**Project guidance**

**Venture Capital and Private Equity (MBA)**

**Level 4 (10 Credits)**

Provide a report for one of the project briefs outlined below. In completing the report:

* You should demonstrate good knowledge of the material and theories covered in lectures,
* you should demonstrate the ability to select an appropriate case and conduct a research enquiry, collecting and analysing secondary data, synthesising and reporting your evaluations in the form of an investment proposal,
* you should make this investment proposal as realistic as possible. It will be read not only by your module convenor, but also by some of our speakers (practitioners),
* ensure to include a 1 page executive summary (400 words max),
* type the report in a 12pt New Roman font and double-space lines,
* report all financial information in GBP,
* use the Harvard referencing style.

1. Imagine you are an executive in a venture capital (VC) or private equity (PE) firm. Identify a potential target investment in any country, market sector or size of your choice. The target can be a start-up, a management buy-out/buy-in or a development/expansion capital project. Prepare a report justifying why this is a potentially attractive investment for a VC or PE firm. Topics you may wish to cover include: current ownership of the venture, likelihood that the company is for sale, price/valuation, market characteristics, personnel and fixed capital resources, possible financing structure, source of potential gains, and possible exit strategy.

**Or**

1. Imagine you are an entrepreneur seeking venture capital (VC) for a start-up or development/expansion capital project; or a manager seeking private equity (PE) finance to fund a management buyout. Prepare a report justifying why this is a potentially attractive investment for a VC or PE firm. Topics you may wish to cover include: current ownership of the venture, likelihood that the company is for sale, price/valuation, market characteristics, personnel and fixed capital resources, possible financing structure, source of potential gains, and possible exit strategy.
2. **Word limit:**

**3,000 words** **(excluding references, and words and symbols used in diagrams). The word count includes appendices and the executive summary as well as all text in tables.** An executive summary should be at the front of your coursework. This should be no more than 400 words.

Please write the word count on the front page of your report. **The word limit is strict and there is no flexibility on this (i.e. There will be no 10% allowance).**

**Additional Project Guidance**

This guidance is not intended to provide you with an explanation of how to do the project, how many words should be devoted to each section, or how many references there should be. There is not a template or ideal project. Your project is unique and will be considered on its own merits. Please note that this is an individual course work. Below are some issues that you might want to consider.

*Report structure*

The structure of lectures provides a useful structure to follow for your dissertation. You can also use the OUTSUIDE IMPACT due diligence structure if you think this is appropriate. It is worth noting that this is an investment report, not a business plan. Emphasis should therefore be placed on how investible is the idea/team/market, the valuation of company, the financing structure of a deal, the source of potential gains, the risk associated with the investment and the possible exit strategies.

*Selection of firm*

For project option 1, please select an existing organisation. They can be at any life stage (e.g. seed, start-up, secondary-buy-out, late-stage LBO, growth funding, etc.) and from any country. However, think about the types of firms that generally seek VC investment and also the types of firms that are appropriate targets for an LBO. Practice and academic literature can guide this. Part of this assignment is to pick an appropriate business to investigate. After a firm is selected both VC and PE firms undertake due diligence, which is a response to an adverse selection problem. Please pick a company you can collect sufficient information on to make an investment decision.

VC and PE firms will undertake some market analysis. What are the characteristics of the proposed target market in terms of size, growth rate and competitiveness? If the firm is in its early stages, does the target firm or entrepreneur have a business proposition to be successful in its market? If it’s a LBO, how well is it performing compared to the industry average or key rivals? Which metrics are you using to judge their performance and competitiveness? If it is underperforming, what can be done to change that (see value creation below)? Are there weaknesses in corporate governance determining under-performance?

*Valuation*

There are standard ways of valuing businesses and the multiples that are used. Please refer back to the Valuation lecture to guide you on the VCs perspective. In the case of the LBO of a mature business, standard corporate finance techniques can be applied. Gilligan and Wright (2014) provide some insight on this. In an LBO a premium for control is sometimes paid. You might want to consider what is driving this. The VC valuation method may also be appropriate when analysing earlier stage companies.

*Capital Structure*

There are two issues to consider here: (i) structuring a deal in a particular way is partly a necessity of financing the deal (although the maximum debt in the capital structure is determined by the amount of cash available to service the debt) (ii) structuring the deal to create financial incentives for both the VC/PE firm and the management. Academic literature provides guidance on how debt and equity attenuate the agency problem. Also be mindful of assessing both the business and financial risks when structuring the deal. For instance higher risk (business risk) early stage businesses tend to be structured more conservatively debt wise (financial risk). LBOs tend to have a lower business risk and therefore can cope with a higher degree of financial risk through higher levels of debt. Lectures 5 and the Hoots case might be particularly helpful here. You may also recommend contractual tools (e.g. tag/drag along rights) to help structure a fair deal and manage the risks.

*Value creation*

Firm value is increased when a firm is more profitable. Simply, profit = total revenue minus total cost, so profit will increase if the portfolio firm generates additional revenue streams or costs can be cut. Higher gross margins can also improve profitability for a given cost base.

A key driver of value creation are the financial incentives created by VC and PE deals. In particular, the theory in the academic literature suggests that equity creates entrepreneurial incentives and debt disciplines use of cash flows, preventing managers from wasting cash.

In early-stage VC deals an explanation of how the firm will penetrate a market and create profit is required. Equity provides managers with incentives and VCs with the incentives to be active investors.

In the LBO of a listed company, restructuring the firm, refocusing on core business and the firm and management focusing at what they are good at could be considered. The sale of assets might be used to pay down debt. Remember, financial incentives are driving behaviour. Equity provides managers with financial incentives and PE firms with incentives to be active investors.

Consider the roles played by VCs and PE firms – are they providing more than finance? Will you offer strategic guidance to support value creation?

*Exits*

A key feature of the VC and PE business model is exit. It is how the investors liquidate the value that has been created and realise their investments. Consider the pros and cons for different types of exit for the portfolio firm in your project and recommend the most appropriate option in your case (e.g. trade sale – can you identify potential buyers for the business x years down the road?).

**Frequently Asked Questions**

*Should I choose a real life example?*

Yes. The exception is project option 2, which might require you to judge the investment potential of a new business idea prior to launch.

*Can I use real accounting/financial information?*

Yes. If you are considering an LBO (MBO or MBI) you might want to choose a larger firm where accounting/financial information are easily available from their websites, Bloomberg, or Datastream. Sometimes it is possible to get information on subsidiaries, so this opens up the possibility of a project examining the LBO of a whole firm or the LBO of a division/subsidiary. Articles of respectable news outlets are another good source for financial information, as well as reports from the CompaniesHouse.gov.uk

If you cannot access all financial information (e.g. future revenue growth) you will have to make sensible and realistic estimations. Support your forecasts with appropriate research (e.g. by comparing them to relevant competitors and market growth rates).

*Do I need to include full financial statements in my report?*

No. We expect you to synthesising and digest all information/financials and report your analysis, evaluations and recommendations. It is your responsibility to filter through the large amounts of information available and make a judgment call.

*Are tables included in the word count?*

Please note, putting text into a table in order to avoid the word count is not acceptable. That will be included in the word count.  Also, it may be useful to organise text in a table, but that will also be included in the word count.

There is nothing to gain from being verbose. If you are over the word limit you have either included irrelevant material or have been inefficient with your use of language and have not got to the point.

It has been requested that calculations of financial scenarios, such as those relating to deal structure, IRR, enterprise value, which are typically incorporated into tables are included in the word count.

We advise that a limited number of financial scenarios are required when used. Last year some reports had a large number of scenarios. There is no need for more than three scenarios, for example: ‘low, medium, high’, or ‘good, neutral, bad’, or 'recession, stable, growth'. It would just involve a bit of care in selecting scenarios for illustration.

**Example 1 (table of content only)**

