PART 1 Getting Started

Chapter 1 Introduction  3

1.1 Entrepreneurship and the Entrepreneur  3
1.2 The Finance Paradigm  12
1.3 The Rocket Analogy  14
1.4 The Stages of New Venture Development  15
1.5 Measuring Progress with Milestones  17
1.6 Financial Performance and Stages of New Venture Development  19
1.7 The Sequence of New Venture Financing  21
1.8 The New Venture Business Plan  24
1.9 Organization of the Book  29
1.10 Summary  31
Chapter 2  New Venture Financing: Considerations and Choices  37
2.1 Sources of New Venture Financing  37
2.2 What's Different about Financing Social Ventures?  55
2.3 Considerations When Choosing Financing: The Organizational Form  57
2.4 Regulatory Considerations  60
2.5 The Deal  64
2.6 International Differences in Financing Options  71
2.7 Summary  73

Review Questions  74
Notes  75
References and Additional Reading  77

Chapter 3  Venture Capital  79
3.1 Development of the Venture Capital Market  80
3.2 The Organization of Venture Capital Firms  89
3.3 How Venture Capitalists Add Value  99
3.4 Investment Selection and Venture Capitalist Compensation  106
3.5 Venture Capital Contracts with Portfolio Companies  107
3.6 Venture Capital Contracts with Investors  109
3.7 The Role of Reputation in the Venture Capital Market  113
3.8 Reputation, Returns, and Market Volatility  114
3.9 Summary  115

Review Questions  116
Notes  117
References and Additional Reading  119
PART 2  Financial Aspects of Strategic Planning

Chapter 4  New Venture Strategy and Real Options  125

4.1  Product-Market, Financial, and Organizational Strategy  126
4.2  The Interdependence of Strategic Choices: An Example  128
4.3  What Makes a Plan or Decision Strategic?  130
4.4  Financial Strategy  131
4.5  Deciding on the Objective  132
4.6  Strategic Planning for New Ventures  134
4.7  Recognizing Real Options  137
4.8  Strategic Planning and Decision Trees  141
4.9  Rival Reactions and Game Trees  151
4.10  Strategic Flexibility versus Strategic Commitment  155
4.11  Strategic Planning and the Business Plan  156
4.12  Summary  157

Review Questions  157
Notes  158
References and Additional Reading  160

Chapter 5  Developing Business Strategy Using Simulation  162

5.1  Use of Simulation in Business Planning: An Example  163
5.2  Who Relies on Simulation?  165
5.3  Simulation in New Venture Finance  166
5.4  Simulation: An Illustration  167
5.5  Simulating the Value of an Option  171
5.6  Describing Risk  173
5.7  Using Simulation to Evaluate a Strategy  176
5.8  Comparing Strategic Choices  187
5.9  Summary  198

Review Questions  198
PART 3 Financial Forecasting and Assessing Financial Needs

Chapter 6 Methods of Financial Forecasting: Revenue 205

6.1 Principles of Financial Forecasting 206
6.2 Forecasting Revenue 207
6.3 Estimating Uncertainty 222
6.4 Building a New Venture Revenue Forecast: An Illustration 225
6.5 Introducing Uncertainty to the Forecast: Continuing the Illustration 228
6.6 Calibrating the Development Timing Assumption: An Example 236
6.7 Summary 239

Review Questions 240
Notes 241

References and Additional Reading 242

Chapter 7 Methods of Financial Forecasting: Integrated Financial Modeling 243

7.1 An Overview of Financial Statements 244
7.2 The Cash Conversion Cycle 248
7.3 Working Capital, Growth, and Financial Needs 251
7.4 Developing Assumptions for the Financial Model 256
7.5 Building a Financial Model of the Venture 266
7.6 Adding Uncertainty to the Model 277
7.7 NewCompany: Building an Integrated Financial Model 281
7.8 Summary 293

Review Questions 294
Notes 295

References and Additional Reading 296
Chapter 8  Assessing Financial Needs  297

8.1  Sustainable Growth as a Starting Point  299
8.2  Assessing Financial Needs When the Desired Growth Rate Exceeds the Sustainable Growth Rate  304
8.3  Planning for Product-Market Uncertainty  306
8.4  Cash Flow Breakeven Analysis  310
8.5  Assessing Financial Needs with Scenario Analysis  315
8.6  Assessing Financial Needs with Simulation  319
8.7  How Much Money Does the Venture Need?  324
8.8  Assessing Financial Needs with Staged Investment  331
8.9  Summary  334

Review Questions  335
Notes  336
References and Additional Reading  336

PART 4  Valuation

Chapter 9  Foundations of New Venture Valuation  341

9.1  Perspectives on the Valuation of New Ventures  342
9.2  Myths about New Venture Valuation  343
9.3  An Overview of Valuation Methods  347
9.4  Discounted Cash Flow Valuation  352
9.5  The Relative Value Method  363
9.6  Valuation by the Venture Capital Method  367
9.7  Valuation by the First Chicago Method  369
9.8  Reconciliation with the Pricing of Options  370
9.9  Required Rates of Return for Investing in New Ventures  372
9.10  Matching Cash Flows and Discount Rates  374
9.11  Summary  378

Review Questions  379
Chapter 10 Valuation in Practice 386

10.1 Criteria for Selecting a New Venture Valuation Model 386
10.2 Implementing the Continuing Value Concept 388
10.3 Implementing DCF Valuation Methods 396
10.4 New Venture Valuation: An Illustration 412
10.5 The Cost of Capital for Non-US Investors 427
10.6 Summary 428

Review Questions 429
Notes 429
References and Additional Reading 430

Chapter 11 The Entrepreneur's Perspective on Value 432

11.1 Opportunity Cost and Choosing Entrepreneurship 434
11.2 The Entrepreneur as an Underdiversified Investor 437
11.3 Valuing Partial-Commitment Investments 430
11.4 Implementation: Partial Commitment 452
11.5 Shortcuts and Extensions 457
11.6 Benefits of Diversification 464
11.7 A Sanity Check: The Art and Science of Investment Decisions 466
11.8 Summary 469

Review Questions 470
Notes 471
References and Additional Reading 472
PART 5 Information, Incentives, and Financial Contracting

Chapter 12 Deal Structure: Addressing Information and Incentive Problems 477

12.1 Some Preliminaries 478
12.2 Proportional Sharing of Risk and Return 479
12.3 Asymmetric Sharing of Risk and Return 481
12.4 Contract Choices That Allocate Expected Returns 483
12.5 Contract Choices That Alter Venture Returns 489
12.6 Implementation and Negotiation 490
12.7 A Recap of Contracting with Asymmetric Attitudes toward Risk 493
12.8 Information Problems, Incentive Problems, and Financial Contracting 494
12.9 A Taxonomy of Information and Incentive Problems 495
12.10 Essentials of Contract Design 508
12.11 Organizational Choice 516
12.12 Summary 520

Review Questions 522
Notes 522
References and Additional Reading 525

Chapter 13 Value Creation and Contract Design 529

13.1 Staged Investment: The Venture Capital Method 530
13.2 Staged Investment: CAPM Valuation with Discrete Scenarios 536
13.3 Valuation-Based Contracting Model 545
13.4 Negotiating to Increase Value, Signal Beliefs, and Align Interests 549
13.5 Using Simulation to Design Financial Contracts 550
13.6 Information, Incentives, and Contract Choice 560
13.7 Summary 567
Chapter 14 Choice of Financing

14.1 Financing Alternatives
14.2 The Objective and Basic Principles of the Financing Decision
14.3 An Overview of the Financing Decision Process
14.4 First Step: Assess the Current Stage and Condition of the Venture
14.5 Second Step: Assess the Nature of the Venture's Financial Needs
14.6 Financing Choices and Organizational Structure
14.7 How Financial Distress Affects Financing Choices
14.8 How Reputations and Relationships Affect Financing Choices
14.9 Avoiding Missteps and Dealing with Market Downturns
14.10 Summary

Review Questions
Notes
References and Additional Reading

PART 6 Harvesting and Beyond

Chapter 15 Harvesting

15.1 Going Public
15.2 Acquisition
15.3 Management Buyout
15.4 Employee Stock Ownership Plans
15.5 Roll-Up IPO