RUSSELL E. MURDOCK, CFA, CFP

MBA 601.41
Financing Small Business

Fall 2003

Monday 6 – 10PM

Orange County Center
Introduction & Course Description

This course is designed to introduce the concept and process of planning for and financing a small business from startup to IPO. We will discuss the genesis of the need, matching that need with the appropriate financing possibilities and implementing the financing.

We will cover such concepts as:

1. the different stages of venture capital
2. mezzanine financing
3. the role of warrants and options
4. the needs of the lender
5. the needs of the borrower
6. the role of investment bankers
7. the negotiation process
8. the term sheet
9. the exit strategy
10. the IPO process

Course Objectives

This course will introduce a variety of analytical tools and provide the student an opportunity to apply these tools to business cases. At the end of this course, you should be knowledgeable in the practical steps and issues that will be faced throughout the small business financing process.
Conduct

“The University expects from all of its students and employees the highest standard of moral and ethical behavior in harmony with its Christian philosophy and purposes. Engaging in or promoting conduct or lifestyles inconsistent with traditional Christian values is not acceptable.

The following regulations apply to any person, graduate or undergraduate, who is enrolled as a Pepperdine University student. These rules are not to be interpreted as all-inclusive as to situations in which discipline will be invoked. They are illustrative, and the University reserves the right to take disciplinary action in appropriate circumstances not set out in this catalog. It is understood that each student who enrolls at Pepperdine University will assume the responsibilities involved by adhering to the regulations of the University. Students are expected to respect order, morality, personal honor, and the rights and property of others at all times. Examples of improper conduct for which students are subject to discipline are as follows:

- Dishonesty in any form, including plagiarism, illegal copying of software, and knowingly furnishing false information to the University.
- Forgery, alteration, or misuse of University documents, records, or identification.
- Failure to comply with written or verbal directives of duly authorized University officials who are acting in the performance of assigned duties.
- Interference with the academic or administrative process of the University or any of the approved activities.
- Otherwise unprotected behavior that disrupts the classroom environment.
- Theft or damage to property.
- Violation of civil or criminal codes of local, state, or federal governments.
- Unauthorized use of or entry into University facilities.
- Violation of any stated policies or regulations governing student relationships to the University.

Disciplinary action may involve, but is not limited to, one or a combination of the alternatives listed below:

- **Dismissal** – separation of the student from the University on a permanent basis.
- **Suspension** – separation of the student from the University for a specified length of time.
- **Probation** – status of the student indicating that the relationship with the University is tenuous and that the student’s records will be reviewed periodically to determine suitability to remain enrolled. Specific limitations to and restrictions of the student’s privileges may accompany probation.”  

GSBM Catalog, pgs. 207-208.

Policy on Disabilities

**Assistance for Students with Disabilities**

“Students with disabilities, whether mental or physical, are encouraged to contact the Equal Opportunity Office before the academic year begins or soon after classes are in session. This office will assist each student by providing general information about campus facilities and available resources. The office will assist in providing reasonable accommodation to students with disabilities pursuant to applicable laws. Inquiries should be directed to equal opportunity officer, Dr. Calvin H. Bowers, (310) 456-4208. (Students who wish to file a formal grievance should refer to the “Nondiscrimination Policy,” which is listed in the “Legal Notices” section of this catalog.)”  

GSBM Catalog, pg. 31.
The Disability Services Office (DSO) offers a variety of services and accommodations to students with disabilities based on appropriate documentation, nature of disability, and academic need. In order to initiate services, students should meet with the Director of the DSO at the beginning of the semester to discuss reasonable accommodation. If a student does not request accommodation or provide documentation, the faculty member is under no obligation to provide accommodations. You may contact the Director of the DSO at ext. 6500 or through e-mail at: lauren.breeding@pepperdine.edu
Text

New Business Ventures and the Entrepreneur, Stevenson, Roberts et al.

Financial Calculator

You should possess a financial calculator capable of performing present value, future value, NPV and IRR calculations.

Internet

There will be much discussion of information and data available on the Internet. You are expected to have access to the Internet for this class.

E-mail

My greatest preference is contact through e-mail. I will be checking my e-mail at russell.murdock@pepperdine.edu at least once per day during the workweek. If you have a more pressing need, please call me during the day at the above number.

Group projects

Because group dynamics are important and inevitable in a business setting, you will be given a group project that I will assign during the first week of class.

Grading

Your grade (using the following weighting) will be comprised as follows:

<table>
<thead>
<tr>
<th>Component</th>
<th>Weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class participation</td>
<td>10%</td>
</tr>
<tr>
<td>Group project</td>
<td>30%</td>
</tr>
<tr>
<td>Business Case</td>
<td>20%</td>
</tr>
<tr>
<td>Individual Cases (4 @ 10% each)</td>
<td>40%</td>
</tr>
</tbody>
</table>
Classes

Session 1 August 25 Entrepreneurial Activities

Form study groups
Select a business opportunity to organize and prepare for raising funds
Review course objectives
Individual & group assignments

Reading assignments:
1. Perspective on Entrepreneurship Pages 3 – 17
2. Start-up Strategies Pages 18 – 33
3. Deal Structure Pages 189 – 195

Individual Assignments – R&R Case
1. Prepare an income statement for Reiss for the first year
2. Be prepared to answer the following questions:
   a) What factors created the opportunity?
   b) What barriers/risks had to be overcome?
   c) How did Reiss overcome these obstacles?
   d) How successful was Reiss? Why?
   e) What should Reiss do about Whoozit?

Session 2 September 8 Financing the Start-up Phase

Reading assignments:
1. The Business Plan Pages 43 – 50
2. Legal Forms of Business Pages 51 – 56
3. The Road Well Traveled Pages 57 – 62

Individual Assignments:
Prepare a formal report critiquing the business opportunity being promoted by the entrepreneurs in the Ice Delights case.

Consider the following questions when deciding what you think they should do. The responses should be 2 to 3 pages in length. No more or less. Make sure to include (as an attachment) a cash flow forecast showing goals and value creation process.

Forecast to incorporate your recommendations for funding and sharing, equity with investors. Address (1) how much financing to raise, (2) what sources and terms should they promote (3) identify financing strategies for opening stores, (4) demonstrate what changes in growth rates, does to the value creation process and the need for growth
financing, (5) consider what affect a faster store opening schedule would do (how many stores could the Florida Market realistically support).

Group Assignments:
(1) Group 1 represents the founders and Group 2 represents interested VC investors.
(2) All Groups prepare a 15 minute presentation of group business opportunity, products or services, competitive advantage, size of the market, competitors, market growth rate, margins.

Session 3 September 15 Structuring External Financing

Reading Assignments
1. Alternative Sources (Bootstrapping) Pages 159-188

Individual Assignment the Steven Belkin Case:
Prepare a formal report recommending Steven’s best course of action.
Consider the following questions when deciding what you think they should do. Use the IRAC writing style, 2 to 3 pages max, with cash flows forecast showing planned goals, financing needed and value creation process.

What happens if you recast Steven’s Proforma to be less conservative.
Your IRAC should incorporate your recommendations for funding sources, amounts and terms. Address (1) how much financing to raise, (2) what sources and terms should be sought (3) identify, financing strategies and equity sharing plans.

Group 3 and 4 Prepare to present and discuss the Steven Belkin Case
(1) Group 3 is Steven Belkin Group 4 is Institutional Investors
(2) All Groups prepare a 15 minute presentation of business opportunity, business model, bootstrapping strategies, cash flow forecast.

Session 4 September 22 Financing Growth

Reading Assignments:
1. Securities Law and Private Financing Pages 196-205
2. Chris Miller Case

Individual Assignments: Heather Evans Case
Prepare a formal report recommending Heather’s best course of action.
Consider the following questions when deciding what you think she should do. Use the IRAC writing style, 2 to 3 pages max, with cash flows forecast showing planned goals, financing needed and value creation process.

Evaluate the opportunity, her approach, the business plan, financing alternatives. Who should she approach, how much should she raise and on what terms.
Address (1) how much financing to raise, (2) what sources and terms should be sought (3) identify financing strategies and equity sharing plans.
Group 1 and 2 prepare to present and discuss the Heather Evans Case

(1) Group 1 is Heather Evans - Group 2 is potential Institutional Investors

(2) All Groups prepare a 15 minute presentation on business opportunity, describe funds needed, likely source of funding.

Session 5 September 29 Financing Growth (continued)

Reading Assignments

1. Managing Growth Pages 460-464
2. Bankruptcy: A Debtor’s Perspective Pages 465-481

Individual Assignments: Dragon Fly Case

Prepare and turn in your recommendation for management of Dragonfly, what is their best option and why?

Consider the following questions when deciding what you think they should do. Use the IRAC writing style, 2 to 3 pages max, with cash flows forecast showing planned goals, financing needed and value creation process.

Address the following issues:

1) Assess Dragonfly’s situation? Operations, financial, future prospects?
2) What options do they have for the resolution of these problems?
3) What is your plan for salvaging the business?
4) What are the legal and ethical issues they must resolve?
5) As Janet’s brother or sister and a director of the company, with Janet, Michael and your parents, what do you recommend to the board?

Group 3 and 4 prepare to present and discuss the Dragonfly Case

(1) Group 3 are the Thompsons & Hepburns Group 4 are the Real Estate firm (Crossroads).

(2) All groups prepare a 15 minute presentation on investor controls, board structure, financial reporting, performance benchmarks.

Session 6 October 6 Financing Growth (continued)

Reading Assignments:

1. Securities Laws and Public Financing Page 574

Individual Assignments Gordon Biersch Brewing Case

Prepare and turn in your recommendations for Dan and Dean, which financing should they accept and why?

Consider the following questions when deciding what you think they should do. Use the IRAC writing style, 2 to 3 pages max, with cash flows forecast showing planned goals, financing needed and value creation process.

Address the following issues:

1. What are the key factors of Gordon Biersch’s success?
2. Do you have any concerns for the company looking ahead?
3. What should Dan and Dean do regarding organizational alternatives?
4. Evaluate their efforts to raise capital?
5. Which offer should Dan and Dean accept?
6. If they decide to accept the Fertitta offer, what issues should Dan and Dean negotiate with the Fertittas?

Group Assignments — All Groups

Prepare a 15 minute presentation of business opportunity Value Creation process, financing needed, and exit plan.

Session 7 — October 13 — Financing Growth (continued)

Individual Assignments - ArthroCare case

Prepare and turn in your recommendations to Dr. Thapliyal’s. What should his objectives be as he communicates ArthroCare’s strategy and financial results to shareholders and to the financial community?

Consider the following questions when deciding what you think the company’s strategy should be. Use the IRAC writing style, 2 to 3 pages max, with exhibits where necessary to show planned goals, and impacts on EPS and expected stockholder wealth over the foreseeable future.

Address the following issues:

1. Review the IPO in February of 1996, was this a sensible financing choice for ArthroCare given its stage of Development?
2. What other alternatives would you have recommended the company consider?
3. How was ArthroCare valued by investments bankers at the time of the IPO, and how has the market valued the company since?
4. Assess the situation the Company is confronting in August 1996?
5. What should Dr. Thapliyal’s do about the two decisions he is considering at the end of the case? the company looking ahead?

Group Assignment — Present Executive Summary (see page 45)

All Groups present Executive Summary of their business plan. Add deal structure and exit strategy to those subjects listed in the book. Plan for about a 30 minute presentation to a potential group of investors. Avoid excess detail and allow some time 5 to 10 minutes for questions.
We will set up study groups, and each study group will be assigned two Cases for which the group will be required to make formal presentations. On the day of these presentations are due the responsible study groups will take over the class, during the second half. They will present their solutions to the issues presented in the problem assigned. Each presentation should provide concrete recommendations, which are reasonable and can be implemented under the circumstances of the case.

Presentations of Cases and Problem Solutions:

Case Presentations represent an important part of your grade. Logistics for visual aid equipment needs to be planned ahead. Each case presentation should be made from the perspective of an Entrepreneurial management team planning for its growth. Every group member must participate in presentations, in a significant way. At the end of the semester, I will ask each student to privately evaluate the contribution of each group member. These peer reviews may affect a student’s class participation grade.

Presentations should, allow for interactive discussions between the presenting group and the rest of the class, during the course of the presentation. It is not acceptable to require the class to hold questions until the end of the presentation. Students not included in the presenting group are expected to provide other important views on the case issues. The presenting groups should ask for feedback from the class on assumptions used for their proposed solution.

A copy of the visual aids for the presentation will be turned in, by the presenting group before the presentation begins. This is not a formal written business communication it is simply a copy of the exhibits used during the presentation. Exhibits should be assembled in the order presented to the class. Attach a cover page listing the names and topics each presenter will cover. This presentation package will be returned the following week with grades and feedback regarding the presentation.

Individual Assignments:

Prepare an analysis of each case assigned, answer the questions asked, add any numerical analysis required by the case. Make sure this work reflects appropriately on your understanding of the issues facing the company and your ability to formulate recommendations for the company. All students, should read the case, identify the issues, and form conclusions about what the company should do, to resolve the obvious financing issues of the case. It is okay to discuss the issues and questions about analytical techniques with your group members but the analysis and the resulting write up should be the student’s own work. When students submit work, which is obviously shared work (plagiarized) the work will receive only one grade to be shared (i.e. divided by the number of students involved in the plagiarizing).

Work turned in late or work turned in without evidence of a reasonable effort will lose credit. Any week you are not able to make it to class you should make sure that your work is either in my Campus Mailbox or turned in during class by another study group member, on the night due. It is not acceptable to turn in work via e-mail.

Final Group Project:
The Final Group Project requires each group to prepare a business plan for a new company or an existing private company. You can divide up the research, share the analysis and discuss options with your group. The group will make weekly interim presentations on sections of the final report each week. The final written plan must be a seamless report with input from all group members. The written report is due during the final meeting. Follow the format given in the book (page 43). This task represents a major part of your grade and should be viewed as an opportunity to demonstrate your ability to apply what you learned, to the assessment of and planning for a Small Business enterprise.

The group will make a joint presentation in week Seven of the final business plan. The presentation will be the Executive Summary for the plan plus the Deal Structure and Exit Strategy for investors. The presentation will designed for presentation to a group of interested investors and the presentation should cover all of the important issues such investors would be interested in. The conclusion of the report should show investors (current and prospective) how the company intends to build the value of shareholders investment over the forecast period and most importantly the financing proposal should present the possible exits for investors in their order of preference.

This report should be double, spaced. It should be no more than 20 pages plus attachments. Graded on both content and style. This should be thought of as a formal business communication. Attachments should include at least a five, year cash flow, and any other research, and related material useful to a prospective funding source. Adding attachments to the report, which do not contribute to the objectives of the report or worse yet which are not discussed in the written presentation will detract from the grading.