

Foundations of VC

B8439-002–Fall 2020

Professor Ed Zimmerman, with Pooja Patel

Time: 2:00PM to 5:15PM

Location: URIS 141

Overview: Our class explores venture capital and angel investing by looking at the primary participants in the venture capital market: venture capital firms (“VCs”), high net worth individual investors (“angel investors”), limited partners who invest in venture funds (“LPs”) and the entrepreneurs who seek, receive, rejoice and/or (sometimes) regret the funding.

With a focus on the intangibles, this class will provide a hands-on understanding of:

1. The process of investing in early state (primarily tech) startups which includes:
 - a. Sourcing deals from the startup ecosystem
 - b. Evaluating/diligencing startups
 - c. Valuing startups¹ (which isn’t formula-driven)
 - d. Negotiating term sheets (financial and governance terms)
 - e. Managing a portfolio post investment
2. Seed stage investing landscape: the market participants and resources
3. The structural differences between venture capital and angel investing (including how venture funds are raised from LPs)

We’ll consider from the investor perspective, the following questions: how do VCs evaluate startup companies as potential investments (especially in tech)², what aspects of a deal are more important than valuation, what happens when there’s a founder dispute, how do venture capital transactions work, how should investors and founders think about convertible notes and SAFEs as opposed to “priced rounds” (preferred stock financings), how do companies replace CEOs/Founders, when does a financing foreclose later venture rounds, what are the perils of bridge funding or of too much funding, how valuable is reputation in venture, how do you spot and resolve ethical issues in venture, how do limited partners (pension funds, endowments, family offices, etc.) evaluate and invest in venture funds and how do VCs get paid? We’ll also discuss the venture community’s failings with diversity and how the tech and venture community are (and are not) addressing those issues.

Intended Audience:

- Aspiring VC or angel investors who want to understand how investors evaluate startups
- Founders who want to understand how seed investors evaluate startups
- Students interested in startups and in understanding the language and the market participants

While students will use some math skills, we encourage interested students to take the course even if they don’t consider themselves to be deeply numerate or technical.

¹ **DISCLAIMER:** This course will not teach students to build a financial model for valuing early stage startups. We believe that preparing a financial model for pre-revenue startups will not separate great startups from those that fail.

² Our class focuses on VC and angel investing, especially in tech (and some low tech) startups and growth companies. We won’t cover life sciences or clean tech VC investing. While we expect some discussion of European venture capital, this class won’t really have a global focus.

Professor Zimmerman has taught this class at CBS since 2005. We include guest lecturers from the VC world, including some alumni of our class. Although the course is taught by a lawyer, this course does not focus on venture law.

Professor Zimmerman has been a startup and venture lawyer at Lowenstein Sandler LLP for 25+ years. He co-founded and chairs Lowenstein Sandler's Tech Group as well as [VentureCrush](#). He's also an active angel and LP investor, with personal investments in more than 100 startups and multiple venture funds. Professor Zimmerman also serves on the Wall Street Journal's Panel of Experts. He has published more than 75 columns on the [Wall Street Journal's blog pages](#) and another 30+ in [Forbes](#). Professor Zimmerman's colleague Pooja Patel (also a startup and venture lawyer in Lowenstein Sandler LLP's Tech Group) will assist with the course.

Pre-Requisites & Connection to Core

Pre-Requisite: Capital Markets

Connection to the Core: This course will apply and build on concepts covered in the following core courses. Students are expected to be able to apply them in the course.

Core Course	Connection with Core
Corporate Finance	1. Time value of money 2. Risk 3. Opportunity Cost
Decision Models	1. Fundamental Concepts of Decision Making 2. Decision Making under Uncertainty and Risk
Leadership Development	1. Ethics 2. Negotiations 3. Influence and Persuasion

Instructor's office hours are by appointment only*

Edward M. Zimmerman Telephone: (212) 204-8696 Email: ezimmerman@lowenstein.com Assistant: Engela Brondum Email: ebrondum@lowenstein.com	With help from: Pooja Patel Telephone: (973) 422-6430 Email: ppatel@lowenstein.com
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Format: We'll largely use the case study method, with some lecturing and interactive exercises. We'll have multiple guest speakers.

Materials: Selected cases, articles, blog posts, & podcasts.

Assignments/Grading:

Class Participation (more than attendance; adding value to the discussion): 40% of grade

Individual Project ("Case Analysis"): 20% of grade

Group Project ("Term Sheet"): 40% of grade

Important Dates

September 17	Last day for add/drop period – students should confirm that date
September 18	Students create their own groups for the Group Project & <i>e-mail</i> Professor Zimmerman & Ms. Patel
September 25	Due date for Phase 1 of Group Project (end of day)
October 6	The last class in which we cover a case study; therefore, it's also the deadline to submit an individual project . If you haven't already submitted an individual project, be sure you're submitting the project on this class's case study, <u>prior to the start of this class.</u>
October 13	Due date for Phase 2 of Group Project (PRIOR to the start of class)
October 13	Final Group Project Presentations

Description of the Projects

Individual Project - “Case Analysis” - 20% of grade

Due Date: Prior to the class in which the case is being discussed.

After the first of class, each student will select **ONE** of the cases we cover this semester for a 5 page, double-spaced analysis. The analysis will be due at the **START** of the class, during which we discuss the case. Please prepare the analysis assuming the reader's familiarity with the case study – please don't summarize the case. You need only briefly recite the facts of the case in the context of analyzing those facts. Your analysis should include a statement of the problem(s) considered (ascertaining which problems deserve focus is a critical skill), an analysis of the options and a recommendation of which option to select.

Group Project – “Startup Selection and Basic Terms” - 40% of the grade

Due Date Phase 1: September 25, end of day

Due Date Phase 2: October 13, prior to class

Soon after the drop/add period ends, the students will form student group and each group will be assigned an actual VC fund, angel team or LP – so each student group will, for purposes of this project, *become* that fund, angel team or LP. Each student group should familiarize itself with the assigned VC fund, angel team or LP (bios, portfolio, stage, sector, size of fund, geography) in order to approach the group projects from the perspective of serving as members of that investor group. The group project will also focus on finding and evaluating startups and/or growth companies that are appropriate to the scope and stage of the fund/angel group etc.

Each student group will “source” a deal for an actual startup or other appropriate investment and present the following to that student group's “investment committee” (the committee will consist of the instructor teaching this course as well as one or more actual investors serving as advisor to our class).

The investment should be stage, sector, investment amount and geography appropriate to the investor group the student group represents. On the Phase 1 due date, each student group will submit a single paragraph on the investment opportunity (including the target's name, geography and funding to date – if known – as well as the URL for the target and its founders(s)) and why it makes sense for that student group. The Phase 1 Due Date will be determined. Once approved, each student group will submit:

- a) A five or six page, double-spaced paper providing a recommendation to fund the investment target (including the basis for seeing it as an investment fit for that Student Group);
- b) A slide presentation, which the student group will present live during the last class. Depending on the size of the class and the number of groups, each group will have roughly 10 minutes to present/respond to questions.

In addition to the above, the paper and summary should:

- 1) Address the business opportunity and value proposition;
- 2) Analyze the market potential (including size and growth opportunity within the market) and competitive landscape;
- 3) Evaluate the financial prospects and potential returns;
- 4) Assess why this is the right team to drive value for this company at this time;
- 5) Assess the main risks/challenges to the proposed business and propose solutions for addressing and overcoming them;
- 6) Describe investment fit: how the startup fits within the investment thesis and mandate of the fund/angel team and
- 7) Identify one or two potential co-investors (other venture funds or investors not already invested in the startup that would be as great co-investors in the investment and why this would be within that investor's mandate/why they'd be a great co-investor).

VC Advisors: We'll have VCs and angels meet (virtually) once with each student group, after the papers are submitted, to provide feedback to that student group.

Pitch Observation Opportunity: We may provide students the ability to attend some startup pitches through Lowenstein Sandler's [VentureCrushFGX](#) events.

Fall 2020 Course Schedule

Foundations of VC	
Week 1 (Tues, Sept. 8)	<p><u>Fundraising Ecosystem:</u> What is a VC fund; how are funds built; how do VCs evaluate talent for their own firms and for the startups in which the invest</p> <p><u>Readings:</u> <i>Floodgate: On the Hunt for Thunder Lizards</i> (HBSP 9-617-044)</p> <p><u>Additional Readings:</u> WSJ Article: Lazerow Is Right Graham Is Wrong: You Shouldn't Ignore Associates At Venture Funds (WSJ 2013)</p> <p><u>Guest Speaker(s):</u></p>
Week 2 (Tues, Sept. 15)	<p><u>Term Sheets and Cap Table Math:</u> What are the pros and cons of speedy financing mechanisms; what are the implications of interactions between existing and new investors and founders, in the context of a seed round and subsequent up round</p> <p><u>Reading:</u> <i>Pommardify: Convertible Notes in Seed Funding</i></p> <p><u>Additional Reading:</u> Startup Founders: Avoid These Convertible Note Glitches (Forbes 2016)</p> <p><u>Optional Additional Reading:</u> Bridge Funding Startups: Interested Board Members, CEOs and How to Sanitize The Process (Forbes 2016)</p> <p><u>Guest Speaker(s):</u></p>
Week 3 (Tues, Sept. 22)	<p><u>Portfolio Strategy and Investment Thesis:</u> Limiting yourself to massive outcomes or looking for overlooked opportunity? How do you invest</p> <p><u>Reading:</u> (1) <i>Aspect Ventures</i> (HBSP 9-217-046) & (2) <i>The Perfect CEO</i> (HBSP 9-805-156)</p> <p><u>Additional Reading:</u> Angel Au-Yeung, How Theresia Gouw Became America's Richest Female Venture Capitalist (Forbes 2018)</p> <p><u>Guest Speaker(s):</u></p>

Week 4 (Tues, Sept. 29)	<p><u>Due Diligence:</u> Angels vs. VCs, what are the key considerations in initial funding, what is “proprietary deal flow” and in/out of scope investing; what are the diligence differences for angels</p> <p><u>Readings:</u> (1) <i>Sales Razor Technologies</i> (HBSP 9-217-040) & (2) <i>Angel Investing in the Blues</i> (CBS ID#190303, September 18, 2018)</p> <p><u>Additional Readings:</u> When Has a Startup Over Shopped for Funding (Forbes 2016) “Help Me Help You”: Asking for Intros to Venture Investors (WSJ 2014)</p> <p><u>Guest Speaker(s):</u></p>
Week 5 (Tues, Oct. 6)	<p><u>Handling Growth:</u> What VCs do when portfolio companies seem to be “crushing it” but may, instead, be “getting crushed;” how VCs discern the difference; how do VCs consider inside-led rounds & scaling in the face of growing pains</p> <p><u>Reading:</u> <i>Founder-CEO Succession at Wily Technology</i> (HBSP 9-805-150) Substantive focus on Term Sheets</p> <p><u>Guest Speaker(s):</u></p>
Week 6 (Tues, Oct. 13)	Group Project Presentations

Our class’s “Venture Advisors” -- investors who will provide feedback on Student Group Projects: list to follow. We typically also include VCs who are alums of our class.