TE 250: Week 11
IP, Building Teams & Business Formation

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Technology Entrepreneur Center

Cozad Demo Day Thurs | Apr 13
The big day is almost here! Come see the latest UIUC student startups as they compete for over $300k in funding and prizes.
RSVP: go.illinois.edu/cozad

Cozad Finals Event Wed | Apr 19
Join the webinar and see the TOP SIX student startup teams pitch at DPI in Chicago. The Grand Prize and other top placement prizes will be awarded!
RSVP: go.illinois.edu/cozad

Speaker Mike Quinn Wed | Apr 19
Join us to hear from entrepreneur Mike Quinn, who will speak to us virtually from the UK, about the hard-won lessons of failing to win. Moderated by Dr. Gerald O. Wilson.
RSVP: go.illinois.edu/mikequinn

Celebrate With Us! Wed | Apr 26
We’ll be awarding the remaining Cozad prizes, the $20,000 Illinois Innovation Award, the $10,000 Fiddler Innovation Fellowship, and more! Food will be provided.
RSVP: go.illinois.edu/apr26

Learn about these events and more at tec.illinois.edu
Agenda

• Review rest of semester
• Team formation
• Business formation
• Pitch presentation examples
• Petal diagram presentations
Looking at the rest of the semester...

• Should be accumulating interviews and documenting them on the tracker. How are they impacting your vision for a solution?

• Topics still to be covered:
  • Week 10: Market segmentation and sizing with breakout (10pts)
  • Week 11: Venture formation, etc with breakout (10pts)
  • Week 12: IP and Finance, Making a pitch with breakout (10pts)
  • Week 13: Alternate activity – combined with TE360/460 – 1 hr class (10pts)
  • Week 14/15: Pitching

• Final Presentations (2): 4/26 & 5/3

• Attendance mandatory for both final presentation sessions
  • Failure to attend without excused absence results in loss of significant participation points
Why form a business?

Liability
• Businesses can be set up to be distinct from their owner(s)
• If set up correctly, actions taken on behalf of the biz do not expose owners to liability

Legacy
• Businesses can evolve, change hands,…live forever
Company Profile

<table>
<thead>
<tr>
<th>Name</th>
<th>Kongo-Gumi Co., Ltd.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Head Office</td>
<td>1-14-29 Shitennoji, Tennoji-ku, Osaka</td>
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<tr>
<td>Founded</td>
<td>578 (Asuka Era, Year 6 under Bidatsu Emperor, 30th Emperor of Japan)</td>
</tr>
<tr>
<td>Business</td>
<td>Design and construction of shrines and temples, restoration and repair of cultural heritage buildings.</td>
</tr>
</tbody>
</table>
Additional Benefits

• Legal tax shelter
• Operational structure
• Image / Perception
• Ability to raise capital
When is the right time to form?

• No sooner than is necessary
  • Capital
  • Award
  • IP assignment
• Upon agreement for a larger group
  • To prevent renegotiation
Considerations

• Legal liability
• Tax implications
• Formation & admin costs
• Flexibility
• Future needs
Entity Types

1. Sole Proprietorship
2. Partnership
   • LP, LLP, LLLP
3. Corporation (Inc., Co. or Corp.)
   • Subchapter S Corp.
   • C-Corp.
     • Not For Profit
   • Benefit Corp
4. Limited Liability Company
   • Single Member LLC
   • L3C
   • LLP, LLLP
Entity Types

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Not-for-profits

An organization that uses surplus revenues to further achieve its purpose or mission, instead of distributing to stakeholders

• 501(c)3 of tax code
• Organizations:
  1. Charitable
  2. Religious
  3. Educational
  4. Recreational

• Contributions are tax deductible
• Not for profit ≠ Not Profitable

➢ *Not for profit is a tax designation, not a way of doing business*
<table>
<thead>
<tr>
<th>Liability (Limited v. Personal)</th>
<th>Sole Proprietorship</th>
<th>General Partnership</th>
<th>S Corporation</th>
<th>C Corporation</th>
<th>Limited Liability Company</th>
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<tbody>
<tr>
<td>Unlimited personal liability for the owner.</td>
<td>An individual carrying on a business for profit.</td>
<td>Association of two or more co-owners carrying on a business for profit.</td>
<td>Limited liability for shareholders even if they participate in management.</td>
<td>Limited liability provided by incorporation with pass through partnership tax treatment.</td>
<td>Limited liability for owners makes it a better choice than sole proprietorship unless cost of formation or maintenance is a controlling factor.</td>
<td></td>
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</tbody>
</table>

| Tax Implications | Single level of income tax. | Pass through tax treatment (partnership files form 1065 but all income and expenses pass through to individual partners on Schedule K-1). | Pass through tax treatment - under most circumstances but not as complete as for the LLC. | Tax at both corporate and shareholder level - this double tax can be avoided to some extent by payment of reasonable salaries to shareholders in exchange for services actually rendered. | Disregarded entity from an income tax perspective: all income and expenses are reported on the sole member's tax return and no income tax return need be filed by the LLC. |

All income and expenses reported on Schedule C of the owner's 1040.
<table>
<thead>
<tr>
<th>Complexity of Formation and Management</th>
<th>Sole Proprietorship</th>
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<tr>
<td>Relatively simple to start.</td>
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<tr>
<td>If business conducted other than under the name of the sole proprietor, assumed name publication needed.</td>
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<tr>
<td>Managed by the sole proprietor.</td>
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<tr>
<td>Relatively easy to start - partnership agreement is typically entered into but is not legally required.</td>
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<td>Formed similar to S corp except Sub S election not filed with IRS.</td>
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<tr>
<td>Formation steps include filing Articles of Incorporation with the Secretary of State, filing Sub S election with the IRS, usually adoption of a Shareholder (buy-sell) Agreement.</td>
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<td>Typically required for publicly traded corporations, businesses that require venture capital, or if a broad based stock option program is utilized.</td>
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<tr>
<td>Can be managed by the members or, more often, by managers selected by the members. Can also elect officers.</td>
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<tr>
<td>Self-employment tax treatment may be less favorable than for S corp.</td>
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</tr>
<tr>
<td>Formation process similar to multiple-member LLC except that the operating agreement will likely be less complex.</td>
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<tr>
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<td>Capital - Effect on Ability to Raise Capital through Angel Investment, VC or IPO</td>
<td>Any transfer of the business would be of the underlying assets as opposed to a transfer of shares in the business.</td>
<td>Ability to raise capital is limited since most investors would prefer to invest in an entity offering limited liability.</td>
<td>Limit of 100 shareholders, only one class of stock is allowed, difference in voting rights is allowed, partnerships and corporations cannot be shareholders, only U.S. citizens and residents may be shareholders.</td>
<td>No limits on type or number of shareholders, different classes of stock allowed (common and preferred) thus enabling different priority for return of capital.</td>
<td>No limitation on the number of members, no limitation on who may invest, treatment of gain on distribution of appreciated property more favorable, different classes of ownership are allowed so there is the flexibility to provide for a priority return of capital.</td>
<td>Outside investment allowed only if converted to a multi-member LLC.</td>
</tr>
<tr>
<td>Capital needs - addressed through loan to sole proprietor.</td>
<td>LLC is almost always the better choice if partnership tax treatment is the goal.</td>
<td>Is easier to convert S corp to C corp than it is LLC to C corp in event venture capital is sought.</td>
<td>If venture capital is being sought, incorporation should be in the state of Delaware.</td>
<td>Often used to own commercial real estate.</td>
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</table>
Assembling A Team

- Honest and Critical evaluation of oneself is key to wise team building
- Diverse skills are required for diverse roles
- Complementary personalities
- Character counts
- It’s a matter of respect
- Build relationships slowly, and when the time comes act swiftly.
Components of the Team

1. Founders, Co-Founders
2. First Employees, Key Managers
3. Service Providers
4. Board of Directors/Advisors
5. Mentors
6. Investors
1. Founders and Co-Founders

- Founder implies single person who launched the business
- Co-Founder implies multiple founders or individuals brought on as partners at the outset of the business
- Co-Founders typically have complementary skill sets
1. Founders/Co-Founders

- Responsible for vision
- Must articulate vision and get buy-in from others
- Founder/Co-Founder is your most important title
2. First Employees, Key Managers

- Working in a startup is not for everyone
- It takes a strong will and stronger stomach
- Buy-in to the vision is key, it’s more than just another job
- Be forthright about risks
- Ultimately, it’s not about the size of the slice, it’s about the size of the pie.
2. Evaluating Employees/Managers

- Would Mother approve?
- Can this person become my best?
- The top prospect scenario:
  - Does it instill panic or relief?
2. Recruiting the Best

• Finding and signing the best is one of your earliest and most important sales calls
• Be willing to share the rewards and power to get the right people
• Be careful about becoming “top-heavy”
• Beware of people unwilling to share early risks.
2. Building Out the Team

- Add to the mix as needs arise and time & funds permit
- Consider creative use of outside champions, part-time help and compensation packages when getting started
- Utilize your network to find the right people.
2. Termination

• You should know about personality, style, values, etc. within the early weeks
• Reduce liabilities early
3. Service Providers

• Outsourcing is NOT a dirty word
  • leave it to the experts!!!
• Ask about reduced rates or deferred payment options for start-ups
• Providers validate your concepts and provide a sense of confidence for potential investors
• Providers include:
  • Attorneys
  • Accountants
  • Consultants
  • Bankers.
3. Service Providers – Corporate Attorneys

- Early assistance in establishing legal form
- Later help with wide variety of business needs:
  - Contracts of all kinds
  - Alliances with other companies
  - Employment law.
3. Service Providers – IP Attorneys

- Early help in deciding what form of protection, if any, is appropriate
- Ongoing assistance obtaining and maintaining protection or negotiating licenses.
3. Service Providers – Accountants

- Help with initial business plan financials
- Ensure roll-outs are on target
- Act as or recommend CFO
- Introduce you to investors
- Produce audited statements.
3. Service Providers: Consultants/Agencies

- Market research
- Business plan preparation
- Technical assistance
- Product prototyping & development
- Business development
- Marketing plan development
- Sales implementation
- Recruiting

Provide value and leverage for founders.
4. Board of Directors / Advisors

• Concerned with the global view and direction of the company
  • Director is a fiduciary role and comes with certain legal obligations
  • Advisors provide expertise in a specific area, but have no legal role
    • Business Advisory Board
    • Scientific Advisory Board
    • Clinical Advisory Board
• Directors and Advisors are both part of building your brand
• Generally compensated in some way.
4. Board of Directors / Advisors

- Shareholders / Members
- Board of Directors / Managers
- CEO
- Employees
- Advisory Boards
4. Filling Boards

- Investors will often require a seat on the Board of Directors
- Each member should bring specific expertise to the table
- Boards are part of building your brand ID
- Look for the ability and willingness to devote time
- Your Boards are more than just a formality – use them!
5. Mentors

- Most loosely defined, but often most influential component of your team
- Finding the right mentor involves chance
- Might be angel investors, successful entrepreneurs, faculty members... and not necessarily from your field
- Often motivated by passion or a sense of altruism, wanting to give back.
5. Mentors – defining the role

- Mentors act as a sounding board for all likes of issues and challenges
- There’s a fine line between advising and running the show
  - Remember: it’s still your company!
6. Investors

- Wide array of sources:
  - Friends, Family & Fools
  - Angels
  - Foundations, Specialty Funds
  - Government Initiatives (incl. non-dilutive)
  - Venture Capital
  - Strategics
  - Private Equity

- All money comes with strings attached
- Zero in on the “smart money.”
6. Investors: Smart Money

- Early round investors validate the concept and pave the way for later round investors
- Value can be found in the experience of early round investors
- Ability to support the company in future rounds
  - Syndicate
  - Contacts
- "Dumb" money that follows "smart" money is good
6. Investors: Points to Remember

• The earlier the investment, the greater the risk, therefore greater returns are expected
• $$$ is the primary motivation
• Investors *always* look for the exit strategy.
Pitch Presentation Examples
Example from previous semester

- [https://mediaspace.illinois.edu/media/t/1_6q6xzykw](https://mediaspace.illinois.edu/media/t/1_6q6xzykw)
- 31:00 – 41:00
- 48:00 – 1:00:00
Team Petal Diagram presentations
Getting ready for Week 12

• Topics for next week: IP, Venture Financing
• In-person Guest Speaker: Haven Allen, mHUB Chicago
• Team Assignment: Submit current customer interview tracker
• Complete your interviews
• Start thinking about your pitch deck
Guest Speaker: Alex Ocampo, Founder & CEO Ganance