

Visionaries

~ The YVCS Newsletter ~

CHARTING YOUR CAREER PATH

Investment Banking vs. Management Consulting

In charting your career path, we at YVCS thought it would be helpful to understand the transitions people have made from **investment banking** and **management consulting** to venture capital.

Below are the number of current venture capitalist who transitioned from the investment banks and consulting companies listed.

To find out more information on where VCs worked or went to school (**Undergrad, MBA, Masters in Engineering, Law or Ph.d**), visit the YVCS website and check out the **VC database** (www.yvcs.org)

Investment Banks	# of VCs
Morgan Stanley	49
Goldman Sachs	47
J.P. Morgan Chase	44
Credit Suisse First Boston	33
Merrill Lynch	29
Deutsche Bank	22
UBS	17
Lehman Brothers	15
Banc of America	11
Bear Stearns	10
Lazard	6
Dresdner Kleinwort Wasserstein	6
Thomas Weisel Partners	4
The Blackstone Group	2
Citigroup	2
Total	297

Note: As of 4-18-05

Management Consulting table on the next page



TO 'LLC' OR TO 'C' THAT IS THE QUESTION?

Choosing the Best Entity for Your Venture Startup?

By: Patrick Michel
Paul J. Marino

There are some undisputable facts when one is seeking venture capital:

- No one wants to hear why a product is going to revolutionize your "space"—they want to know how that product revolves around earnings; and
- That no cost is as "sunk" as money spent by an entrepreneur to pay down a startup company's debts.

While item number one might be a surprise to some "newbie" entrepreneurs, most savvy entrepreneurs know that sometimes the better product does not always win the earnings race (see, example BETA vs. VHS). With that being stated, one thing that almost all entrepreneurs have in common despite their experience, is that they often overlook current for future events. In other words, many entrepreneurs do not think about their company's needs today as they focus on (or more accurately, react to) what a potential investor is expecting to see. This article will focus on one point in this process, namely choosing the right entity to begin your business.

Entrepreneurs are successful for having the foresight and drive to make their vision a reality. Within that vision lies the usual thought processes, beginning with the formulation of an idea to drafting a marketable business plan, putting together a credible management team and securing venture capital. Missing from that vision is how the entrepreneur runs his business in between inception and funding. For example, while most entrepreneurs know enough about operating a business to realize that their company and *big idea* should have some form of limited liability protection, however, most do not understand the ramifications of choosing one entity over the other. Take the choice of a C corporation, it offers a multitude of options for corporate finance and shareholder structure flexibility (e.g., different series of stock, hybrid debt, and a large body of management friendly case law (especially in [Delaware])). While, the foregoing are well reasoned and recognized means for electing to incorporate as a C corporation, and further, as a general rule, most companies that receive venture financing do so as a C corporation (and are usually incorporated in Delaware). However, what most entrepreneurs forget is that it (usually) takes a considerable amount of time to receive financing and during that ramp up period cash losses mount. Thus, unless the company receives funding immediately, the potential for losses to remain trapped inside the company could be an unexpected let down for the entrepreneur and management team.

To start, incorporating as a Delaware C corporation sounds like a great idea because most publicly traded companies are incorporated in Delaware and a substantial number companies funded by venture capital are incorporated there as well. However, by starting off life as a C corporation (be it Delaware or New York) what many entrepreneurs do not realize is that potential losses that they may be able to use to offset on their income tax return are trapped in that C corporation (how long they are trapped depends on the earnings of the company; however usually this dilemma is irrelevant because by the time the company has cash-flow positive or is in the black the losses are the property of the company).

For instance, when starting a business most entrepreneurs use their own capital to move the business forward (e.g., professional fees, office supplies, leases, employees, equipment, etc.). As the sunk costs begin to mount, most entrepreneurs are too busy refining their vision and readying it for the day when the proverbial VC ship comes sailing into port to worry about realizing the losses accruing in the company; it is the rare entrepreneur (or in some cases investor) who recognizes the tax advantages in

Consulting Firms	# of VCs
McKinsey & Company	55
Bain & Company	21
Boston Consulting Group	18
Booz Allen Hamilton	11
Deloitte	7
Monitor Group	5
Mercer Management Consulting	5
Accenture	4
Gartner	3
A.T. Kearney	3
The Parthenon Group	2
Mercer Oliver Wyman	0
Mercer Human Resource Consultir	0
IBM BCS	0
Towers Perrin	0
Total	134



EXPOSE YOURSELF

The Young Venture Capital Society is creating a resume book for **member's only**. The YVCS is constantly approached by a variety of venture capital and private equity funds for potential candidates. If you are a venture capital job seeker this is an additional way to gain exposure to funds.

If you are a **member** and have not already done so, please provide the YVCS with your resume/cv.

If you are interested in having your information included in the resume book, please first register online at www.yvcs.org - registration and then provide us with your background information.

Career Link

Coming in **June** – the career link, allowing members to search some of the open jobs currently available in the marketplace.

WALSH & AMICUCCI LLP
ATTORNEYS AT LAW
A LIMITED LIABILITY PARTNERSHIP



organizing the new entity in a manner where that entrepreneur could worry about writing down losses on his/her tax return—that is until it's tax season—or until a VC firm elects to invest and tells that lucky entrepreneur “thanks for the sweat equity”.

Today, some (a few) venture funds do not require that a company be a C corporation to place an investment (although, most require that it be a Delaware entity); some venture funds (*if* they have experience with limited liability companies) will provide funding to a company if it is a limited liability company. However, most venture funds will require that the company receiving of funding be a Delaware C corporation.

What is an entrepreneur to do? Well for starters, there is no general rule of thumb for what entity one should choose because each situation provides its own set of facts. For example, is the management team coming off a previously successful venture that might enable the company to proceed directly to go for venture funding; does the company have a market ready product or is it still in trials (does the company even have a product); are the entrepreneurs still figuring out if their *big idea* has enough behind it to create a business model based upon it? Each question will invariably affect how a venture fund receives its funding and as a result the entrepreneur should choose its entity based upon that reasoning. Regardless, what one must remember is that the decision to seek an alternative to a C corporation is a decision that should be given consideration because the decision goes beyond just the basic comparison between entity types (e.g., LLC offers many of the same benefits of a C corporation without the prospect of double taxation and the ability for losses to flow through to the unit holders). Instead, the decision should be focused on a number of different factors including but not limited to how long the company intends to forego venture financing, whether it is going to attempt to raise a small round of financing (e.g., friends and family) and whether the entrepreneur will use equity to attract intellectual capital (*i.e.*, attracting key employees, board advisors, *etc.*).

Determining whether to select a corporation, partnership or limited liability is a weighted analysis of tax, liability and management issues. These issues may help flush out an entrepreneurs vision of where the company will progress in the short term. Planning the capitalization and operation in a particular vehicle will help entrepreneurs crystallize what kind of relationship they may want with investors. Additionally, the entity selection can help create flexibility for the companies that change strategy.

C Corporations:

- Corporation is taxed a legal separate entity.
- Corporation shareholders are taxed on dividends.
- Corporations have a large body of corporate law in existence.

S Corporation:

- S Corporation is limited to 100 shareholders.
- S Corporation is not taxed separately.
- S Corporation's income passes to the shareholders.
- Foreigners cannot hold shares of an S Corporation.

Limited Liability Company:

- LLCs can have unlimited number of members.
- LLCs can have foreigners as members.
- LLC members can participate in management.

One of the primary reasons C corporations continue to be the preferred vehicle of VCs is the significant body of law around them that allows VCs to predict how they will be treated. Statutes, case law, no action letters and administrative case history are much more developed in favor of C corporations over LLCs. Notwithstanding the foregoing, LLCs have still become very popular vehicles for startups but just not with VCs. Although, some VCs have chosen to invest in LLCs, most invest by using a “blocker” corporation or the VC is willing to report the income (or losses) of the LLC.

Since LLCs are structurally impeded from going public they present significant problems for VCs who want to maintain that avenue of exit from the investment. This is one of the real world road blocks for VCs investing in LLCs. C Corporations allow VCs to keep this option available. It may be irrelevant whether the IPO market is flourishing since VCs do not necessarily know how long they will hold an investment. Delaware is very flexible in its laws regarding the conversion of LLCs to Corporations, but these conversions can be expensive depending on the length of operations and the amount of investors already in place in the company. Many entrepreneurs have begun to try and explore the best of both worlds by selecting the LLC and then planning to convert when the VC invests. An entrepreneur should be forewarned however, because this strategy is fraught with peril and entrepreneurs (and their counsel) must keep in mind that conversion can be a transaction that can drain finances and resources of a prospective portfolio company and result in a nullification of the positives originally sought from the LLC.

“Blocker Corporation” – is a corporation added between the investor and Portfolio Company.

“Board of Directors” – is the group of individuals elected by the shareholders to manage a corporation.

University and Investment Banking Captains



The Role of the Captain

The captain is a critical part of the YVCS organization, and is responsible for creating and spreading awareness about upcoming events, products and services. Moreover, they are the mouthpiece or conduit for attendees to voice changes or improvements on YVCS products. They should be seen as leaders and a significant component of the management structure, as their knowledge will often be relied upon by the directors and officers of the YVCS.

Benefits to Becoming a Captain

As sign of appreciation and recognition, University and Investment Banking captains will be highlighted on the website, newsletter and will be an integral part of management's effort to formulate compelling products. In addition, prizes for top performing captains will be awarded based on their attendee and membership production. Furthermore, captains will attain complimentary event entry and membership as a result of the aforementioned attendee and member production. And finally, captains eager to become increasingly involved in the organization and management of YVCS will likely have an opportunity to take on more responsibility.

Who Should Apply

In the eyes of management, the captain is an extremely important role. A role for a driven, intelligent and passionate individual at either a university or investment bank.

Next Steps

Should you be interested in pursuing this opportunity, please contact us at www.yvcs.org.

Get Ready for YVCS Singapore

This new chapter run by Jeffrey Paine and Daryl Wong will aim to offer events and conferences to VCs, investment bankers, students and related professionals. YVCS Singapore is working in conjunction with INSEAD and the Singapore Venture Capital Association

"C Corporation" – A legal, taxable entity chartered by a state government. Ownership of a corporation is held by the stockholders and is a corporation that is taxed separately from its shareholders.

"Limited Partnerships" An organization comprised of a general partner, who manages a fund, and limited partners, who invest money but have limited liability and are not involved with the day-to-day management of the fund. In the typical venture capital fund, the general partner receives a management fee and a percentage of the profits (or carried interest). The limited partners receive income, capital gains, and tax benefits.

"LLC" – is a limited liability company where the owners of the company can select to be taxed

"Portfolio Company" – is a company that has received investment from a venture capitalist.

"S Corporation" – A legal, non-taxable entity chartered by a state government and given its pass through status by the federal government and in some cases a state government (e.g., New York State--however, some jurisdictions do not recognize 'S' corporation status). Ownership of an 'S' corporation is held by the stockholders and is a corporation that is taxed on the shareholder level and passes its income to its shareholders.

US venture capital activity focused on rebuilding in 2004

15/02/2005. Source:Ernst & Young.

Venture capital activity in 2004 is expected to complete the year on a positive note, based on investments recorded through the end of the third quarter by the Venture Capital Report compiled by Ernst & Young LLP and VentureOne.

This good news was due to the modest return in the liquidity market for venture-backed companies and the subsequent bullishness on the part of investors who regained focus on company-formation investments. World-wide, venture-capital financing has increased 13% so far in 2004, over the comparable period in 2003. In total, \$18.99 billion has been invested in 2,369 transactions in the U.S., Europe and Israel.

"The investment downturn that followed the bubble appeared to reach its lowest point last year, marking the end of a venture-capital cycle that began in 1995, the last normal year before the ramp up to the bubble," said Gil Forer, global leader of the Venture Capital Advisory Group at Ernst & Young. "This year was one of rebuilding in the venture-capital industry, as investors world-wide put substantial sums into early-stage investments and increased their fund-raising activities. While we are not anticipating another bubble, it is fair to say that we are at a starting point in a new venture-capital investment cycle."

One of the clearest signs of this starting point is the renewed early-stage investing activity, which represented 32% of the rounds completed so far this year in the U.S., Europe and Israel. Prior to this year, early-stage investing had been on a mostly downward trend since 2000.

The median round-size also trended upward in 2004, both for early stage and follow-on rounds. This is related to another trend: the lengthening of the median time between rounds. Investors appear to be requiring portfolio companies to reach significant milestones in their growth and wait nearly twice as long (18 months in the U.S.) for a Series B investment than they did during the bubble.

The reopening of avenues for liquidity also had a role in the year's positive outcome. The IPO window was virtually shut for the previous three years but 2004 has clearly seen a return for exits as \$4.4 billion has been raised by venture-backed companies in the U.S. and European public markets thus far this year. That is the highest amount since the bubble," said John Gabbert, vice president of worldwide research for VentureOne. "On the other hand, mergers and acquisitions activity has remained steady for the past several years, but the bright side is that the amount being paid for these venture-backed companies is steadily improving."

Among those companies achieving liquidity, capital efficiency has proved to be a requirement that has become quite important. A study of the data for recent exits compared the ratio of the total amount invested prior to exit to the sale price, in the case of an M&A, or the pre-money valuation, in the case of an initial public offering.

The most successful exit ratios for investors were for those companies that received less investment, and reached liquidity in the shortest time, clearly proving that there is greater reward for those companies able to execute efficiently with limited capital.

IPO exits in 2004 have been dominated by health-care companies, with 39 of the 68 venture-backed IPOs completed so far this year coming from that industry, compared with 21 information technology IPOs. Information technology, meanwhile, has found promising exit opportunities via M&A and represents 64% of these exits in Europe and the U.S.

"The year started with a rally of the public biotech companies, which enabled a number of emerging private companies to break through a limited IPO window. The companies with a mature, well-validated product portfolio, such as Eyetech, Idenix, Pharmion and Theravance, were rewarded with strong IPO valuations which they were able to build on throughout the year despite the macro market turmoil," said Nicholas Simon, general partner with MPM Capital.

US recorded largest number of IPOs in 2004 since internet bubble

Source: AltAssets.

Last year saw the largest number of IPOs in the US since the internet bubble. In 2004, 260 IPOs were completed, nearly a threefold increase over the 88 deals completed in 2003, according to U.S. IPO Watch, a quarterly report issued by PricewaterhouseCoopers' Global Capital Markets Group.

Total US IPO proceeds rose from \$18.6bn in 2003 to \$51.9bn in 2004 and the average deal size increased from \$113m in 2003 to \$150m in 2004 - excluding the ten largest IPOs in each year.

The largest US IPO of the year 2004 was Genworth Financial, the spin-off of General Electric's life insurance and mortgage business, at \$2.8bn, followed by Chinese Semiconductor Manufacturing at \$1.8bn and accident and health insurer Assurant at \$1.76bn. Google's IPO was the year's fourth largest at \$1.7bn. The ten largest deals in 2004 accounted for a smaller proportion of overall IPO proceeds - 30 per cent in 2004 compared with 48 per cent in 2003.

US IPO activity in 2004 increased across virtually all industry sectors in 2004. Biotechnology led the way with 30 deals, followed by real estate investment trusts with 24, banking and software with 21 each, and healthcare with 20.

Scott Gehsmann, North American leader of PricewaterhouseCoopers Global Capital Markets Group, said, 'Google's high-profile auction-style IPO grabbed the lion's share of headlines in 2004, but the interest in Google is just one indicator of the rebirth of initial public offerings.'

'In fact, across virtually every metric - number of deals, size of deals and IPOs by industry sector - 2004 saw a sizable increase over 2003. Moreover, the sharp rise in IPO activity suggests that the enhanced reporting requirements of Sarbanes-Oxley have not had the dampening effect on IPOs that some had predicted,' Gehsmann continued.

The number of non-US companies completing IPOs in the US markets also more than tripled in 2004, with Chinese companies leading the way.

The Global Capital Markets Group of PricewaterhouseCoopers advises US and non-US companies on entering the US and overseas capital markets.

Like What you See?

If you are a leader and want to get involved in YVCS, think about starting your own chapter in another location. Contact YVCS at info@yvcs.org for more information

"However, the majority of the IPOs consisted of less mature companies which the public investors bought at heavy discounts to their proposed IPO price range. Having traded flat to down from their IPO prices, these companies are just recently starting to get the attention of public investors. Their venture investors will need to wait for these investments to mature as public companies before they maximize their returns on them. As for next year, we are seeing a nice post-election and year-end rally among public biotech companies. This bodes well for the prospect of another IPO window during the first half of 2005."

In another positive sign, valuations crept upward for venture-backed companies receiving investments this year in Europe or the U.S.

Following the IPO trends, later-stage health-care companies were among the most highly valued companies in the U.S. in the first half of year. By the second half, early-stage biopharmaceutical and software companies saw valuations rise to their highest levels in two years. In Europe, German companies were the most highly valued this year, but valuations were up for U.K. companies as well, compared to last year.

Despite an overhang of capital that remains to be invested since the bubble, venture-capital firms in the U.S. and Israel have had a relatively robust fund raising year so far in 2004. The total amount raised in the U.S., Europe and Israel reached \$11.65 billion through the third quarter.

"The downturn in the venture capital market has ended and a new investment cycle is beginning. Capital inflows into venture capital in 2004, though down from the peak of 2000, show a venture capital market that has grown four times in size and importance over the past decade," said Gary Morgenthaler, general partner, Morgenthaler Ventures.

"Entrepreneurship is alive and well: major innovations are transforming traditional IT and life science markets, as well as new markets of nanotechnology and alternative energy. Entrepreneurial companies are being formed and financed at near record rates. Despite burdensome new government regulations-including Sarbanes-Oxley, stock options expensing and the separation of research from investment banking-a growing number of venture-financed companies, including Google, have successfully completed their IPOs and are outperforming in the public markets. In summary, the venture capital market ended 2004 back on track and poised for renewed growth through the end of the decade."

Although there has been an improved level of financing this year, European investment activity remains constrained by the transfer of investments into the U.S.

"European investors participated in almost 200 financing rounds in the U.S. through the first three quarters of the year, yet U.S. investors were active in only 142 rounds in Europe, creating a disproportion of international transfers," said Stephen Harmston, director of international research at VentureOne. "The majority of the European investment into the U.S. came from the United Kingdom and Germany, but on the other side, U.S. investors were much more active in financing U.K. companies, followed by French companies, than investing in German startups."

Beyond Europe, Israel, and the U.S., investors also are considering their Far East investment strategy. The year 2004 may well be remembered as the year of the trip, as increasing numbers of investors ventured to China and India to explore the burgeoning investment opportunities there. The investment level in Asia appears poised to increase significantly in the next few years, beyond the estimated 9% of global investment that it now receives.

Ummm.....I don't know what that means.

Have you ever said this?

We all have, but don't make it a regular occurrence in your venture job by checking out **THE VENTURE CAPITAL TERMS GLOSSARY**.

Powered by VC Experts, this glossary holds hundreds of terms you need to know to both understand and communicate vc dealings.

Check it out on the **RESOURCES** page of the **Young Venture Capital Society** (www.yvcs.org).

The Back Page

Employee Benefit Packages:

Selecting a Plan Your Employees Will Appreciate

By: Kevin R. Luchetta, CFP®, Northwestern Mutual Financial Network

To many small to mid-size business owners, an employee benefits package seems more like an expense than an asset. But a well-designed plan benefits not just the employees but the entire company as well. Above all, a good benefits plan can play a critical role in recruiting and retaining key employees. For a sought-after employee considering several offers, a competitive salary isn't enough. Benefits weigh heavily into a job candidate's decision and, in some instances, can tip the scales in one company's favor.

For many companies, the loss of even one employee can be detrimental, particularly if that employee is highly specialized or required a significant investment in training. A strong benefits package can contribute to current employees' satisfaction on-the-job. Employees who feel they need better benefits may be tempted to look at other jobs, while those who are satisfied with their current plan may be more loyal.

A plan with real value

While cost is an important consideration, it is also critical to determine that the plan suits the needs of both the employer and the employees. An employer doesn't need to break the bank in order to offer competitive benefits.

Offering a variety of "voluntary benefits" (which the employee selects and funds) is a cost effective way to enhance an existing benefits package. Dental, vision and a variety of flexible spending accounts can help offset health expenses not covered by traditional health plans. Life, long and short-term disability, and long-term care insurance options can help employees address a number of personal financial needs. There are also countless other non-traditional benefits to help employees feel they have a healthy work/life balance.

Where to Start

Most employee benefits plans consist of three parts: 1) health insurance; 2) retirement plans; and 3) ancillary benefits such as life insurance, disability insurance and vacation time. Each part requires careful consideration and should start with some basic research:

Selecting a Benefits Plan

- **Analyzing the needs.** Talking with employees to determine what benefits they find most attractive allows an employer to customize its benefits package to include options that are valued and avoid those which are not.
- **Examining the competitive arena.** Similar companies usually compete for talent, both locally and nationally. Knowing the benefits offered by competitors is important to remain competitive as an employer. A company that recruits across industry lines should keep in mind the popularity of certain benefits can vary by industry as well as by region. Flextime, for example is offered at 76% of companies in the high-tech industry, but only at 31% of companies in the wholesale/retail trade industry.¹
- **Tapping into professional associations and other resources.** Many professional groups provide information about benefits packages offered within the industry or even have them available for purchase. Before signing on the dotted line, however, owners should check to see if an organization's plan is truly suited for their companies' needs.
- **Consumer-driven health care.** In today's environment, a discussion on employee benefits would not be complete with considering consumer driven health care. In an effort to hold employees more responsible for their medical expenses and educate them as to the true cost, more and more employers are exploring consumer driven health care options such as health reimbursement accounts and tiered network plans. While a majority of employers have shown skepticism toward consumer-driven benefits, according to a recent survey by Deloitte & Touche, that may be changing. There is a clear trend of increasing interest in consumer-driven plans. The interest is in offering this alternative side-by-side with existing options, rather than a total replacement for existing arrangements.²

Seeking professional help.

In addition to careful research on the employer's part, a well-laid plan often requires counsel from an outside professional. The laws and regulations surrounding benefit plans can be complicated and change rapidly. Unlike large corporations, most small and mid-sized businesses don't have a human resources department with people highly trained in employee benefits.

With the constant introduction of new products, frequent price changes and the vast array of options available, a knowledgeable financial professional can be critical to designing the most effective plan to meet the specific needs of a company. It can also have the welcome result of freeing up the business owner(s) to stay focused on running the business.

Selecting a Benefits Plan

Throughout the process, it's important for business owners to maintain a long-term perspective. A good employee benefits package might not have a dramatic and immediate impact on the bottom line, but its subtle implications can help a company prosper for many years to come.

1 Society for Human Resource Management; 2004 Benefits Survey Report

2 2003 Consumer Driven Health Care Survey Deloitte & Touche

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