Foundations for Entrepreneurial Success: Building the Dream

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Agenda

- Entrepreneurs
- Startups
- Foundations for Success
  - Legal
  - Financial
  - Personnel
  - Operational
WHAT MAKES AN ENTREPRENEUR AN ENTREPRENEUR?

Being an entrepreneur is neither a part-time job nor a full-time job,

It’s a Lifestyle
An Entrepreneur

- See a need
- Develop an idea to fill the need
- Find way to make it work
- Develop a reputation
- Find the target audience
- Take a risk
- Fail
- Try again
- Fail
- Pivot strategy
- Succeed
- (Repeat as needed)
- Fill the need!
THE MIND SUBWAY
GETTING ON THE ENTREPRENEUR'S LINE OF THINKING
by Anna Vital

- behave yourself
- money is evil
- work is a necessity
- work is an opportunity
- I know best
- be authentic
- be nice
- my gut is usually right
- first learn then do
- what if I fail?
- am I doing as well as Bob?
- don't follow the rules
- follow the rules
- I don't know enough
- people in charge have the answers
- where can I add value?
- think different

what to always remember
what to never think
what to learn to think
what to unlearn from school

FundersandFounders.com
WHAT MAKES A STARTUP A STARTUP?
Definition of a Startup?

“The act or an instance of setting in operation or motion” or “a fledgling business enterprise”
— Merriam-Webster Dictionary

“A business or undertaking that has recently begun operation”
— American Heritage Dictionary

“A company which has recently been set up”
— Collins English Dictionary
# But What is a Startup, Really?

A company working to solve a problem where is solution is not obvious and success is not guaranteed.  

*Neil Blumenthal, co-founder & co-CEO of Warby Parker*

<table>
<thead>
<tr>
<th>A company working to solve a problem where is solution is not obvious and success is not guaranteed.</th>
<th>Key attribute of a startup is its ability to grow; a startup is a company designed to scale very quickly. It is focused on growth unconstrained by geography.</th>
<th>Employees feel like what they are doing has impact, that they can will the company to succeed.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neil Blumenthal, co-founder &amp; co-CEO of Warby Parker</td>
<td>Paul Graham, CEO of Y Combinator</td>
<td>Russell D’Souza, co-founder of SeatGeek</td>
</tr>
</tbody>
</table>

You know you are a startup when you are a small, high-growth company based on a big idea”…a series of experiments looking for evidence of repeatable outcomes.  

*Ariel Garten, Co-founder and CEO of InteraXon*  

Being a startup is more of a mentality than anything. It’s about the high energy culture of believing anything is possible. And it’s about being the underdog.  

*Matthew Salzberg, Co-founder of Blue Apron*
The Development Phase

DIVIDING LINE
EARLY-STAGE STARTUPS
LOCAL SUPPORT RESOURCES

CULTURE • OPPORTUNITY • TALENT

INCUBATORS • FUNDING
LATER-STAGE RESOURCES

COMMERCIALIZATION

IDEA
R&D
TECHNOLOGY TRANSFER
PRODUCT LAUNCH
PRODUCT SUCCESS
BUSINESS SUCCESS

MENTORSHIP
FOUNDER'S TOOLKIT
RESOURCES

VALLEY OF DEATH

PROFIT

LOSS

TIME

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The Development Phase
—the entrepreneur’s perspective

THE EMOTIONAL ROLLER COASTER OF ENTREPRENEURSHIP

Are we on a ride?!
FAMILY
NEW CUSTOMER
ENTREPRENEUR
NEED MONEY!
WANT TO QUIT!
THIS IS FUN!

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Entrepreneurial Support

**Startup Ecosystem**
- Ideas, inventions and research
- Startup at various stages
- Entrepreneurs
- Startup team members
- Investors
- Mentors
- Advisors
- Other entrepreneur people
- People from related organizations

If you want to go fast, go alone.
If you want to go far, go together.
Foundation for Success

PURPOSE GOAL MISSION

PERSONNEL  Management, Oversight, Others

LEGAL  Structure, Requirements, Regulations

FINANCIAL  Tax, Funding sources, Limitations

OPERATIONAL  Administrative, Efficacy, Reporting
Foundation for Success

LEGAL
Structure, Requirements, Regulations

PURPOSE GOAL MISSION

LEGAL Structure, Requirements, Regulations
Entrepreneurial Entities

- L3C
- LLC
- LLP
- S Corp
- Nonprofit
- B Corp
- Tax Exempt
- GP
- PC
- Hybrid
- LP
- For profit
- C Corp
# For-Profit Entities

<table>
<thead>
<tr>
<th></th>
<th>Sole Proprietorship</th>
<th>C Corp</th>
<th>S Corp</th>
<th>LLC</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formation</strong></td>
<td>None</td>
<td>File with state with fee</td>
<td>File with state with fee</td>
<td>File with state with fee</td>
</tr>
<tr>
<td><strong>Personal Liability</strong></td>
<td>Unlimited</td>
<td>Shareholders not typically liable</td>
<td>Shareholders not typically liable</td>
<td>Members not typically liable</td>
</tr>
<tr>
<td><strong>Administrative</strong></td>
<td>Few</td>
<td>Election of board, officers, annual meeting, annual reports</td>
<td>Election of board, officers, annual meeting, annual reports</td>
<td>Few</td>
</tr>
<tr>
<td><strong>Management</strong></td>
<td>Full control</td>
<td>Shareholders elect directors, directors appoint officers &amp; oversee business activities</td>
<td>Shareholders elect directors, directors appoint officers &amp; oversee business activities</td>
<td>Flexible; members determine structure</td>
</tr>
<tr>
<td><strong>Term</strong></td>
<td>Terminates at cessation of business or death of proprietor</td>
<td>Perpetual</td>
<td>Perpetual</td>
<td>Perpetual</td>
</tr>
<tr>
<td><strong>Taxation</strong></td>
<td>Proprietor taxed</td>
<td>Corporation pays taxes on income</td>
<td>Corporate income passed through to shareholders—no corporate tax, shareholder tax only</td>
<td>Entity income passed through to members—no entity tax, member tax only</td>
</tr>
<tr>
<td><strong>Ownership restrictions</strong></td>
<td>No</td>
<td>No</td>
<td>Subject to IRS guidelines</td>
<td>Subject to Operating Agreement</td>
</tr>
<tr>
<td><strong>Tax Forms</strong></td>
<td>1040</td>
<td>1120</td>
<td>1120S K-1 to shareholders</td>
<td>Single member LLC- 1040-Schedule C Multimember LLC-1065, K-1 to members</td>
</tr>
</tbody>
</table>
WHY FORM AN ENTITY AT ALL

Ability to act as group

Pre-determine equity and ownership

Protection from individual liability
**Entity Selection**

**LLC over S Corp**
- Fewer limitations on types of owners
- Payment of salary not required for working owners
- Fewer administrative requirements
- Multiple classes of ownership

*Caveat: Self-employment tax*

**LLC over C Corp**
- Single taxation
- Flexibility
- Simpler management
- Fewer administrative requirements

**Conversion**
- Statutory Conversion
- Statutory Merger
- Nonstatutory Conversion
The LLC

State law entity
- Protection from personal liability
- Ability for group of people to act as one
- Separate from individuals

Types
- Single Member
- Multi-member, single class
- Multi-member, multi-class
- Series

Formation
- Articles of Organization
- Operating Agreement
- Equity Structure
- Federal tax identification number (EIN)

Formalities
- Separate bank account
- Accurate books and records
- Treatment of capital
- Prevent commingling between entity and individual(s)
FINANCIAL
Tax and Funding
Taxation

Flow Through Taxation/Single Taxation

Single member LLC—treated as a sole proprietorship

Multimember LLC—treated as a partnership

*Election to be taxed as a S corporation*

*Caveat: LLC members pay self employment tax; S corp shareholders do not*
Capitalization

- Adequate initial capitalization
- Additional capital contributions
- Members’ ability to loan to and from LLC
- Additional Members
- Current and Future Valuation
- Dilution
Distributions

Timing

Source of Funds

Amount

Class A vs. Class B

Withdrawal of Members
  – Voluntary vs involuntary
  – Valuation
Funding

Show me the money!!
Funding Sources

Traditional Sources of Funding

- Informal “friends & family” financing
- Sale of equity
  - Common stock
  - Preferred stock
  - Convertible preferred
- Sale of debt
- Banks, savings & loans associations
- Investment bankers

Modern Sources of Funding

- Venture Capital (VC) funds
- Small Business Investment Companies (SBICs)
- Small Business Innovation Research Grants (SBIRs)
- Microlending
- Asset Licensing
- Crowdfunding
Funding Stages

Amount of money

Stage of Startups

- Concept/Research
- Business Planning
- Product Development
- First Commercial Deals
- Fully Operational
- Expansion
- Ready for IPO


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The JOBS Act

Initiatives aiding Entrepreneurship and Small Businesses:

- Focus on modernizing and rehabilitating American infrastructure
- Tax breaks, credits, payroll tax cuts, and tax incentives to new businesses
- Aiding the unemployed through access to resources for creation of startups
- Extending 100% expensing, allowing firms to take an immediate deduction on investing in new plants and equipment
- Reduce regulatory burdens on crowdfunding and mini-offering opportunities
Foundation for Success

PERSONNEL
Management, Oversight, Others

PURPOSE GOAL MISSION
INTERNAL PERSONNEL

- Who is involved?
- What are they doing?
- Are the right people doing the right things?
- Who oversees whom?
- Do we need contractual arrangements?

Beneficiaries/Customers/Clients

- Organization
- Members/Shareholders
  - Manager?
  - Directors?
  - Committees?
  - Officers?
- Executives/Administration
- Employees/Staff
External Personnel

- Customers/Clients
- Vendors/Providers
- Advisors
- Independent Contractor
- Employee

NDA

Early, Often, Always

Do you need contracts to cover:
- Work product ownership
- Confidentiality/Non-disclosure
- Non-compete
- Job specs
- Fees

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## Independent Contractor or Employee

Which one is better for you? Doesn’t matter what you call them, it’s what the IRS calls them.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Employee if:</th>
<th>Independent Contractor if:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control</td>
<td>Business controls means, manner and location of work</td>
<td>Worker controls details of work</td>
</tr>
<tr>
<td>Type of Business</td>
<td>Worker is engaged in occupation not distinct from business</td>
<td>Worker’s occupation is distinct from business</td>
</tr>
<tr>
<td>Supervision</td>
<td>Business supervises work</td>
<td>Worker works without supervision</td>
</tr>
<tr>
<td>Skill Level</td>
<td>Skill level commensurate with business needs</td>
<td>Skill is specialized, unique or requires special training</td>
</tr>
<tr>
<td>Tools &amp; Materials</td>
<td>Business provides tools, facility</td>
<td>Worker provides tools and works off site</td>
</tr>
<tr>
<td>Continuing relationship</td>
<td>Worker works for extended, continuous time period</td>
<td>Worker works on specified project for a limited amount of time</td>
</tr>
<tr>
<td>Method of Payment</td>
<td>Paid regularly as determined by business standard</td>
<td>Paid by the project</td>
</tr>
<tr>
<td>Integration</td>
<td>Work is part of employer’s business</td>
<td>Work is unique, temporary, outside regular business</td>
</tr>
<tr>
<td>Intent</td>
<td>Worker and business intend to be employee-employer</td>
<td>Worker and business do not intend to be employee-employer</td>
</tr>
<tr>
<td>Risk</td>
<td>Worker does not incur loss or profit independently of business</td>
<td>Worker can incur loss or profit from the work performed</td>
</tr>
<tr>
<td>Dependence</td>
<td>Worker is economically dependent on business</td>
<td>Worker has other sources of income</td>
</tr>
<tr>
<td>Investment</td>
<td>Worker has no investment in tools or facilities separate from employer</td>
<td>Worker has own tools or works off site</td>
</tr>
<tr>
<td>Other employment</td>
<td>Worker provides services only to business</td>
<td>Worker provides services to others in the marketplace</td>
</tr>
</tbody>
</table>
Equity in Lieu of Cash Considerations

• Type
  – Outright ownership interest
  – Convertible security
  – Stock option
  – Restricted Stock

• Amount and Value

• Voting Rights

• Vesting
  – Immediate
  – Passage of time
  – Occurrence of event or achievement of target
Business Functions

What do we need to succeed?

- How do we transact business?
- Suppliers
- Customers
- Marketing, Branding, Advertising
- Delivery of goods or services
- Property
- Equipment
Intellectual Property

Tangible property that arises out of mental labor and human intellect, encompassing inventions, designs, artistic works, processes, methods

• Laws define ability to use or own intellectual property

• Categories of Protections
  – Trademark
  – Copyright
  – Patent
  – Trade secret
Trademark

A word, phrase, symbol and/or design which identifies or distinguishes the source of goods or services

Strong vs. Weak Marks

- Fanciful and arbitrary marks
  - “Banana” for tires
  - “Belmico” for insurance services
- Suggestive Marks
  - “Glance-a-Day” for calendars
- Descriptive Marks
  - “Creamy” for yogurt brand
- Generic Marks
  - “Bicycle” for bicycle retail store
Copyright

General rule: Original creative works of authorship fixed in a tangible medium is owned by author, creator

- Can be licensed to others
- Can be assigned to others
- Works Made For Hire
  - Must fit 9 categories
- Common law right
- Use of ©
- Registration
Purpose of a Patent

Any person who “invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof” may obtain a patent.

- Grants right to inventor
- Provides notice to others
- Inhibits others’ rights to create, market, or sell product
- Published and public to incent innovation
- Grant of monopoly to inventor
Types of Patents

• Utility
  – New, useful process, machine, manufacture, composition of matter or a new and useful improvement thereof
  – 90% of patents
  – 20 year monopoly

• Design
  – New, Original and ornamental design embodied in or applied to an article of manufacture
  – 15 year monopoly

• Plant Patent
  – New and distinct, invented or discovered asexually reproduced plant, other than a tuber propagated plant or a plant found in an uncultivated state
  – 20 year monopoly
  – Not subject to the payment of maintenance fees.
Provisional Patent

- Does not provide patent protections
- Establish early effective filing date
- Lower cost
- Patent Pending
- 12 months
Trade Secret

- Includes i.e. formula, plan, process, programs, methods, tools
- Generally not patented to avoided termination of 20/15 year monopoly
- Liability for theft only if owner proves valuable commercial interest and acquisition by improper means
Take-Aways

• Use the entrepreneurial ecosystem as a resource
• Be nimble, flexible and willing to pivot
• Start with an LLC; you can always convert
• Be vigilant on who and how many people you are talking about funding
• Use independent contractors instead of employees at first
• Use NDAs early, often and regularly
• If you want to pay with equity in lieu of cash, use class B equity
• Put © on everything you draw and write; may not be copyrightable but no harm
• Track of involvement and input into development product, ideas, business from the beginning
• You don’t have to be first; just better and distinguishable
• Mind your Ps; People, Property and Paper

• Get out there and do this!
“The way to get started is to quit talking and begin doing.”

- Walt Disney,
  Co-Founder of the
  Walt Disney Company.
Foundations for Entrepreneurial Success: *Building the Dream*

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