CONNECT®

The UCSD Program in Technology and Entrepreneurship

Entrepreneur's
Anthology

Sponsored by a grant from the
University of California
Office of the President

This publication is primarily for the many small start-up companies UCSD CONNECT works with on a continuing basis: companies participating in the Springboard program; entrepreneurs taking the "How to Start and Manage a High-Tech Company" course; and companies receiving assistance through UCSD CONNECT's collaboration with the San Diego Manufacturing Extension Center.

The **Springboard** program was started to assist high-tech and biotech entrepreneurs who are in the early stages of developing a concept and strategy for a business. Successful applicants to the Springboard program are invited to make a presentation to a select group of UCSD CONNECT sponsors and members. This group will typically include a venture capitalist, accountant, corporate and patent attorney, marketing professional and an executive from a successful company in the same industry. Experts are also drawn from insurance, real estate, human resources and other areas as needed.

The goal of the Springboard presentation is to provide the entrepreneur with candid recommendations for the development of his or her business plan or concept and to help define the desired outcome of his or her efforts.

The **San Diego Manufacturing Extension Center** (SanMEC) is an independent, nonprofit organization affiliated with the Manufacturing Extension Partnership. SanMEC provides high quality, unbiased information and expertise using SanMEC center staff and well-established, successful community partners, such as UCSD CONNECT. SanMEC is part of a national network of manufacturing extension centers combining federal, state and local resources. SanMEC has partnered with UCSD CONNECT in order to enhance support services offered to very early stage manufacturing companies in San Diego County.

August 1997

Table of Contents

Table of Contents:

Introduction: Page 5

Section One: The Business Plan:

7
Why do you need a business plan? 8
Outline of the business plan 12
Sample business plan: Big Sky Technologies

Section Two: Raising Venture Capital:

Approaching a Venture Capital Finn 17
What are venture capitalists looking for? 18
Presentation do's and don'ts 19
Presentation Template 20
Stages of development in financing 23
Top Ten Things NOT to Say to a Venture Capitalist 24

Section Three: A Resource Anthology for Operations

Choosing your service providers 25
Intellectual Property Laws 26
Marketing Planning 29
Choosing a legal structure for your company 32
Protecting Your Corporate Status 33
The Human Resource Function 35
The IRS Guidelines for Independent Contractors 36
Insurance 39

Appendices

Local Organizations 41
Financing Alternatives 43
Comparison of Corporate Structures 46

Introduction

tough, competitive, healthy, competent, confident, hard-working, and socially adroit...

While there are no specific personality traits that can predict success as an entrepreneur, there are some characteristics that come up again and again when people describe successful entrepreneurs.

Are these characteristics markedly different from those of people who succeed in the corporate world? Not really. But the way in which they are useful in an entrepreneurial setting may be quite different.

What are the most noticeable differences between being an entrepreneur and working in the corporate world?

Time - No matter how hard you worked before, you will work harder as a business owner and operator.

Accountability - There is no one to share credit with, but conversely, no one to share blame with, either.

Risk - Risk covers everything from the potential embarrassment of failure to personal financial disaster.

Security - All the things you count on as an employee: a regular paycheck, health benefits; staff support. It's one of the reasons good health and high energy are requisite characteristics of an entrepreneur.

Feedback loop - Everyone needs a pat on the back sometimes, and sometimes we even need someone to tell us we're off base. Independence and internal motivation are helpful characteristics for an entrepreneur.

Sociability - They say it's lonely at the top, but it's also lonely when you're alone. The small daily interactions we take for granted in a corporate setting must be replaced with new types of sociability.

Level of support - Taking care of the basic logistics, such as copying, typing, and purchasing, can take away from your ability to run the company.

Identity - For some, for whom you work is part of your identity. "I'm with IBM," automatically tells others something about what you do for a living.

Lifestyle - The business is usually the primary commitment and while that is helpful for building a successful business, the personal costs can be high.

The same basic rules apply to anyone trying to start and run a business. This book is about what it takes to develop a comprehensive business plan, communicate effectively about your business in order to raise capital, and understand your financial and operating situation.

The book is organized into three sections: the business plan; raising capital; and a resource anthology for operations.

The Business Plan: Center of the Entrepreneur's Universe

1

Who will want to see your business plan? People who want to invest in you, have you as a client, or help you:

Banks
Potential investors
Potential strategic partners
Potential merger or acquisition partners
Customers
Suppliers
Distributors
Law firms
Accounting firms
Insurance firms

Why do you need a business plan?

To communicate clearly, both externally and internally, about your goals for the company and the course you are charting to success. Remember, you are communicating about your company, not your product. Every aspect of the operation must be examined by you, all potential questions must be answered by you, before you can skillfully communicate this information to others. The business plan is a powerful tool in clarifying business issues and setting goals and objectives.

Externally, you need a business plan to demonstrate to potential investors, customers and service providers that your ideas are sound and your projections are based on quantifiable research.

Internally, the business plan is key in attracting a strong board of directors and recruiting corporate management and staff. It creates a course for management to follow in the early years. In addition to setting goals and objectives, it establishes milestones and benchmarks to measure progress.

The business plan is a dynamic document. As the business develops, if underlying assumptions change or significant changes occur in the market, the business plan should be updated and modified to accurately reflect the changes.

A note about preparing a business plan: the length of the business plan should not exceed 35 pages; supporting data should be presented in appendices; be clear, a layperson should be able to understand what your product does and how. Make it look professional—pay attention to detail. Get feedback and use the feedback to modify the plan. Prepare and practice an oral presentation of your plan.

Business Plan Outline:

The Executive Summary —

Your classic one chance to make a good first impression. The Executive Summary should include:

- A compelling description of your business
- Market opportunities including market size, growth potential and segmentation
- Sustainable strategic competitive advantage and competitive differentiation
- Product strategy and positioning
- Description of the management team
- Financial projections for next 3-5 years
- Funding objective

Business History —

The history of the firm and its founders can help to position the company.

- When the company was founded
- Progress to date and description of founders' experience and roles
- The form of the organization (S Corporation/C Corporation/partnership)—summarize the classes of stock/shares outstanding
- Past investment in or loans made to company
- Strategic partnerships
- Management's investment
- Products or services the company has successfully marketed

The Product or Service—

Define exactly what you intend to develop and market.

- Describe any distinct benefits versus the competition
- Discuss legal protection obtained or applied for, such as patents or trademarks
- Detailed technical description of the product with drawings, etc.
- Any governmental/regulatory approvals/clearances needed

The Market—

A comprehensive description of current and future markets.

- Who are your customers?
- What is the rate of growth in your market segment(s)?
- Where, geographically, are your present and future markets?
- Exactly how you intend to sell and distribute to each market segment
- Who makes the purchasing decision in your customers' organization?
- How does each market segment purchase the product?
- What are the channels of distribution?
- Critical product characteristics - price, performance, reliability

The Competition—

Who are they? How big are they? What are their respective market shares? Why have they succeeded thus far?

- Competitors' strengths and weaknesses
- How do you intend to compete with them?
- How will they react to your entry into their marketplace?
- How will you react to their reaction?

Business Plan Outline Continued...

Manufacturing and Operations—

These are tangible things that need to be clearly described.

- Where and how do you plan to manufacture?
  i.e. local, offshore, direct, subcontract
- Will you need to expand manufacturing?
- If so, how, when, how much?
- Are there any manufacturing strengths or weaknesses?
- Your ability to reduce materials and direct manufacturing labor costs over time

Management—

Show the experience and competence of key team members, including the Board of Directors and Scientific Advisory Board.

- Job descriptions/compensation data/equity interests
- Detailed resumes for each key team member already in place
- Do you need any additional key team members?
  If so, what functions are missing? When do you plan to fill them and with what kind of person? How much will it cost?
- Show your planned management structure with an organization chart

Financial Projections—

Make sure to update your projections if market conditions change or other assumptions change over time.

- Years 1-3 should be detailed by month
- Years 1-5 should be detailed by quarter and year
- All major assumptions underlying your financial projections should be included

In order to estimate the total capital requirements over the first 3-5 years, an entrepreneur needs to be familiar with some basic accounting statements and principles:

Break-even analysis—The break-even point describes the sales volume or units of production needed to produce zero profit. In most start-up situations, this analysis offers a very simple, yet inexpensive method of making decisions related to pricing, staffing, marketing feasibility, etc.

Fixed and Variable Costs—Fixed costs are costs which remain constant regardless of sales volume. These include rent, insurance, salaries, interest and depreciation. Variable costs are costs associated directly with sales including cost of goods sold, freight, sales commissions, etc. Total cost equals fixed plus variable cost.

Cash Flow projections—A new enterprise must plan for its start-up financial needs by estimating cash flow month to month. Many enterprises take months or even years to operate in the black. You need approximately six to nine months of working capital to begin operations and to provide for emergencies.

Profit and Loss Pro-Formas—This is also referred to as the Income Statement. It depicts the results of your business operations during a period of time. The "bottom line" result reveals net profit (after taxes) or the magnitude of the loss.

Balance sheet—The balance sheet gives a static picture of your business at a given point in time. It includes the total assets, liabilities and net worth of your enterprise. The "current ratio" is derived from the balance sheet. This ratio consists of current assets divided by current liabilities. It serves to assess a company's ability to pay its debts promptly. Working capital is also derived from the balance sheet. It is calculated by subtracting current liabilities from current assets. Although it is possible for this number to be negative, financial analysts recommend having working capital in reserve as mentioned in the section on cashflow projections.

Appendices—

Include background data, market analysis, product analysis, and information that may provide a greater understanding of your business and the opportunity it offers.

Example of an Executive Summary

Big Sky Technologies, Inc.
Integrating the Computer and the Telephone

For millions of business professionals, computers and telephones play a crucial role in our daily communications. Telephones are used for voice messaging and computers are used for e-mail. Rarely are these devices interchangeable or these functions integrated. This results in inefficiency in an age when increased productivity is a goal and responsiveness creates a competitive edge. Now Big Sky's *unified messaging* products integrate the telephone and voice with today's computers and data network to significantly enhance communications in mobile workgroups.

Big Sky has targeted 30 million mobile professionals with a suite of products that enhance communications both in and away from the office. This group of users includes executives and business professionals who travel frequently and mobile workgroups such as sales forces who require continual communication with corporate offices, customers, and peers. Mobile professionals recognize the competitive advantage gained by being part of the workflow process anytime, anywhere.

Big Sky is delivering solutions to this growing market. *Unified messaging* offers the mobile professional compelling efficiency and productivity gains. Big Sky has been successfully selling its Remark! line of *unified messaging* products in the Lotus Notes market for over two years. The company recently introduced MaxMail, its line of *unified messaging* products for the I*net (Internet/intranet). Through its MaxMail product line, Big Sky intends to lead the transition by corporations and consumers from I*net e-mail to I*net *unified messaging.*

Unified messaging introduces several new paradigms to the user including the capability to:

a) Read e-mail over the phone

b) Listen to voice mail over the PC

c) Send voice messages over the I*net

Unified messaging is differentiated from today's disparate messaging systems in three significant ways:

a) Messages are processed from a **single mailbox** containing all e-mail, voice mail, and fax messages.

b) Messages may be sent, forwarded, or answered **in any medium**. For example, voice may be used to respond to an e-mail message, an e-mail message may be listened to in voice over the telephone, or an e-mail message may be forwarded to a fax machine.

c) Messages may be **accessed anytime, anywhere** from a desktop PC, a portable multimedia notebook, or from a cellular or ordinary telephone.

Unified messaging is emerging as the next generation of electronic messaging. Industry analysts believe that the *unified messaging* market will become a multi-billion dollar market within five years. Rapid market growth will be supported by:

Advances in technology resulting in the widespread usage of low cost multimedia notebooks, pagers, digital cellular services, and personal communication devices.

The transformation of the I*net to an e-mail and voice messaging network.

The growth of I*net messaging as a means of communication for millions of users.
Big Sky has a strong management team in place and presently has over 250 customers using its products, including many Fortune 500 companies. The company has been generating revenue in the Notes marketplace for over two years and has established a leadership position in Notes-based *unified messaging*. Big Sky, through the MaxMail product line, is now focused on establishing a similar position in the I*net *unified messaging* market.

Financial Projections December 31 ($000)	1997	1998	1999	2000	2001	2002
Unified Messaging Products	$1,300	$2,500	$5,500	$10,000	$20,000	$40,000
Telephony Server Products	1,000	1,400	2,000	4,000	6,500	10,000
Engineering Services	430	600	1,000	1,500	2,000	2,500
Software Maintenance	120	400	700	1,500	3,500	7,500
Total Sales	$2,850	$4,900	$9,200	$17,000	$32,000	$60,000
Net Income	($169)	$198	$874	$1,496	$2,445	$5,956

Use of Proceeds

To achieve the company's five year revenue goals, Big Sky must accelerate the product development of *unified messaging* products for the I*net and aggressively expand sales and marketing. Big Sky is seeking $1.5 million of equity capital to fund these efforts.

The use of the proceeds is as follows:

Sales and Marketing	$.5 million
Product Development	.5 million
Working Capital	.5 million
Total	$1.5 million

Example of an Executive Summary Continued...

Shareholders

Big Sky Technologies has 2,354,546 shares of common stock and 1,390,000 shares of preferred stock outstanding. A summary of shareholders follows:

Shareholder	Common	Preferred	% Outstanding
William Doll	1,452,889		38.8
Other Big Sky Employees	225,971		6.0
Outside Shareholders	675,686		18.1
Private Investor		1,000,000	26.7
Local Company		390,000*	10.4
Total Outstanding	2,354,546	1,390,000	100.00
Warrants and Options	520,000		
Fully Diluted Total	2,874,546	1,390,000	

* Non-voting, no Board representation, convertible upon Initial Public Offering only.

Professional Services

Accounting:	Nation Smith Hermes Diamond, P. C.
Legal:	Pillsbury Madison & Sutro
Investment Banking:	Flemming & Lessard

Management Biographies

William J. Doll, President and CEO. Mr. Doll became President & CEO in December, 1994, when Big Sky Technologies was spun out of Simpact, Inc. Mr. Doll founded Simpact in 1972 and grew the company to $25 million. Prior to founding Simpact, Mr. Doll held management and technical positions in several companies including Bell Telephone Laboratories, Foxboro Company, General Electric, and Systems Engineering Laboratories. Mr. Doll has 35 years of experience in the software industry. He graduated from Rutgers University in 1964 with an A B. degree in Mathematics and completed two years of graduate study at Stevens Institute of Technology in Applied Mathematics.

Mark Bannon, Vice President, Sales & Marketing. Mr. Bannon brings more than 15 years of sales and marketing experience to Big Sky. He came to Big Sky from Cayman Systems, where he was Vice President of Sales, Marketing, and Technical Services. Prior to Cayman Systems, he was with Banyan Systems as Northeast district manager. Before joining Banyan, he worked as Eastern regional manager of Syntrex, Inc., a national systems integrator for large-scale internetworking systems. He holds a B.S. degree in Business Administration with a double major in Marketing and Finance from American International College.

Tom Krier, Product Operations. Mr. Krier is responsible for all aspects of product marketing, engineering, and customer support for Big Sky's voice and telephony products. He also oversees product testing and production. Mr. Krier was a key member of the original team that launched the Remark! product line. Mr. Krier joined Simpact in 1985 as a systems engineer developing communications connectivity and security products. Prior to joining Simpact, Krier was an engineer with General Dynamics' Space Systems Division. Mr. Krier graduated with honors in 1982 from South Dakota State University. He holds a B.S. degree in Electrical Engineering.

James B. Reeg, Chief Financial Officer. Mr. Reeg has responsibility for all financial matters including accounting, financial reporting, and financial forecasting. Mr. Reeg has been associated with Big Sky since its inception as a subsidiary of Simpact, Inc. Since 1984, Mr. Reeg has been the Vice President of Administration and Chief Financial Officer for Simpact. Prior to joining Simpact, Mr. Reeg held several high level financial positions with General Atomics. He holds a B.S. degree in Accounting from San Diego State University and has completed both the Certified Public Accounting (CPA) and the Certified Managerial Accounting (CMA) exams.

Board of Directors: William J. Doll, Big Sky; James B. Reeg, Big Sky; John C. Belden, Octus.

UCSD CONNECT would like to thank Big Sky Technologies, Inc. for permission to use material from their Business Plan to illustrate a good executive summary.

Raising Capital: The Art of Venture Capital and the Science of Financing 2

Approaching a Venture Capital Firm

There are many different ways to finance a start-up company. This discussion will focus primarily on raising venture capital.

It is important to remember that investors tend to bet on the jockey rather than the horse. Management is extremely important to an investor. A good business plan poorly executed will almost always fail.

When approaching a venture capital firm with a business plan, make sure to include a statement spelling out the offer, the exit, and uses of capital. This statement clearly communicates what you intend to do with the financing, how long it will take to do it, and when the investors will receive the return on their investment.

Another form of private investment is "angel" investment. Angel investors are typically wealthy individuals with significant business experience. In addition to financial support, their business experience and advice can be of great value to the companies in which they invest. Angel investors tend to fund start-up companies which venture capitalists consider too small for investment. They provide seed capital, usually under a million dollars.

There is a summary of financing alternatives in the appendices.

"Anytime you talk to people—especially a group of people—you're by definition projecting an illusion. You're projecting the illusion that you're talking to each one of them individually. So you've got to picture in your mind what the conversation would be like if it was just with one person..."

Josh Boger, Chief Scientist and CEO, Vertex, from the book "The Billion-Dollar Molecule," written by Barry Werth, published by Simon & Schuster, 1994

What are venture capitalists looking for?

"(Boger's) main device, though, was a strenuously rehearsed spontaneity. As he spoke, Boger listened intently to his own words, then quickly anticipated the questions of those in the audience and tried to answer them matter-of-factly in the next sentence or two...he did it so well that it allowed him to give the same talk over and over again, never once the same, without the slightest trace of boredom."

from "The Billion-Dollar Molecule"

Approaching a Venture Capital Firm

What are venture capitalists looking for?

Ideally, venture capitalists want a certain return on investment within a certain range of time. One example would be a 10x return on investment in 3-5 years. Venture capitalists want a high rate of return due to the high risk invoved with investments in start-up companies.

From the venture capitalist's perspective your company should offer:

- A high rate of return
- The potential for a "home run"
- Seasoned management
- High barriers to competition (patents)
- No regulatory delays
- Reasonable exit strategy

Earmarks of a good product/market idea:

- Proprietary (patentable) products
- Focus on large niche market, i.e. $1 billion in size over 10 years
- Reasonable investment required with an exit IPO/sale in 5 years to realize returns
- Market penetration strategy must be clear, competitive price possible
- Capable, professional management team

Propositions that won't fly:

- Technology in search of a market (most never find one)
- A technology with too many markets
(marketing costs are too high)
- A "me-too" idea in a crowded market (no clones)
- An applications-heavy technology (custom vs. standard)

- A good idea ahead of its time
(can't wait for market to catch up)
- Many products to many markets
(thinking "one must succeed")

Contrasts between internally funded growth and venture backed growth:

Internally funded growth	*Venture-backed growth*
Very high risk, no access to capital	Access to capital lowers risk
Slow R&D-often lagging market	Rapid R&D to catch window of opportunity
Slow growth-1-20% per year for years	Rapid growth in value and sales penetration
Can't attract "A" players for management-owner makes all decisions-control issues	Rapid formation of team-shared responsibility and risks
Won't give up stock-no exit plan-owners control the equity	Planned public exit to realize value-everyone shares in benefits

Making Presentations:

Be prepared to tell your story to anyone and everyone. You will make many presentations while you are getting your business going and looking for capital. Anyone who has an interest in your company, whether as a customer, service provider or investor, will want to hear you explain your business. You are the personification of your business plan—you bring it to life.

Presentation Do's and Don'ts

Do have a strong, canned opener

Introduce yourself, your company and your product immediately. Here are some sample opening lines:

"Good afternoon, thank you all for being here. My name is John Glimpsher, I'm the CEO of Glimpsher Gizmo Incorporated, and we make infindibulators. Here's a slide showing one of our infindibulators and what it does..."

"Good morning, I'm Jill Smith, president of Artificial Industries. We make a series of Artificial Flanges that are over 30 times more efficient than the competition. This picture shows one in operation..."

Approaching a Venture Capital Firm Continued...

Do assume a general knowledge of your industry

Don't say, "the telecommunications industry is huge"—they know that. Instead, explain exactly in which part of the industry you are a player.

Don't assume a general knowledge of your product

Explain exactly what your product is and what it does in simple, one-syllable words.

Don't tell them—show them!

Don't tell them, for example, "we have an exciting opportunity." Do show them the size of the potential market and let them decide it's exciting. Don't tell them "we have a world-class management team." Do show them your credentials and let them decide that you are qualified.

Don't "open with a joke"

Jokes may confuse your audience—what if they Don't "get" the joke? Also, a joke runs the risk of falling fiat, which will set a negative tone for your entire presentation.

Presenting Skills

Stance:
Stand with your feet planted squarely
Let your hands do the talking!
If speaking from a podium, do NOT grab the podium

Eye Control:
Look from person to person: three beats each, then move on—
make eye contact with everyone in the room
Why? Makes it a natural conversation *with* individuals, not *at* a group
Also: it wakes people up!

Energy:
Let your energy be expressed through your hands
Gestures will communicate excitement and ideas
Be excited—let your nervousness show as excitement
Your audience will only be as excited as you are!

Overheads

Keep it simple. Use bullet points and graphics. NO paragraphs or spreadsheets

- No more than six bullets per slide.
- Use cryptic expressions—limit of three to five words per bullet. This will eliminate the temptation to read to your audience.

- Turn and touch the visual, turn and talk to your audience. This keeps you from staring at the visual aid too long.
- Don't forget to use pictures or photographs.
- YOU are the best visual aid...explain...interpret!

Suggested Slides for Presentation:

Slide "0": Company Name

Note: this slide is up before you begin speaking, while people enter the room. It helps to remind them of who you are and what the meeting is about.

- Show the company name and logo (if there is one).
- A brief motto explaining what you do.

Slide 1: Product

- What is the product? Show a picture or photo, if possible, or a diagram. REMEMBER: it's obvious to you, because you know it so well, but if you don't make it obvious to your audience NOW in the first 30 seconds, you'll lose them and the rest of your presentation will be wasted.
- What is patented or proprietary about the product?
- Why can't just anyone do this? ("barrier to entry")
- DO NOT explain the technology in detail!

Slide 2: Customers

- Who are your customers?
- What is better about your product from their point of view? ("end-benefit")
- What is the quantifiable dollar benefit to your customer of buying your product?
- How will you reach them? What is your channel of distribution?
- What is the price of your product and how did you arrive at that price?

Approaching a Venture Capital Firm Continued...

Slide 3: Market

- What is the total size of the relevant market in units? In dollars?
- How is it broken up, or segmented? Use a pie chart.
- What is the projected size of the market in 3-5 years? Venture capitalists will want to see at least a $100 million market.
- What is driving this growth?
- Using your planned distribution strategy, show how you will reach x customers at a cost of y, thereby selling z units and making big $$$.
- DO NOT simply say: "we expect a market share of____%."

Slide 4: Competitors

- What is your competitive advantage?
- Who are your competitors?
- What are your competitors strengths and weaknesses?
- If you have no direct competition, explain what you will do when it inevitably arises.

Slide 5: Financials

- Show a bar-graph of sales-to-date (if applicable) and a 5-year sales projection. (no spreadsheets please!)
- How much money do you need? Name a single amount.
- Show a breakdown of the projected use of funds.
- Identify major hurdles and risk stepdown points. What is total investment and total value at each?

Slide 6: Alliances (if appropriate)

- Identify strategic alliances already formed and those needed.

Slide 7: Management Team and Advisory Board

- List the individuals on your management team and/or advisory board and give a brief resume for each. Use this format:

Bob Smith, Vice President	former CEO of XYZ Technologies
Jane Jones, Marketing	grew ABC Widgets to $100 million in sales

Other Considerations:

Location makes a difference—most venture investors like to be within a certain geographical range of the companies they work with so interactions, such as board meetings, are convenient.

Fit or affinity—most venture firms focus on areas where their partners have expertise. Make sure the firm is interested in your type of business.

Stage of development—different firms may focus on different stages of development. The stages of development and the levels of financing are:

Initial/seed—a relatively small amount of capital provided to an inventor or entrepreneur usually to prove a concept. It may involve product development, but rarely involves initial marketing.

First round—financing provided to companies that have expended their initial capital and require funds to initiate commercial manufacturing and sales.

Second round—working capital for the initial expansion of a company that is producing and shipping and has growing accounts receivable and inventories. Although the company has clearly made progress, it may not yet be showing a profit.

Third round—funds provided for the major growth of a company whose sales volume is increasing and that is beginning to break even or turn profitable. These funds are typically for plant expansion, marketing, and working capital for the development of an improved product.

Follow-on—a subsequent investment made by an investor who has made a previous investment in the company—generally a later stage investment in comparison to the initial investment.

Buyout—funds provided to enable operating management to acquire a product line or business, which may be at any stage of development, from either a public or private company.

Secondary purchase—purchase of stock in a company from a shareholder, rather than purchasing stock directly from the company.

Bridge/Mezzanine—financing for a company expecting to go public, usually within six months to a year. Often bridge financing is structured so that it can be repaid from proceeds of a public underwriting.

IPO—an initial public offering, a company's first offering of stock to the public.

State of Fund—Venture capitalists themselves raise money for "funds" to invest. Typically it can take three to three and a half years to fully invest all the money in a fund. At this time, the partners will decide whether or not to raise a new fund. Make sure the firm you are approaching has money available that has not been committed to other investments.

Track Record—Make sure you know something about the success rate of the companies in which the venture firms have invested. Since venture capitalists tend to become involved with the company's management, the overall success of the company can reflect on their expertise.

Getting through to a venture capitalist—A referral by a respected business associate will always improve your chance of getting a face-to-face meeting. The first visit will most likely be one-on-one. This partner will be your champion with the other partners. This partner is screening you and your idea and is attempting to screen you out. In a group presentation to the partners, the company CEO should be the person who presents. After this point, an investment decision will be made.

Top Ten Things NOT to Say to a Venture Capitalist:

1. I don't care if we ever make money as long as my idea gets to market.
2. I'd like your money, but I sure don't want you on my Board of Directors.
3. I don't think my former employers will ever sue me for taking this technology from them.
4. Anyone who doesn't know how an MI can be positively affected by a glycosolated peptide that is ammindated at the C-teminosus has got to be an idiot!
5. Once I have my own company, I can spend all the money I want.
6. You take the stock, I want a good cash salary because it's less risky.
7. Present to all your partners? If they want to know about me, they'll have to fly down here.
8. I'm no lawyer, but I sure know about Chapter 11 filings.
9. No matter how we price the stock, I've promised my brother that he'd always own 10% of the company.
10. I sure don't want to spend any of our money on lawyers and accountants.

From a presentation by Timothy J. Wollaeger, General Partner, Kingsbury Associates

A Resource Anthology for Operations

3

Even entrepreneurs need help sometimes!

"Work with service providers who are experienced in working with new companies. When someone we know comes to us and says, 'I've been working with this company and I think it's worth a look,' we look. Choosing your attorney, choosing your banker, choosing your accountant, these are really important decisions because they can help provide avenues to financing."

Bill Stensrud, Partner
Enterprise Partners

The thrill of a discovery, the elation of actually starting a business..after the stardust settles, there are operational issues that must be dealt with in an organized and professional manner. Where do you start? Who can help you?

You're lucky if you start a business in San Diego. There are many firms in San Diego—some national, some local—which specialize in helping new companies get on the right track.

In this section there is information on some of the most important issues you will need to address in order to conduct your business in accordance with generally accepted practices and protect your inventions and ideas.

The information is presented in the broadest possible terms. It is not meant to be used as specific advice for your business but rather as a guideline and an example of some of the operations issues every company faces.

When you begin to look for service providers, think of them as part of your team. Give it the same consideration you would give bringing a new senior-level employee on board. Interview different companies, ask questions, choose carefully. These relationships will be extremely important as you begin the quest for capital. In some cases, the service providers you work with—attorneys, accountants—will be your best reference.

Don't forget that operational issues are management issues. Time spent doing marketing planning, or setting up human resource systems will pay off in the long run through fewer crises and fewer surprises.

Intellectual Property

Intellectual property rights are an asset and need to be protected. Intellectual property laws are a set of laws which provide certain rights to intangible products of the mind. Understanding what kind of intellectual property you have, and protecting it, will help you commercialize and add value to your business. Patents help to attract investors and enable you to license others to manufacture or market your invention.

The principal intellectual property rights are:

Patents: a patent protects inventions or ideas and provides the patent owner the right to exclude others from making, using and selling the claimed invention in the United States.

Basic criteria for patentability:

Novelty—the invention must be novel or new.

Nonobviousness—the difference between the new invention and the "prior art," or known technology, must not be obvious to one with ordinary knowledge of the art.

There are two important types of patents:

Utility patents:

- Utility patents protect inventions or discoveries of any new and useful process, machine, manufacture, composition of matter, or any improvements to any of those.
- In the United States, a utility patent based on an application filed on or after June 8, 1995 has a term of twenty years from its filing date.

Design patents:

- Design patents cover new, original and ornamental designs.
- A design patent has a term of fourteen years from its issue date.

Trademarks: a trademark is any word, symbol, name, or device used by a manufacturer to identify his or her goods or services to distinguish them from those of others.

- Trademarks signify the source and associated quality of products or services to a consumer and when enforced can prevent misappropriation of a company's goodwill or reputation.
- Trademark ownership is generally established by the first use of the trademark in interstate commerce.
- Registration is not required but it is advisable because it gives notice to others of ownership. Registration alone does not ensure protection of the trademark.
- Trademark rights can be lost through misuse. The owner of a trademark has an affirmative duty to prevent misuse of the trademark by his or her own company or by third parties. Failure to prevent use by others can result in the loss of trademark rights.
- Trademark owners must also prevent the use of "confusingly similar" marks by others.
- If correctly managed through policing the use and filing periodic renewals of the registration, a trademark can continue for an indefinite period.

Copyrights: copyrights prevent others from copying such "writings" as computer programs, books, musical compositions, artworks, and dramatic works, etc.

- A copyright protects only the means or manner in which an idea is expressed and not the underlying idea itself.
- In the U.S. and in most foreign countries, a copyright arises the moment a work is first fixed in a "tangible" object.
- No registration is required in order to obtain a copyright in a work of authorship. Although copyright protection commences with the creation of a work in the United States, an action cannot be brought for copyright infringement of works first created in the U.S., unless the copyright bas been registered.
- A copyright lasts for the life of the author plus fifty years. For corporate copyright owners, copyright lasts for seventy-five years from the date of first publication/distribution to the public or one hundred years from the date of creation, whichever is shorter.

Intellectual Property Laws Continued...

Trade secrets: A trade secret is any formula, pattern, device or compilation of information which is used in one's business and which confers an advantage over competition who do not know or use it.

- Trade secrets can include programs, documentation, know-how, basic algorithms and even non-novel information of value to the owner, such as databases.

- Trade secrets can be protected against the unauthorized disclosure or use of confidential information whether by former employees, direct competitors, confidential disclosures breaching a contractual obligation or anyone else.

- The law requires that the owner of a trade secret take reasonable steps to maintain the confidentiality of the secret in order to obtain trade secret protection. Trade secret protection can continue indefinitely as long as the information does not become generally known.

The Marketing Plan

Many aspects of a marketing plan may seem very similar to the business plan. Think of a business plan as a roadmap for building a company, especially for raising capital, and the marketing plan as the roadmap to creating revenue for the company through understanding and effectively reaching your customers.

The marketing concept is based on the importance of customers to a firm. To use the marketing concept, entrepreneurs should:

- **Determine the needs of their customers through marketing research**
- **Analyze their competitive advantage through marketing strategy**
- **Select specific markets to serve through target marketing**
- **Determine how to satisfy those needs through the marketing mix**

Market research is an orderly, objective way of learning about people. According to the American Marketing Association, marketing research is the "systematic gathering, recording, and analyzing of data about problems relating to the marketing of goods and services."

Marketing strategy encompasses identifying customer groups or target markets which your business can serve better than other companies. Good marketing strategy implies that no business can be all things to all people and that the marketing focus should be on the target market it can serve best.

Target Marketing is simply concentrating on segmenting the market to make the best use of marketing resources. The major ways to segment a market are:

geographical segmentation—developing a loyal group of consumers in the home geographical territory before expanding into new territories

product segmentation—extensively promoting existing best-selling products and services before introducing a lot of new products

customer segmentation—identifying and promoting to those groups of people most likely to buy the product

The marketing mix combines the four key marketing decision areas in a marketing program. The four areas are: **products and services; promotion; price; and distribution.**

Products and services—effective product strategies may include concentrating on a narrow product line, developing a highly specialized product or service or providing a product-service package containing an unusual amount of service

Promotion—This area includes advertising, salesmanship, and other promotional activities.

Price—determining price levels and/or pricing policies (including credit policy) is the major factor affecting total revenue. Generally, higher prices mean lower volume and vice-versa.

Distribution—the company must decide how to distribute its products. Working through established distributors or manufacturers' agents generally is the most feasible for small manufacturers.

After marketing program decisions are made, owner-managers need to evaluate how well decisions have served the company. Standards of performance need to be set up so results can be evaluated against them. Sound data on industry norms and past performance provide the basis for comparing against present performance.

Sample Marketing Plan Outline

Mission statement—one or two lines that describe the chief function of your business and identify your customers and specific attributes of your businesses that address customers' needs.

I. Market Analysis

A. Target Market
   1. Definition of your customer
      a. who makes purchasing decision in your customers' organization
   2. Location of your customer
      a. local/regional
      b. national/international

B. Overall Industry Trends
   1. Types of products/services offered
   2. Price range
   3. Successful distribution methods

C. Specific Competition
   1. Products/services
   2. Quality of products/services
   3. Customers served

D. Competitive Products/Services Comparison
   1. Strengths
   2. Weaknesses
   3. Price position

II. Strategy

A. Detailed positioning statement
   1. Specific product/service description
   2. Price/quality of product/service
   3. Distribution methods/business location

B. Promotion
   1. Advertising
      a. Specific media
   2. Public relations
      a. Public speaking engagements
      b. Educational seminars

C. Budget (percentage of projected sales)
   1. Percentage for advertising
   2. Percentage for public relations

The Legal Structure of Your Company

There are a number of options available for the legal structure of your business as outlined below. There is a comparison chart in the appendices showing additional information.

Sole Proprietorship

Sole Owner
Unlimited liability
Profits are yours
Taxed as personal income
Few organizational costs
Easy to end

General Partnership

Two or more owners
Liability—unlimited, joint and several
Joint control—partnership agreement
Taxed as personal income; flexible in allocations
Low organizational costs
Easy to end, difficult to divide assets

Limited Partnership

Two or more owners
Unlimited liability for general partners
Limited liability for limited partners
Managed by general partner(s)
Profits distributed per agreement
Very high organizational costs
Difficult to end; difficult to divide assets

Corporation

One or more shareholders each with limited liability
Day-to-day control by the Officers, elected by the Board of Directors, elected by the shareholders
Investment and profits determined by shares
Corporate tax rate
High organizational costs
Difficult to end; difficult to divide assets

S-Corporation

Same as a C-Corporation except that profits are treated as having passed through to shareholders who are taxed at individual rates.

Limited Liability Company

Two or more owners (if California LLC)
Limited liability for members
May elect to be taxed as personal income (if requisites met)
Managed by one or more members or an outsider
Flexible allocations
High organizational costs
Easy to end; difficult to divide assets.

Some Practical Advice on Protecting Your Corporate Status

Your corporation has an identity and existence separate from you and you must take certain steps to ensure this corporate separateness. Failure to do so could result in the Corporation being disregarded by both the Internal Revenue Service, which could result in tax complications, and by third parties who could assert personal liability against you.

Do not intermingle your personal funds with those of the Corporation.

Personal expenses may not be paid with corporate funds. Consult your accountant about "perks" which are utilized for both business and personal purposes, regarding the allocation of expenses and the possibility that these "perks" could be considered income.

Do not informally borrow money from the Corporation.

Any loan made to you or any other corporate employee must be approved by the Board of Directors and be properly documented by an enforceable written instrument, preferably a promissory note. Similarly, personal loans to the Corporation should be documented and approved by the Board.

Make certain your customers/clients know they are dealing with a corporation.

All stationery, billings, signs, listings, etc. must bear the corporate name. Only individuals who have been authorized by the Board should sign documents on behalf of the Corporation and they should always note their position with the Corporation on those documents. If you lead someone to believe they are dealing with an individual rather than a corporation, you may ultimately be held personally liable.

Have the Board of Directors approve all major corporate transactions.

Under California law, the Board is responsible for the operation of the Corporation. The execution of contracts, leases, significant purchases, the employment/termination of significant employees, etc. should be approved by the Board before the action is taken or ratified by the Board after the fact.

The Corporation must hold annual meetings of its shareholders.

The shareholders should meet and vote on necessary corporate matters every year. These meetings should follow the guidelines set forth in the Corporation's bylaws and articles of incorporation.

At a minimum, the Board of Directors must meet annually.

The Board of Directors should meet at least once annually, in accordance with the Corporation's bylaws and articles of incorporation. Minutes or written consents should accurately describe the actions taken and should authorize corporate officers to implement those actions.

Some Practical Advice on Protecting Your Corporate Status continued:

You cannot, under any circumstances, issue new stock or transfer existing shares of stock in the Corporation without complying with the California Corporate Securities Law of 1968.

The Corporate Securities Law of 1968 is broadly applied and strictly enforced. The definition of security includes not only stock, but partnership or joint venture interests and loans that will later be converted into stock and even certain promissory notes.

All tax returns should be carefully prepared and filed in a timely way.

The Corporation will receive an employer identification number that should be used on all corporate returns filed with the Internal Revenue Service. You should consult your accountant regarding which state and federal tax reports are required.

The Corporation must file an annual information statement with the California Secretary of State.

This statement sets forth the names and addresses of its officers and directors and the address of its principal office. An agent for service of process must also be named in this statement. The statement must be filed by the end of the calendar month of the anniversary date of incorporation.

It is important that the Corporation be sufficiently capitalized.

Corporations which are thinly capitalized are more likely to be viewed as mere "corporate shells," thereby losing their capacity to shield you from certain personal liabilities.

From a presentation made by William W. Eigner
an attorney with Procopio, Cory, Hargreaves & Savitch

The Human Resource Function

There are significant reasons why small businesses and start-up companies should establish a human resource function immediately:

To make sure the company is in legal compliance with government regulations:

Some specifics in regard to legal compliance: Equal Employment Opportunity; Americans with Disabilities Act; Family Leave Act; ERISA; Unemployment Claims; Workers' Compensation, and the INS.

To help create the infrastructure of the company in an orderly and efficient manner:

Creating infrastructure provides a framework to: streamline the employment process; develop salary structures and compensation administration; establish guidelines and procedures/employee handbook; begin keeping personnel records; start a performance management system; formalize employee communications; and institute employee training and development programs.

To help establish the company's values and culture:

Using the human resource function will help establish the company's values and culture by: defining the nature of your company; setting expectations about the employment relationship; positioning management's relationship with constituents; establishing and communicating management's vision; and structuring and communicating management's business model.

How should you manage the HR function in the beginning? Outsourcing is currently a popular method, as is using individual consultants, using fill service organizations, and using industry associations.

Initially, an entrepreneur may choose to do everything for himself or herself, or use family and friends when needed. The decision to hire employees makes the business more complicated. In addition to having a payroll to meet, an employer must prepare and file federal and state unemployment taxes, Social Security taxes, and withhold income tax from wages. An employer must also comply with employee health and safety laws, workers' compensation laws, antidiscrimination laws, U.S. immigration laws, and all government regulations relating to employees.

In many cases it may be an advantage to hire an independent contractor to perform certain services. However, there are stringent IRS rules that govern the use and definition of an independent contractor.

The IRS uses a 20-factor test to evaluate whether or not a person is an independent contractor:

	Yes = Employee	No = Independent Contractor
Instructions: Is the worker required to comply with instructions about when, where, and how he or she is to do the job? *The right to give instructions rather than whether the employer actually gives the worker instructions is determinative.*	❑	❑
Training: Does the worker receive training from the employer?	❑	❑
Integration: Is the worker integrated into the operations of the employer? *If the services of the worker are necessary for the continuation or success of the business, the worker is generally integrated into the operations of the business.*	❑	❑
Services Rendered Personally: Is the worker required to render his or her services personally?	❑	❑
Hiring, Supervising, and Paying Assistants: Are any assistants required by the worker hired by the employer? *If the worker hires assistants at the direction of the employer, the employer may be considered to be indirectly hiring the assistants.*	❑	❑
Continuing Relationship: Is there a continuing relationship between the worker and the employer? If the arrangement with the worker contemplates continuing or recurring, the relationship is permanent even if the services are part-time, seasonal or of short duration.	❑	❑

	Yes = Employee	No = Independent Contractor
Order or Sequence Set: Does the employer set the order or sequence of the services to be performed?	❑	❑
Oral or Written Reports: Does the employer require the worker to submit regular oral or written reports?	❑	❑
Payment by Hour, Week, Month: Is the worker paid by the hour, week, or month rather than by commission or by the job?	❑	❑
Payment of Business or Travel Expenses: Does the employer pay the worker's business or travel expenses?	❑	❑
Furnishing of Tools and Materials: Does the employer supply tools and materials to the worker?	❑	❑
Significant Investment: Has the worker failed to invest in facilities (such as an office) used to perform services?	❑	❑
Realization of Profit or Loss: Does the arrangement prevent the worker from realizing a profit or suffering a loss?	❑	❑
Working for More Than One Firm at a Time: Does the worker perform services primarily for one employer rather than working for several employers at one time?	❑	❑
Making Services Available to the General Public: Does the worker not make his or her services available to the general public?	❑	❑

IRS uses a 20-factor Test for Independent Contractors Continued...

	Yes = Employee	No = Independent Contractor
Right to Discharge: Does the employer have the right to discharge the worker? *Since employers rarely have complete flexibility in discharging an employee, the inability to discharge a worker, by itself, is not persuasive evidence that the worker is an independent contractor.*	❑	❑
Right to Terminate: Does the worker have the right to terminate the relationship at any time without incurring liability? *The presence or absence of limits on a worker's ability to terminate, by itself, does not constitute useful evidence in determining a worker's status.*	❑	❑
The following three factors should be given little weight in determining a worker's status:		
Set Hours of Work: Does the employer require the worker to work specific hours?	❑	❑
Full Time Required: Does the worker devote substantially full time to the employer?	❑	❑
Working on the Employer's Premises: Does the worker work on the employer's premises or at a specific location designated by the employer?	❑	❑

The fact that more than half of the factors may point to one result does not necessarily mean that this is the correct determination; rather, *all of the facts must be analyzed to determine whether certain factors may be more important than others under the particular circumstances.*

IRS Classification Factors taken from University of California Independent Contractor Pre-Hire Worksheet.

Insurance

Insurance is a complex subject which requires professional advice. A qualified agent, broker or consultant can explain the various options and recommend the right coverage. However, before you consult your agent, you should have a protection plan in mind.

- Write a statement of what you expect insurance to do for your company.
- Select an agent who can provide advice as well as sell insurance.
- Develop an insurance budget, but be realistic about what you need and be careful not to underinsure.
- Study insurance costs. Investigate umbrella coverage.
- Once you have purchased insurance, review it periodically to make sure coverage is adequate and your premiums are cost efficient.

The purpose of insurance is to minimize your risks and protect your business. The term "risk management" is often used in discussions of insurance. Risk management is a planned approach by company owners to avoid losses of assets or earning power. Risk management consists of more than insurance policies. For example, risk can be reduced by establishing internal controls such as an adequate inventory control system, cash reconciliation system, employee safety program, a security system, etc.

Types of insurance:

- Property insurance:
  - Fire Insurance
  - Auto Insurance
  - Theft, burglary and robbery insurance
  - Fidelity bonds
- Liability insurance:
  - Product liability insurance
  - Professional liability insurance
- Health, Disability, and Life insurance
- Workers' compensation
- Other types of insurance:
  - Business interruption insurance
  - Bad debt insurance (credit insurance)
  - Glass insurance
  - Boiler and machinery insurance

Local Organizations

There are an ever-increasing number of agencies and organizations to help you with starting a business in San Diego. The following is a listing of organizations you can contact with questions or requests for information:

UCSD CONNECT
Links high-tech and biotech companies with the resources they need to succeed.
(619) 534-6114
www.connect.org/connect
e-mail: connect@ucsd.edu

San Diego Manufacturing Extension Center (SanMEC)
Serving small area manufacturers with technical and marketing assistance.
(619) 515-9820
e-mail: sanmec@sanmec.org

Small Business Development Center, San Diego Chamber of Commerce
Provides free seminars, training programs, consulting and library resources, to small businesses in Northern San Diego County.
(619) 453-9388
www.smallbiz.org
e-mail: sbdc@smallbiz.org

Small Business Development & International Trade Center at Southwestern College
Provides free seminars, training programs, consulting and library resources, to small businesses in Southern San Diego County.
(619) 482-6391
www.sbditc.org
e-mail: bernie@sbditc.org

Service Corps of Retired Executives (SCORE)
SCORE is a volunteer arm of the SBA, providing office and on-site counseling to small companies, including workshops and a resource library.
(619) 557-7272

American Electronics Association
Membership organization dedicated to supporting the efforts of U. S. electronics companies to be world-class competitors.
(619) 452-9288

BIOCOM/San Diego
Regional association for the healthcare technology and bio-agriculture industries.
(619) 455 0300
www.biocom.org

Foundation for Enterprise Development
Nonprofit organization that fosters the development of employee ownership.
(619) 459-4662
www.fed.org/fed/

Software Industry Council
Membership Organization supporting the growth of San Diego's software industry.
(760) 930-9163
www.sdsic.org

San Diego Economic Development Corp.
Focuses on building the regional economy. Offers free consulting services and programs.
(619) 234-8484
www.sdedc.com

Local Organizations Continued

MIT Enterprise Forum
Organization helping technology businesses in San Diego through using presentations and feedback.
(619) 236-9400

San Diego Venture Group
Membership organization focused on the use of venture capital to finance business growth.
(619) 272-1985

Small Business Administration
San Diego Office
The SBA offers workshops, individual counseling, publications and resources at business information centers.
(619) 557-7269
www.sbaonline.sba.gov/

Center for Applied Competitive Technologies
San Diego City College
Center to help businesses with production issues including quality assurance.
(619) 230-2080
www.cact-sd.org

San Diego Regional Technology Alliance
The San Diego RTA is an industry-driven, non-profit agency designed to assist companies and entrepreneurs in developing emerging technologies.
(619) 685-1475

CDC Small Business Finance Corp.
Provides debt financing to for-profit businesses through government guarantee programs. Certified by U. S. Small Business Administration.
(619) 291-3594

A Summary of Financing Alternatives

Alternative	Terms and Uses	Security	Requirements	Advantages	Disadvantages	Sources
Bank lines of credit or revolving credit	1-3 years; borrowings often float as a percentage of receivables and/or inventory. Seasonal working capital use optional.	Unsecured or secured by receivables, inventories, property, plant equipment, fixtures, etc. .	Have collateral, have established sales/ earnings record. Have predictable cash flow.	No equity dilution. Support services. Interest deductions. Interest predictable. Flexibility to borrow and repay funds as need dictates.	May need collateral. Leverage can be expensieve. Can impede additional financing. Restrictive debt covenants.	Commercial banks. Hybrid lenders. Commercial finance companies.
Short-term notes	60-364 days. Seasonal working capital use.	Unsecured or secured.	Have collateral, have established sales/ earnings record. Have predictable cash flow.	No equity dilution. Support services. Interest deductions. Interest predictable. May be fixed-rate interest.	May need collateral. New documentation required for each borrowing. Must meet maturity.	Commercial banks. Individuals.
Revolver/term	1-2 year revolver converting to a 2-7 year term loan. Working capital use. Equipment needs. Acquisitions. Expansion.	Unsecured or secured.	Have collateral, have established sales/ earnings record. Have predictable cash flow.	No equity dilution. Support services. Interest deductions. Flexibility to borrow and repay funds. Principal payments at maturity. Provides long-term commitment. Able to package assets purchased over time into a single loan. May be able to renew revolving portion indefinitely, subject to performance.	May need collateral. Hard to obtain in difficult times. Leverage can be expensive. Can impede additional financing. Restrictive debt covenants. Prediction of interest may be difficult with floating loan rates.	Commercial banks. Hybrid lenders. Institutional lenders.
Term loan	1-7 years. Equipment needs. Acquisitions. Expansion.	Unsecured or secured.	Have collateral. Have established sales/earnings record. Have predictable cash flow.	No equity dilution. Support services. Interest deductions. Interest predictable with interest-rate protection. May be fixed-rate interest. Repayment over time.	May need collateral. Hard to obtain in difficult times. Leverage can be expensive. Can impede additional financing. Restrictive debt covenants. Interest rate may be higher.	Commercial banks. Hybrid lenders. Commercial finance co. Institutional lenders. Individuals. Government sources.

A Summary of Financing Alternatives

Alternative	Terms and Uses	Security	Requirements	Advantages	Disadvantages	Sources
Mortgage note	7-30+ year amortization. 5-7 year maturity. Equipment needs. Real estate purchase. Expansion.	Real estate. Equipment.	Have collateral, have established sales/ earnings record. Have predictable cash flow.	No equity dilution. Support services. Interest deductions. Interest predictable with interest-rate protection. Likely fixed rate of interest. Lower repayment terms over longer periods.	Need collateral. Prepayment penalty on fixed-rate loans possible.	Commercial banks and finance companies. Institutional lenders. Individuals. Government sources. Insurance companies.
Subordinate debt	5-10 years. Working capital use. Equipment needs. Acquisitions. Expansion.	Unsecured.	Subordinated to other senior lenders. Have established sales/ earnings record. Have predictable cash flow.	Interest deductions. Interest predictable with interest-rate protection. May be perceived as equity by senior lender. May be fixed rate interest. Lower repayment terms over longer periods.	Possible equity dilution. Hard to obtain in difficult times. Leverage can be expensive. Restrictive debt covenants. Interest rate may be higher.	Commercial banks. Hybrid lenders. Institutional lenders. Individuals. Public market. Venture capital. Investment firms.
Leases	Limited to life of asset leased. Equipment needs. Real estate.	Asset leased.	Have collateral. Have predictable cash flow.	No equity dilution. Support services. Interest deductions. Interest predictable. May be fixed-rate interest. Lower repayment terms over life of the asset. May not be capitalized.	Need collateral. Interest rate may be higher. Payment may be required at end of lease.	Commercial banks. Leasing companies.

A Summary of Financing Alternatives

Alternative	Terms and Uses	Security	Requirements	Advantages	Disadvantages	Sources
Government Financing **Specific Programs:**	Working capital use. Equipment needs. Expansion.	Guaranteed portion cannot exceed certain amounts. Government will guarantee up to 90% of loan.	Cannot be dominant in its field. Must be independently owned and operated. Must meet size standards. Use funds only for eligible activities. Sufficient collateral.	No equity dilution. Support services. Interest deductions. Unable to obtain commercial credit. Typically lower interest rates. Lower repayment terms over longer periods.	Smaller amounts. Need collateral. Leverage expensive. Restrictive debt covenants. Can restrict future expansion. No unessential assets/operations. Cannot pay owners with the proceeds.	SBA field offices. Commercial banks. State agencies.
SBIR (Small Business Innovation Research) Grants .	Phase I - 6 months to evaluate scientific and technical merit of idea. Maximum of $100,000. Phase II expands on results of Phase I and further pursues development. Period of up to two years and maximum of $750,000. Phase III is for the commercialization of the results of Phase II and requires the use of private sector funding.	Unsecured. Grant.	Independently owned and operated for-profit business. Fewer than 500 employees, including affiliates. More than 51% U.S. owned.	Since this is a grant program, not a conventional loan, there is no equity dilution and no repayment.	Competitive process. Must submit proposal. Only research and development work eligible for grant.	Ten Federal agencies currently participating in SBIR program: Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Transportation; Environmental Protection Agency; NASA; National Science Foundation; and Nuclear Regulatory Commission.
7 (a) Loan Guaranty	Long term loans for many business purposes such as real estate, expansion, equipment, working capital, or inventory	SBA can guarantee 75% of loan up to $750,000. Some personal guarantee required.	Fewer than 500 employees. Cannot obtain financing at reasonable terms through normal channels.	SBA guarantees part of loan. Interest rate capped at no more than 2.75% over prime. No equity dilution.	Need collateral.	Certified Development Corporations. Commercial Banks.

Comparison of Different Legal Corporate Structures

Type*	Liability	Tax	Control	Investment	Profits	Formation Costs	Moving On
Sole Proprietorship	Full	Personal	Sole	Personal	You get to keep.	Minimal	Easy
General Partnership	Joint and several for all actions.	Pass-through to personal; flexibility in allocations.	Flexible: one partner/one vote to Managing Partner.	Flexible: can have sweat or equity contributions.	Flexibility in sharing.	Expensive. Flexibility requires detailed analysis and drafting.	Certain steps required. Flexibility in distribution of assets.
Limited Partnership	GP joint and several.	Minimum franchise; pass-through flexibility; some limitation on LPs.	Flexible; GPs generally control but LPs can be granted extensive rights.	Flexible. LPs must contribute property not services. LP interests are securities.	Flexibility in sharing.	Same as above. Also $800 filing fee with Secretary of State.	Same as above.
Corporation (without S election)	None to shareholders.	Corp. pays tax; "double taxation." Special capital gains rule for small corporation.	Structured; Majority SH generally controls through Board; some flexibility in SH agreements.	Structured. Stock is security. Some flexibility in debt, preferred stock. Adequate capitalization protects against "alter ego" claims.	Ultimately distributed to Shareholders in proportion to shares. Flexibil -ity in officer compensation.	$1,000 in costs. Approximately $1,000 in legal fees.	Structured. Requires assumption of tax liability. Can be difficult to break up.
Corporation with S election	Same as above.	Pass through to shareholders, including on sale of assets.	Same as above.	Same as above.	Same as above. Little incentive to minimize profits.	Same as above.	Same as above.
Limited Liability Corporation	None to members.	Annual LLC fee based on gross income; otherwise taxed generally same as LP.	Most flexible; members can control or managers and/or officers can control.	Flexible: can have sweat or equity contributions.	Flexibility in sharing.	Approximately $95 in filing fees. Legal fees generally similar to general or limited partnerships.	Similar to LP or general partnership, but requires assumption of tax liability.