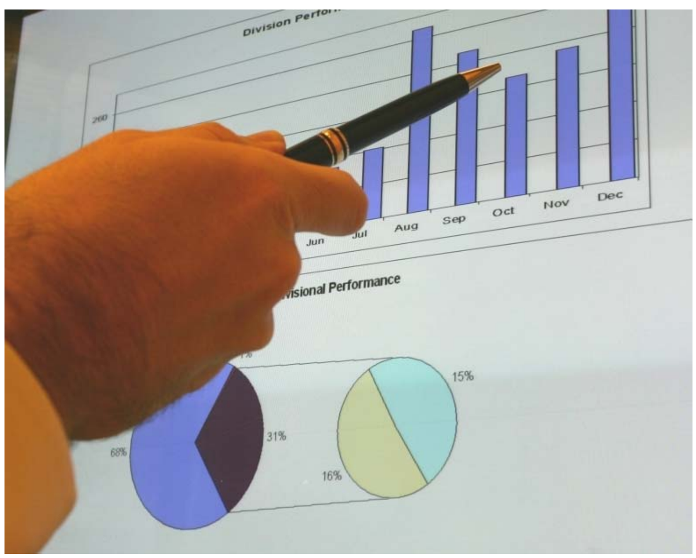
CONNECT®

Business Plan Guide



Business Plan Guide

A practical guide for technology companies

A business plan is the pen-to-paper "rallying cry" of any start-up venture. Sound business plans not only help companies raise capital but they also help create enduring value. The business plan acts as the operations manual for the company and as a reference tool for investors and board members. It's therefore very crucial to think through and write a good business plan. This guide will walk you through the whole process in writing a successful business plan that will fit your technology company.

How to Use this Guide Book

The first part of the guide will walk you through the key elements that should be included in a business plan. The second part describes the choice of entity selection. The last part includes a template that you could use in writing your own business part. At the end of the guide we have included a glossary for your assistance.

Written By:
Nepi Ilgaz, Director of Affiliate Programs, CONNECT

Edited By:
Tyler Orion, COO, CONNECT

Business Assistance Guide

TABLE OF CONTENTS

The Business Plan

The Benefits of Creating a Business Plan

A business plan is the pen-to-paper "rallying cry" of any start-up venture. Sound business plans not only help companies raise capital but they also help create enduring value. The business plan acts as the operations manual for the company and as a reference tool for investors and board members. Developing the plan forces you to analyze corporate strengths, weaknesses, opportunities, and threats. An effective business plan should:

- Help focus ideas about a market opportunity and turn them into a realistic course of action.
- Create a track for management to follow in the early years of a business.
- Identify milestones & benchmarks the management team can use to measure progress.
- Be succinct, interesting, and sufficiently solid enough to attract prospective investors.
- Be flexible enough to handle contingencies and unexpected events.

To effectively write the plan you must keep in mind what a good investor is looking for:

- A specific and realistic source of value that differentially fulfills a specific and unmet need.
- A team that can plan and execute the plan with success.
- A sustainable and defensible product/service position.

First Steps

The plan should be formula-driven and present a fluid, not static, estimate of actions. Your projections and your plans for execution must be committed to, but must also demonstrate room for flexibility. More than likely, an investor reviewing the plan will cut the sales projections and raise the costs. The plan should be adaptable to handle these types of contingencies and be flexible enough to guide you through dire situations. Building a fluid set of plans and decision criteria will take longer but it will pay off in the end. Multiple levels of projections formalized in the plan will serve as real tools.

Before you solicit financing, an important first step is to analyze the business thoroughly and prepare yourself for the fierce competitiveness of the capital markets. Keep in mind that it is not just the numbers that matter, you should be able to make transparent your venture's source of value.

Action items:

1. What core competencies and values will the business possess?
2. What compelling need does the venture fill?
3. What is the company's basic value proposition?

The Business Plan

Twenty pages is the target length for the plan, however, the length and content vary depending on such factors as company maturity, nature, and complexity. Here is a list of items to consider:

DO
1. Write an engaging executive summary 2. Talk about managing change 3. Talk about maintaining competitive advantage 4. Make the venture's true value transparent 5. Demonstrate the plan's flexibility 6. Base financials and projections on formulae 7. Provide a table of contents 8. Indicate the plan is private and confidential 9. Use visuals to enhance the presentation 10. Spiral bind the final copy
DON'T
1. Make the plan more than 25 pages 2. Send your plan to a VC cold - talk to them first 3. Make claims you can't substantiate 4. Discuss possible valuations in the plan 5. Wander in your writing - be succinct instead 6. Underestimate current/possible competition 7. Overestimate the company's strength 8. Underestimate required funding 9. Go it alone - enlist knowledgeable help 10. Ignore the potential for unexpected obstacles

Executive Summary

This three-page maximum section should summarize the business plan and provide an overview intended principally to catch and hold the interest of prospective financing sources. While the Executive Summary is the first section of the business plan, it should be written last in order to incorporate the relevant pieces found in the subsequent parts of the plan.

More often than not, the summary is all that investors will read, so it must capture their attention. An effective summary positions the company accurately and differentiates a company from others competing for limited investment capital. If the summary fails to persuade the prospective source of capital to read further, it has not done its job.

At the very least, the summary should include:

- A description of the business and the target markets for the product or service.
- Ways in which the business will distinguish itself from its competition and the need that it will fill.
- An argument that concisely and persuasively addresses factors which will enable the venture will succeed in a competitive situation.
- A description of the management team, relevant experience and special skills of each key executive. Discuss strategies and timing for strengthening and inexperienced management team.
- A summary of key financial projections for the next three to five years.
- A synopsis of funding needs, amounts of capital as well as when and how it will be spent.
- A grid showing projected estimates of Revenues and EBITDA for the next 3- 5 years

Action items:

1. What pulls all the other elements of the business plan together?
2. What does each part of the business plan show about the value of the venture?
3. Have I addressed the important issues relevant to the investment community?
4. Does the summary inspire management to execute and investors to invest?

Introduction

This section is intended primarily for prospective investors who need to know where a business has been before they can evaluate where it is likely to go. If you have little history, you should place more emphasis on the description of the management team and relevant experience. This section of the plan should discuss:

- When the business was founded, its progress to date and a brief description of the founders, emphasizing their relevant experience and their roles in the company.
- The form of organization (partnership, S Corporation, LLC, etc.) and distribution of equity. Summarize the company’s capitalization, classes of stock, shares outstanding and other relevant data.

- Past loans to, or investments in, the company by outside sources, as well as management's investment in the company. Detail any outstanding stock options or warrants as well as other financial commitments, including name of those involved and principal terms (price, expiration date, and so on) of each commitment.
- Products or services the company has developed or marketed and the success of each.
- The state of development that your product or service is in and what further approvals, upgrades, or development it must still undergo (e.g. stage of FDA approval, R&D status, status of website's technology if imperative to operations, etc.)

If you have reasons for believing that the company's past performance is not a reliable indicator of its potential, cite those reasons in this section and discuss them more fully elsewhere in the business plan. Also keep in mind that the current volatility of the business environment may require you to change directions. Be sure that the history displays an ability to adapt and grow and that your vision is dynamic.

Action items

1. On what common vision has the venture been founded to date?
2. 0How will the past fuel future, sustainable growth?
3. How has the venture shown performance and exercised good practices in the past?
4. Have you demonstrated an ability to adapt to and overcome obstacles?

The Market Opportunity

This section of your business plan is intended to paint a picture of the unfulfilled need your venture will fill. Take the time to give factual as well as educated estimates of the market size and growth today and in the future.

Give a brief description of your target customer; their behaviors and ways in which you plan to capitalize on those in order to bring the venture to profitable and sustainable fruition. Describe the present market and future opportunities. If the product or service is new, market research probably will be required to put meaningful dimensions on the initial and future market.

This section should describe the results of such research, if it has been completed, or outline the plans for future research. If the product or service represents an improvement on what is available, there already may be well-defined dimensions to the market. In that case, summarize them here, using both historical data and reliable forecasts from industry, trade associations or government sources.

Action items:

1. Who are the customers?
2. What is the historic and predicted rate of growth for each market segment?
3. Where are the present and future markets? Are they regional, national, international?
4. How does each market segment purchase the product?
5. What are the critical product/service characteristics? Consider performance, reliability, durability, availability, price and service.
6. What substitutes are available for this product? Or what are

prospective customers doing now to fill this need?
7. Does the market have any special characteristics, such as seasonal, cyclical or other important factors?

The Offering

The purpose of this section is to define precisely what you intend to develop and market while pointing investors (directly and transparently) to the source of continuing and profitable growth.

This section should include a summary of all of the company's existing or planned products or services. The length depends on the complexity and number of products or services. The language should be concise and understandable by a layperson.

This section should also include discussion of any legal protection the company has obtained or applied for (i.e. patents, copyrights, trademarks, etc.). If, for example, a patent protects the product or process, that fact would influence the marketing strategy and interest prospective investors.

Attach as appendices any lengthy or detailed diagrams, technical documents or descriptions necessary to understand the products. Alternatively, you might opt to provide detail at a later stage of the investigation, especially if the information is proprietary.

One of the keys to success is knowing what sets you apart from the competition. When describing the product or service, give special attention to characteristics distinguishing it from others in the market. State the specific benefits (i.e. lower cost or greater versatility).

Action items

1. How is the venture different from other companies in the market?
2. Is the product or service patentable?
3. How will the venture maintain long-term profitable growth?
4. Can a layperson understand the description of the product or service?

The Competition

If the company is new, you will likely face entrenched competition from mature organizations with far greater resources. Identify competitors in the business plan and note the strengths, weaknesses and market share of each.

Be realistic about the analysis and address all the negatives to show that the venture is prepared. The business plan should also indicate the market share you expect to capture in the first three to five years. Spell out your rationale for these forecasts. From which competitors do you expect to draw customers, and why? Define the niche in the market and summarize the strategy to gain market share.

Cite the principal competitive factors in the marketplace: product performance, reliability, durability, styling, delivery, service, aggressive merchandising, price, and other factors. Identify trends and explain how you plan to react to them. A prospective investor will also want to know how competitors are likely to react to entry in to the market and how you plan to respond.

Perhaps the greatest temptation will be to overstate your own strengths and understate competitors' skills. In the end, this approach is self-defeating since you base the actions on the directions charted in the business plan. Moreover, prospective investors are unlikely to back an entrepreneur who lacks a realistic view of the competition. Show how competition could deter your plans and how the venture can be adaptable to meet the changing environment in these situations. Remember if there is *"no competition"* maybe there is no need for this product!

Action items:

1. How has the industry of the venture evolved and how will global, domestic, and Internet competition affect it in the future?
2. What is the venture's specific competitive advantage? Weakness?
3. How can that advantage be defended in the face of changing competitors?
4. Who is the competition & what are their strengths? Weaknesses?
5. What substitutes exist for the product or service and how do these substitutes constitute either direct or indirect competition?

Marketing

Marketing is a crucial element of a business plan, and its importance is often underestimated. It defines strategy and charts the marketing direction for the staff. This section of the business plan should give prospective investors confidence that you can convert your ideas and assets into a strong brand and marketing position. Investors want reassurance that the business will generate a growing profit stream.

The marketing section of the business plan normally sets the stage for, or summarizes, a more detailed marketing plan. When the time is right -- either at startup or at some future stage -- the marketing executives will need to develop a comprehensive marketing plan to guide that critical function on both an annual and a long-term basis. Regardless of whether the company is in the research and development stage or ready to take products to market, summarize the marketing goals. These goals should be quantitative, realistic and consistent with the marketing analysis. They should also address the consistently and rapidly changing markets of the new economy. Here are some key areas of interest to prospective investors:

Branding
One of the most significant issues in the new economy is the need for a startup to brand itself. In today's constantly changing markets, you must have a recognizable name. You must decide what the company's name means and what it will stand for. You must decide how you intend to build a brand name and maintain its equity for years to come.

Channels of distribution
In the new economy, the manner in which product or service is distributed has become of paramount concern. New business models have given rise to new distinct modes of distribution: pure-play Internet companies and the hybrid clicks and mortar. The web has developed into a necessity in any business model. Internet considerations should also be balanced with a strategy that includes traditional channels, such as use of a sales force and physical order fulfillment centers or retail centers.

The scale of your operations will also be important. Regardless of the type of operations you choose, you must decide whether or not distribution will be handled internally or outsourced. You must consider how to deliver to the increasingly global market that the Internet has created and how expansion will be handled in terms of capacity, whether its in terms of your technology, handling traffic, or a distribution center shipping orders.

Pricing strategy
You must decide how you will price your product compared to the competition. You must also be able to support that price by identifying ways in which your venture adds to the value of the item if there are readily available substitutes for your product. Keep in mind the product's current and projected product life cycle stages, how pricing will change at different times, and how your competition will react under those conditions.

Promotion
Few products, however good they might be, can succeed in a competitive marketplace without effective, continuing promotion. Continually leveraging a venture's brand is of paramount importance in the new economy.

Sales
Your marketing plan should address your strategy for building sales and therefore revenues. These plans should be consistent with both market data and your financial projections. Advertising on the Internet, email campaigns, as well as traditional media such as television commercials must all come under consideration. The market must be aware of your brand and want to choose your product, given that there is a need for your market offering. You must also decide how much of the promotion will be handled internally and how much will be outsourced. If you have chosen an advertising or public relations agency, prospective investors will want to know which one.

Action items:

1. What markets are you prepared to serve from a financial, logistical, operational and management perspective?
2. How do you intend to monitor the market on a continuing basis?
3. Will you conduct product eval's, price comparisons or market-share analyses?
4. What is the plan for adapting to changing market conditions?
5. How will you advertise or publicize the offering?
6. What does your brand mean, what will it stand for, and how can you build equity in that name?
7. What are the critical factors which will allow the venture to maintain profit and growth?
8. What part of the venture is the source of value for the consumer?
9. What allows the firm to hold barriers to entry and competitive advantage?
10. What is the cost of a new customer? How will these costs be controlled?

Management

No matter what stage the venture is in, you must develop a strong management framework. Prospective investors take a dim view of a company that lacks a well-balanced management team. However brilliant a product idea might be, or however great the market need, prospective investors want assurance the company can manage its operations effectively and adapt to the changes that will inevitably occur.

Even in the case of a new product, competition from established companies may follow on the heels of an entrepreneur's initial success.

If the company's management team has respected production, marketing and financial executives, a solid board, strong strategic alliances, and a history as well as a plan for adaptability, you can greatly enhance the probability of success. In some cases, potential investors may be able to help you fill key slots in management and/or the Board. But many turn away from a company with a poorly conceived organization, investing instead in well structured operations.

Most prospective investors believe the presence of a complete first-rate management team is the single most important criterion in the evaluation of any funding opportunity. Therefore, this section of the plan should emphasize the experience and competence and strengths of each key management executive. It is helpful to include job descriptions, compensation data, equity interests, and detailed resumes on all management executives in place. While the internal business plan need not include such information, it is of interest to prospective investors who need assurance that the team is well qualified to implement the business plan.

Personal data on key executives should include all relevant business experience, educational background, patents or copyrights, significant awards and any other information that would show a potential investor that you have the necessary management and technical resources.

If one of the post funding goals is to strengthen the management team, deal with that issue here by outlining the planned management structure in chart form and providing detailed job descriptions and the minimum qualifications for each unfilled slot. Also indicate the level of compensation for each open position, and when and how you expect to fill it. Also do not discount the value of a strong advisory board-either business, scientific or both. The use of respected advisors during the initial stage of business formation can strengthen your credibility and add great depth to your planning.

Action items:

1. Is the management team complete?
2. Have you proven the management team to be a flexible one?
3. What are the management team's strengths? Weaknesses?
4. How can the team be strengthened?
5. What is the venture’s human resource strategy?
6. What is the venture’s planned organizational structure?
7. How do you intend to acquire and retain the personnel you will need to execute the business plan?

Financials

In this section, all the assumptions and quantitative data presented elsewhere in the business plan are put to a numerical test. In other words, bring together all of the company’s sales, market, and cost projections in a financial summary format. Be sure to keep the model open to query and adaptation. Make this a contingency- and formula-based model instead of a static uncompromising set of numbers. This will help potential investors to see your ability to react and adapt as to allow you to prepare mentally for investors to question the sales projections during a meeting.

Three-to-five-year financial projections serve a dual purpose: They guide the management team and they inform prospective investors. Include financial statements and other detailed information in an appendix or make it available upon request.
At a minimum the financials should include:

- Current financial statements.
- Past financial records -- balance sheets, profit and loss statements, cash-flow statements -- for up to three years if relevant.
- Projected balance sheet information on an accrual basis for the next three to five years.

- Profit and loss projections and cash flow projections on a monthly or quarterly basis, if possible, for the first two years and annually for the next three years.
- The venture's current funding desired and future funding expectations (be as precise as possible with dates and amounts).
- A brief statement about the planned exit strategy.

Potential investors want to see how much money you will need and when you will need it. Put at least a modest cushion in the funding request. Many early stage businesses fail because of underestimated cash needs. Be realistic and prepare yourself for the unexpected.

You should include a detailed description of all major assumptions underlying the projections. At the very least, you should describe the accounting principles, as well as sales and market share expectations. In addition, you need to be forthright about assumptions regarding the anticipated number of days sales in accounts receivables, bad debts, interest expense, research and development costs, facility costs, warranty costs, payroll, costs of materials and components and, of course, federal, state and local taxes.

A major problem facing many enterprises is cash flow. Revenues often do not flow in predictably and burn rates often exceed expectations. Some of the factors that lead to the failure of new businesses include under capitalization, failure to anticipate setbacks and unexpected expenses, and failure to be rigorous with accounts receivable. The plan should anticipate cash flow problems. The financial projections must be realistic and adaptable. If they represent a major deviation from past experience or established industry parameters, you should present reasonable evidence to support such a rosy projection. Otherwise, the forecast will generate skepticism within the management group and among prospective investors.

Action Items:

1. How will the venture effectively manage its financial assets?
2. How will you deal with cash flows that are different than projected?
3. How will the venture's financial assets contribute to the business model?
4. What is the competition doing with its financial assets to maximize value?
5. How much funding does the venture currently need and how much (based on the projected financials) will the venture need in the future?
6. Have you included all relevant assumptions in your estimates?
7. Do your projections match your sales and marketing assertions?

Milestones

This section is concerned with committing to some very definitive goals and plans for achieving those goals. Your milestones do not have to be detailed, in-depth accounts of how you plan to execute on your idea, but must give a general idea of what action items you want to fulfill for at least the next two years. Try to isolate and identify the high-level actions , giving a range for completion no longer than one calendar quarter. Include as much of the following as possible:

- Plans to complete stages of product development (e.g. FDA trials, patents or copyrights, and the like) and/or rollout on new and existing products.
- Planned stages of your technology in time and timing for upgrades and/or redesigns.
- Plans for strategic alliances and your actions for negotiations and actions.

The milestone section can be as simple as a single bulleted list of these action steps. The intent is to show that management can commit to a plan. The milestones will serve as a way in which the right team and the investors can gauge the company's progress, by comparing actual results with projections.

Action items:

1. What is the current state of the planned product line in terms of research and development and production? When will the new products be completed?
2. Is the venture's technology up to par? If not, when will the necessary adjustments be completed?
3. Is the venture's means of doing business (e.g. website) up to par and scalable?
4. What lines of expansion will the venture take to grow its business

Business Entity Selection

The choice of legal entity for an entrepreneur can be one of his or her most important choices. It can ease the task of raising capital, protect him or her from liability and facilitate the sale of the business. On the other hand, the wrong choice can have the opposite effect. Before deciding on a type of legal entity, the entrepreneur needs to consider six issues:

- Ease/cost of formation
- Liability
- Tax treatment
- Management and control
- Liquidity
- Raising capital

In California, the entrepreneur can select from seven types of entities: sole proprietorship, general partnership, limited partnership, C corporation, S corporation, limited liability company and limited liability partnership. These entities are described briefly below:

Definitions

Sole Proprietorship
A sole proprietorship is a business in which an individual runs his business directly rather than through a separate entity, such as a corporation or a partnership. A sole proprietorship is formed automatically when a person begins to do business alone. It avoids virtually all of the formalities and reporting requirements of other forms of business organization. However the individual will be personally liable for all of the debts of the business.

General Partnership
A general partnership is an association of two or more individuals or companies who wish to carry on a for-profit business as co-owners. Each partner is an “agent” of the partnership and can bind the partnership in the ordinary course of business.
In addition, each partner is personally liable for the obligations of the partnership. The death or withdrawal of any partner will dissolve the partnership unless there is a written agreement to the contrary.

Limited Partnership
A limited partnership is an association of companies or individuals, which has one or more “limited partners” and one or more “general partners.” Limited partners are those designated in the partnership agreements that do not participate in the control of the business and have limited liability for the obligations of the partnership. General partners, on the other hand, are those who actively manage the business. General partners have unlimited personal liability for the obligations of the partnership.

C Corporation
A corporation is an entity in which the owners (shareholders) are not liable for the corporation’s obligations simply by being a shareholder. Corporations are considered a separate legal entity from the shareholders. Officers at the direction of a board of directors run a corporation. Shareholders elect directors. Unless an entrepreneur elects to be an “S” corporation, a corporation will be “C” corporation for tax purposes. “C” corporations are subject to “double taxation” because the corporation first pays a tax on its income and the shareholders then pay taxes on dividends which they receive from the corporation.

S Corporation
"S" corporations are treated the same as "C" corporations under corporate law, but are treated differently under tax law: they are "pass through" entities and their shareholders avoid "double taxation" which means that there is no tax at the corporate level. The tax laws also limit the type and number of investors in an "S" corporation.

Limited Liability Company ("LLC")
A limited liability company is a newer form of entity, which combines the characteristics of a corporation and a partnership. Members of an LLC do not have personal liability (like a corporation), but a LLC is treated as a "pass through" entity for tax purposes (like a partnership).

Limited Liability Partnership
A limited liability partnership is a form of general partnership in which the liability of each partner may be limited. However, in California, it may only be used for attorneys and accountants and will not be discussed further.

Most entrepreneurs start out as a sole proprietorship because it is the simplest form of entity. However, once they begin to hire employees and seek financing, they will generally choose one of the other forms of entity. The issues in making these decisions are discussed below:

Ease of Formation/Costs

A general partnership can be the easiest type of entity to form because of its informality. However, general partnership law is only a "framework" which provides awkward "default" choices on many important issues. Most general partnerships are formed using a written partnership agreement. This agreement requires the potential partners to make decisions about a large number of issues: right to income and losses from the business, right to vote on matters, authority to act for the general partnership, transferability of partnership interests and admission of a new partner. The very flexibility of the general partnership can significantly increase the cost of forming a general partnership. The formation of a limited partnership has similar disadvantages because, once again, the "framework" nature of the statute means that the drafting of the limited partnership agreement requires many similar decisions by the prospective partners.

The formation of a LLC is more similar to a partnership than a corporation in its creation. It has the same problems as forming a partnership. These problems are compounded by the relatively new nature of this entity, which results in lack of certainty about the laws governing the LLC.
The formation of a corporation (either an "S" corporation or a "C" corporation) requires more formalities than other entities, such as drafting and filing articles of incorporation, drafting bylaws, electing directors and appointing officers. However the number of decisions is limited by the detailed nature of corporate law. As a practical matter, the formation of a corporation can be less expensive than forming a general partnership, a limited partnership or a LLC.

Tax Treatment

The tax treatment of an entity is one of the most important criteria in this decision. A general partnership, limited partnership, limited liability company and "S" corporation are "pass through" entities: the owners are taxed directly on their portion of the income from the entity but the entity is not taxed separately. On the other hand, a "C" corporation is first taxed as a corporation and its owners (shareholders) are taxed a second time upon the distribution of dividends. Naturally, if the entrepreneur is an employee of the corporation, he can obtain a return through salary within certain limits (instead of dividends), which will be taxed only once.

Liability

The liability of the entrepreneur and his investors is another critical issue in choosing the proper type of entity. Most high technology companies do not choose the limited partnership or general partnership form because of the potential for liability. Although limited partners in a limited partnership do not share the unlimited liability of a general partner, this limited liability under partnership law is lost if the limited partner takes an active role in management. Many significant investors wish to serve on the board of directors or otherwise participate in managing their investment. This format is rarely used for start-ups (except for research and development partnerships). A corporation provides limited liability for its owners (shareholders) and management (officers). The LLC offers similar limitation of liability, but its flexible internal management structure (which is similar to a partnership) makes determining how the LLC is managed more complicated than in a corporation.

Management and Control

In a corporation, management is generally separated from ownership: shareholders who in turn elect directors hold the ownership of a corporation. Directors appoint and supervise officers to run the corporation. The directors and officers may or may not be shareholders themselves. A shareholder cannot bind the corporation unless she is also an officer. If a corporation has a large number of investors, the management will be very centralized in a small number of officers. On the other hand, for smaller companies the shareholders and officers may be the same.

Unless the general partnership agreement provides otherwise, each general partner can bind the partnership. However, any restriction on the authority of a general partner will not be effective against third parties who are not aware of it. Thus, a general partner could enter into an agreement, which would be binding on the general partnership even though the partnership agreement did not permit him to do so if the other party to the agreement was not aware of this restriction on the partner's authority. In a limited partnership, a general partner has similar freedom of action, but the limited partners may not participate in management. Consequently, for management purposes limited partners are more like shareholders in a corporation than general partners in a general partnership.

The management of LLC's is very flexible. Unless its articles of organization state otherwise, its members would manage the LLC's business and affairs. Members have authority similar to the partners of a general partnership. They can bind the LLC. A different type of LLC is also permitted: it is run by managers. In this second type of LLC, the members cannot bind the LLC. The rights and responsibilities of the managers are described in a written operating agreement.

Liquidity

The entrepreneur's ability to transfer his interest in the business can be very important in determining how he or she receives a return from his or her investment in the business. In this context, the entrepreneur must carefully consider the nature of his "exit strategy." The most common exit strategies are an initial public offering or sale of the company to others.

From a legal point of view, the stock of a corporation is the most easily transferable type of ownership interest. Except for the limitations imposed by the federal and state securities laws, there are no statutory limits on a shareholder's right to transfer stock (i.e., the consent of the other shareholders need not be obtained prior to the transfer). However, contract or provisions in the articles or bylaws may limit this "free transferability".

General partnership interests are generally difficult to transfer because of the "management" responsibilities that run with them. Unless such transfer is expressly authorized in the general partnership agreement, partners in general cannot sell their interest to another party because the admission of a new partner would require the consent of the other partners. In some cases, the partners may transfer their economic interest in a partnership to a third party without such agreement, but such transfers apply only to the right to share in distributions and profits and losses, but do not transfer the rights to participate in management.

Limited partnership interests are more transferable than general partnership interests. Once again, however, the transfer of the limited partner's voting rights requires the consent of the other partners unless otherwise agreed in the limited partnership agreement. Limited partnership agreements may permit the admission of a substitute limited partner with the agreement of the general partner but without the agreement of the limited partners. This approach makes the partnership interest much closer to shares of stock. The transfer of LLC interests varies depending on the nature of the LLC agreement and can be either like a partnership interest or corporate stock.

Raising Capital

A "C" corporation has great flexibility in raising capital because it can sell different types of stock, common and numerous types of preferred, with different rights and at different prices. Since investors in a general partnership will be active in management and be subject to unlimited liability, many investors are reluctant to invest in a general partnership except for limited purposes. A limited partnership does not have the liability disadvantages of a general partnership, but does require that the investors be passive. The purchase of a limited partnership interest is not attractive to many investors who wish to be active in management because the limited liability of limited partner is lost if he or she becomes active in management. A limited partnership also requires that the limited partners find a general partner who is willing to undertake unlimited liability. Limited partnerships are generally used for passive investors in real estate matters and other tax-advantaged investments. The LLC has much more flexibility but its relative newness requires significant decisions about the internal structure by potential investors. It is worthwhile to note that LLC's are not able to take advantage of certain "tax-free" reorganizations and are therefore poor candidates for M&A transactions. Given (i) the current capital market conditions; and (ii) LLC's inability to utilize a "tax free" reorganization, the LLC's ability to effect liquidity is thus significantly impaired.

Silicon Valley Experience
Most high technology companies in the Silicon Valley are organized as “C” corporations. They do so because they will generally seek financing from either venture capitalists or corporate sources and want to issue different classes of stock. Most investors are conservative in their choice of entity because they wish to focus on making the business a success and not what they view as the marginal advantages of different legal forms. At some point, the LLC may provide an alternative to the standard “C” corporation but this entity is new and is not currently used. One exception to this rule is a startup who will initially be obtaining its financing from individuals who are willing to purchase a single type of stock. This type of company will frequently be organized as an “S” corporation initially. An “S” corporation can easily be converted to a “C” corporation when it becomes time to seek funding from corporate, venture capital or other sources. An entrepreneur may choose the “S” corporation or LLC for the long term if he believes that he will not need professional investors or corporate financing because the business will be self-financing or individuals will be able to finance the business. General partnerships and limited partnerships are very rarely used for technology start-ups.

	Ease of Formation	Liability	Tax Treatment	Management and Control	Liquidity	Raising Capital
C Corporation	• Must file Articles of Incorporation with State	• Limited liability for shareholders and management	• Double taxation: corporation taxed as an entity and shareholders taxed on distributions	• Management generally separate from shareholders: Management appointed by Board of Directors	• Liquidity for stock of a private company generally achieved upon a sale of the Company or upon an initial public offering	• Greatest flexibility: May establish rights, type and price of stock. May create preferred stock that has preferential rights
General Partnership	• Formed by an agreement between the partners (desirable to have agreement in writing)	• Each partner has unlimited, joint and several liability for all obligations of the partnership, and each partner is bound by the acts of the other partners	• "Pass through" entity: Partners are taxed on the entity's profits and losses but the entity is not taxed separately	• Each partner has a right to manage the business and a right to participate in the profits/losses of the business	• Difficult to transfer interest: requires consent of other partners	• Difficult: Investors reluctant to invest except for limited purposes
Limited Partnership	• Formed by an agreement between the partners and the filing with the state of a certificate that discloses the names of the general and limited partners	• General Partners: Unlimited, joint and several liability for the obligations of the partnership • Limited Partners: No personal liability for the debts of the business beyond the extent of their capital contribution to the partnership	• "Pass through" entity: Partners are taxed on the entity's profits and losses but the entity is not taxed separately	• General Partners have general powers of management • Limited partners cannot be involved in management	• Difficult to transfer: usually requires consent of general partners	• Difficult if investors, i.e., the limited partners want to participate in management
Limited Liability Company ("LLC")	• File LLC-1 form with Secretary of State • Operating Agreement governing operation (like partnership)	• Limited liability — Uncertain case law and precedent over new nature of entity	• "Pass through" entity: Members are taxed on the entity's profits and losses but the entity is not taxed separately	• Flexible management organization i. Owner-managed or ii.Manager-managed	• Ease of transfer varies according to nature of operating agreement; usually requires consent of other members • Not eligible for "tax-free" reorganization treatment	• Complex: Investors often don't understand membership interests and the pass through tax consequences of the entity • VC's typically do not invest in LLCs; however, an LLC can be rolled-up into a corporation relatively easily
S Corporation	• Similar to C Corporation	• Same as C Corporation	• "Pass through" entity: Shareholders are taxed on the entity's profits and losses but the entity is not taxed separately	• Same as C Corporation	• Similar to C Corporation	• Difficult: — Limited to one class of stock — Limited to 75 shareholders — Cannot have foreign investors • VC's typically do not invest in S corporations; however, an S corporation can elect to be a C corporation