

**Kellogg School of Management
Northwestern University**

**FINC 445
Venture Capital and Private Equity Investing
Winter 2009**

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Course Introduction / Outline

A. COURSE OVERVIEW

This course focuses on the venture capital and private equity industry, where private equity is defined as the universe of investments in private (non-publicly traded) vehicles. The course is motivated by increases in both the supply and demand for private equity all over the world. On the supply side, private equity investments (venture capital, leverage buyouts, real estate, etc.) have increased from under \$5 billion in the 1980's to over \$200 billion nowadays. This rapid growth is likely to continue in the near future as pension plans and other institutions continue to diversify their portfolios. On the demand side, an increasing number of individuals (MBAs, engineers, etc.) are interested in understanding the private equity industry and managing their own businesses.

The primary objective of this course is to provide an understanding of the concepts and institutions involved in entrepreneurial finance and private equity markets. For this purpose, the course follows the private equity 'cycle': the structuring and governance of a fund, how the money is used, what are the valuation techniques of early stage investments, how contracting and term sheets work, and what are the possibilities of exit of such investments. Within private equity finance, this course will focus primarily on venture capital; however, treatment of the structure of the overall PE firm will be covered, in addition to topical coverage of leveraged buyouts and other PE vehicles.

Word of warning: if you are looking for a course primarily focused on LBOs, this may not be the course for you. Whereas we will cover to some extent the structure of LBO funds and deals, we will not cover valuation in companies with established revenues. You will note that we offer plenty of mainstream finance courses that cover in detail valuation of well-established companies; therefore, in an effort to avoid duplication of materials, this course will focus its attention on taking traditional valuation approaches and learning about the challenges of applying them to early stage ventures without established revenues and cash flows. If you are interested in later stage investing and buyouts, you may want to supplement this class with the finance elective courses in Financial Decisions, Corporate Restructuring, and Hedge Funds and Private Equity.

B. COURSE ORGANIZATION

In the first session of the course I will provide an introduction to the different classes of private equity and to the concerns faced by investors in private equity partnerships. The remainder of the course is divided roughly into three sections: i) Fund-raising and the investor-fund relationship, ii) The role of intermediaries, iii) Exit

In the fund-raising and the investor-fund relationship, we will study the issues faced by individual entrepreneurs and managers when raising funds. We will focus on evaluating the qualitative attractiveness of the opportunity and on establishing its quantitative value. We will also look at the challenges faced by those investing in these funds. In particular, we will be interested in the incentives faced by both private equity partnerships and investors, and in why the incentives and contractual terms take the form they do. In the role of intermediaries / private equity partnerships section, we will study the issuers of private equity, focusing on the role of the private equity partnerships in choosing, valuing, and structuring and managing private equity investments. We will finish with a section in

which we will study the issues faced by entrepreneurs and PE partnerships in exiting or cashing in their investments. More generally, this section of the course will consider why particular methodologies and structures have evolved in the way they have, as well as possible ways to improve them.

C. COURSE STRUCTURE

The course will consist of 3 hour sessions per week during 10 weeks. Sessions will include case study discussions, lectures on relevant materials and methods, and guest lectures.

i) Course Sessions

Lectures will cover diverse topics, with the objective of preparing you for the challenge of the next case analysis or topic. Please note that the lectures will not spoon feed the solution system for the cases. Part of the learning process in this course (as in the real world) is tackling new problems via the cases and thinking about how to apply tools and principles from other courses as well as this course's lectures.

This course is a time-consuming and challenging course. Every week I will require you to read several papers and to prepare for the discussion of the case in class. Hence, you must be ready to allocate time to work on the material and also to participate in class.

ii) Cases Studies

For each case, I will assign study questions concerning every case one week in advance. I will post these questions on blackboard or give them to you in class. Students are required to hand in a case analysis on the assigned case prior to the start of the classroom session. Case analyses may be completed in groups of no more than 3 students. Please note that I consider rotation of case responsibility to be a violation of the honor code in this class (by rotation, I mean that one of the persons in the group is designed to do the assignment in a given week). If a case analysis is handed in with your name on it, it must be the case that you performed a significant part of the work involved in that analysis, and your ability to answer questions on the material in that analysis should reflect that effort.

iii) Required course material

This course requires a packet of cases plus a list of readings. Additionally, other required material, including my lecture slides and assignments, will be made available either in hard copy or on the Blackboard course website.

iv) Optional material

- 1) Gompers, Paul A. and Josh Lerner (2001). The Money of Invention. HBS Press
- 2) Metrick, Andrew (2006). Venture Capital and the Financing of Innovation. Wiley Ed.
- 3) Levin et al. (2005). Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions.
- 4) Gompers, Paul A. And Josh Lerner (2004). The Venture Capital Cycle. MIT Press.

D. COURSE PROCEDURES

i) Classroom sessions

Because of the nature of the course, and its grading criteria, it is highly recommended that you attend every class. This course places a strong emphasis on presentation and discussion skills. It will be important that you prepare every class and you participate in the discussions by explaining your

positions and defending your arguments (if it helps, think of it as an opportunity to work on your communication skills in a low-risk environment). If you want your participation to count, I will need to see a name tag in front of you in every class.

Any student may be cold-called specifically during the class to participate in the discussion. However, I prefer to engage in discussion that is willingly proffered, rather than to use cold-calling. It is therefore to your advantage to willingly participate of your own volition. Do not count on me to up your participation grade by cold-calling on you. Participation is an important part of the learning process, and I have set the incentive structure (i.e. grading) appropriately. It is your responsibility to be prepared for the class discussion.

ii) Course Assignments

During this course, you will work in groups of up to three students. For each case, I will assign study questions concerning the case (I will post these questions on blackboard one week in advance). For much of the class period, we will consider these questions and the material in the case. You are allowed and encouraged to meet in your groups outside of class to discuss and analyze the cases.

Each student group will submit a two page case analysis of each case to be discussed that week, prior to the start of the class. Your write-up should summarize your analysis of the assigned case, and should be written as if you were writing to the major decision maker in each case. Argue as if you are in a funding meeting, not a doctoral seminar. The process of arriving at the answer is as important as the answer itself. All write-ups should be typed and at least 1.5 spaced. The two-page limit is for text only. You can back up your conclusions with as many additional numerical calculations as you wish. **Write-ups will not be accepted after the start of the class.** Case write-ups will be given credit if handed in, and not given credit if not handed in. I will not grade your memoranda initially. However, I will use the memoranda to determine final grades for those students who are on the border of an A or B, the border of a B or C, or the border of a C, D or F.

Please note that it is my policy not to hand out answers to the cases. This is because there are no absolute right answers. The best cases are deliberately written to be ambiguous. There may be good arguments and bad arguments, however, and one of the course's goals will be to help you learn to distinguish between sensible and senseless arguments. Handing out my analysis would reduce the uncertainty and partially defeat the purpose of doing cases. Handouts also tend to circulate, which is a problem when I teach the case in another quarter. **If you are uncomfortable with ambiguity, do not take the class.**

E. GRADING

Grading will be based on class participation, the short memoranda and a final examination.

i) Class participation

Class participation will count for 30% of the final grade. I will judge your performance based both on the quality and the quantity of your comments. Because so much of the learning in this course occurs in the classroom, it is very important that you attend every class. Low class participation combined with several absences can lead to a failing grade.

ii) Memoranda

The memoranda will count for 10% of the final grade. The memoranda will have greater importance for those students on the A / B, B / C, or C / D / F borders.

If you are unable to come to class and turn in memoranda, you can email them to me.

iii) Final Exam

The final examination will count for 60% of your final grade. The final examination will be an **individual**, take home case analysis. You will have approximately one week to work on the case.

iv) Standard of Conduct

Each student in my class is expected to abide by the Kellogg Honor Code. Any work submitted by a student in this course for academic credit must be the student's own work. Collaboration in groups is allowed where stated.

v) Laptop Policy

Laptop use is prohibited during classroom sessions unless I say otherwise.

Office Hours and Contact Information

My office hours are:

- From 5pm to 6pm on Tuesdays on the Evanston campus, at my office 410 in the Jacobs Center.
- From 4:30pm to 5:30pm on Wednesdays on the Chicago campus,

My email is a-toldrasimats@kellogg.northwestern.edu . My office is 410 in the Jacobs Center.