



MGT 295A: Entrepreneurship & Venture Initiation

Prof. Olav Sorenson - Winter 2021

Location: Zoom (until further notice); Time: Tuesdays & Thursdays 8:30am-10:00am

Course overview

Recent research indicates that one in three people in the United States will become their own bosses at some point in their lives. An even larger share will find themselves employed at a startup, a young company, at some stage in their careers. So, even if you do not see yourself becoming an entrepreneur today or right after school, having a better understanding of the entrepreneurial process will probably prove useful.

Entrepreneurship and startups are surrounded by many myths: Entrepreneurs are born not made. Experience and education get in the way. Tech startups need to be in Silicon Valley to succeed. Most of these myths are not just wrong but also potentially damaging as they can lead entrepreneurs to poor choices.

To some extent, these myths have arisen because little research had been done on entrepreneurs and startups until quite recently. To some extent they exist because people focus only on successful startups, without considering how those success stories differed from those that had failed along the way. But research on entrepreneurship has experienced a renaissance over the last two decades. We know a lot more about what are just myths and what are truths in the entrepreneurial process.

Although some parts of the process remain more art than science, this course distills recent research in competitive strategy, financial economics, innovation, organization theory, psychology, and sociology to develop an evidence-based approach to entrepreneurship.

While the lessons have been built based on rigorous theory and evidence, the course nevertheless has a highly practical focus: How can entrepreneurs improve their odds of success? At the end of the course, your ability to answer the following questions, among others, should have improved:

- What are the characteristics of successful startups, founders, and founding teams?
- How can I identify and evaluate entrepreneurial opportunities?
- Who should I choose as an initial customer?
- How can I build a financial model of my business?
- What resources will I need to pursue the opportunity?

Many elements of building a startup depend on the industry or the type of business. As much as possible, I have tried to remain domain-agnostic in the design of this course. Please note also that, though I teach the course from the perspective of the entrepreneur, potential startup employees, investors, and policymakers, and those interested in being more entrepreneurial in the context of a large organization should also find useful a better understanding of the process.

Assessment

I will evaluate your performance in the course on four components: class participation and polls, the individual idea generation exercise, the group pizza pitch project, and the course-long team project. I will weight them as follows in the final grade:

Component	Weight
Class participation and polls	30%
Idea generation	10%
Pizza pitch	10%
Team project	50%

Class participation and polls:

For most days that involve case discussion, I will have a brief poll available that you should fill out prior to class (by the night before). The answers need not be long: one or two bullet-point lines will suffice. These polls solicit your opinions on one or more of the important issues in the case, allowing me both to focus our in-class discussions and to assess participation even for those who do not have the opportunity to talk during class.

Through effective class discussion, we will all learn more about the entrepreneurial process. You add value when you (i) listen to others, (ii) *constructively* critique others' arguments, (iii) ask questions or pose arguments that improve our understanding of the materials, (iv) describe and connect related personal experiences to the discussion, and (v) integrate ideas from other courses.

Idea generation:

All students must come up with at least two startup ideas and must assess at least some of their classmates' ideas (on the Wiki poll). Part of the assessment of ideas will come from the Wiki poll evaluations; part of it will come from my own assessment of the originality and quality of the idea.

Pizza pitch (group):

We will use the same groups as for the team projects for this assignment. Each group needs to develop a financial model of their concept for a pizza business. Grading will depend on the quality of the model. Does it have sufficient detail? Does it include the relevant costs? Does it have reasonable assumptions (based on data where possible)?

Team project:

By the end of the class, you will produce an *annotated* 10- to 12-slide pitch deck and an associated spreadsheet with your financial model. Many of the elements of the pitch deck will get developed earlier in the course, either in class or as part of an out-of-class assignment. But I care most about the final product. Teams that use feedback on the component assignments to refine their final submission will receive better grades.

The Pitch Deck: Pitch decks should include one or more slides that address each of the following elements.

- Value Proposition: How does the product or service create value for the user?
- Market & Competition: How large is the potential market? Who are the most relevant competitors? Why hasn't anyone else done it yet?
- Go to Market Plan: Who will you target as your initial customers? How will you reach them?
- Operations: How will you build your product or service? How will you scale it?
- Financing: Provide a pro-forma statement for the first four years of the business (a simplified version of your spreadsheet). How much money do you need? What do you see as the most likely funding source?
- Research: Where relevant, you should report the sources, research, and reasoning behind your assumptions and hypotheses.

Deliverables: Much of the information in and behind your decks will come from a series of in-class and out-of-class activities and assignments.

- Potential customers (January 26): Describe and evaluate at least five types of customers who might serve as a “beach head” for your venture. Based on your preliminary research, identify two as the most promising.
- Customer research (January 31 - individual): Write up your two interviews of potential customers.
- Financial model (February 9): Develop a draft financial model.

- Hypotheses (February 11): Describe one critical assumption in your plan and propose a strategy for testing it.
- Production research (February 21 - individual): Write up your interview of someone who can inform the operations side of the business.
- Draft deck (February 28): Submit an initial draft of your pitch deck.
- Final report (March 8): The final pitch deck (see description above).
- Peer evaluation (March 8): Your final grade will depend in part on how your teammates evaluate your contributions to the team project.

Instructor

You can reach me by e-mail at olav.sorenson@anderson.ucla.edu. If you wish to schedule office hours (for the time-being on Zoom), you can find my calendar at <https://olavsorenson.youcanbook.me>. It will show my availability each week and allow you to book a time slot.

Schedule

1. COURSE INTRODUCTION (JANUARY 5).

- Reading: Felin, Teppo, Alfonso Gambardella, and Todd Zenger (2020), “Value lab: A tool for entrepreneurial strategy.” *Management & Business Review*, 1: forthcoming
- Going deeper (optional): Mollick, Ethan (2020), *The Unicorn’s Shadow: Combating the Dangerous Myths that Hold Back Startups*. Wharton School Press: Philadelphia
- Case: *Apple’s Core*

Study questions:

- (a) Why did Jobs & Wozniak see an opportunity that others had not?
- (b) What are the attributes of successful founding teams?
- (c) Does Apple have a strong founding team?
- (d) What should Wozniak do now?

2. GENERATING IDEAS (JANUARY 7).

- Reading: Fleming, Lee (2007), “Breakthroughs and the ‘long tail’ of innovation.” *Sloan Management Review*, 49: 69
- Reading: Graham, Paul (2011), “Organic startup ideas.”
<http://www.paulgraham.com/organic.html>
- Reading: Peper, Eliot (2017), “Why business leaders need to read more science fiction.” *Harvard Business Review* (online)
<https://hbr.org/2017/07/why-business-leaders-need-to-read-more-science-fiction>
- Video: IDEO Shopping Cart Design, *ABC Nightline*, July 13, 1999 (YouTube)

Assignment: Idea Generation (January 10) – Come up with at least two ideas for startups. These could come from your own personal experience; they could come from carefully observing others; or they might come straight out of science fiction. Provide a one sentence title that encapsulates the idea, and a one paragraph description that gives a little better sense of the idea and what inspired it.

3. EVALUATING OPPORTUNITIES (JANUARY 12).

- Reading/video: Hale, Kevin (2019), “How to evaluate startup ideas.”
<https://www.ycombinator.com/library/6e-how-to-evaluate-startup-ideas>
- Case: *R&R*

Study questions:

- (a) What created the opportunity for Bob Reiss?
- (b) Who bore the most risk?
- (c) What accounts for the success of the venture?
- (d) Would Y-Combinator have considered it an attractive startup?

Assignment: Idea Evaluation (January 15) – Go to the Wiki poll linked in CCLE. There you can evaluate the ideas submitted last week. Do at least 20 paired comparisons. You can do more if you wish. Because of the combinatorics, there are more than 7,000 possible pairs!

4. ASSEMBLING THE TEAM (JANUARY 14).

- Video: Lindred Greer, Startup Success Secrets: How to Build the Best Teams, March 10, 2019 (YouTube)
<https://www.youtube.com/watch?v=B0Ye87QtKb0>
- Going deeper (optional): Ruef, Martin (2010), *The Entrepreneurial Group: Social Identities, Relations, and Collective Action*. Princeton University Press: Princeton, NJ

- Going deeper (optional): Gans, Joshua, Erin Scott, and Scott Stern (2020), “Choosing your identity.” Chapter 6 of *Entrepreneurial Strategy*
- Case: *Investic (A): Assembling the Founding Team*

Study questions:

- (a) What’s the opportunity for Latham?
- (b) How can Investic outcompete Bondcom?
- (c) Does Investic have a strong founding team? Why or why not?
- (d) What else should Nicholas do to ensure Investic’s success?

5. TEAM FORMATION (JANUARY 19). The authors of the top 10 vote-getters in the Wiki poll, plus of another 8-10 ideas that I will select based on their Idea Generation paragraphs, will each get one minute to “pitch” their idea. These initial founders will need to convince others to join them. As other members come on board, they can help with recruiting additional members. Teams require a minimum of four members to move forward as a team for the course. Once a team has reached six members, they should stop recruiting and turn in their team composition form.

6. SPLITTING THE PIE (JANUARY 21).

- Reading: Wasserman, Noam, and Lauren Barley (2011), *A Note on the Legal and Tax Implications of Founders’ Equity Splits*
- Case: *Cofounder Equity Split Vignettes*

We will probably not have time to discuss all of the vignettes here, so please focus on the first and the last: Pivots and Demotions and Bad Blood.

Study questions:

- (a) For each vignette, note the differences in the equity splits and cash compensation?
- (b) How might vesting schedules influence the decision to assign equity?
- (c) How should founders reassign equity when their roles and responsibilities have changed?

7. CHOOSING CUSTOMERS (JANUARY 26).

- Reading: Gans, Joshua, Erin Scott, and Scott Stern (2020), “Choosing your customer.” Chapter 4 of *Entrepreneurial Strategy*
- Reading: Liu, Chuck (2014), “Never ask what they want – 3 better questions to ask in user interviews.” (Link on CCLE)
- Going deeper (optional): Blank, Steve, and Bob Dorf (2020), Chapters 3-5 of *The Startup Owner’s Manual: The Step-By-Step Guide for Building a Great Company*. Wiley: New York.

Assignment: Customer Research (January 31) – Each team member should independently do two interviews, each one should represent one of the two most attractive segments from our January 26 in-class exercise. Write up the findings in a short two-page report. Based on your research, which potential beachhead customer seems more attractive? Why?

8. DECIDING HOW TO DO IT (JANUARY 28).

- Going deeper (optional): Gans, Joshua, Erin Scott, and Scott Stern (2020), “Choosing your technology.” Chapter 5 of *Entrepreneurial Strategy*
- Case: *EverTrue: Mobile Technology Development (A)*

Study questions:

- (a) Who’s the customer for EverTrue? How does it create value?
- (b) What criteria should Brent use to evaluate his development options?
- (c) Which option will cost the least? Which one will maximize his odds of success?

9. BUILDING A FINANCIAL MODEL I (FEBRUARY 2).

- Case: *The Pizza Challenge*

Assignment: Pizza Pitch (February 3) Complete your financial model for the pizza business. Turn in both the spreadsheet that you developed and a two-page pitch: one page that conveys the concept, the second that states the financing need and expected use of proceeds.

10. BUILDING A FINANCIAL MODEL II (FEBRUARY 4).

- Reading: McGrath, Rita, and Ian C. MacMillan (2009), “Creating reverse financials and the assumption checklist.” Chapter 6 of *Discovery-Driven Growth: A Breakthrough Process to Reduce Risk and Seize Opportunity*. Harvard Business School Press: Boston.

Assignment: Financial Model (February 9) Build an initial cash flow model for your business idea. You should allow the model to change depending on the “beachhead” customer chosen and depending on at least one production decision. If these decisions influence more than a couple of lines, you may want to have different pages of your spreadsheet reflect the different choices (after you build a generic template for the business). Turn in your spreadsheet along with a document that classifies the main inputs in terms of your level of uncertainty about them and provides an estimate of how much initial capital you believe that you need.

11. PRACTITIONER PANEL (FEBRUARY 9).

12. CREATING AND TESTING HYPOTHESES (FEBRUARY 11).

- Reading: Eisenmann, Thomas, Eric Ries, and Sarah Dillard (2013), *Hypothesis-Driven Entrepreneurship: The Lean Startup*
- Going deeper (optional): Blank, Steve, and Bob Dorf (2020), Chapter 6 of *The Startup Owner's Manual: The Step-By-Step Guide for Building a Great Company*. John Wiley & Sons: New York.
- Case: *GharPar: The Lean Beauty Start-Up (A)*

Study questions:

- (a) What were the team's key assumptions/hypotheses?
- (b) What's a good hypothesis? Why are some tests better than others?
- (c) How did they test their hypotheses? Were those good tests?
- (d) Has GharPar been profitable?

Assignment: Production Research (February 21) – Each team member should interview one person who should have information relevant to understanding better the production side of the business. What are the pros and cons of different technologies? How much will it cost? Are there hidden costs that you have not anticipated?

13. FINANCING THE EXPERIMENTS (FEBRUARY 16).

- Reading: Sorenson, Olav (2020). "Valuing new ventures"
- Case: *Lovepop*

Study questions:

- (a) Create capitalization tables for the two scenarios: (a) Rose and Wise choose the Techstars offer, (b) they choose the Founder.org offer.
 - Assume that the founders currently own 10 million shares of common stock and that they do not have an option pool.
 - Assume that the convertible notes described in Exhibit 5 have a 20% discount and a valuation cap of \$3 million.
 - Finally, assume that the Series A raises \$2 million at a \$10 post-money valuation and that it stipulates that the company must create an option pool equal to 10% of the fully diluted total shares.
- (b) What should Rose and Wise do?

14. FINANCING THE EARLY STAGE (FEBRUARY 18).

- Reading: *Vivos Term Sheet*
- Going deeper (optional): Feld, Brad, and Jason Mendelson (2011). *Venture Deals*. John Wiley & Sons: New York.

15. PITCHING (FEBRUARY 23).

- Going deeper (optional): Heath, Chip, and Dan Heath. *Made to Stick: Why Some Ideas Survive and Others Die*. Random House: New York.
- Going deeper (optional): Hu, Allen, and Song Ma (2020). “Persuading investors: A video-based study.” Working paper, Yale School of Management.

Assignment: Pitch Deck (February 28) – Prepare a draft pitch deck. Try to limit the deck to 10 content slides. See the lecture notes from Session 15 for additional information on what to include in the deck.

16. EXPANDING THE TEAM (FEBRUARY 25).

- Going deeper (optional): Baron, James N., and Michael T. Hannan (2002). “Organizational blueprints for success in high-tech start-ups: Lessons from the Stanford Project on Emerging Companies.” *California Management Review*, 44: 8-36
- Case: *Outfit7 (A): Human Resource Management and Culture at a Start-up*
Study questions:
 - (a) Would you consider Sam and Iza a strong founding team?
 - (b) To what do you attribute the early success of Outfit7?
 - (c) How would you describe the organizational culture? Would you be a good fit to Outfit7?
 - (d) Would you hire Candidate A for Outfit7?

17. FINANCING FUTURE GROWTH (MARCH 2).

- Case: *Soofa: Displaying the Right Path?*
Study questions:
 - (a) Would you want to invest in Soofa?
 - (b) Why has Richter found it difficult to raise funds?
 - (c) Should Soofa pursue a more aggressive growth strategy?

18. EXITING THE BUSINESS (MARCH 4).

- Case: *KCC: Third Time's the Charm?*

Study questions:

- (a) What did KCC's founders learn from their first two attempts to sell KCC? How did that lesson affect their current selling process?
- (b) Do you agree with KCC's aversion to forming a board of directors? Why or why not?
- (c) What should KCC do about the current offer: accept it, reject it, or push back on a particular term?

19. FINAL PRESENTATIONS (MARCH 9).

20. FINAL PRESENTATIONS (MARCH 11).

Materials

1. Felin, Teppo, Alfonso Gambardella, and Todd Zenger (2020), "Value lab: A tool for entrepreneurial strategy." *Management & Business Review*, 1: forthcoming
2. *Apple's Core*, HBS Case 9-809-063
3. Fleming, Lee (2007), "Breathroughs and the 'long tail' of innovation." *Sloan Management Review*, 49: 69+
4. *R&R*, HBS Case 9-386-019
5. *Investic (A): Assembling the Founding Team*, INSEAD Case INS426
6. Wasserman, Noam, and Lauren Barley (2011), *A Note on the Legal and Tax Implications of Founders' Equity Splits*, HBS Note 9-809-110
7. *Cofounder Equity Split Vignettes*, Stanford GSB Case E-578
8. Gans, Joshua, Erin Scott, and Scott Stern (2020), "Choosing your customer." Chapter 4 of *Entrepreneurial Strategy*
9. *EverTrue: Mobile Technology Development (A)*, HBS Case 9-813-122
10. *The Pizza Challenge*, Yale SOM Case
11. McGrath, Rita, and Ian C. MacMillan (2009), "Creating reverse financials and the assumption checklist." Chapter 6 of *Discovery-Driven Growth: A Breakthrough Process to Reduce Risk and Seize Opportunity*. Harvard Business School Press: Boston.

12. Eisenmann, Thomas, Eric Ries, and Sarah Dillard (2013), *Hypothesis-Driven Entrepreneurship: The Lean Startup*, HBS Note 9-812-095
13. *GharPar: The Lean Beauty Start-Up (A)*, Lahore University Case LCA056
14. Sorenson, Olav (2021), *Valuing New Ventures*
15. *Lovepop*, HBS Case 9-818-015
16. *Vivos Term Sheet*
17. *Outfit7 (A)*, INSEAD Case IN1556
18. *Soofa: Displaying the Right Path*, HBS Case 9-820-098
19. *KCC: Third Time's the Charm?*, USC Marshall Case SCG-533