

CAPITAL FORMATION Q AND A (10/11)

The Q&A herein are excerpts from "Technology Commercialization Manual. Strategy, Tactics, and Economics for Business Success." (www.tclearningcenter.com). Notation after each heading reflects the (# of excerpts/total Q&A).

The Q&A are for information only. Seek legal or accounting advice for specific situations.

1. How do I get funds to "test-drive" my business idea?

Risks are much greater when investing in an "idea" that is not yet a working company. Numerous things can change the risk exposure of an up-and-running business, so capital for development of a business "concept" becomes even more risky given the lack of validation of the business model as viable in that particular market space.

It's important to do a quick review of the stages in a company's life cycle and understand the use of funds for each stage. There are four stages: the pre-launch, the launch, the ramp-up and the viability stages. Questions pertaining to the pre-launch cover two unique sub-phases. First, interest in raising money could be to conduct "concept feasibility" work. The work would be to develop working prototypes and working models or various versions of the product or service to see if it does what it is supposed to do. In addition there may be a need for funds to "market test" which would involve surveys, focus groups and field tests of beta versions.

It's during the concept period that research and development happens for a brand-new product or service to determine all aspects of the ultimate manufacturing, distribution and support processes. Funds invested here have very little substantive expectations because no one can be sure if the feasible solution can be put together and the kinks worked out in a satisfactory manner. Funds used to do market testing is also risky because, while trying to determine price points, potential sales volume and viable buying patterns of targeted customers, results could be very negative and point toward a lack of support for the idea/concept in the industry.

Some basic rules to follow when trying to find capital for the pre-launch areas follows. First, because of the high risk for the investor and lender be reasonable in expectations on the potential investors. If they don't immediately show enthusiasm for the plan, be open to working with them on identifying what can be done to alleviate some of their risk concerns. Always remember that this effort could end without any plan on how to proceed further and actually open for business.

Second, money used for "getting ready" will almost certainly be tied to the likelihood that there will in fact be a business doing business after all the testing and R&D is finished. Investors will want to have a significant stake in that enterprise that follows, because they recognize that without their money now, there can never be a company later. But remember that the person with the idea and expertise to make the concept a reality, counts for something, too. When deciding on percentage stakes in the ultimate firm, keep in mind that it is a mutual relationship, in which, almost equally, the money needs the idea and the idea needs the money.

Finally, there is a need to clearly demonstrate an expected path from pre-launch to launch; otherwise, investors will view their funds as going into a black hole. Product testing, lab research, surveys collected and focus groups polled could all result in no forward momentum. Outline strategic vision at each stage, and show the benchmarks that will define success or failure at each critical juncture. Get agreement that "if we do this and this and that, then we will proceed to do these next steps."

What complicates this type of funding is that during this pre-launch stage, there is no revenue - only development expense. Therefore ask yourself: "Would I provide funds for this idea in its current state? If the answer is no, then what things need to be tightened up before approaching real investors? If the answer is yes, get two or three other people to provide an objective opinion as to whether you're ready to ask for money. If a clear path to a launch date and

eventual sales is evident, then there are investors who will provide funding to do these pre-launch activities.

2. How do I determine how much of my company I should give to an investor?

Beauty Is In The Eye of The Stockholder

Rather complex financial analysis tools are used to establish the value of a business and its stock. Although the tools seem to apply a degree of scientific accuracy to the subject, they do not produce automatic results. In the case of an established company, it is possible to use three or four different methods and arrive at three or four radically different results. It is then up to the person doing the valuation to find an "average" among the results. For an early stage company, the valuation question is even more problematical, because the valuation is typically done based on projected future cash flows and what you can sell the business for in 3 or 5 or 7 years, which are inherently subjective in the first place.

Entrepreneurs, being naturally enthusiastic people, tend to get carried away with their projections and assume there will be no obstacles to the company becoming a roaring success. Venture capitalists, being naturally skeptical people, will take these same projections and discount them (lower them) based on the degree of risk the venture capitalist sees that the projections will not turn into reality. The more skeptical the venture capitalist is, the greater the percentage of the company he will want for a given level of investment.

Reaching an agreement on the price of the company's stock depends on how this natural gap can be bridged. A valid question for the entrepreneur to pose is, "If this investment is so terribly risky that you need 80% of my company, why do you want to get involved at all?" The investor's counter argument is then, "My investment will cause your company to be larger and more valuable. Wouldn't you rather own 20% of a large, successful company, than 100% of what you have now?"

A Little Analysis Is Better Than None At All

Occasionally we have seen an entrepreneur propose a deal based on absolutely no financial analysis, instead using this logic(?): "I need \$5 million. I don't want the investor to have control of my business, but I need to give them a nice chunk. How about 40%?" Despite the imperfections in the process of trying to project future cash flows in a growing business, it is better to at least try to tie your valuation of the company back to the projections instead of using this non-valuation method of business valuation.

Never Listen to Someone Who Says Investors Have To Have Control

You should never assume that you must give up control of your company to investors in order to secure financing. Some of the larger venture capital firms, in fact, prefer to have a minority share because they believe that a management group with a higher equity stake is more likely to put their full energies into building the company.

The Fine Print Can Be Hazardous to Your Wealth

One of the most perilous parts of structuring a venture capital investment involves the performance criteria set for the existing owner/managers. These parameters are set in to protect the investors in the event the company under performs relative to what was projected. This fine print of the agreements could specify that the investors receive more shares, giving them control for example, or may say they have the right to bring in their own management team, or even sell the company out from under the original owners in order to recoup their investment. You, the entrepreneur should assume that actual results will vary from what had been forecast, and be very cautious when agreeing to the performance criteria that will be used to trigger any of these changes.

We heard of one wealthy individual investor who never objected to puffed-up projections, but set the management performance criteria based on them, knowing full well that management could not achieve the results and he could take over the company.

He let them hang themselves by their own spreadsheets.

My Advice Is To Get Advice

Although it is possible to read books on the subject of valuing a business and setting the price for an investment, being able to usefully employ these analytical tools only comes through experience of having been through the process many times.

If you are negotiating with professional venture capitalists, you are at a distinct disadvantage, because they have put deals together many times, and know how to structure them in their favor. You, then, need people on your team who have seen many deals put together. Among the options available to you:

- CPAs who work on corporate finance transactions.
- Business valuation consultants (and have professional accreditation.)
- Investment bankers who specialize on smaller or mid-market companies.

Don't assume these professionals are completely out of your price range. They may be willing to defer part of their advisory fees until the deal is closed, especially if you have reasonable prospects of getting investors interested in your company, or are in discussions with investors at the present time.

3. Does anyone know how to go about obtaining Seed Financing for product development, market research etc.?

Seed money is the most difficult of all to obtain. The reason, of course, is that the promise of success very seldom matures into an invention that pays back a profit.

Here are a few ways to go about getting seed money:

1. Form a close corporation, and sell shares in a high risk venture to friends and relatives. Do not ask for loans; this creates hard feelings in the majority of cases. A corporation places each investor on equal footing. Be sure to get an attorney experienced in startups to do the incorporating. The key here is to reserve enough stock for future investors (venture capitalists and the like). If this isn't done right, you can stall at the very point that success is near.
2. Locate successful persons in the same line as your invention fall into, and ask for a grant to proceed. The grantor must know more about your field than you do, or at least as much, or the probability of attracting him/her is zilch. Sometimes a bored lawyer, doctor, dentist, etc., may act as an angel in the early stages. But go back to point 1 above in any case in dealing with any such persons.
3. Locate vendors who will eventually manufacture your invention, and form a strategic partnership that includes yielding manufacturing rights and/or royalties etc. to the vendor. All of these methods require a lot of effort to put in place, but it can be done. See www.inventorhelp.com

4. What are some recommendations that you would make for raising venture capital?

The Challenge

For the past fourteen years I have been raising venture capital, either as an entrepreneur or as a venture capitalist. This has included raising capital for my own businesses and helping others to raise capital for their new or existing businesses.

Raising venture capital is both a marketing and a sales challenge in that, to insure your success, you must both develop a product that a large enough market wants to buy, and you must have the selling skills to convince the dogs that they should eat your particular brand of dog food. Most professional venture capitalists are essentially in the business of screening, qualifying, and selecting venture capital investments from as large a source of quality deal flow as they can muster. A few venture capitalists are essentially entrepreneurs themselves and can work with an entrepreneur to start and develop a new company.

Increasingly, the start up variety of venture capitalist is hard to find, in that over the past decade most venture capitalists now have so much money to manage that they cannot afford the

time or effort required to help develop and then invest in a start up. For all but the very few, start up capital will not come from the professional V.C., but rather from the D.D.F. market - Doctors, Dentists, and Friends, or from personal savings, credit, or family members. Some states have incubator programs or incubator venture funds which will provide small amounts of capital (\$100,000-\$200,000), but once again generally only the few, the persistent, and the lucky will qualify.

To successfully raise professional venture capital, particularly for a start up, your venture will need to address a large, rapidly growing market with a unique product, which is very tough to duplicate and for which there is little or no known present competition. Your product needs "compelling economics" - twice as fast, twice as cheap, twice the margins, and twice the appeal. If the potential product is likely to gain rapid favor in the stock market after in IPO, all the better. The good news is that the D.D.F. market is about \$25 billion annually. The professional V.C. market is only \$3-\$5 billion. There are more friends and family than Venture Capitalists.

Use the following checklists as guides to raising venture and to assess the likelihood of success.

Obtaining A State Of Mind Conductive To Raising Venture Capital

Several authors, combining the best of the ways of Eastern mysticism and relaxation techniques with Western competitiveness, present approaches to obtain your goals which permit the participant to "go with the flow" rather than against the grain. This "oneness with what you are doing" approach permits the objective, in this case raising venture capital, to be obtained with a minimum of hassle, anxiety, and difficulty. Those who are successful in raising venture capital obtain a state of mind as well as an understanding of the process which promotes and permits success. Administer this self-awareness review to determine whether your stuff is right:

- I would rather be rich than be the big cheese.
- While I want to be rich, I would rather build a successful company.
- While I want to build a successful company, I would rather be creative and effective in what I do everyday.
- I work effectively with peers, but not well for another.
- I want the best around me in my products, employees, investors, and other supporters, but if they are not available I will on occasion compromise, but not too much.
- I am afraid to fail and admit it, but succeeding is okay.
- I will work both very hard and very smart to obtain my goals.
- I accept that in this life it is difficult to have everything, at least at one time, and that it will be necessary at times to surrender personal life for business success.
- I know in what way I am truly unique, and what it is that I want to bring to the world.
- I will let my family and friends know that it's not that I am not interested in them, but that this is just something that I have to create for a time.
- I will never give up.
- If forced to give up by adverse circumstances, I will start over.

Steps in Successfully Raising Venture Capital

Successfully raising venture capital is an established process and your chances of success are enhanced if all bases are covered in a logical progression.

Develop a unique product, concept, or service.

Develop an outline of what is required in people, money, organization, strategy and tactics, and other assets to build this particular business.

Assemble a management team with the ability to successfully build and operate this business.

Prepare, with the assistance of the members of the management team, a clear, concise business plan representing the "game plan" of how the business will be operated and financed.

Identify those venture capitalists who are most likely to review a business plan in your

industry and stage of development.

Mail the plan, with a cover letter indicating why the plan is unique to four or five selected venture capitalists.

Call the venture capitalist in several weeks to determine the status of your plan if a reply has not yet been received.

Meet with the venture capitalist to initially present your deal.

Prepare for "due diligence" meetings with the venture capitalist to continue to you're your deal.

Negotiate with venture capitalists over deal structure and price.

Complete investment syndicate formation by entrepreneur and lead venture capitalist.

Obtain commitment by all venture capitalists in the deal. Prepare legal documents of closing (time to involve your deal-making attorney).

Officially close the deal.

Work with the venture capitalist after the sale.

Cash out for the venture capitalist through a sale, merger, or public offering.

5. How much money do I need to get my business off the ground?

To help you estimate the amount of financing you will need to get your business off the ground, use the following checklist. For each item, estimate a monthly amount needed.

Monthly Expenses:

Salary of owner-manager (if applicable)

All other salaries and wages

Rent

Advertising

Delivery expense

Supplies

Telephone

Utilities

Insurance

Taxes, including Social Security

Interest

Maintenance

Legal and other professional fees

Miscellaneous

One-Time Start-Up Costs:

Fixtures and equipment

Decorating and remodeling

Installation of fixtures and equipment

Starting inventory

Deposits with public utilities

Legal and other professional fees

Licenses and permits

Advertising and promotion for opening

Accounts receivable

Cash

Other

TOTAL

Your total will depend on how many months of preparation you want to allow for.

6. Is there “free” money and if so how can I get it?

Free Money" is grants, loans (micro loans, low doc), awards and prizes from government, corporate or philanthropic sources.

Who can get "free money"- business people & entrepreneurs (especially high-tech and specialists; more difficult for traditional retailers), students, researchers, inventors, home buyers, bill payers, car buyers, veterans, the disabled, the disadvantaged, the elderly, the (ethnic, racial, gender & culturally) diverse, poets, writers, clubs, organizations, social services, not-for-profits, nonprofits, etc.

To obtain the various types of "free money" use the sources listed below. Also research programs of interest and contact the program's organization- ask for a description of the program, guidelines, deadlines and a copy of successful applications.

Before you actively go after the money review this material carefully. You may also want to speak with a program representative to make sure you understand everything. Know what you are getting yourself into, e.g., Is it a free grant or does it require remittance?

Get the money

Follow instructions to the letter. Send in your carefully completed application and anything else that's required as soon as possible. Send it to the proper person, address and office. Follow up after submission: call, write or even visit.

Keep following up until you receive a reply. If favorable, you have what you want. If not, this time, reapply, and seek out new sources. "If at first you don't succeed, try, try again."

Obviously there's not enough room in this book to list every "free money," grant, loan, award and prize resource available so here's a "free money" quick list:

- Government Agencies (Dept. of Agriculture, Dept. of Education, Dept. of Education, HUD, SBA etc.)
- The U.S. Government's "Catalog of Federal Domestic Assistance"
- The Foundation Center publications, i.e., "Foundation Directory"
- "Annual Register of Grant Support"
- Matthew Lesko's "Government Giveaways," "Info Power," "1001 Free Goodies and Cheapies," etc.
- Internet/World Wide Web (see "Internet Resources" in the Computer Info chapter of "THE Self-Employment Resource Guide," see resource box below)

These and many other "free money" sources without cost can be found at the local Public Library and on the Internet. Also contact government agencies - SBA, SCORE, GSA, nonprofit organizations and groups you belong to. See "Your Info Quick List" and the "Free Information From Your Government" chapter earlier in this book ("THE Self-Employment Resource Guide" see resource box below).

WARNING: Nothing is absolutely FREE. It may take a lot of time and effort just to find the right program (programs may not be listed or found in non-traditional areas).

Obtaining free money, grants and loans at the very least requires time, effort, postage, phone calls and follow up. If you fail to follow instructions, send your application to the wrong sources or forget to follow up don't be surprised if you unconditionally lose out without hearing about it. Give yourself the best chance for success. Do the right thing!

This information was excerpted from Arthur A. Hawkins II's book "THE Self-Employment Resource Guide" (\$25 US) (c)Copyright 1996.

7. Can you tell me about factoring and when should I consider such a financing method for my business?

Dealing with cash flow is a common problem. If a product is involved, competition will likely take a "wait and see" approach for a while – if the product takes off, then the gross revenue will attract competition. One might pursue a line of credit (LC) with their bank based upon orders from the retailer to take care of this concern.

Because of the short time in the manufacturing business, it's more likely that one would rely on factoring - selling his receivable (invoice) to a factoring house the day orders are shipped. This is arranged in advance of shipping with a factoring company (some banks offer factoring services).

Factoring *discount* rates depend on the quality of the receivable (invoices to "Joe's Home Handyman" would not likely be factorable, because Joe could skip out on the payment - go out of business - and the factoring house loses). However, Home Depot would be a low risk receivable. Therefore, figure on possibly 4-6% discount on the invoice amount to get your money *today* versus in 90 days.

Factoring - cash in return for receivables with hefty interest charge; may be good for short-term capital. For information see: "Finding money: the small business guide to financing", K. Lister and T. Harnish, Wiley & Sons, 800 225 5945 \$17.95

1. Commercial Finance Assoc. -info on factoring and commercial credit industry; <http://www.cfa.com>.
2. The International Factoring Assoc. - matches businesses with factors; <http://www.factoring.org>.
3. Commercial Finance Online - factors & brokers specializing in factoring; <http://www.factoring.com>.
4. Hoovers; company's history & financial report; <http://www.hoovers.com>.

If cash flow is a serious problem for your small business or you're looking for quick cash to expand your business, you may want to consider factoring your accounts receivables.

Are you familiar with factoring? If not, it's a form of financing for small and medium-sized businesses whereby you "sell" your accounts receivable to a factoring company at a discount. It's a \$70 billion industry in the U.S. and a \$250 billion industry worldwide. Although the terms you'll get will vary from company to company, factoring contracts all have the following elements in common:

1. Advance rate. The advance rate is the percentage of your accounts receivables that companies will advance to you. Some companies will advance the full 100 percent up front. Others will advance 70 percent and then will pay you the balance once the receivables are collected. The typical range for how much they'll pay in cash up front is 60 percent to 90 percent of your account receivables.
2. Discount rate. The discount rate is the fee charged by the factoring company for the financing. The typical range is 2 percent to 7 percent of your accounts receivables, although I have seen as low as 1 percent.
3. Recourse vs. no recourse -- In a no recourse agreement, the factoring company bears the burden of collecting the accounts receivable. In a recourse agreement, the small business owner bears the burden (in other words, if they are uncollectable, they will be charged back to you). Obviously, for a small business owner, the no recourse agreement is preferred, although the rates you'll get won't be as good as with a recourse agreement.

You'll have to weigh one against the other. Just make sure that you understand whether your agreement is recourse or no recourse before you agree to the terms.

As with most financial arrangements, the terms and rates depend upon what the lending institution views as your credit worthiness. Small businesses with higher sales volumes or with what are viewed as stronger account debtors get better rates than those with small sales volumes or more questionable account debtors. Thus, the smaller the business, typically the worse the terms.

If you're interested in factoring, the first question you should be asking yourself is: Why don't I just get a bank loan and use the accounts receivables as collateral? The answer is "you should" -- if you can get a bank to loan you the money. Bank fees will typically be much lower than factoring fees, and you should definitely pursue that option if it is available to you.

But factoring companies are betting that most small businesses can't easily get loans from banks these days, particularly those with a troublesome cash flow history. And judging from the size of the industry, they appear to be winning their bet.

The factoring companies also believe they can outperform the banks in one other area -- speed. "Factoring provides cash in 48 hours or less after an account is set up," says Paul Chapman, founder and president of American Certified Factors, a worldwide factoring company based in New York. "The account set-up typically takes about seven days, but often we can provide access to funding immediately."

You'll just have to crunch the numbers to figure out if factoring makes sense for your business. Ask your lawyer or accountant what they think about factoring. And ask some of your business associates for their experiences.

If you're interested in pursuing this further, here's a short list of factoring companies with web sites where you can find more information. The list is by no means exhaustive. There are literally hundreds of factoring companies all around the world, and many of them have web sites. Before you choose a company, make sure that you shop around for the best rates.

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| 1. American Certified Factors | members.aol.com/AmericanCF/index.htm |
| 2. Stratford Funding, Inc. | choicemall.com/newyork/ny169-01 |
| 3. Business Funding Services | www.busfund.com/busfund |
| 4. Hilldun Corporation | www.hilldun.com |
| 5. 21st Capital Corp. | websites.earthlink.net/~21stcapital |

Factors measure viability of a business by looking at what it does, how well it does it, and the financial strength of its customers Not by financial ratios, equity, profitability or years in business.

If account is viable they purchase the invoice and advance cash to the business. Comparable to credit cards for payments factor acts as a commercial credit card service that gives a business the ability to sell its receivables in return for immediate funds, albeit for a much higher fee than those imposed by credit card companies.

Factors buy the receivables on a monthly basis or carry them until they are paid. Fees can be huge from two to seven percent a month. Fee is only paid as long as the receivable is outstanding and typically such receivables are paid within 30-60 days BUT still expensive proposition.

8. What kind of company does receivables factoring?

Factoring is when the financier is essentially buying a book of actual debtors. Based on his review of the quality of the debtors, he might pay 90% of face value and the balance less fees within 90 to 120 days. A purchase order is an offer to buy, not a debt. The debt crystallizes when the product is sold, not before it is manufactured.

The range of purchase order value that is necessary for obtaining "purchase order" order financing or factoring can be as low as \$75,000 of purchase orders whereas some investors may want \$1-5M in valid PO's. Shop around!

9. Does anyone have an opinion about the advisability of a university non-profit tax exempt tech transfer office's taking an "ownership interest" in an LLC as opposed to an S Corp or C Corp?

For some reason that is not entirely clear to me, most of our faculty spin-offs are opting for the LLC type of organization. This gives me heartburn, because we often take equity in these start-ups but we do not want to be a "member" of the LLC. We do not get involved in the choice of entity by the spin-off although they do often ask us our opinion. To the extent that we have an opportunity to influence this decision, does anyone have any advice to share? (Multiple responses to question.)

The only reason for a startup to take the LLC route is if the members are looking for the tax losses on their personal incomes in the first few years. Membership for an institution would be interesting.

You do an S or C corporation (usually C) because your rights in the company are generally fungible with cash, i.e. if you want to sell it's a straight up exchange of cash for equity. Makes the attorneys and tax counsel happier too. Add to it that any company with an eye to the public markets will eventually incorporate and the formation of the LLC is pointless.

The primary reason lawyers would advise against using an LLC form has to do with the fact that stock ownership legal issues are more settled (more case law to provide a basis for a court ruling) as opposed to those involving member units in LLCs (which is a relatively new form of business entity). As to the benefits to the founders (choosing between LLC vs. Corp.), there is no easy answer as demonstrated by the fact that there are very large complex LLCs out there and very small corps out there. Although it largely depends on the specific needs of the parties, I certainly would not suggest you write off an LLC just because it's owners have ownership interests that appear dissimilar to that of a corp. LLC interests can be as fungible as stock in a startup (which btw is generally NOT very fungible).

LLCs are considerably less costly to set up and you can generally start with a clean sheet of paper without being hamstrung into "traditional" structures and requirements, e.g., reporting requirements.

Another benefit that may apply here is the ability to structure the tax losses of early stage development against the parties that put hard cash into the LLC while the NPO has no particular interest in the tax write-offs.

While the S corporation's special tax status eliminates double taxation, it lacks the flexibility of an LLC in allocating income to the owners.

For example, the owner of 25% of an S corporation normally pays 25% of the taxes on reported income. On the other hand, LLC owners are free to divide income and tax liability among themselves within the constraints of IRS regulations for distribution of partnership income. Equal partners may change the allocations of profit or loss from year to year to benefit their individual tax needs.

In addition, LLCs have no ownership restrictions. An S corporation limits the number of owners to just 35 and prohibits corporate and foreign ownership.

Regarding the issue of being a "member," it is not a problem. There may be a desire not to be a "managing member" or a "manager" of the LLC, but being a member is really no different than being a shareholder - different words for comparable rights.

The most experienced and astute investors seem to rely heavily on the LLC. Even though an IPO is the exit strategy, it is well accepted that the LLC provides sufficient advantages in the early stages to start with an LLC and convert it into a C-Corp when the time is right. Most states are working on improving the "rollover" capability to C-corps as well.

The big downside that most attorneys will warn one about is that LLC is a state device and the risk is that other states may not recognize your state's LLC as you would like them to. Since they have now been around for a decade with interest and implementations only continuing to increase annually, probably not a serious concern. Also, most will have been rolled over prior to doing any serious transactions across state lines.

We just set up an LLC and there is not much difference, except there is no stock. The ownership interest entitles you to a pass through of whatever income there is distributed to the members. Note that there are different classes of members, such as voting and nonvoting, not to mention various ownership transfer rights, so you definitely want to have an attorney who knows LLC's to look at the agreement.

Note also that since there is no stock, there is no appreciation, nor is there something you can sell later on, so you either have to do a deal with royalties as well, or put language in your agreement that forces the LLC to distribute a certain amount or percentage of net to the members.

Otherwise the other members (who are usually the people running the company) can pay themselves \$1M a year and distribute nothing to the membership at large, so you would get zilch.

It's a clean sheet of paper at the start. If there are "different classes of members..., etc.," it is because the architect wanted to have those complexities. If you don't, then negotiate them out of the way.

A "member interest" is virtually identical to a share of stock. Write the LLC Operating Agreement so that there is a measurement system comparable to shares of stock. They can be called "Equity Units" or more appropriately "Member Interest Units." These are merely means of measuring change and shared ownership and valuation as new investors enter downstream. Everything can be made to look as much like a corporation share company as the architect wishes.

Dealing with dilution is far easier using such a measurement system than merely using percentages.

Again, if all eyes are directed towards making the company a C-corporation then why do anything other than set up a C-corporation? A VC will not invest in a company that isn't looking for entry in the public markets. The company may get sold before then, but the intent is to exit via IPO and cash in the chips.

In the context of a university-based startup funded by venture capital, it makes little sense to do anything but the C-Corp.

Faculties are as protected from personal liability in an LLC as they are in corporations. That is one of the key benefits of the LLC. The beauty of the LLC is that the tax losses can all be applied to the folks who put in the capital. Since they are likely to profits they seek to shelter (or their investors seek to shelter), then they generally appreciate an investment opportunity that allows them to do that concurrently with making a sound, albeit risky, investment. Faculty typically put in their IP and some time (and often get fees for their time). They generally are not seeking the tax sheltering effects. Again, this is the beauty of the LLC vs. corps.

At the end of the day, the business is selling IP to the best bidder. Although a bit brutish... "If you want to kill rats, feed them rat poison." If you want to attract quality VCs and "sophisticated" investors to your IP licenses, then be prepared to bend to their desires, interests, and needs.

10. What are the differences between the Dept of Commerce SBIR and STTR programs?

Department of Commerce -Small Business Innovation Program (SBIR) and Small Business Technology Transfer Program (STTR)

Criteria	SBIR	STTR
American owned & independent operation	Y	Y
For profit	Y	Y
Principal Investigator employed by company	Y	N or Y
Company size < 500	Y	Y
Phase I, \$ (can vary by agency)	<\$100K	<\$100K
Phase II, \$ (can vary by agency)	<\$750K	<\$500K
Phase III, \$	\$0K	\$0K
Duration of phase I	0.5 yr	1yr
Duration of phase II	2yr	2yr

Small business Administration (SBA) phone # 202 205 6450 or 1 800 382 4634 (<http://www.acq.osd.mil/sadbu/sbir>). Time or year for submission varies with agency.

Five agencies must reserve part of R&D dollars for STTR - Department of Defense (DOD), Department of Energy (DOE) Department of Health and Human Services (DHHS), National Aeronautical and Space Agency (NASA), and National Science Foundation (NSF).

Ten Agencies must reserve part of R&D dollars for SBIR - Department of Agriculture,

Department of Commerce (DOC), Department of Defense (DOD), Department of Education (DOE) Department of Health and Human Services (DHHS), National Aeronautical and Space Agency (NASA), National Science Foundation (NSF), Department of Transportation (DOT), Environmental Protection Agency (EPA), Department of Energy (DOE). In 1997 DOE received 1200 proposals and funded 200.

ACEnet - matching of angel capital with business needs to post for solicitation of capital business must complete small corporation offering of registration (SCOR) forms (basic elements of business plan) which are reviewed by state securities organization and be classified as Reg. A (<\$1M company) or Reg. B (<\$5M company).