University of Chicago  
Graduate School of Business  

Entrepreneurial Finance and Private Equity  
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Business 34101  
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Fall 2003  
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Course Introduction / Outline  

A. REQUIRED MATERIAL  

1) A packet of cases.  


B. OPTIONAL MATERIAL  


C. COURSE OVERVIEW  

This course will use the case method to study entrepreneurial finance and, more broadly, private equity finance. The course is motivated by increases in both the supply of and demand for private equity. On the supply side, the amount of private equity under management -- by partnerships investing in venture capital, leveraged buyouts, distressed companies, real estate, etc. -- has increased from under $5 billion in 1980 to over $300 billion in 2002. On the demand side, an increasing number of MBAs and others are interested in managing their own businesses. The supply and demand for funds have also grown substantially outside the U.S.  

The primary objective of the course is to provide an understanding of the concepts and institutions involved in entrepreneurial finance and private equity markets. To do this, I have purposely designed the course to be broad and comprehensive. We will explore private equity from a number of perspectives, beginning with the entrepreneur / issuer, moving to the private equity partnership, and finishing with investors in private equity partnerships.  

Organization:  

The first case of the course -- Yale University Investments Office -- provides 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: (1) Issuers / users of private equity; (2) The role of the private equity partnership; and (3) Investments in and fundraising by private equity partnerships.
In issuers/users of private equity, we study the issues faced by individual entrepreneurs and managers. The focus in the cases in this section is on evaluating the qualitative attractiveness of the opportunity -- whether a start-up or buyout -- and then placing a quantitative value on the opportunity.

In intermediaries/private equity partnerships, we continue to study issuers of private equity, but we also focus on the role of the private equity partnership. In particular, we study the role of the private equity partnership in choosing, valuing, structuring, and managing private equity investments. In this section, we look at particular investments made by venture capitalist partnerships and leveraged buyout partnerships. We finish this section of the course by studying the issues faced by entrepreneurs and private equity partnerships in exiting or cashing in their investments. More generally, this section of the course considers why particular methodologies and structures have evolved in the way they have, as well as possible ways to improve on them.

The final section of the course -- investments in private equity partnerships -- studies the issues faced in structuring private equity partnerships and in raising funds for them. In this section, we focus on the incentives faced by private equity partnerships and by investors in those partnerships. We also try to understand why the incentives and contractual terms take the form they do.

Requirements:

The course requires and applies some of the concepts and techniques learned in corporate finance (Business 35200, 35201, or 35902) and competitive strategy (Business 42001) to the case situations. Because the course assumes knowledge of corporate finance from the start, corporate finance cannot be taken concurrently. One or two cases will require some familiarity with the techniques or concepts of option pricing.

This course also places a strong emphasis on presentation and discussion skills. It will be important to explain your positions or arguments to each other and to try to argue for the implementation of your recommendations.

D. COURSE PROCEDURES

This course is designed to be a time-consuming and challenging course. Unless you have the time to prepare two cases per week, I strongly recommend not taking the course.

For each case, I will assign study questions concerning the case. For most of the class period, we will consider these questions and the material in the case. This includes the first meeting. You are allowed and encouraged, but not required to meet in your groups outside of class to discuss and analyze the cases. In the past, students have found that these groups complement class discussion well.

Each student will submit a two-page memorandum of analysis and recommendations at the beginning of each case discussion. If you are working in a group, I will accept one memorandum from the group and count it for all students in the group. If you choose to do this, the group cannot exceed 3 students. Each memorandum should be typed and double-spaced. Write these as if you were writing a recommendation to the major decision-maker in the case. The two-page limit is for text only. You may attach as many numerical calculations as you wish. Memoranda will not be accepted after the class has met. A memorandum will be given credit if it is handed in and no credit if it is not. Initially, therefore, I
will not grade them. 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.

**Students in 34101-01 should prepare a memorandum on Yale University Investments Office for the first class.**

**Students in 34101-81 and 85 should prepare a memorandum on both Yale University Investments Office and Technical Data Business Plan for the first class.**

The readings and articles that I have assigned and will hand out are largely non-technical in nature and summarize the findings of academic research. These articles are meant to serve as background material to help you analyze the cases. They should not necessarily be cited in the case discussion. You should argue as if you are in a funding meeting rather than in a doctoral seminar. The process of arriving at the answer is as important as getting the answer.

Because of the nature of this course (and its grading criteria), it is extremely important that you attend every class, arrive on time and be prepared to participate. To help me out, you should bring your name cards to each class. I may not remember who said what without those cards.

In the past, students have asked me to hand out my case analysis after the class has discussed the case. I will not do this, because there are usually no absolute right answers. The best cases are deliberately written to be ambiguous. While there are no right answers, there are good arguments and bad arguments. This course is designed to help you learn to distinguish between sensible and senseless arguments. Handing out my analyses would reduce the ambiguity in the cases 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 this class.**

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**E. GRADING**

Grading will be based on class participation, the short memoranda and a final examination. **Students cannot take this course pass/fail.**

1. **Class participation**

Class participation will count for 40% 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. For those of you who think that 40% is high, remember that in the post-GSB, real world, more like 100% of your "grade" is based on how you communicate with your colleagues. This class may be the last low-risk environment for second-year students to work on their communication skills. **If you are uncomfortable with such a heavy weight on participation, do not take this class.**

2. **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.

3. Final

The final examination will count for 50% of the final grade. The final examination will be an
individual, take home case analysis. You will have six days to work on the case.

F. EXCEL Files

For most of the cases in the course, I have created an EXCEL worksheet. Each worksheet contains
one or more of the exhibits in the case. This will make it easier for you to spend time on the analysis,
rather than punching in numbers. The worksheets are available on my web page. Specifically, the
worksheets are in the restricted teaching materials section of my web page:

http://gsbwww.uchicago.edu/fac/steven.kaplan/teaching/private/

G. GUESTS

It is my policy to invite guests with relevant expertise to class in several of the course meetings. In
order to cover the relevant material and benefit from the guests, we will spend extra time in class.

Campus Section 34101-01

On dates we have guests, the campus section will meet from 11:00 to 12:45 rather than from 11:00
to 12:20. I.e., class will be extended by 25 minutes. I expect to have guests on October 8, October 10,
October 20, November 5, November 19, and November 24.

Downtown Section 34101-81

On dates we have guests, the downtown section will begin at 5:45 rather than at 6:00. If you
happen to show up late, please enter the classroom quietly in the back. I expect to have guests on October
6, October 20, November 3, November 17, and November 24.

Weekend Section 34101-85

On dates we have guests, the weekend section will end at 12:15 rather than at 12:00. I expect to
have guests on October 4, October 18, November 1, November 15, and November 22.
Class Schedule

A. Introduction

Week 1A: Introduction, Organization, and Overview

Case: Yale University Investments Office. – July 2000


B. Using / Investing in Private Equity

Week 1B: Technical Data Business Plan.


Week 2A: Technical Data (continued).

Case: Florida Air.

Readings: “A Note on Angel Financing,” Gompers

C. The Role of the Intermediary in Private Equity

Week 2B: Iron Gate Technologies

and Prowse.
“The Structure and Governance of Venture Capital Organizations,”
Sahlman.

Week 3A:  
**Case:** Iron Gate Technologies

**Reading:** “Financial Contracting Theory Meets the Real World,”
Kaplan and Stromberg.

Week 3B:  
**Case:** Apex Investment Partners (A)

Week 4A:  
**Case:** Horizon Communications (A)

**Reading:**
“Characteristics, Contracts, and Actions: Evidence From Venture
Capitalist Analyses,” Kaplan and Stromberg.

Week 4B:  
**Case:** Valuing Term Sheet Terms

**Reading:** Publishing Group of America (A)

Week 5:  
**Case:** BW/IP.

**Reading:**
“Note on Discounted Cash Flow Valuation Methods,” Kaplan.
“Note on Valuation in Entrepreneurial Settings,” Kaplan.
“Note on the Cash Flow to (Levered) Equity Method,” Kaplan
K-III case.
“The Evolution of Buyout Pricing and Financial Structure in the
1980s,” Kaplan and Stein.
“LBOs: The Evolution of Financial Structures and Strategies,” Jay R.
Allen
“Corporate Governance and Takeovers in the U.S.: Making sense of the
‘80s and ‘90s,” Holmström and Kaplan

Week 6A:  
**Case:** Accuflow.

Week 6B:  
**Case:** Project “Dial-Tone”

Week 7A:  
**Case:** The Exxel Group

**Reading:**
A Note on Private Equity in Developing Countries, Lerner
A Note on Private Equity in Europe, Lerner.
Week 7B:  
**Case:** Grand Junction

**Readings:**
“A Review of IPO Activity, Pricing and Allocations,” Ritter and Welch  
A Note on Securities Law and Public Offerings.

D.  
**Fundraising**

Week 8A:  
**Case:** Accel Partners

**Readings:**
“Intermediaries in the Private Equity Market,” Chapter 4, Fenn, Liang,  
and Prowse.  
“The Role of Agents and Advisors in the Private Equity Market,”  
Chapter 6, Fenn, Liang, and Prowse.  
A Note on Private Equity Partnership Agreements, Lerner.  
“Structuring the Formation of a Venture Capital Fund,” Chapter 10,  
Levin.

Week 8B:  
**Case:** Platinum Capital Partners

**Reading:**
“Private Equity Returns: Persistence and Capital Flows,” Kaplan and  
Schoar

Week 9:  
**Case:** Offering Memorandum (handout).

E.  
**Comprehensive Case**

Week 10A:  
**Case:** Fojtasek Companies and Heritage Partners

Week 10B:  
**Cases:** Yale University Investments Office – July 2000

Course Summary and Recap.

Handout final exam on 12/01 for 34101-81.  
Handout final exam on 12/03 for 34101-01.  
Handout final exam on 12/06 for 34101-85.

Week 11:  
Final exam due on 12/08 at 9 P.M. for 34101-81.  
Final exam due on 12/10 at 1 P.M. for 34101-01.  
Final exam due on 12/13 at 1 P.M. for 34101-85.