MS&E 272: Course Wrap-Up

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Finance

- The study of the allocation of scarce resources
- Simple rules:
  - More cash is preferred to less cash
  - Cash sooner is preferred to cash later
  - Less risky cash is preferred to more risky cash
  - Don’t run out of cash
Entrepreneurship

• Working Definition:
  – The relentless pursuit of opportunity without regard to tangible resources currently controlled

• A complete process from identification to harvesting

• A way of managing
Management Approach

- Opportunity driven vs resource driven
- Revolutionary vs evolutionary commitment
- Multi-staged vs single-staged commitment
- Use & rent resources vs own and control
- Flat organizations vs formal hierarchy
- Value created vs resources controlled compensation
Structural Model

• Critical elements:
  – people
  – opportunity
  – context
  – deal

• Concept of “Fit”

• Concept of dynamic “Fit” management
Important Skills

• Resume reading
• Financial statement analysis
• Proforma modeling
• Industry and competitive analysis
• Opportunity analysis
• Valuation
• Deals
• Negotiation
• “Fit” analysis and management
Essential Questions

• Who is the customer?
• How do they make decisions?
• What risks do they perceive?
• What benefits?
• What is the potential profit margin?
• How much capital is required to support sales?
• What is the lifetime value of a customer?
• Is this a large or a small NPV project?
• Who else can ask these questions and respond to the opportunity?
Spotting Opportunity

• Customer
• Supplier
• Employee
• “Knowing and being known”
• Getting in the “game”
Valuation Tools

• Cash Flow Models
  – Free cash flow @ WACC

• Price-to-Earnings (P/E) Ratios
  – Fundamental determinants
  – Comparables

• Venture Capital Method
  – Success scenario
  – Carving up the terminal pie
  – Discount rate factors
  – Future dilution
Limitations of the Tools

- Theory problems
- Estimation problems
- Bias
- Intractability
- What’s a comparable?
Valuation via Questions

- A discount rate vs a range of reasonable discount rates
- Common sense and benchmarks (e.g., junk bond rate)
- Tradeoffs between different elements (e.g., profitability and growth rate)
- What would the present value be for a competitor?
- IRR--how wrong could I be?
More Questions

• What if same outcome, but two years late?
• What if need twice as much capital?
• What if terminal value is different?
• What is the upside potential?
Lessons on Financing Ventures

- From whom you raise capital is often more important than the terms
- Running out of cash is disastrous
- Maximizing the price at each stage of a venture is not a sensible objective
- Preserving options is essential
- Think of the amount of equity you raise in terms of buying insurance
- Raising cash is best viewed as buying time
- Price is not the same as value
- Horse race between fear and greed
Attitudinal Objectives

- Anything is possible
- Myth debunking
- Success and failure
- Kinds of failure
- Luck
- Timing
- Acknowledging lack of knowledge
Attitudinal Objectives (cont’d)

• Proper role of analysis
• Arrogance vs confidence
• Cynicism vs skepticism
• Criticizing vs fixing
• Risk avoidance vs risk management
• Common sense
• Logic
• Learning/investing
On Goals

I don’t make pictures just to make money. I make money to make more pictures.

Walt Disney
Some Rules

• Don’t maximize short-term anything
• Time cannot be replaced
• Subscription businesses are great
• Don’t run out of cash
• Family is all that matters