University of Maryland  
Robert H. Smith School of Business  
BUFN755 – Entrepreneurial Finance and Private Equity  
Spring 2014

I. Information on Instructor

Instructor: Professor Xiaohui Gao  
Email: xiaohui@rhsmith.umd.edu (preferred method of contact)  
Office: 4426 Van Munching  
Mobile Phone: (240) 507 9877  
Course Notes Site: https://myelms.umd.edu/courses/  
Office Hours: TBA, and I am always available so always feel free to contact me.

Class meeting venue and time:  
Term D, Tuesdays & Thursdays,

II. Course Description and Objectives

• Course Overview

This course is an advanced corporate finance course with emphasis on entrepreneurial finance and private equity globally.

Entrepreneurial finance focuses on the role of financing in the formation and growth of a firm. Private equity covers the full range of private equity funds from venture capital funds to growth equity funds to buyout funds and we will give special emphasis on venture capital funds.

We will follow three major phases of the private equity cycle. The first phase of a private equity fund is to raise money so that the fund can invest. The second phase of a private equity fund is to decide on the firms to invest and manage the portfolio companies. The third phase of a private equity fund is to exit their investments.

In the first phase, we start with institutional features of the private equity industry. We will discuss how private equity funds are raised and structured. Along with the discussion of various aspects of private equity fundraising, we aim to understand and analyze the relationships among the general partners, limited partners, and intermediary institutions.

In the second phase, we focus on the decision making process of private equity investors and explore how they interact with the entrepreneurs and companies that they finance. Making a good investment decision varies over time and highly depends on the geographic place as well as the investors. Throughout, we will rely on cases to understand the nature of various investment decisions.
In the third phase, we examine the process of how private equity funds exit their investments. In particular, we want to understand and analyze what constitute a successful exit. A successful exit could generate attractive profits for private equity funds and their investors, and could guarantee success in the next round of fund raising.

The three phases complete the life cycle of a private equity fund. Upon completing this class, you will have a good understanding of the private equity industry. Understanding the patterns and investor behavior in this industry could be helpful if one intends to work for, invest in, or compete with private equity funds.

This class is modeled along similar courses taught at Harvard Business School, Northwestern University, and Yale University. All the cases have been chosen carefully to help students to comprehend the nature of entrepreneurship and private equity financing around the world.

- **Course Organization**

  This is a seven week class. Prior to the first day of class, students are expected to form a team of no fewer than three and no more than five members. The pre-class case (case 0) is expected to be turned in before the first class. I will email everyone detailed instructions on the case as well as useful background readings and material well in advance.

  Each case requires a written submission on the second class of each week and a team will be chosen to present the case. Non presenting groups are expected to actively engage in the case discussion.

- **Grade and Final report**

  The final report is an individual take home assignment. Your grade in this class consists of 70% of the seven group case written summaries and in class presentation, and 30% of the final individual report.

- **Textbook**


- **Readings and Cases**

  We will use lecture notes and cases as the primary material for this course. The lecture notes and supplementary readings will also be posted on Canvas. The case package can be purchased from Study.net at: [http://www.study.net/r_mat.asp?crs_id=30047224](http://www.study.net/r_mat.asp?crs_id=30047224)

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**III. Dingman Center for Entrepreneurship**

Below I list some programs and events to be held by Dingman center for entrepreneurship. I highly recommend you to participate in these activities.

**Innovation Fridays**  
Entrepreneurs-in-Residence are available every Friday to give feedback and next steps to students with an idea for a business.  
*Every Friday*  
11 a.m. to 1 p.m., 2518 Van Munching Hall

**Cupid’s Cup**  
[http://cupidscup.com](http://cupidscup.com)  
Chaired by Under Armour Founder & CEO, Kevin Plank, Cupid’s Cup is a national business competition awarding a total of $115K in cash prizes to student entrepreneurs from across the company running revenue-generating businesses. As a signature event of the Smith School, Cupid’s Cup draws over 1000
attendees. Before the competition is the Business and Innovation Showcase where attendees can network with the region’s leading startups who will be exhibiting their latest products and technologies. All Smith School students are strongly encouraged to attend.

Friday, April 4, 2014
Noon to 4 p.m., Clarice Smith Performing Arts Center

**Pitch Dingman Competition**

Twice annually, students can compete for $3,500 in start-up funding at the Pitch Dingman Competition. Five finalists will pitch to a panel of all-star judges including regional entrepreneurs and members of the Smith School community. Audience members will text-to-vote for their favorite company and award them the $500 Audience Choice Award. Here is a video of the last Pitch Dingman Competition in November 2013 which featured a keynote from Tim Chi, Founder & CEO of the Bethesda-based technology company, WeddingWire.

http://youtu.be/6UUPIp-ITMA

Thursday, May 1, 2014
6:00 p.m., Tyser Auditorium, Van Munching Hall

**Dingman Center Angels Review Days**

On the last Friday of every month, students are invited to sit in on review sessions with regional startups and members of the Dingman Center Angels Investor network. Startups give a 10 minute presentation followed by feedback and advice from the angel investors. Think Shark Tank for DC startups. Students are encouraged to attend and ask questions. An RSVP link is provided by me (Adam VanWagner) every month.

*Last Friday of every month, 10 a.m. to 1 p.m.*

Friday, January 31 – [RSVP here](#)
Friday, February 28 – [RSVP here](#)
Friday, March 28 – [RSVP here](#)
Friday, April 25 – [RSVP here](#)
Friday, May 30 – [RSVP here](#)
**Dingman Venture Fellows**

The Dingman Venture Fellowship (DVF) program is designed for first year MBA students who are highly interested in entrepreneurial innovation and/or startups. Through this program, a select number of students are designated Dingman Venture Fellows and work closely with the Dingman Center to pursue summer internships with VC- or angel-funded startups and early stage companies.

**Fearless Founders**

The program guides student ventures from idea to launch in three stages – Idea Shell, Hatch and Terp Startup. Using the lean startup methodology, students learn the strategy, frameworks and tools necessary to develop their business idea. Students in the Idea Shell stage will not receive credit, but will participate in seven workshops, two events, and give a final presentation. At the end of the each semester, 10 students from Idea Shell will be selected to receive a $500 Capital One seed-stage grant. Students with a business ready for the Hatch stage may enroll in the for-credit Fearless Founders course; BMGT458R / ENES 498R. The class meets once a week plus regular advising sessions and workshops. At the end of the course, 10 students will receive a $1,500 Capital One seed-stage grant.

**IV. Academic Conduct**

**Academic Integrity**

The University's Code of Academic Integrity is designed to ensure that the principles of academic honesty and integrity are upheld. All students are expected to adhere to this Code. The Smith School does not tolerate academic dishonesty. All acts of academic dishonesty will be dealt with in accordance with the provisions of this code. Please visit the following website for more information on the University's Code of Academic Integrity:

http://www.studenthonorcouncil.umd.edu/code.html

On each assignment you will be asked to write out and sign the following pledge. "I pledge on my honor that I have not given or received any unauthorized assistance on this exam/assignment"

"The University of Maryland, College Park has a nationally recognized Code of Academic Integrity, administered by the Student Honor Council. This Code sets standards for academic integrity at Maryland for all undergraduate and graduate students. As a student you are responsible for upholding these standards for this course. It is very important for you to be aware of the consequences of cheating, fabrication, facilitation, and plagiarism. For more information on the Code of Academic Integrity or the Student Honor Council, please visit http://www.studenthonorcouncil.umd.edu/whatis.html."
Refinancing the Western Harbor Crossing, Hong Kong

Case information

This case deals with the operational phase of a privately operated urban infrastructure project, Hong Kong's Western Harbour Crossing (WHC), a toll road tunnel from West Kowloon to Sai Ying Pun on Hong Kong Island, developed as part of the prestigious Airport Core Program supporting the new Hong Kong Airport development in the early- to mid-1990s. The tunnel opened for business in 1997 and has underperformed financially since then. Explores the hypothetical purchase of the tunnel as an infrastructure portfolio asset by a prominent bank acting for a private equity group. The bank is also interested in providing long-term debt financing on a non-recourse/limited recourse basis to the potential purchasers. Revisits the economics of the project, valuation of the tunnel as a going venture, and financing of the purchase, and discusses the merits of investing in it as a portfolio decision. The analysis considers two corporate/project finance activities. First, as a fundamental capital budgeting function, we consider valuation of the Western Harbour Crossing as a going concern relative to its historical cost ("book value") in order to highlight the problems associated with sunk costs and irreversibility in underperforming real fixed assets structured as project-financed ventures. Secondly, we outline the potential purchaser's financing decision and the approach that banks take in syndicating very large financial commitments to very risky projects.

Student Assignments

1. As a project lender, what value would you place on the Western Harbour Tunnel Company?
2. How much does the attractiveness of the project vary according to different financing arrangements and economic scenarios?
3. What are the risks associated with acquiring and refinancing the Western Harbor Crossing?
JAFCO America Ventures, Inc.: Building a Venture Capital Firm

Case information

JAFCO, a large Japanese venture capital firm, is making a second attempt to enter the U.S. venture capital market. The U.S. subsidiary, JAFCO America Ventures, is in the midst of a challenging turnaround. Going forward, the U.S. subsidiary's leadership needs to make a number of important decisions regarding investment focus, deal flow generation, compensation, and cooperation with the Japanese parent company.

Student assignment

Please consider the following questions:

1. What is your assessment of JAV’s performance to date? What is your assessment of JAV’s USIT1 fund performance to date?
2. What are JAV’s challenges over the next five years?
3. Would you advise Barry Schiffman and his colleagues to move into seed stage investing? Should they move into life sciences?
4. How can JAFCO learn from JAV?
5. How should JAFCO change its incentive system, if at all?
Case Information

FOX Venture Partners (FVP) is a proposed "Fund-of-Funds" that will enable wealthy individuals to invest in venture capital. While several leading venture capitalists are enthusiastic about the concept, FVP's general partners are finding it difficult to invest individually in the fund.

Student Assignment

1. Why the venture capital organizations have been enthusiastic about the proposed fund?
2. What resistance do Frazier and Lawrence face?
3. What are the challenges that Frazier and Lawrence will face if they can successfully raise the fund?
JAFCO Asia in China

**Case Information**

In the autumn of 2002, JAFCO Asia, a subsidiary of JAFCO Co., Ltd., became the first foreign private equity firm to open an office in Beijing's Haidian Science Park. JAFCO was the only Japanese private equity firm operating in China. As such, Managing Director Vincent Chan observed, "JAFCO is the bridge between Japan and China." Yet, under that bridge the waters appeared increasingly choppy. While the economic relationship between Japan and China had grown increasingly close, their political relations had not and some Japanese firms had begun to reassess their commitment to China. Would capital-rich Japan and capital-poor China find a way to transcend their troubled history? Could JAFCO Asia be a catalyst for cooperation, or would its managers find their own operations affected by rivalry between Asia's two most important countries? The mix of formal rules and informal practices that governed foreign private equity firms in China was complex. Opening an office in Beijing signified a renewal of JAFCO Asia's efforts to master these challenges and coincided with an acceleration of the firm's investments. But JAFCO's first years of engagement with China had not been notably successful, and without some fundamental changes, there was little reason to believe that the addition of a physical presence there would yield better results now.

**Student Assignment**

1. Analyze the rules, customs, and dynamics of VC and private equity investment in China.
2. As a Japanese investor in China, discuss the political issues faced by JAFCO Asia.
3. Evaluate JAFCO Asia’s future in China and consider the role that China should play in JAFCO’s overall business model.
Case Information

This case examines an acquisition in the highly competitive new media advertising industry in China in late 2005. The transaction leads to eventual consolidation of the industry and a positive stock market reaction. It discusses valuation in the context of an M&A transaction in an emerging economy and the role of private equity and venture capital in the development and the eventual consolidation of the new media advertising industry. Provides a context in which to discuss antitrust regulation, or lack thereof, on an industrial organization in China.

Student Assignment

1. Use the Discount Cash Flow (DCF) model, as well as trading and transaction multiples, to value Framedia as a stand-alone business.
2. Discuss the alternative strategies for Framedia.
3. Discuss the alternative strategies for Focus Media.
4. Discuss the role of private equity investors in the fast developing Chinese market.
Case Information

The case focuses on two major challenges in deal making in emerging market economies—deal sourcing and negotiation—by focusing on a real (but disguised) Indian private equity deal. In 2010 Surya Tutoring was a fast-growing tutoring academy for high school students aspiring to gain admission to the prestigious Indian Institute of Technology (IIT). Surya's CEO, R. K. Sharma, wanted to expand its reach beyond Kota (a city of 1 million people in the northern state of Rajasthan), which had become the center of the IIT prep school industry and home to tens of thousands of students studying for the rigorous IIT entrance exam. Sharma knew there was vast untapped potential in the teeming Indian metropolises of Mumbai, Chennai, Delhi, and Bangalore, as well as in foreign markets such as Dubai and Australia. Sharma had received term sheets from two private equity firms willing to finance Surya's expansion. By the end of the month he needed to decide which to accept: the offer from big bulge bracket fund Blackgem, or the one from ZenCap, a small Indian firm based in Mumbai with which he had become intimately familiar during the past year.

Student Assignment

1. Identify the differences and tradeoffs offered by the two prospective investors.
2. Compare the two term sheets and discuss the differences in details.
3. Which offer should Sharma accept?
Elephant Bar Restaurant

Case Information

In November 2003, John Fruehwirth, a principal at Allied Capital, was considering a $20 million mezzanine investment in growth capital for Elephant Bar, a California restaurant chain. Elephant Bar had had some initial success in California but now Allied's investment committee had to wrestle with the question of whether the restaurant concept was strong enough to travel and become a national brand or whether it was mainly a "California Concept." And if the concept was strong enough to travel, would Allied Capital be able to meet its underwriting standards? Because Elephant Bar is a company with aggressive growth plans, it is significantly riskier than traditional mezzanine investments. The case can be used in courses on venture investing to illustrate another funding source available to young companies. Traditional mezzanine financing is often used to provide a portion of the funding for late-stage investments, such as leveraged buyouts. The case can also be used in courses on private equity to illustrate the perspective, risk mitigation strategies, and return expectations of mezzanine investors. This case has a teaching note and a spreadsheet, which are available to registered faculty members.

Student Assignment

1. Identify the strengths and weaknesses of investing in Elephant Bar.
2. What are the risks of a mezzanine investment in Elephant Bar?
3. How has Allied Capital structured the investment to account for the additional risk of this investment?
4. What return will Allied Capital earn on this investment?
Investitori Associati: Exiting the Savio LBO

Case Information

Investitori Associati seeks to exit a leveraged buyout investment. Choosing the appropriate way in which to undertake their exit—an initial public offering or sale of the firm—proves problematic.

Student Assignment

1. List the pros and cons of taking Savio public.
2. Discuss the merits and demerits of listing Savio on Milan exchange, the EASDAQ, the NASDAQ, and the London stock exchange.
3. Evaluate how much Savio is worth in two ways: use comparables and use free cash flows.
Case Information

Cheick Sanankoua is an MBA student who believes that he has found the perfect investment property, a small, independently-owned hotel, on the Ivory Coast. However, he has had trouble raising money for the investment beyond friends and family. Through contacts in the private equity industry, he has one last opportunity to pitch the deal to Asdar Capital. If unsuccessful, the time on Sanankoua’s exclusivity agreement with the owners will run out.

Student Assignment

1. Identify the opportunities for Sanankoua to increase profit margins and grow the customer base.
2. How should Sanankoua properly address all the key risks with this transaction?
3. Evaluate the exit strategy.