values
- Financing new ventures:
  - Large financing needs
  - Severe information problems
  - Severe agency problems
- These issues are common to all new “projects,” but here we focus on how investors and entrepreneurs deal with them.

# *Course Perspectives and Goals*

- Understand the broader issues of investing in entrepreneurial ventures
- Understand the more detailed issues of how to evaluate and finance entrepreneurial investments
- Apply tools developed in 15.401 and 15.402, and go beyond them:
  - Issues here are more complex
  - Finance most important in birth and death of firms
- Study interaction of finance and strategy

# *Course Perspectives and Goals*

- Ultimately our goal is to give you some of the tools you need to:
  - Start a company and finance it
  - Be a venture capitalist or private equity partner
  - Invest in private equity partnerships

# *Course Overview*

- Module 1: Business Valuation
  - Framework for qualitative and quantitative evaluation of new business opportunities
    - » DCF Method
    - » Venture Capital Method
    - » Real Options Method

# *Course Overview*

- Module 2: Structuring Investments/Financing
  - Terms of the initial investment/financing
    - » Understanding deal terms
    - » Evaluating deal terms
    - » Negotiating deal terms
  - Follow-on investments
  - Later Stage Deals

# *Course Overview*

- **Module 3: Venture Capital Funds**
  - Structure of partnership compensation
    - » Structure of partnership covenants
    - » Partnership strategies
  - Corporate Venture Capital Funds
  - International Venture Capital Funds

# *Course Overview*

- Module 4: Employment Issues
  - Joining start-ups
  - Valuing alternative compensation plans
  
- Module 5: Exit
  - IPO
  - Sale
  - Liquidation

# *Course Mechanics*

- Cases (16), Lectures (6), Guests (2)
- Guideline questions for each case available
  - Work in study groups of no more than 4
  - Expect to grope around
    - » Not meant to be easy, but you'll learn more
    - » Do not use outside sources (library, web) to find out what happened

# *Memos*

- Memos are 10% of grade
- Hand in memos for 12 out of 16 cases. Must do first case, Technical Data Corporation
- Be ready to discuss cases even if you're not handing in memo
- Memos should answer two questions:
  - What is going on?
  - What would you do?
- Write to major decision-maker
- Up to two pages of text
  - Attach exhibits / calculations

# *Class Participation*

- 30% of final grade
  - Individual
  - Based on quality and quantity
  - Good chance for to practice in low-risk environment
  - Isn't class participation grade subjective?
    - » Not after 20 cases
    - » TA will be taking notes in class
  - Mid-term participation grades

# *Class Participation Process*

- You know the basic rules
- Listen to others and build
  - Try not to change the subject
- Ask questions
  - Sometimes whole class is lost
- I may cold call
  
- Please don't come late!

# *Final Exam*

- 60% of your grade
- Case based
- Take home exam
- I grade the exams, not T.A.

# *This Course Is Not For Everyone*

- Requires Tolerance for Ambiguity:
  - Entrepreneurial ventures involve massive uncertainty
  - Not always a formula or “right answer”
  - Please do not take the course if you are looking for cookbook answers
- Requires Work:
  - One Case/Memo Per Week
  - Class Attendance



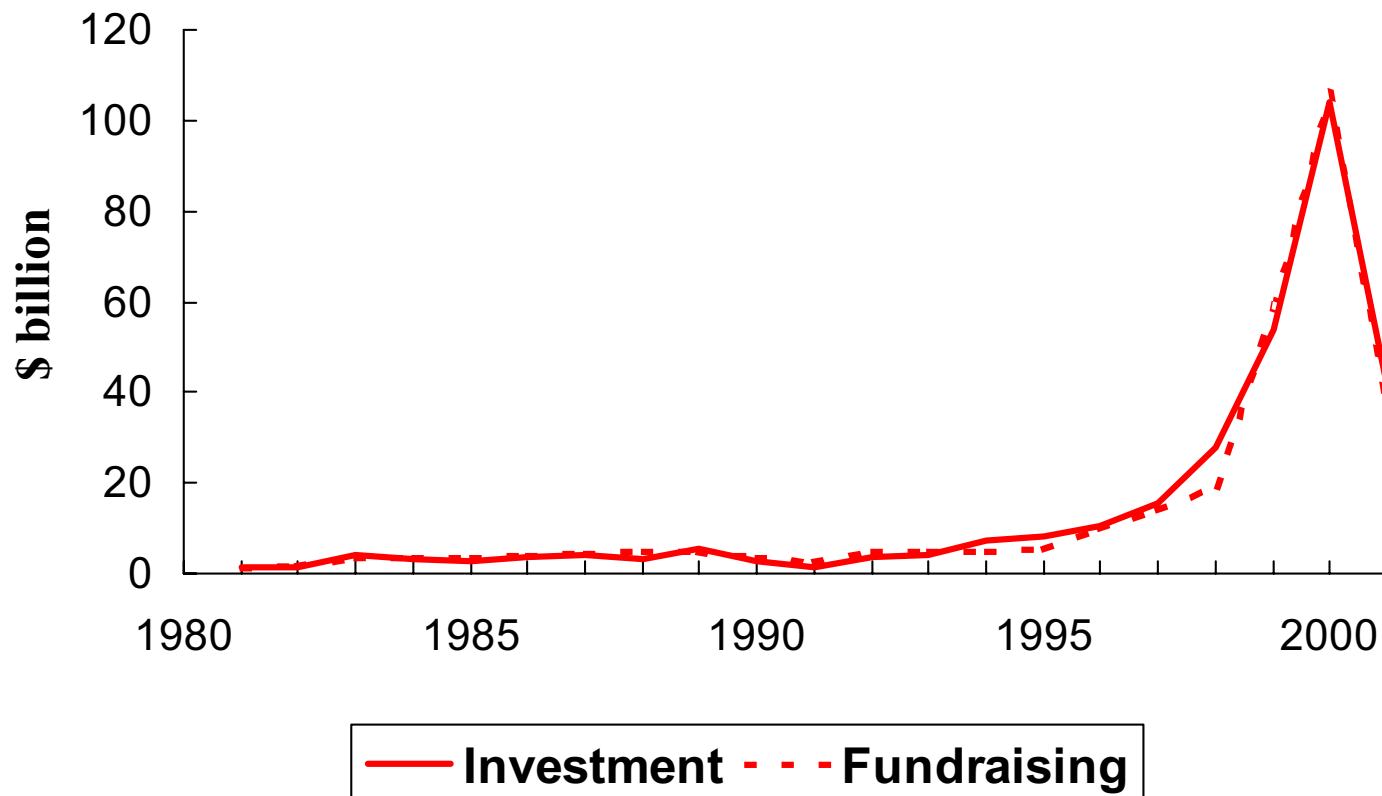
## *Scheduling: Guests*

- John Chory (Hale and Dorr)
  - Thursday, April 4th
- Alan Spoon (Polaris Venture Partners)
  - Tuesday, April 9th

# *Exciting Time for Entrepreneurship*

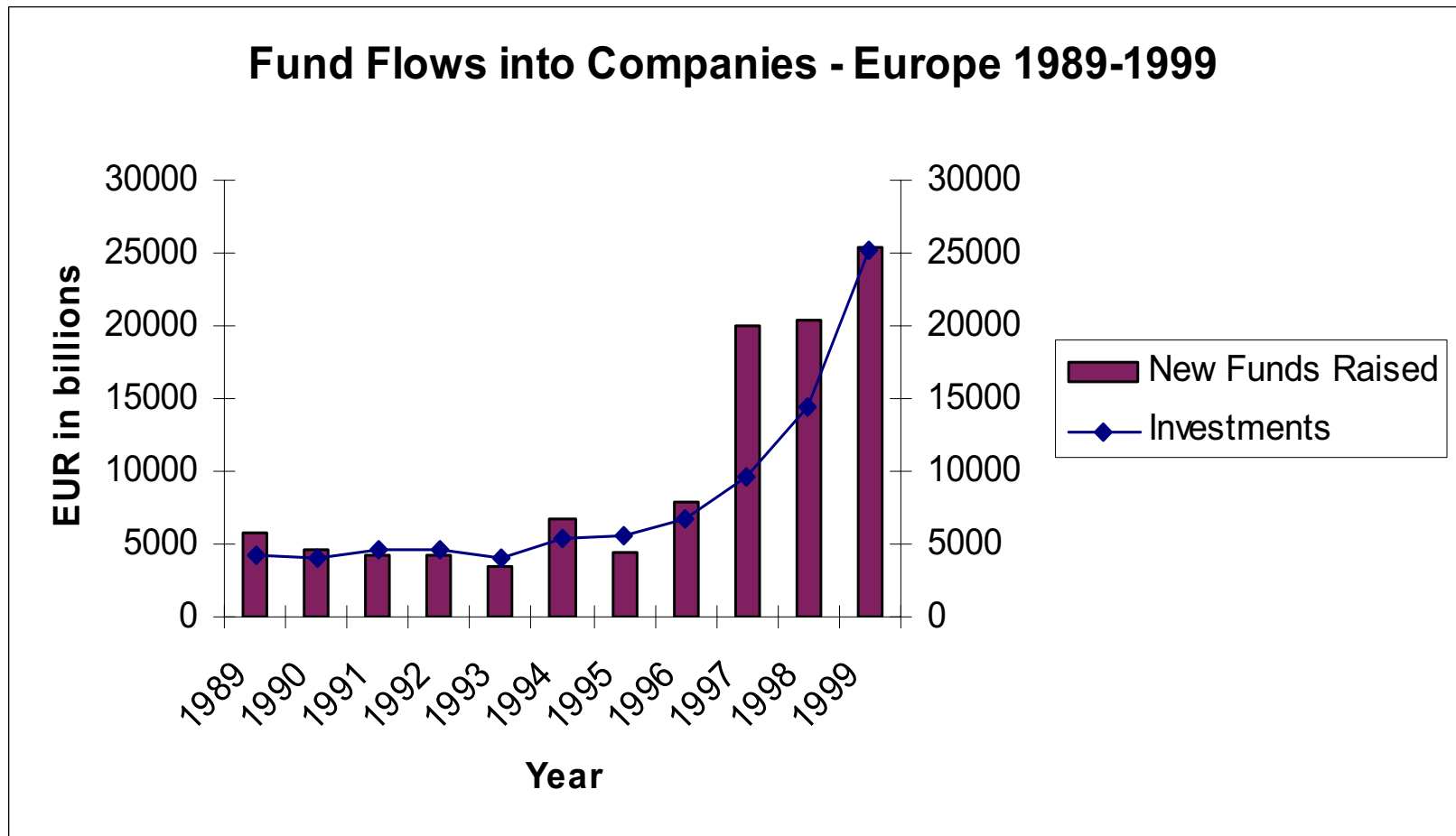
- Large increase in supply and demand for private equity
  - Massive inflows of funds in to VC partnerships
  - Record number of firms in the industry
- Huge opportunities
  - New technologies
  - Regulatory changes
  - Organizational changes

# *Unprecedented Flow of Funds into Start-up Companies*



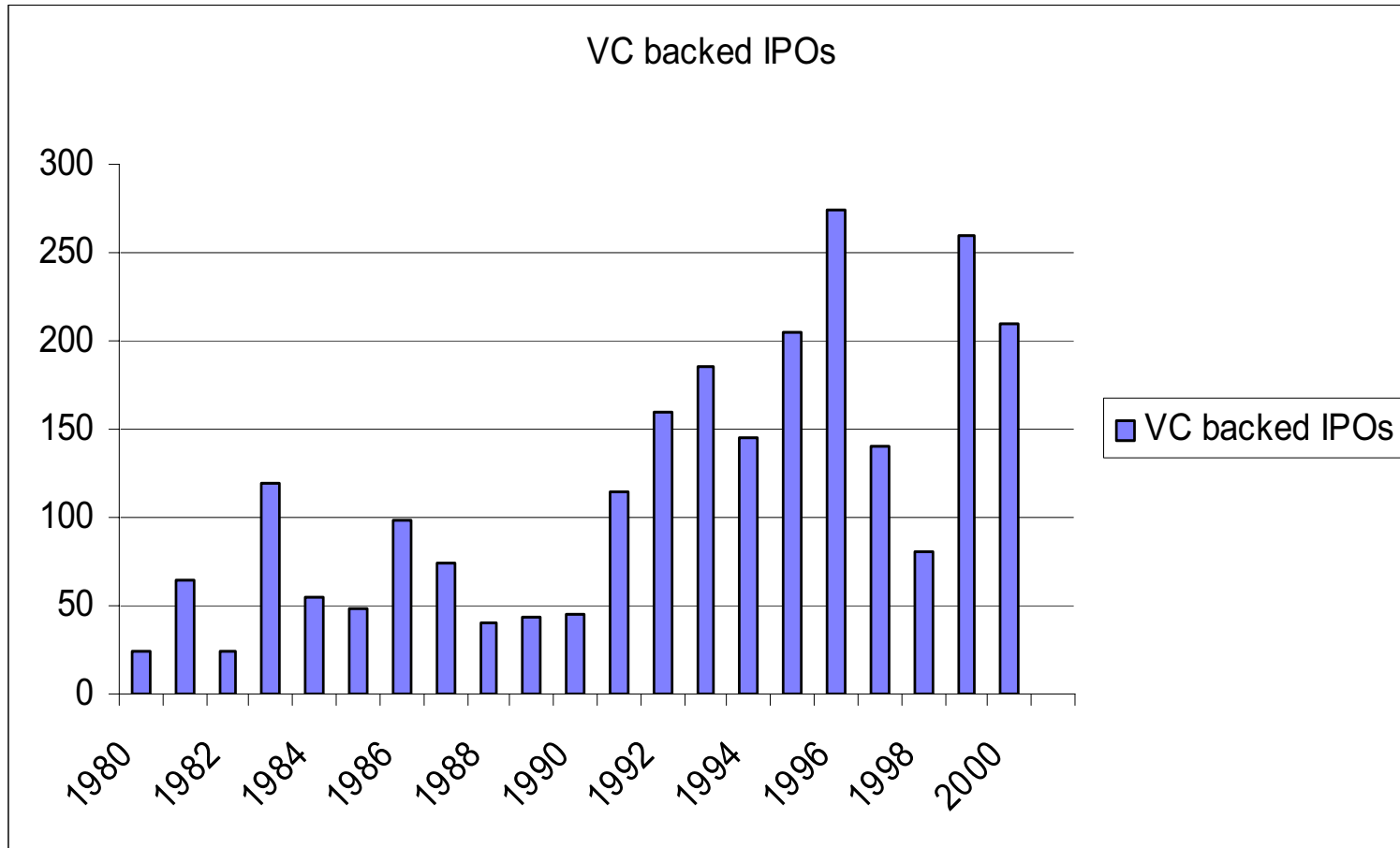
Data Source: Venture Economics

# *World wide rise in New Venture Financing*



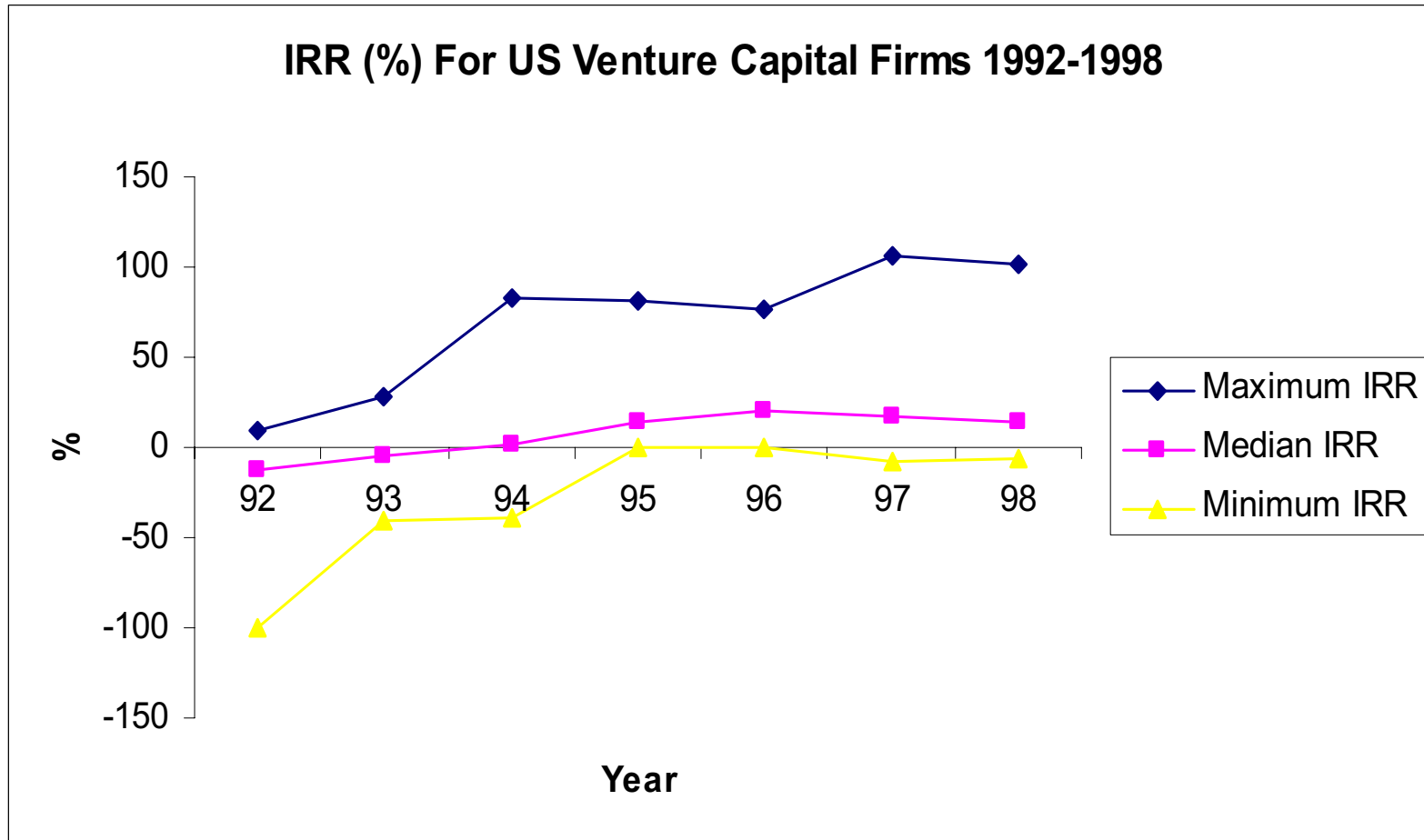
Data Source: European Venture Capital Association

# *Unprecedented Number of IPOs*



Data Source: SDC

# *But there are Differences ...*

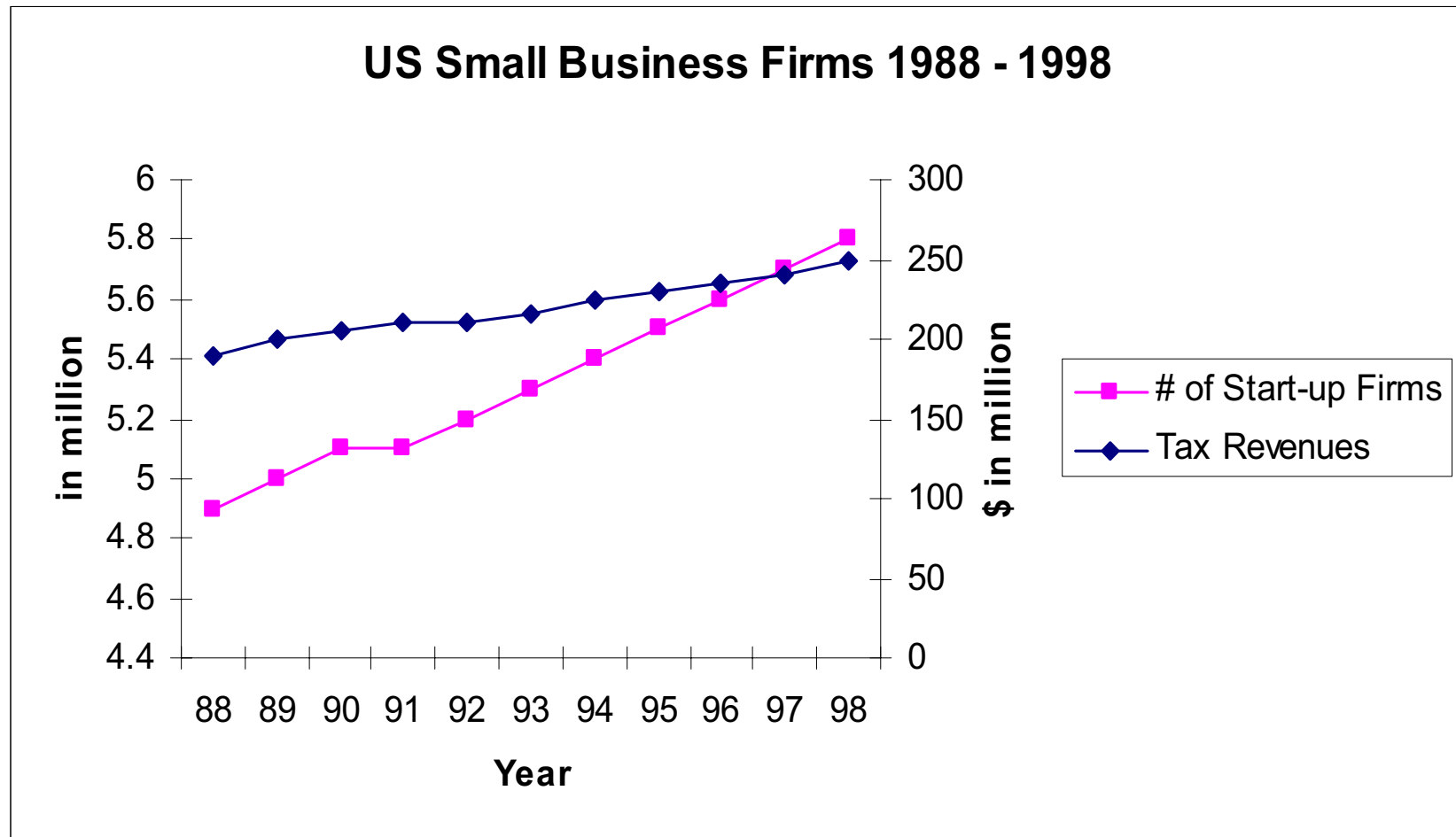


Data Source: Venture Economics

# *Why is Entrepreneurship Important?*

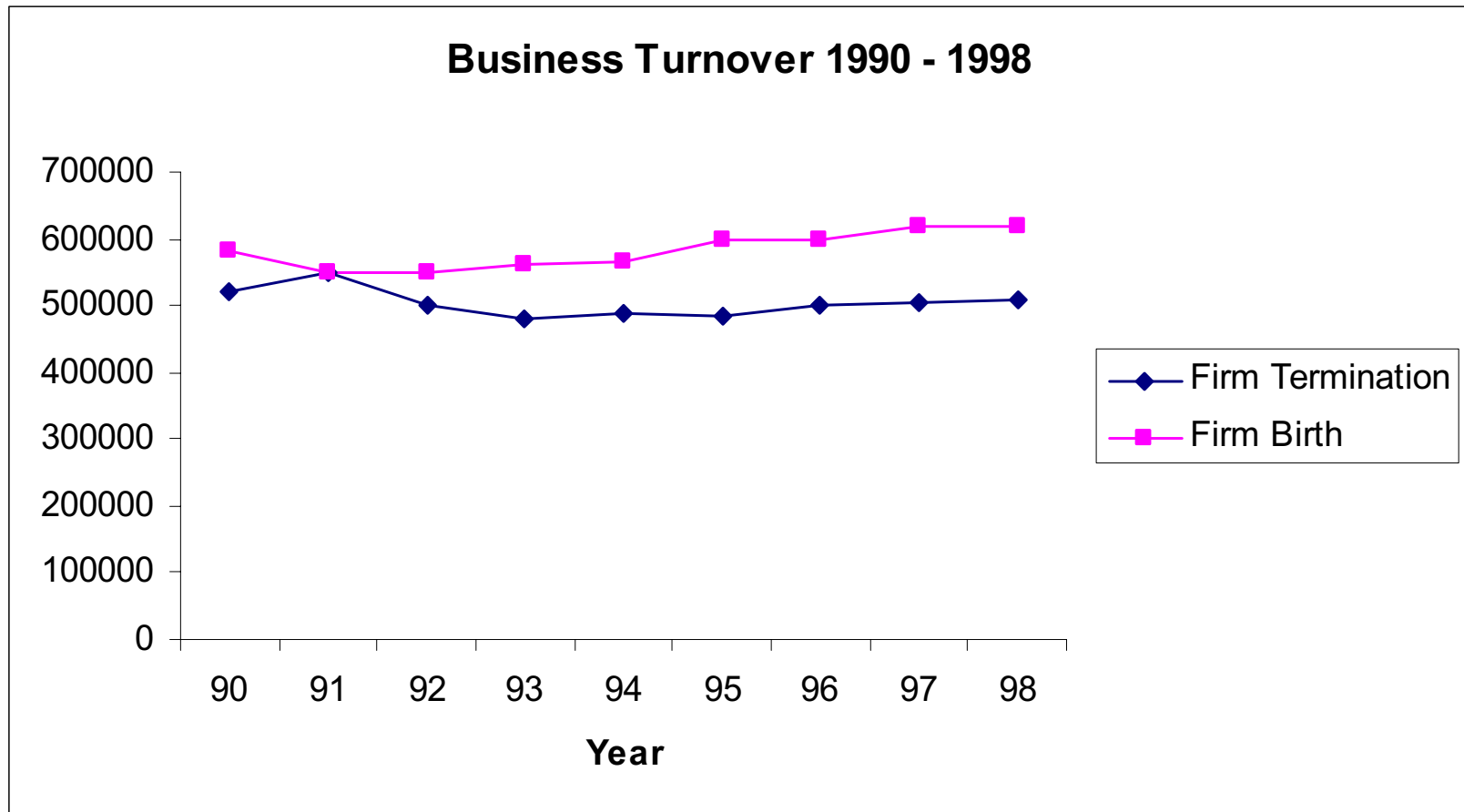
- Central to Growth and Job Creation
  - Small companies earn 50% of GDP
  - Small companies provide 50% of jobs in the US
- Important for Knowledge Creation
  - Young firms patent “groundbreaking” innovations
- Entrepreneurs have Higher Upward Mobility

# *Small Firms are Increasing in Importance in the Economy*



Data Source: U.S. Census Bureau

# *But Uncertainty is High*



Data Source: U.S. Census Bureau