New Venture Motivations

- In Chapter 2 Types of Entrepreneurship we identified some motivations for creating new ventures.
Types of New Ventures

• Salary Substitute Firms
  – In this kind of entrepreneurship, the entrepreneur is seeking to create a career for themselves. They generally want to create a business at which they intend to work for many years. They may not intend to sell the business unless they are planning to retire and do not have a family member to hand this down to.
  – Examples include: Restaurants, convenience stores, dry cleaners, doctor’s offices, service stations, etc.

• Life Style Firms
  – These kinds of firms are created when a person wants to indulge their passion, their hobby or their desire for a particular lifestyle.
  – Examples might include: artists and galleries, custom jewelry makers, pet services, sporting goods and services, and others.
  – Marina owner I met in Tortola was a former Wall Street Executive.

• Entrepreneurial Firms
  – Details on the next page.
Types of New Ventures – Entrepreneurial Firms

• Entrepreneurial Firms
  – These kinds of firms are generally created by individuals that feel that they have a potential business from which they can profit handsomely.
  – In many cases, the entrepreneur is planning to start the firm, but than find a way to sell the firm, go public, or otherwise profit from the value that their hard work has created.
  – Many of our best known examples of recent entrepreneurship fall in this category.
    • Examples include Facebook, Amazon, Google (Now Alphabet), Instagram.

• Often they begin as private firms, but eventually most of them “go public” through some kind of “exit strategy.”
  – Going public refers to being able to sell shares of the company in one of the public market places or stock exchanges.

• An exit strategy is some way that the founders and early investors are able to cash out on the value they have created.
  – One exit strategy is to sell the company to a larger company. The early investors are then paid for their shares and take the profit. This is termed “being acquired.”
  – Another way to exit is to do an Initial Public Offering (IPO).
    • In an IPO, the company registers their shares on a stock exchange and offers them for sale to the public. This is a very formal and highly regulated process.
Bessant and Tidd approaches this in a parallel way:

- First: They suggest that the goal of most entrepreneurs is to create independent employment rather than the creation of innovative businesses.
  - That is true primarily because most entrepreneurship is local and small.
  - These are the entrepreneurs that I (and many others) classify as “Salary Substitute Entrepreneurs.”

- So then B&T then classifies the other motivations of more innovative new ventures as:
  - **Lifestyle entrepreneurs** – as I defined it earlier
  - **Growth entrepreneurs**
    - These are what I and others term “Entrepreneurial Firms.”
  - **Innovative entrepreneurs**
    - I view this classification as a part of both “Entrepreneurial Firms” and “Social Entrepreneurship.” These ventures are founded by individuals whose primary motivation is to make change and create something new. The problem with this classification is that research on entrepreneurship has shown this to be the primary motivation of entrepreneurs in both categories.
  - **Socially-motivated entrepreneurs**
    - Covered fully in my earlier material
Innovative Small and Medium-sized Enterprises (SMEs)

B&T contend that SMEs:

• are more likely to involve product innovation than process innovation
• are focused on products for niche markets, rather than mass markets
• will be more common amongst producers of final products, rather than producers of components
• will frequently involve some form of external linkage
• tend to be associated with growth in output and employment, but not necessarily profit.

• I find some of these contentions to be debatable and not well substantiated by research. B&T partially recognize this. Their view seems to be skewed by viewing small firms that are coping with change as being “entrepreneurial.”

• SME - Small and Medium-sized Enterprises
Types of New Ventures

• B&T is a Euro-centric text that often uses terms that find little use in the US. Their classifications given here are examples:
  – Superstars – small firms that became big after 1950
    • Ex: Polaroid, DEC, Texas Instruments, Xerox, Intel, Microsoft, Compaq, Sony, Casio, Benetton
    • You may find it amusing that several of these firms have disappeared or nearly disappeared! I do.
  – New Technology Based Firms (NTBF)
    • A term virtually unknown outside of Europe, but which attempt to describe new technology based ventures that start small and might evolve into either a superstar or specialized supplier.
  – Specialized firms
    • Generally supply components to larger firms.
  – Supplier Dominated Firms
    • Many traditional products or services that are adapting innovations by suppliers.
    • New design tools, IT systems for distribution, management, etc.
Gazelles: Fast growing firms.

• In our Introductory chapter we introduced the concept of very fast growing new ventures which are often called *gazelles*.  
  •  (http://www.jackmwilson.net/Entrepreneurship/Principles/JMW-Principles-Syllabus-F2016-Doc.pdf  ),

• Gazelles represent only 15% of new firms but accounted for an astounding 94% of job creation in the U.S.

• For that reason there has been a lot of focus on understanding why such firms grow rapidly and on implementing governmental policies to encourage and nurture the growth of gazelles.

• Some of these firms grow so rapidly and attract such investor attention, that they reach a valuation of over $1 Billion.

• We call these firms “*Unicorns*.”
  – While the mythological beast, the unicorn, does not exist, the financial new venture creature that we call unicorns do exist —although they are very rare!
Unicorns

- Unicorns are very rare and very desirable.
- **Unicorn** A startup company that achieves a valuation of $1 Billion dollars.
  - [http://www.jackmwilson.net/Entrepreneurship/Cases/Glossary-Terms-Entrepreneurship.htm](http://www.jackmwilson.net/Entrepreneurship/Cases/Glossary-Terms-Entrepreneurship.htm)
  - [https://www.cbinsights.com/research-unicorn-companies](https://www.cbinsights.com/research-unicorn-companies)
- In late 2015 there were over 140 Unicorns.
- Like the “**Superstars**” of old these Unicorns might continue to be successful or flame out and become “**Uni-corpses**.”
- I have several case studies of Unicorns that are available:
  - Theranos (became a Unicorpse)
    - [http://www.jackmwilson.net/Entrepreneurship/Cases/Case-Theranos-ElizabethHolmes.pdf](http://www.jackmwilson.net/Entrepreneurship/Cases/Case-Theranos-ElizabethHolmes.pdf)
  - Uber
    - [http://www.jackmwilson.net/Entrepreneurship/Cases/Case-Uber.pdf](http://www.jackmwilson.net/Entrepreneurship/Cases/Case-Uber.pdf)
Valuing a start-up company – The **Unicorn**

- The fable of the unicorn: A much-hyped medical startup is suddenly plagued with doubts;”
  - The Economist; Oct 31, 2015

“Yet in other ways Theranos evokes a central theme in today’s tech industry: startups which promise to disrupt lucrative businesses and become valued on the basis of fantasies about their potential, rather than present reality. Investors are so keen to get a piece of any sexy-sounding startup that they lap up entrepreneurs’ hype—and anyone who asks awkward questions risks being cut out of the funding round in favour of someone more trusting.”

“All this helps to explain the inflation of valuations among unlisted technology companies. Today there are 142 **unicorns**, more than three times as many as in 2013. Many of them are growing quickly. But in terms of reaching profitability, they are often far behind the stockmarket-listed competitors they are seeking to displace, and thus are burning through cash. Theranos, for example, is not believed to have any significant revenues or profits, yet it is valued about as highly as Quest Diagnostics, a listed laboratory company, which last year achieved $7.4 billion in revenues and nearly $600m in net profits.”

“Many unicorns have been insulated from scrutiny, because they have no obligation to publish figures or provide progress reports on their technology. Not having to worry about a fluctuating share price frees their founders to think long-term, but also makes it easier for them to brush aside searching questions. However, in time Silicon Valley’s growing herd of fabled creatures will have their encounter with reality. If they do not live up to their promise, their valuations will slump, either at their next funding round or when they finally go public. Many vials of blood may spill.”
## Unicorns in 2016 (Top 25)

<table>
<thead>
<tr>
<th>Company</th>
<th>Valuation ($B)</th>
<th>Date Joined</th>
<th>Country</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uber</td>
<td>$62.50</td>
<td>8/23/2013</td>
<td>United States</td>
<td>On-Demand</td>
</tr>
<tr>
<td>Xiaomi</td>
<td>$46</td>
<td>12/21/2011</td>
<td>China</td>
<td>Hardware</td>
</tr>
<tr>
<td>Didi Chuxing</td>
<td>$28</td>
<td>12/31/2014</td>
<td>China</td>
<td>On-Demand</td>
</tr>
<tr>
<td>Airbnb</td>
<td>$25.50</td>
<td>7/26/2011</td>
<td>United States</td>
<td>eCommerce/Marketplace</td>
</tr>
<tr>
<td>Palantir Technologies</td>
<td>$20</td>
<td>5/5/2011</td>
<td>United States</td>
<td>Big Data</td>
</tr>
<tr>
<td>Lufax</td>
<td>$18.50</td>
<td>12/26/2014</td>
<td>China</td>
<td>Fintech</td>
</tr>
<tr>
<td>China Internet Plus</td>
<td>$18</td>
<td>12/22/2015</td>
<td>China</td>
<td>eCommerce/Marketplace</td>
</tr>
<tr>
<td>Snapchat</td>
<td>$18</td>
<td>12/11/2013</td>
<td>United States</td>
<td>Social</td>
</tr>
<tr>
<td>WeWork</td>
<td>$16</td>
<td>2/3/2014</td>
<td>United States</td>
<td>Facilities</td>
</tr>
<tr>
<td>Flipkart</td>
<td>$15</td>
<td>8/6/2012</td>
<td>India</td>
<td>eCommerce/Marketplace</td>
</tr>
<tr>
<td>SpaceX</td>
<td>$12</td>
<td>12/1/2012</td>
<td>United States</td>
<td>Other Transportation</td>
</tr>
<tr>
<td>Pinterest</td>
<td>$11</td>
<td>5/19/2012</td>
<td>United States</td>
<td>Social</td>
</tr>
<tr>
<td>Dropbox</td>
<td>$10</td>
<td>10/5/2011</td>
<td>United States</td>
<td>Internet Software &amp; Services</td>
</tr>
<tr>
<td>DJI Innovations</td>
<td>$10</td>
<td>5/6/2015</td>
<td>China</td>
<td>Hardware</td>
</tr>
<tr>
<td>Spotify</td>
<td>$8.53</td>
<td>6/17/2011</td>
<td>Sweden</td>
<td>Internet Software &amp; Services</td>
</tr>
<tr>
<td>Zhong An Insurance</td>
<td>$8</td>
<td>6/11/2015</td>
<td>China</td>
<td>Fintech</td>
</tr>
<tr>
<td>Snapdeal</td>
<td>$6.50</td>
<td>5/21/2014</td>
<td>India</td>
<td>eCommerce/Marketplace</td>
</tr>
<tr>
<td>Lianjia</td>
<td>$6.20</td>
<td>4/8/2016</td>
<td>China</td>
<td>eCommerce/Marketplace</td>
</tr>
<tr>
<td>Lyft</td>
<td>$5.50</td>
<td>3/12/2015</td>
<td>United States</td>
<td>On-Demand</td>
</tr>
<tr>
<td>Intarcia Therapeutics</td>
<td>$5.50</td>
<td>4/1/2014</td>
<td>United States</td>
<td>Healthcare</td>
</tr>
<tr>
<td>Stripe</td>
<td>$5</td>
<td>1/23/2014</td>
<td>United States</td>
<td>Fintech</td>
</tr>
<tr>
<td>Olacabs</td>
<td>$5</td>
<td>10/27/2014</td>
<td>India</td>
<td>On-Demand</td>
</tr>
<tr>
<td>Coupang</td>
<td>$5</td>
<td>5/28/2014</td>
<td>South Korea</td>
<td>eCommerce/Marketplace</td>
</tr>
<tr>
<td>Ele.me</td>
<td>$4.50</td>
<td>8/28/2015</td>
<td>China</td>
<td>On-Demand</td>
</tr>
<tr>
<td>Magic Leap</td>
<td>$4.50</td>
<td>10/21/2014</td>
<td>United States</td>
<td>VR/AR</td>
</tr>
</tbody>
</table>

[https://www.cbinsights.com/research-unicorn-companies](https://www.cbinsights.com/research-unicorn-companies)
Challenges for NTBF

• New Tech based firms face same challenges
• The first relates to long-term prospects for growth.
  – Very few technology-based small firms can become superstars, since they provide mainly specialized ‘niche’ products with no obvious or spectacular synergies with other markets. How far the firm will grow, or how long it will survive, will often depend on its ability to negotiate the transition from the first to the second (improved) generation of products, and to develop the supporting managerial competencies.

• How far the NTBF will grow depends on the second strategic choice: whether the management is aiming to maximize long-term value of the business or merely seeking an increase in income and independence.
  – Thus, owners of small firms often sell their firms after a few years and live off their investments.
  – And university researchers set up consultancy firms, either to increase their personal income (the BMW effect) or to find supplementary income for their university-based research and teaching activities in times of increasing financial stringency.
Spinout companies

- Larger firms (and even universities) will often choose to license technologies to smaller firms or even create a new venture. There can be several reasons for doing this:
  - No existing company is ready or able to take on the project on a licensing basis.
  - The invention consists of a portfolio of products or is an ‘enabling technology’ capable of application in a number of fields.
  - The inventors have a strong preference for forming a company and are prepared to invest their time, effort and money in a start-up.
Universities often are the sources of spin-offs

<table>
<thead>
<tr>
<th>University</th>
<th>Number of VC-funded university entrepreneurs</th>
<th>Number of VC-funded new ventures</th>
<th>Mean VC capital funding per new venture ($m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stanford, USA</td>
<td>378</td>
<td>309</td>
<td>11.388</td>
</tr>
<tr>
<td>UC Berkeley, USA</td>
<td>336</td>
<td>284</td>
<td>8.493</td>
</tr>
<tr>
<td>MIT, USA</td>
<td>300</td>
<td>250</td>
<td>9.666</td>
</tr>
<tr>
<td>Indian Institute of Technology</td>
<td>264</td>
<td>205</td>
<td>15.36</td>
</tr>
<tr>
<td>Harvard, USA</td>
<td>253</td>
<td>229</td>
<td>14.13</td>
</tr>
<tr>
<td>Tel Aviv, Israel</td>
<td>169</td>
<td>141</td>
<td>8.89</td>
</tr>
<tr>
<td>Waterloo, Canada</td>
<td>122</td>
<td>96</td>
<td>10.50</td>
</tr>
<tr>
<td>Technion, Israel</td>
<td>119</td>
<td>98</td>
<td>8.133</td>
</tr>
<tr>
<td>McGill, Canada</td>
<td>74</td>
<td>72</td>
<td>7.458</td>
</tr>
<tr>
<td>Toronto, Canada</td>
<td>71</td>
<td>66</td>
<td>14.06</td>
</tr>
<tr>
<td>London, UK</td>
<td>71</td>
<td>67</td>
<td>15.94</td>
</tr>
</tbody>
</table>

Some motives for new ventures

- **Antecedent influences. (Corridor Principle)**
  - Often called the ‘characteristics’ of the entrepreneur, including genetic factors, family influences, educational choices and previous career experiences, all contribute to the entrepreneur’s decision to start a venture.

- **Individual incubator experiences.**
  - Immediately prior to start-up include the nature of the physical location, the type of skills and knowledge acquired, contact with possible fellow founders, the type of new venture or small business experience gained.

- **Environmental factors.**
  - Include economic conditions, availability of venture capital, entrepreneurial role models, availability of support services.
Institutional variables in academic entrepreneurship

• Formal policy and support for entrepreneurial activity from management.
  – UMass formed a Vice president for Economic Development
  – Created Massachusetts Tech Transfer Center
  – Created President’s S&T Fund and prototyping fund
  – Riverhawk Venture Forum
  – Mass Medical Device Development Center (M2D2)

• Perceived seriousness of constraints to entrepreneurship, e.g. IPR issues.
  – Managing conflict of interest
  – Sharing IP (intellectual property rights) with both the inventor and research funder. [link](http://www.jackmwilson.net/Entrepreneurship/TE/TE-Chap4-IntellectualProperty.pdf)

• Incidence of successful commercialization, which demonstrates feasibility and provides role models.
  – What is the institutions track record?
Policies are required

- Specific guidelines on the use of university facilities, staff and students and IPR.
- Specific guidelines for, and periodic reviews of, the dual employment of scientist-entrepreneurs, including permanent part-time positions.
- Mechanisms to resolve issues of financial ownership and the allocation of research contracts between the university and the venture.
Top 20 Universities in Commercialization (2010)

- Here are the top 20 technology transfer programs among universities included in the AUTM survey, ranked by 2010 licensing income:
  1. Northwestern University, $180 million
  2. New York University, $178 million
  3. Columbia University, $147 million
  4. University of California System, $104 million
  5. Wake Forest University, $86 million
  6. University of Minnesota, $84 million
  7. Massachusetts Institute of Technology, $69 million
  8. University of Washington/Washington Research Foundation, $69 million
  9. Stanford University, $65 million
  10. University of Wisconsin-Madison/Wisconsin Alumni Research Foundation, $54 million
  11. California Institute Of Technology, $52 million
  12. University of Rochester, $42 million
  13. University of Massachusetts, $40 million
  14. University of Michigan, $40 million
  15. University of Texas System, $38 million
  16. University of Utah, $38 million
  17. University of Florida, $29 million
  18. University of Iowa Research Foundation, $27 million
  19. Duke University, $26 million
  20. University of South Florida, $17 million
University Research Growth

- AUTM- Association of University Technology Managers

![Graph showing long-term trend in R&D expenditures at universities & colleges and at other nonprofits.](https://www.bio.org/sites/default/files/BIO_2015_Update_of_I-O_Eco_Imp.pdf)
• Federally-funded inventions commercialized under Bayh-Dole contributed $1.18 trillion to our economy while supporting nearly 4 million good jobs, and create more than two new products and companies every day of the year.

• “The report, entitled, “The Economic Contribution of University/Nonprofit Inventions in the United States: 1996-2013,” estimates that during this 18-year time period academic-industry patent licensing bolstered U.S. gross industry output by up to $1.18 trillion, U.S gross domestic product (GDP) by up to $518 billion, and supported up to 3,824,000 U.S. jobs.”

Stages in a New Venture

• Assessing the opportunity for a new venture – generating, evaluating and refining the business concept.
• Developing the business plan and deciding the structure of the venture.
• Acquiring the resources and funding necessary for implementation – including expert support and potential partnerships.
• Growing and harvesting the venture – how to create and extract value from the business.
Critical points in a new ventures development

• Opportunity recognition
• Entrepreneurial commitment
• Venture credibility
Common sources of ideas for new ventures

- Extensions or adaptations of existing products or services.
- Application of existing products or services in different or newly created market segments, or at different price points.
- Adding value to an existing product or service, e.g. Web search engines for specialist fields.
- Developing a completely new product or service.
Fundamental drivers of opportunities

- Economic factors, e.g. changes in disposable income.
- Technological developments – which may reduce (or increase) barriers to entry.
- Demographic trends, e.g. the ageing population, more leisure time.
- Regulatory changes, e.g. environmental requirements, health and safety.
A business plan consists of:

- **Written narrative** telling how the founder expects the business to develop over time using the work done in the feasibility analysis and further work.
  - Written narrative of ~25-35 pages
    - A summary business plan can be about 15 pages — this is the kind of business plan that is due later in the course.
  - PowerPoint of ~10 slides
  - Elevator speech of ~60 seconds

- **It is written for two different audiences:**
  - Inside audience — guidance in execution — a road map — forces founders to think through plans systematically
  - Outside audience — for investors and potential partners and other stakeholders

- Many companies do not write a business plan, but it is highly encouraged.
- At ILinc we did write a business plan — which helped tremendously.
Business plan variations

- **Summary Business plan of 1-15 pages**
  - Early stage, preliminary discussions

- **Full Business plan**
  - The mainstay of 25-35 pages with significant detail to allow investors to invest with confidence.

- **Operational Business Plan**
  - An expansion of the plan to provide an internal operational guide—or blueprint for operations.
  - Approximately double the size of the full business plan, but can be much larger.

- In most companies business plans change dramatically as things develop. Don’t get stuck in a rut.
Structure

- Cover Page
  - company name, address, phone number, date, contact person, web site, Facebook, Twitter, etc.
  - Confidentiality statement
- Table of Contents
- Executive Summary of 1-2 pages (critically important)
- Industry analysis
- Company Description (mission statement, tagline, position, milestones)
- Market Analysis (market segmentation, target market, competitor analysis)
- Economics
  - financial analysis, COGS, contribution/gross margin, fixed costs, variable costs, operating leverage
- Marketing Plan (marketing strategy)
- Product/Service Design and Development Plan (product, service, or virtual prototype)
- Operations Plan
- Management Team and Company Structure (B of Directors, B of Advisors, Org Chart)
- Overall Schedule
- Financial Projections
  - sources and uses of funds, assumptions, pro-forma or projected financial statements, ratios –ROI, ROA, ROS, etc
- Summary and Appendix
Questions for new venture structure

• How much capital is needed to start the business?
• How much control and ownership do I want?
• How much risk am I willing to take on, in the case of failure?
• How large could the business become, and how fast?
• What are the registration, reporting and tax implications of different structures?
• What are the proposed harvest strategies or exit routes?
• Who could become the beneficiary of the business?
Form of the Business  (This material replaces the B&T material)

• There are several legal forms that a new venture may consider including.
  – Sole Proprietorship
  – Partnership
  – Corporation
  – Limited Liability Company

• These forms differ in how various issues are handled and may offer different advantages and disadvantages to a venture. Considerations include:
  – Cost of formation
  – Liability protection
  – Tax
    • does the entity get taxed itself or does it pass profits through to the owners for taxation. In the former case, the owners will still have to pay taxes on any profits distributed. This is often termed double taxation.
  – Types and numbers of investors
  – Liquidity
Sole Proprietorship

• **Advantages**
  – Easy and inexpensive to create
  – Owner retains complete control and keeps all profits
  – The owner can deduct any losses against other owner income
  – Is **taxed only once** to the owner
  – Easy to dissolve the business

• **Disadvantages**
  – **Unlimited liability** to owner
  – Very reliant on skills, abilities, and dedication of owner
  – Can be difficult to raise capital
  – Loss of owner to death or disinterest terminate the business
  – **Low liquidity** of the investment
Partnerships

- General Partnership - with partnership agreement
  - Advantages
    - Easier and less expensive than a corporation or LLC
    - Pools several persons skills and resources
    - Can be easier to raise funds than a sole proprietorship
    - Business losses are deductible to partners against other income
    - Taxed only to the partners and not to the company
  - Disadvantages
    - Unlimited personal liability
    - Relies on small number of people
    - Difficult to raise capital
    - Disagreements among partners are common
    - Unless a partnership agreement provides differently - the partnership ends at death or withdrawal.
    - Liquidity of the investment is low. It is hard to cash out any owner.
Partnerships

- **Limited Partnerships**
  - often have both general and limited partners
  - General partners are liable for debt, but the limited partners are limited to the amount of their investment
  - Limited partners do not share in control (or jeopardize the limited liability)
  - This is common in real estate development, oil and gas exploration, motion picture venture.
Corporations

- There are two slightly different types of corporation termed **C Corporations** or **S Corporations**
- **C Corporation** – allows both preferred and common stock
  - The preferred has special rights over common stockholders for dividends and liquidation.
- **Must file articles of incorporation** with the Secretary of State (SOS) in the state of incorporation that give:
  - Name, purpose, number of shares, classes of stock, other items
  - Corporations must file annual papers with S.O.S. and pay annual fee.
  - Provides protection against personal liability
    - Piercing the corporate veil – in some cases, especially if malfeasance or malicious behavior can be shown, the directors may be held personally liable.
  - Profits are taxed to the corporation and then taxed again to the stockholders if distributed to stockholders through dividends
    - This is often called **double taxation**
    - Many owners prefer to profit through stock appreciation rather than through dividends because capital gains are generally taxed at lower rates and do not have to be paid until the stock is sold. Taxes on dividends received must be paid in the year received.
Sub-Chapter C Corporations

The C corporations can be of several varieties.

• Public Corporations
  – Stock is listed and traded publically on the stock exchanges.
  – It is very liquid – allowing stocks to be sold or bought at will.

• Private corporation
  – In a private corporation the stock is held very closely and not traded publically. It is very illiquid because buying and selling ownership cannot be done on exchanges.

• Closely held corporation
  – In a closely held corporation the stock is infrequently traded among a small group even though the stock may be available publically. It is somewhat illiquid.

• Stock options are often issued to reward employees.
  – The right to buy stock at some set price.
  – If stock appreciates, then one can buy -then sell and take the profit.
  – Links success of employee to success of firm. Can also handcuff the employee or keep them working at the firm in order to obtain vesting of stock options.
Sub-Chapter C Corporations

- The C-Corp has both advantages and disadvantages:
  - **Advantages**
    - Protection from liability
    - More ways to raise capital – easier to do so
    - No restrictions on the number of shareholders
    - If traded, then very liquid
      - Private -> Public = IPO – initial public offering
    - Can offer stock options.
  - **Disadvantages**
    - Requires more work and legal advice to set up.
    - Cannot deduct business losses against your personal income.
    - Double taxation – at corporate and at shareholder level
    - Small shareholders have little influence in management
Sub-Chapter S Corporations

The S-Corp has some aspects of a partnership but is an incorporated public corporation.

• Most notable the S-Corp does not pay taxes. It files an information return and passes the profits/losses to the stockholders for their personal tax returns. (This tax treatment is similar to partnerships)

• The S-Corp provides protection from liability like the C-Corp (with the same caveat that the corporate veil can be pierced legally under some circumstances making the owners personally liable

• Only actual salaries are subject to Self Employment tax –not passed through income to shareholders

• Requirements for an S-Corp
  – It cannot be subsidiary of another corporation.
  – The shareholders must be US citizens and cannot be partnerships or corporations
    • They can have no more than 100 ownership units (husband-wife is one unit)
    • All shareholders must agree to the formation of an S-Corp
  – There is only one class of stock –either preferred or common
Limited Liability Company (LLC)

- The LLC Originated in Germany. Wyoming was the first state in US to allow LLCs.
- All the members (similar to partners or stockholders) have limited liability – this is similar to corporations.
- It must be a private business and not a publically traded company.
- The income is passed through to owners for taxation
  - No double taxation
  - Can be split any way they wish
- It is more flexible than S-Corp on number of members and tax-related issues.
- The LLC introduces new terminology to describe owners and the type of Ownership.
  - Stockholder → “members”
  - Owning stock → “interests”
- If the LLC wants to “go public,” and sell their shares publically then they must convert to a C-Corp.
Sources of Capital

- Personal Savings
- Friends and family (and other fools!)
- Bootstrapping
- Business angels
- Venture capitalists
- Corporations
- IPO
  - Initial Public Offering Selling stock publically

- Banks
  - Borrowing is difficult
- The SBA
  - Guaranteed Loan Program
  - Small Business Admin
- Government grants
  - SBIR - Small business Innovation research
  - STTR – Small business tech. Transfer
Financing Rounds

- Financing for a new venture often comes in “rounds” at different stages of the venture’s development.

- These rounds include:
  - Initial financing for launch. Seed funding.
  - First round.
  - Second-round financing for initial development and growth.
  - Third-round financing for consolidation and growth.
  - Maturity or exit.

- In the first round, the financing is most likely to come from personal sources, family, or even borrowing on a credit card or mortgage. Angel investors may follow on soon thereafter.

- Venture capitalists enter late in the first round or in subsequent rounds. Different venture firms specialize in financing in different stages.
Sources of finance  (Note this is in the UK)

FIGURE 12.1  Source of finance for starting new ventures

Comparison of venture rounds in various countries.

**TABLE 12.3** Median venture capital funding per venture by stage ($ million)

<table>
<thead>
<tr>
<th></th>
<th>Seed funding</th>
<th>First round</th>
<th>Second round</th>
<th>Late stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>0.5</td>
<td>2.5</td>
<td>5.7</td>
<td>10.0</td>
</tr>
<tr>
<td>Europe</td>
<td>0.3</td>
<td>1.3</td>
<td>3.3</td>
<td>6.7</td>
</tr>
<tr>
<td>China</td>
<td>0.4</td>
<td>4.0</td>
<td>10.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Canada</td>
<td>0.1</td>
<td>1.6</td>
<td>5.3</td>
<td>5.0</td>
</tr>
<tr>
<td>Israel</td>
<td>0.7</td>
<td>2.6</td>
<td>9.5</td>
<td>8.1</td>
</tr>
<tr>
<td>India</td>
<td>0.2</td>
<td>1.5</td>
<td>6.0</td>
<td>10.0</td>
</tr>
</tbody>
</table>

*Source: Data derived from EY (2014) Global venture capital insights and trends 2014, EY.com.*
Venture Capital is almost uniquely US based.

- China is growing rapidly.

**FIGURE 12.2** Venture capital funding by country ($ billion)

For much more information about new ventures see

- **Sources of Innovation**:  

- **Business Planning**  

- **Financing New Ventures**:  
  - [http://www.jackmwilson.net/Entrepreneurship/TE/TE-Chap12-FinancingOrFunding.pdf](http://www.jackmwilson.net/Entrepreneurship/TE/TE-Chap12-FinancingOrFunding.pdf)

- **Organizational Structures (Partnerships, corporations, etc.)**  