BUILDING COMPANIES & JOBS

The case for a VENTURE CAPITAL Program in Wisconsin

A white paper by:
Wisconsin Growth Capital Coalition

EXECUTIVE SUMMARY

Wisconsin has a strong tradition of entrepreneurship. Think of the marquee companies, headquartered in Wisconsin, that are our economic calling cards – Oshkosh Corp., S.C. Johnson, Johnson Controls, Manitowoc Company, Harley-Davidson, Briggs & Stratton, Johnsonville, Kohler, Kohl's and Quad Graphics. These companies all have one thing in common: They were named after the Wisconsin municipality of their founding or the last name of their founders.

There is no truer evidence of entrepreneurial spark. However, that spark requires fuel to ignite.

Thirty-five years ago, the first state-leveraged venture capital program was launched in Connecticut. Today, state-leveraged venture capital programs have been deployed in more than 30 states, including many of Wisconsin's neighbors and economic peers. These programs have provided fuel to be ignited by the myriad entrepreneurial sparks in those states.

In 2005, a bipartisan effort led to the signing of Wisconsin Act 255. This legislation created a national model for developing, promoting and leveraging early stage investment capital in Wisconsin. Numerous states have replicated these tax credits including the Big Ten Conference states of Minnesota, Illinois and Nebraska.

This program, now called Accelerate Wisconsin, along with the creation of the Wisconsin Angel Network, has helped enhance early stage investing in Wisconsin – but largely at the "angel" capital level. The product of our success is a need for continued investing by venture capital firms in emerging companies as they enter the later stages of growth and job creation.

Wisconsin has all the right ingredients for success. It has an entrepreneurial heritage. Academic research funding in Wisconsin over-performs for its population. So do patent filings and other technology transfer metrics. While Wisconsin has built a strong foundation on research, intellectual property and angel capital, it has lagged in the venture economy.

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The time is right for Wisconsin to develop sources of capital for high-growth, early and mid-stage companies. There is broad, bipartisan consensus that Wisconsin's entrepreneurial ecosystem and overall economy need an accelerant. That accelerant is venture capital.

In 2010, venture capital-backed companies in the United States employed nearly 12 million people (11 percent of private sector employment) and generated $3.1 trillion in revenue (21 percent of gross domestic product).

Wisconsin represents 1.84 percent of the nation's population but only .55 percent of the venture capital investment. If the state received its proportional share of venture capital, that would mean 259,215 jobs today versus the 60,000 venture-rooted jobs created over time.

Wisconsin's productivity, a testament to its well-trained workforce and equally well-developed infrastructure, means that one U.S. job was created for every $20,000 of venture capital dollars invested in the state of Wisconsin. The same job in California costs $75,000.

Year after year, venture-backed companies outperform the overall economy in terms of creating jobs and growing revenue. Perhaps most important, venture capital builds new industries nearly from scratch through investments in "disruptive" technologies and business models.

In 2009, a broad coalition of companies, organizations, angel networks and early stage funds came together to advocate for enhancements to Wisconsin's investor tax credits. This coalition has been reconvened to expand support for a venture capital program in Wisconsin.

The Wisconsin Growth Capital Coalition presents this comprehensive white paper as a roadmap for the state on the best and most efficient way to leverage the state's limited resources to catalyze venture capital investments and management in Wisconsin.

THE ADVANTAGES OF THE COALITION'S RECOMMENDATIONS ARE:

- Creation of a "master" fund-of-funds that would invest in 14 to 20 venture capital funds over time. The creation of a $350-million, state-leveraged, privately managed fund-of-funds would spur private co-investment at home and beyond. These recipient funds will raise an additional $350 million to $1.05 billion in aggregate and commit to offices, staff and investments in Wisconsin.
- While such a fund is designed to invest in Wisconsin over time, some investments could be rapidly deployed. By utilizing indigenous Wisconsin funds with existing structures, network connections and deal-flow pipelines, a portion of the money can be put to work quickly. There are deals on the table today that could be closed within six months of enactment.
- Rapid deployment would also be enhanced through creation of Wisconsin Angel Acceleration Funds, which would establish angel "sidecar" or co-investment funds that would be used to match "super-angel," angel network and fund investments. Because angel networks and funds are close to the action in Wisconsin, they would be able to invest money quickly through existing deal-flow pipelines. This would also enhance deal flow for venture funds later in the capital continuum.
- Investments would be made across the full capital continuum, from seed stage to growth stages.
- This state-leveraged fund could be backed by taxpayer guarantees and tax credits, which could eliminate the state's need to incur direct debt. The fund would be constructed in a way that mitigates taxpayer risk and pays back the state's investment over time.
- Professional fund management should be competitively selected, which brings experience, national perspective and existing co-investment relationships to Wisconsin's table.
- Industry clusters with high-growth, high-wage job creation potential would be targeted.
- In addition to attracting out-of-state funds, this approach accelerates and catalyzes development of indigenous Wisconsin funds. The coalition recommends that a minimum of one-third ($117 million at the target of $350 million) be committed to "Certified Wisconsin Funds," with the flexibility to exceed that percentage. One of the best ways to create venture capital in Wisconsin is to increase the number of funds that are sourcing and competing for homegrown deals.
- The fund could be sustained over time with an "evergreen" feature that re-invests a certain percentage of state tax revenue growth from companies in designated sectors.

DEFINING THE NEED FOR **VENTURE CAPITAL** IN WISCONSIN

Lee Edwards, Virent Energy

Identifying the need for more venture capital in Wisconsin didn't begin this year or last. It began well over a decade ago, when the rise of the state's innovation economy began to bump its head against the short ceiling of venture capital.

Consider this passage from "Wisconsin's Economy in the Year 2010," a study written in early 2000 for the UW-Madison School of Business.

"Venture capital is extremely important to the flow of new ideas into the economy. It is the money that new companies need to get started, to buy facilities and to have working capital," the report said. Unfortunately, it added: "Venture capital investment in Wisconsin would have to be four times as large to be comparable to the rest of the nation."

Or this statement from "Vision 2020: A Model Wisconsin Economy," first published in 2002.

"The lack of sufficient venture capital is a serious problem that must be addressed as part of the overall environment for entrepreneurship. The lack of financial resources is the most common reason for the failure of an entrepreneurial business. Based on the level of technology development in Wisconsin (patents issued per year) and the amount of venture capital available in surrounding Midwest states, we need substantially more venture capital under management in Wisconsin by local firms. Unfortunately, less than 10 percent of the needed amount is currently available."

The more things change; the more they stay the same.

Wisconsin has long possessed the basic ingredients to compete in the innovation economy, with the most glaring exception being sufficient venture capital to help its best start-up companies prosper and grow close to home. Those ingredients include:

- A robust academic research and development foundation;
- A proven ability to turn ideas into intellectual property;
- Competitive scientific and technical talent produced by Wisconsin colleges and universities;

- A vibrant entrepreneurial support structure; and
- Of late, a cadre of experienced business managers who know how to take a company from startup to the job-producing growth stage.

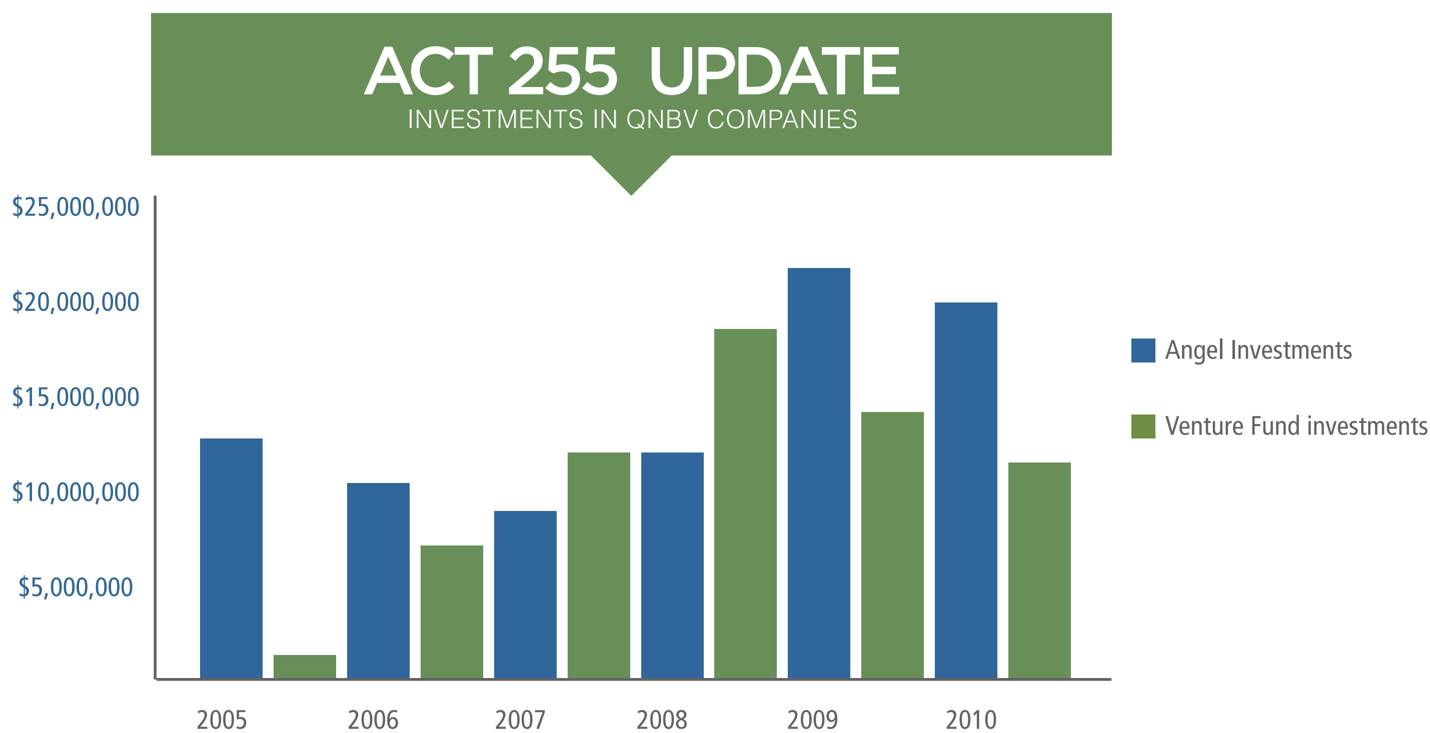
While the Act 255 or "Accelerate Wisconsin" tax credits that took effect in 2005 helped meet the capital needs of companies in the earliest stages, there has never been enough indigenous venture capital – nor enough venture capital attracted from beyond Wisconsin's borders – to keep those companies growing close to home.

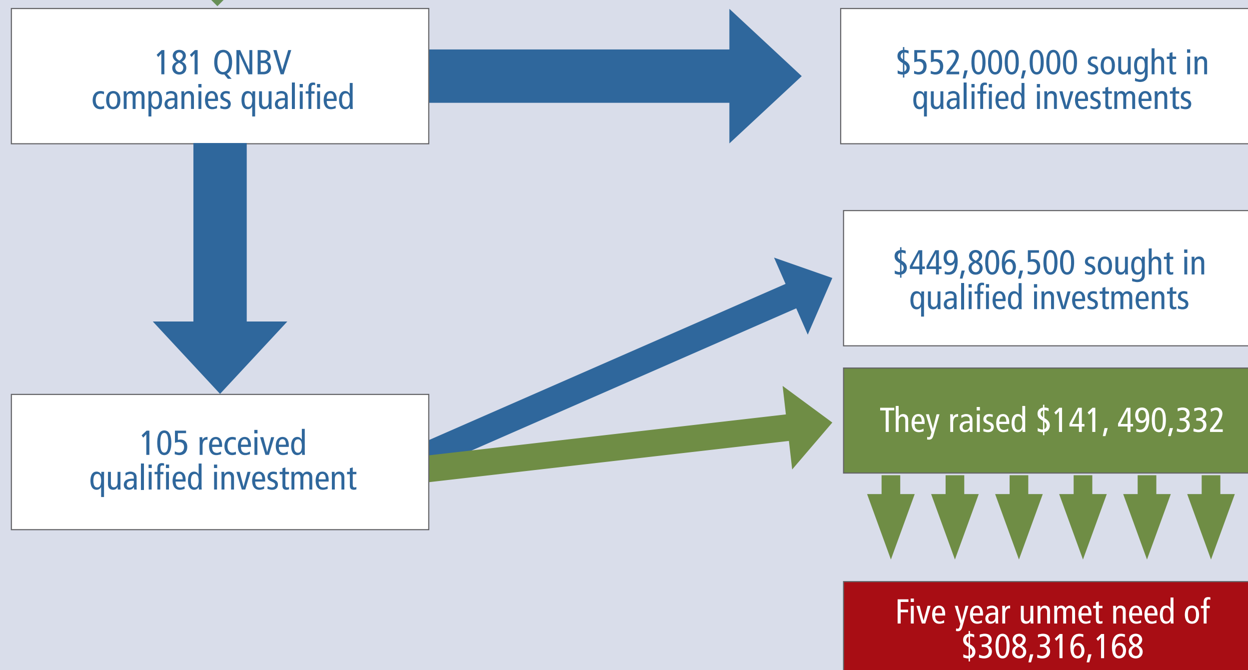
In fact, more than 11 years after "Wisconsin's Economy in Year 2010" and 10 years after "Vision 2020" were written, venture capital investments in the state are still a fraction of the U.S. average or other objective measures tied to the state's intellectual assets.

As a direct result of that imbalance, companies that could have grown in Wisconsin have moved away, along with the talent that created them. At precisely the time Wisconsin's economy needed more start-up companies to replace those traditional firms that were fading away, its best and brightest ideas and people were being lured away for lack of investment dollars in Wisconsin.

Beginning in the late 1990s, peak years for venture capital investments nationally, private-sector leaders in Wisconsin began to realize that a powerful economic wave was passing by the state. That wave was venture capital, which was transforming economies in California, Massachusetts, Texas and even neighboring states such as Minnesota, but which was barely lapping against the shores in Wisconsin.

A number of initiatives were launched to help better position Wisconsin to attract its "fair share' of venture capital investments, meaning a level of venture capital investment that seemed to better match the state's intellectual resources and its entrepreneurial activity. Those included:

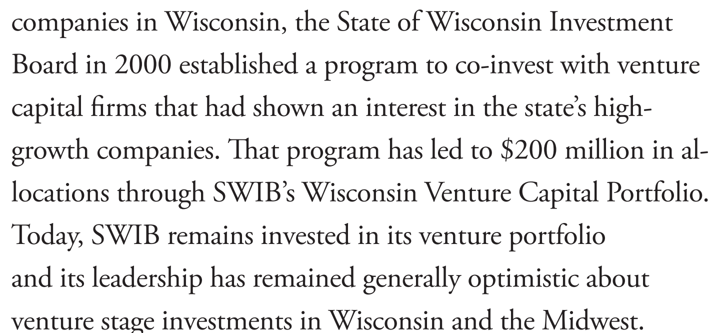




1. The creation of the Wisconsin Technology Council by legislative act in 1999 and as a non-profit corporation in 2001. A mission of the Tech Council was to help create a strategy that would lead to a stronger, tech-based economy, which meant finding ways to attract more capital. By late 2004, the Wisconsin Angel Network was born to focus specifically on building Wisconsin's angel network capacity.
2. The 2001 and 2002 Governor's Summits on Venture Capital, which were designed to raise awareness, explore best practices and make recommendations for next steps in public policy and private actions.
3. The 2001 and 2002 Wisconsin Venture Missions to Boston, Mass., and San Francisco, Calif., which were scouting missions by high-level state delegations to introduce coastal investors to specific deals and general resources in Wisconsin.

There were other early but mixed results from these policy and marketing initiatives.

In 1998, the Wisconsin Legislature gave initial approval to a Certified Capital Company program, which was a state tax credit program designed to target investments to promising startup and early stage companies. It provided $50 million in tax credits. A survey conducted by Dr. Donald Nichols, an emeritus professor of economics and public affairs at the UW-Madison, looked at the job creation results of two of the three CAPCO funds created in Wisconsin. It showed that 23 CAPCO companies created nearly 1,000 jobs. However, the Nichols survey was unable to track results for the third fund, which appears to have performed poorly and at significant cost to taxpayers. Recognizing the investment potential for high-growth



companies in Wisconsin, the State of Wisconsin Investment Board in 2000 established a program to co-invest with venture capital firms that had shown an interest in the state's high-growth companies. That program has led to $200 million in allocations through SWIB's Wisconsin Venture Capital Portfolio. Today, SWIB remains invested in its venture portfolio and its leadership has remained generally optimistic about venture stage investments in Wisconsin and the Midwest.

In 2011, SWIB announced a venture catalyst program to attract top-quartile venture funds. The pension fund board is earmarking up to $80 million in its new "Catalyst Portfolio," which will invest in one or more blue-chip venture funds. That would give SWIB an opportunity to play matchmaker between the coastal VCs, emerging companies and Wisconsin-based investors, who are usually well-positioned to spot deals that could become profitable while creating jobs.

While there's no guarantee SWIB's desired investor-to-company matches will happen, the odds of pulling more venture dollars into Wisconsin should increase as top coastal investors see the quality of state and regional start-up companies. The "Catalyst Portfolio" also demonstrates SWIB's faith in the marketplace.

In 2008 and 2010, SWIB's white papers on the venture capital landscape in Wisconsin described a "market inefficiency" that made conditions right for venture capital investments and returns. Here is a passage from the 2010 report:

"SWIB's initial investment thesis back in 1999 when considering investing locally into venture capital was simple, 'there were high quality investment opportunities here in Wisconsin (and Midwest) based on the gap between the high quantity and quality of research and development supported in the state region and the low level of capital for these types of start-up investments.'

"Although 10 years have passed and the Wisconsin venture ecosystem has matured, it is still early in its life. In looking at the history of other venture capital regions around the United States, the journey here in Wisconsin has only just begun. The local venture capital environment is markedly better today than it was 10 years ago, but there is still much to do to continue to support and foster the local early stage community," the SWIB report noted.

Specifically, the notion of an "inefficient market" is characterized in several ways that would support a significant state investment in a venture capital fund:

- There are imbalances between the high quality and quantity of research and development in Wisconsin and the region and the low level of venture capital dollars offered for investment.
- Investors with deep connections to state or regional research channels are afforded the opportunity to find attractive investments at very attractive valuations.
- Investors who are willing to invest early benefit from better pricing and less competition for the best deals, and often get the first look at new opportunities, as well.
- The relatively lower cost of operating a business in Wisconsin or the region compared to the East and West Coasts means a business located here can get more value out of each dollar invested.
- Due to the hands-on nature of venture investing, venture capitalists tend to invest close to home or co-invest with those who already know the landscape. Therefore, a lack of venture capital in any state or region need not be a sign of a lack of investment possibilities. In the case of Wisconsin, it is more likely a case of not enough venture funds being domiciled here – or that existing funds could use more capital to invest.
- The R&D institutions and technology transfer characteristics of Wisconsin rival those found almost anywhere in the United States, and a more efficient venture capital market would more fully tap those resources.

HOW OTHERS VIEW WISCONSIN AND THE MIDWEST

In a January 2010 report, "Turning up the heat: How venture capital can help fuel the economic transformation of the Great Lakes Region," researcher Frank Samuel concluded that conditions are right within the region for significant venture capital investments.

"Its deep problems notwithstanding, the Great Lakes region has formidable assets that will necessarily provide the foundation for future economic growth, including substantial research and development capacities, a strong existing industrial base, and growing prowess in key economic sectors and technologies," Samuel wrote. "But this isn't enough: The region still lacks the venture capital investments needed to help translate the huge amount of innovation these assets generate into the high value firms, products, and services that, as the Great Recession recedes, will define the next economy."

Samuel's report for the Brookings Institution recommended creation of a Great Lakes 21st Century Fund, a multi-state fund ranging from $1 billion to $2 billion to invest in early stage opportunities. Samuel envisioned the fund would (1) invest in private early stage funds with a presence in the region that focus on investing in operating companies in the region; (2) co-invest in selected operating companies that are in the portfolios of venture capital funds in which the larger fund invests; and (3) co-invest with large national and international firms that create offices in the Great Lakes region.

The same Brookings report underscored the existence of an inefficient market in the Great Lakes region. It noted that 33 percent of all U.S. research and development dollars and 35 percent of National Institutes of Health research grants are spent in Great Lakes states, but less than 14 percent of all venture capital is invested in the region.

"Even more discomfiting," the report noted, large public pension funds in the Great Lakes region contribute 40 percent of all venture capital investments by large U.S. public pension funds – but most of it winds up in investment deals on the East and West coasts.

"Venture-backed economic development is vital to the ability of the Great Lakes region to tell a new, future-oriented story about the region and its communities, rebranding them as innovative and creative talent centers, rather than industrial backwaters," Samuel wrote.

The Brookings report was an outside analysis of what many insiders already knew – that the Great Lakes region is a "donor" region when it comes to attracting and retaining start-up capital.

Many financial institutions in the region invest in venture capital as an asset class, but historically most have done so through large coastal investors rather than mid-sized and smaller funds much closer to home. In the 1990s and early 2000s, that phenomenon could be explained by anticipated return on investment, but that rationale is poised to change as coastal deals become more expensive, regional deals become more attractive and the venture capital industry overall becomes leaner and more value-oriented. Others who have examined Wisconsin's dearth of venture capital have reached similar conclusions. Those reports include:

- "Be Bold: The Wisconsin Prosperity Strategy," an analysis by the Wisconsin Economic Summit
- "Refocus Wisconsin," a report by the Wisconsin Policy Research Institute
- "Looking to the future: A case for bold action," the biennial white paper report of the Wisconsin Technology Council

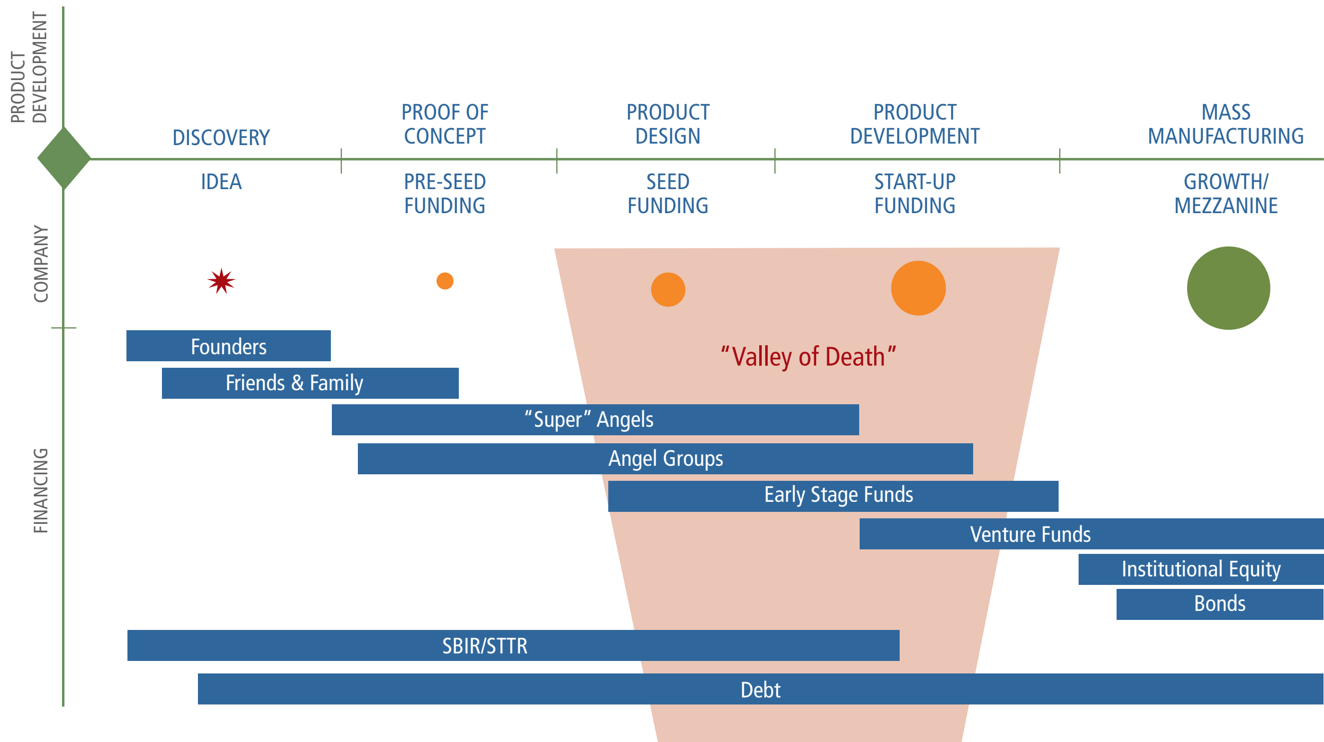
CROSSING THE VENTURE "VALLEY OF DEATH"

Here's a quick geography quiz. Where is the "Valley of Death" located?

(a) Some place faraway and biblical
(b) Some place in southern California
(c) Someplace in Wisconsin

If you're a Wisconsin entrepreneur in search of venture capital, the "Valley of Death" is a bit too close to home. That forbidding term describes the funding gap for early stage companies caught between their initial rounds of investment – family, friends, founders and angel investors – and follow-up rounds from venture capitalists.

The gap covers the seed funding and start-up phases on the investment capital continuum. A number of companies report hitting the funding gap as they seek to raise rounds of $2 million to $5 million. For those who fail to bridge the gap, the "Valley of Death" is a dry and dusty desert from which there is often no return. It kills young companies and the jobs they create.



WHAT VENTURE CAPITAL MEANS TO THE ECONOMY

Since the birth of the American venture capital industry in 1946, it has deeply and inalterably reshaped the U.S. economy.

Venture and angel capital is a prolific jobs creator. There were 11.9 million venture-backed jobs in the United States in 2010, according to the National Venture Capital Association, a figure that represented 11 percent of total U.S. private sector employment (107.3 million jobs). ***Venture and angel capital has shaped modern entrepreneurism.*** In doing so, it also sparked the formation of new businesses that grew into some of the corporate giants of our time, such as Microsoft, Apple, Google, Genentech, FedEx, Amazon, Amgen, Starbucks, Twitter, Cisco, Intel, eBay, Costco, Medtronic, Staples, Outback Steakhouse and Home Depot.

Venture and angel capital has created entire new industries. They include semiconductors in the 1960s, microprocessors in the 1970s, and biotechnology and cellular communications in the 1980s and 1990s. There are 17,000 venture-backed companies in the information technology cluster, which includes the Internet, arguably the most dynamic economic force of our time. In the broad “cleantech” sector, which is vital to our future supplies of energy, water and materials, there are more than 900 venture-backed companies.

Venture and angel capital repay the economy far more than it costs. Annual venture investment less than 0.2 percent of U.S. gross domestic product, but it generates revenues that are exponentially larger. For every dollar of venture capital invested from 1970 to 2010, $6.27 in revenue was generated in 2010. Annually, venture-backed companies have generated revenue equal to 21 percent of U.S. gross domestic product.

Venture and angel companies tend to grow faster. Compound employment growth rates for venture-backed companies grew by 1.6 percent during a three-year period ending in 2009, compared to 0.2 percent for the U.S. private sector as a whole.

Venture and angel capital can weather economic storms. While total employment and revenue for venture-backed companies contracted during the 2008-2010 economic recession, both did so at lower rates than in the larger U.S. economy. As a result, venture-backed companies actually increased their percentage shares of total U.S. activity in both categories. The ability of venture-backed firms to out-perform their non-venture counterparts, during good times and bad, stems from venture capital’s focus on highly innovative, emerging growth companies. From 2008 to 2010, the

2.11% of the nation’s patent filings

2.15% of the nation’s academic research spending

0.55% of the nation’s venture capital investment

0.11% of the nation’s venture capital under management

eye of the recession, the 500 largest public companies with venture roots increased their collective market capitalization from $2.1 trillion to $2.8 trillion.

THE RELATIONSHIP BETWEEN VENTURE CAPITAL AND WISCONSIN'S ENTREPRENEURIAL CULTURE

The U.S. economy is beginning to resemble a train so overloaded with baggage that it never works up a full head of steam. The federal debt, the trade deficit, high energy prices, a sluggish real-estate market and more have combined to produce a "jobless recovery."

Let's contrast that with The Little Engine That Could: Entrepreneurism.

If there's one part of the economy that constantly aspires to chug uphill, even during hard times, it's the start-up sector. The U.S. and Wisconsin economies undergo constant renewal through the creation of small businesses that provide innovative products and services, and which help foster markets where none existed before.

The jobless recovery is a national concern but also a worry in Wisconsin, where the erosion of manufacturing jobs over time – long before the recession began in 2008 – has left a hole in the state's economic fabric. Emerging companies in high-growth sectors such as information technology, advanced manufacturing and life sciences are essential to plugging that hole.

That was the conclusion of Tim Kane, a senior fellow at the well-respected Kauffman Foundation, in his 2010 report on "The Importance of Startups in Job Creation and Job Destruction." It is a report that drew upon federal data from 1977 through 2005 and which crystallized what most economists and development experts have believed for years: Start-up companies drive job growth.

"… Without startups, there would be no net job growth in the U.S. economy," the paper noted. "That fact is true on average, but also is true for all but seven years for which the United States has data going back to 1977."

The report went on to explain that companies in their first years are largely "job creators" but older firms – five years old and older, generally speaking – are net "job destroyers." It's the latest empirical evidence to support the decades-old concept of "creative destruction," a term that describes how the economy constantly remakes itself from the bottom up as new ideas and companies replace the old. The Kauffman report heavily influenced "Be Bold: The Wisconsin Prosperity Strategy," a paper produced by the 30 or so groups that took part in the Wisconsin Economic Summit throughout 2010. The Wisconsin report stressed the importance of the "innovation economy" and urged Wisconsin to embrace a more entrepreneurial culture.

"Wisconsin is chock-full of innovative, highly educated, worldly, hard-working people who can launch venture companies," it read. "Let's give them the support they deserve. Let's make them the champions of the new economy. In short, hug our entrepreneurs."

A long time ago in Wisconsin, there were plenty of entrepreneurs to hug. People named Harley, Davidson, Kohler, Johnson, Evinrude and many more began with an idea and grew. In time, however, the state's economy grew fat and a bit sassy. "Entrepreneur" became another word for unemployed and un-bankable – and the state's creation of new companies stalled out while others (California, Massachusetts, Texas and Minnesota) soared ahead.

Today, Wisconsin is slowly crawling back from the depths of the 50-state company creation list to a middle-of-the-pack rating. That's still not good enough. In order for Wisconsin's economy to regenerate jobs lost to recession and mega-trends, it must become one of the nation's best states for starting and growing a company.

But how do we get there? Here are some of the efforts highlighted by the Wisconsin Prosperity Strategy:

- The statewide network of angel investment groups, which has grown from five to 23 groups in six years, should continue to evolve to include more early stage and later-stage funds. Foundations, pension funds, legacy entrepreneurs, out-of-state venture capitalists and state government all have an enlightened self-interest in Wisconsin's capital creation.
- The rate of university-based start-up companies should be accelerated. Unexploited intellectual property inside corporations should be tapped, as well.
- Mentoring programs such as MERLIN Mentors in Madison and BizStarts Mentors in Milwaukee should be expanded.
- Entrepreneurs in Residence should be placed on all major public and private campuses. Simultaneously, entrepreneurship education should be deepened and broadened.
- The culture of entrepreneurism, which includes business plan contests, networking events and more, should be celebrated – even when the inevitable happens and many start-ups fail.

Another specific strategy is redefining how business incubators contribute to company creation. Incubators today are much more than mini-offices carved out of abandoned warehouses. They're places where entrepreneurs can get tailored support as they build their companies, from prototyping to business plan guidance to connections with partners and investors.

That's the approach being followed by 94 Labs, a software and mobile applications incubator in Milwaukee and Madison, as well as Sector67, a "hacker space" for a mix of technologies in Madison. Such efforts build on successful models such as California's Y Combinator and Ohio's Jumpstart. "States and cities with job creation policies aimed at luring larger, older employers can't help but fail," the Kauffman report concluded, "not just because they are zero-sum, but because they are not based in realistic models of employment growth. Job growth is driven, essentially entirely, by start-up firms that develop organically."

Wisconsin is experiencing an entrepreneurial revival. Entrepreneurs in Wisconsin should encounter more hugs than hurdles as they grow.

TRIANGULATING THE NEED: HOW MUCH VENTURE CAPITAL IS ENOUGH?

Even if they agree that a lack of venture capital is hampering Wisconsin's innovation economy, responsible policy-makers and taxpayers should ask: How large of an investment should the state make?

While any plan for a state-leveraged venture and angel capital program should be structured to return that seed money to the taxpayers, the size of the risk is important. Anecdotal evidence about the need for venture capital in Wisconsin, while persuasive, is not enough.

The Wisconsin Growth Capital Coalition took a multi-pronged approach to determining the optimum size of a state-leverage venture capital bill. A figure of roughly $350 million spread over five years was the result of this exercise, which examined the following factors.

- ***Wisconsin and U.S. population:*** The state of Wisconsin represents 1.84 percent of the U.S. population, according to the latest census figures. In 2010, Wisconsin attracted 0.55 percent of the nation's venture capital investments and had 0.11 percent of the nation's venture capital under management. Over five years ending in 2010, had Wisconsin received the same percentage of total venture capital investments as the nation as a

whole, Wisconsin would have received $450.2 million in venture investments instead of $70.9 million.

- ***Wisconsin and peer states:*** Eight states have workforces that are roughly the size of Wisconsin's 2.5 million non-farm worker base. Those eight states are Arizona, Colorado, Indiana, Maryland, Minnesota, Missouri, Tennessee and Washington. The five-year average for venture capital investments in those states range from $863 million (Washington) to $59.5 million (Missouri), with Wisconsin placing second from last to Missouri at $70.9 million in average investments from 2006 through 2010. If Wisconsin's average venture investments matched the eight-state average over five years, it would have shown $349 million instead of $70.9 million.
- ***Wisconsin and neighboring states:*** States surrounding Wisconsin or considered neighbors are Iowa, Illinois, Minnesota, Michigan and Indiana. The five-year average for venture capital investments in those states was $194.9 million. At $70.9 million, Wisconsin trailed every state but Iowa, which has averaged just under $39 million per year but about $63 million in the past three years.
- ***Wisconsin and patent production:*** Patents are a leading indicator of intellectual property and innovation. Wisconsin is among the nation's top patent-producing states, ranking 14th overall from 1977 through 2010 and also 14th in 2010 with 2,232 patents of all types. In 2010, that represented 2.11 percent of the U.S. total. If Wisconsin attracted venture capital investments on a par with its 50-state ranking on patent production, it would have shown $515.7 million in average venture investments for the five years ending in 2010.
- ***Wisconsin and academic research spending:*** Wisconsin ranked 12th in the nation in 2009 for attracting all forms of academic research funding, and 14th among the 50 states in winning federal R&D grants. That is driven primarily but not exclusively by the UW-Madison, which has ranked among the nation's top five R&D universities in each of the past 20 years. Wisconsin colleges and universities attracted about $1.25 billion in R&D grants in 2009, according to the National Science Foundation, or 2.15 percent of the U.S. total. If Wisconsin attracted venture capital on a par with its R&D ranking among the 50 states, it would have shown $525.5 million in average investments for the five years ending in 2010.
- ***Wisconsin's QNBV companies:*** The Act 255 investment tax credit program has been a success by many measures, including the startling number of Qualified New Business Venture companies that have received investments. Of the 181 QNBV companies certified since the program began in 2005, 105 have received a qualified private-sector investment. That's a 58 percent success for QNBV companies seeking investments. Nationally, about one in 10 startups receive angel investments – and roughly one in 10 angel companies receive venture funding. In order to be certified, QNBV companies were required to show their total investment needs. For the 181 certified companies, that represented $552 million. For the 105 companies that collectively raised $141.5 million, total investment needs were estimated at $449.8 million. For those companies alone, that equates to a five-year unmet investment need of $308.3 million. On an annualized basis, that's $61.7 million for a subset of Wisconsin high-growth companies.

TRIANGULATING THE ANNUAL NEED IN WISCONSIN

	MEDIAN	AVERAGE
QNBV Gap	$61,663,234	$61,663,234
Neighboring states	$139,977,650	$194,942,007
Peer states	$247,335,967	$349,076,308
Population	$450,208,289	$450,208,289
Patents	$515,720,579	$515,720,579
Academic research	$525,497,272	$525,497,272
	$348,772,128	$349,517,948

- ***Aggregate venture capital fundraising by Wisconsin funds:*** A coalition survey of all Wisconsin-based venture firms showed nearly $200 million under management in active funds created in the past five years. Those legacy firms, as well as emerging Wisconsin firms, expect to form new funds totaling $415 million in aggregate. It is unlikely, based on historic patterns, that these fundraising goals will be met without a state-leveraged venture capital program.

When calculated by annual average, these factors reveal Wisconsin's "share" of venture capital should be $349.5 million from all private and public sources. When calculated by annual median, the figure is $348.7 million. A state-leveraged fund of $350 million would deploy about $70 million per year over five years. This would attract matching investments ranging up to $210 million per year. The rest of the need would be filled by non-leveraged investments, such as venture and angel investments made outside the program.

CASE STUDY: VENTURE CAPITAL IN ISRAEL

It's slightly smaller in size than New Jersey and slightly larger in population than Wisconsin, but the nation of Israel plays big on the international stage when it comes to entrepreneurism and tech-based economic growth. What can Wisconsin learn from the Israeli experience?

A modern innovation economy needs five forms of capital – knowledge, social, human, entrepreneurial and financial – to flourish. And if any of those ingredients are missing, that economy will sputter.

Israel built its knowledge capital over time by focusing on technology development across a full spectrum of sectors, from the life sciences to Internet platforms, and from software to "cleantech."

Its human capital was initially driven by former military personnel who entered the private sector with strong backgrounds in science and engineering, but later grew with a relentless devotion to producing science, math and engineering graduates through its higher education system.

Today, Israel has one of the largest percentages of such degree-holders in the world. The United States, in contrast, continues to slide down in world rankings of science and engineering graduates. States such as Wisconsin have managed to swim against that national tide, producing above-average numbers of engineering graduates and PhD's in the sciences.

Israel's social capital – meaning, its penchant for non-stop networking among business people, technologists and investors – is another relatively recent phenomenon. Unlike the United States, where networking and forming associations are part of the national fabric, Israel didn't develop that trait until it began to absorb waves of immigrants. Its entrepreneurial capital was also a product of recent decades, he said, but has now begun to feed on itself.

What may truly set Israel apart, especially from venture-capital poor Wisconsin, is its ability to attract private equity capital for its tech-based companies.

In the first quarter of 2011, when a handful of Wisconsin companies raised $6.67 million in venture capital, 140 Israeli companies attracted $479 million from foreign and domestic investors. While that was an impressive quarter, even by Israeli standards, it was comparable to Israel's investment totals in each of the past eight quarters. Those totals ranged from a low of $234 million in early 2010 to $344 million in the fourth quarter of 2010.

In Wisconsin, companies raised $121 million in venture capital in all of 2010 – and that was the second-highest total on record. Israeli companies raised $13.2 billion between 1993 and 2005 alone. Again, this is a nation of 5.85 million people, not much larger than Wisconsin's population of about 5.7 million.

What's the secret to the Israeli entrepreneurial experience? Being surrounded by potential enemies certainly creates a national sense of urgency, but it's hardly limited to that. Its willingness to embrace innovation, train and retain the right people and attract risk capital is essential.

CASE STUDY: SILVER SPRING NETWORKS AND SPINBACK

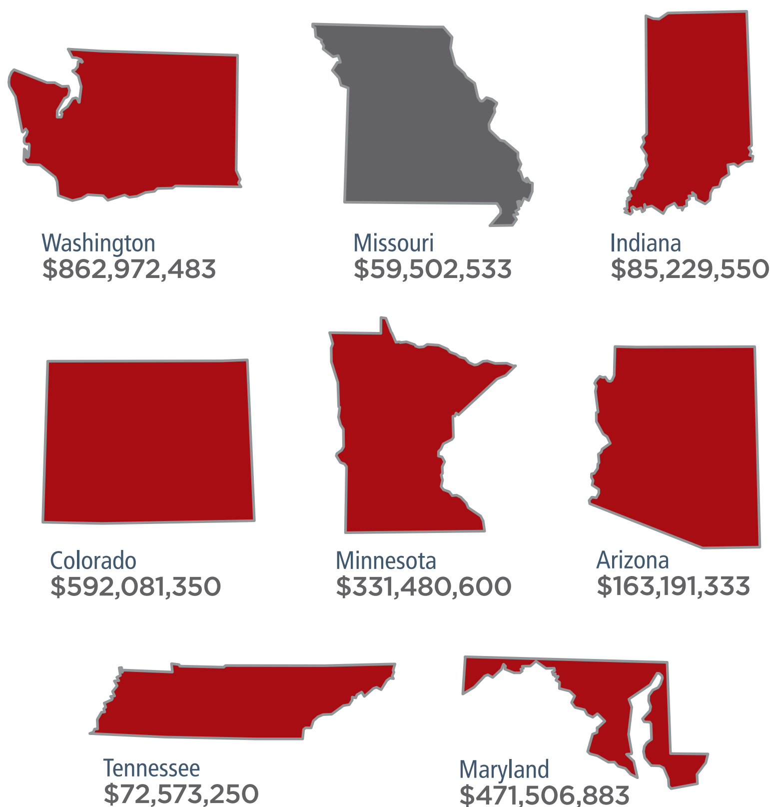
When is a success story also a story about a state's failure to keep its emerging companies at home?

Recent news about two companies with Wisconsin roots, Silver Spring Networks and Spinback, falls into both camps. Their stories also illustrate why Wisconsin needs more venture capital to help keep talent and technology within its borders.

Silver Spring Networks filed its paperwork this year with the federal Securities and Exchange Commission to begin the "initial public offering" process, which is how privately held companies issue common stock to the public for the first time. The company began under a different name in Milwaukee in 2002, but it was shuttered and transferred its technology to Silver Spring Networks (named after the city street) in 2003. An angel investor in Denver, Colo., provided early capital, and in late 2003 Foundation Capital Partners in Menlo Park, Calif., invested $8 million and moved the firm to Redwood City to find software and networking engineers. Foundation Capital quickly followed with another $44 million and Kleiner Perkins Caufield & Byers, another California-based investor, led a $75 million round in 2009.

PEER STATES WITH WISCONSIN WORKFORCE SIZE

HOW WISCONSIN STACKS UP



5 YEAR AVERAGE OF VENTURE CAPITAL INVESTMENTS IN PEER STATES

Spinback is a much more recent story. Founded by three UW-Madison graduates, it was sold recently to Buddy Media, a New York company that markets a Facebook advertising program. Spinback, which helps e-commerce retail firms track social media traffic and sales, was a New York company with six employees when it was sold.

On the one hand, these stories demonstrate that Wisconsin has the ideas and home-grown technology to compete globally. On the other hand, they highlight the difficulties associated with keeping those ideas, technology and talent in Wisconsin, where they can produce jobs and wealth for a state that could use a lot more of both.

The rap on Wisconsin for years was that it lacked the talent to grow. That is changing rapidly in the life science and software sectors, to cite two examples. Anchor companies in Wisconsin have become sources of management talent for emerging companies – and emerging companies have shown an ability to attract outside managers who once feared being marooned in Wisconsin if something went wrong. Those managers now know there's a chance to land on their feet.

The biggest remaining hurdle is access to capital. Angel network and fund investments in Wisconsin have grown sharply since the state passed a landmark tax credits law that took effect in 2005. In order for the investment ecosystem to work, however, venture capital and other forms of private equity must follow the angel rounds.

The stories of Spinback and Silver Spring Networks aren't the only examples of Wisconsin-born companies that moved away in search of capital. If the Legislature comes together around a bill that stimulate venture dollars, helps emerging companies and protects taxpayers, perhaps such stories will become old news instead of current events.

CASE STUDY: EXACT SCIENCES AND WISCONSIN'S BIOTECHNOLOGY INDUSTRY

If you didn't know that Exact Sciences was on the verge of a breakthrough in the war against cancer, you might conclude it's a company on the ropes.

The Madison-based firm reported in August that it lost about $6.6 million in the latest quarter and about $11 million for the first six months of 2011, numbers that could signal trouble for most publically traded companies of its size.

But for Exact Sciences, which moved to Wisconsin from Boston about three years ago under the leadership of president Kevin Conroy, the losses represent a common rite of passage for biotechnology companies – especially those savvy enough to develop game-changing drugs or diagnostic tests.

That rite is preparing for clinical trials, and it's a guaranteed drain on biotech company bank accounts.

Exact Sciences has begun clinical trials, a three-stage process required by the U.S. Food and Drug Administration, for its non-invasive test to screen for colorectal cancer. The test, called Cologuard, could revolutionize how people are tested for colorectal cancer, a slow-moving disease that can be treated and cured if detected early. The trials, which will involve 10,000 patients over the next year or so, began in June. If the trials pass FDA muster for safety and results, Exact Sciences could begin marketing Cologuard and start recovering the $100 million invested in the company over time. The company would likely grow by leaps and bounds and become Wisconsin's next biotech star. If the trials fail, well… a lot of investors would lose a carefully calculated bet.

Such is the life of a typical biotech company, especially one aspiring to create the next blockbuster drug or diagnostic test. It's a risky proposition, fraught with regulatory

peril, technological hurdles, management challenges and uncertain financial rewards – even if all goes well.

Over time, and against most odds, Wisconsin has become home to a cluster of biotech companies such as Exact Sciences. Today, however, Wisconsin's biotech industry is caught in something of a perfect storm. Some of those clouds are much like those looming over biotech firms in California or Massachusetts, such as federal patent backlogs that can hinder innovation and FDA regulations that compound the problem. At least one threat, however, is more acute in Wisconsin than in most other biotech states: Lack of venture capital.

More so than most emerging companies, those in the medical biotech space require lots of capital to move through the stages of discovery to delivery. The potential payoffs are enormous, however, because tech companies can produce hundreds of high-paying jobs over time. The average tech job in Wisconsin pays nearly twice the statewide per capita average.

Venture capital is invested across a mix of industry sectors, so it's not just biotech that would benefit from a state-leveraged plan that pays back taxpayers over time. But biotech is an example of a sector where large investments are often required.

WISCONSIN GROWTH CAPITAL COALITION

MEMBERSHIP AS OF AUGUST 25, 2011

Accuitive Medical Ventures
AlphaTech
Axley Brynelson
Baird Venture Capital
BizStarts Milwaukee
Burrill & Company
Calumet Venture Fund
Capital Midwest Fund
Central Wisconsin Angels
Charter Life Sciences
Chippewa Valley Angel Network
Competitive Wisconsin Inc.
Crescendo Ventures
CW Technologies
DaneVest Tech Fund I
Exact Sciences
The Falk Group
Foley and Lardner
Flaherty & Associates
Geo Investors Fund
Godfrey & Kahn
Golden Angels Network
Great Lakes Ventures
Greater Milwaukee Committee
Mason Wells
Michael, Best & Friedrich
Milwaukee Water Council
Neider and Bocher
NEW Capital Fund
Northwoods Angels
Omphalos Venture Partners
Open Prairie Ventures
Patriot Partners
Peak Ridge Capital Group
Phenomenelle Angels
Promontory Point Capital
Quarles & Brady
Ratio, Inc.
Rose Ventures
Rosetta Partners
Silicon Pastures
State of Wisconsin Investment Board
St. Croix Valley Angel Network
Sun Mountain Capital
Thrive
Triathlon Medical Ventures
University Research Park
Venture Investors
Whyte Hirschboeck Dudek
Wisconsin Alumni Research Foundation
Wisconsin Angel Network
Wisconsin Entrepreneurs Network
Wisconsin Innovation Network
Wisconsin Investment Partners
Wisconsin Technology Council
ZBB Energy
Zurex Pharma

IDENTIFYING A STRUCTURE FOR A STATE-LEVERAGED VENTURE PROGRAM IN WISCONSIN

The Wisconsin Growth Capital Coalition undertook an exhaustive analysis of the various models utilized in other states, including those previously promoted in Wisconsin. {A full listing of the various state-leveraged programs can be found in the appendix.}

While every model has some level of risk, cost and advantage, the coalition firmly believes that a fund-of-funds model with the following components has the greatest potential for success and is most suited to Wisconsin's existing entrepreneurial and investment infrastructure:

- Public-private partnership
- State-leveraged and backed by taxpayer guarantees and tax credits
- Professional fund management that is competitively selected
- Focuses on the full capital continuum
- Targets select industry clusters with high-growth, job creation potential
- Catalyzes and accelerate indigenous funds
- Attracts out-of-state funds
- Is self-sustaining or "evergreen"
- Maintains consistent deal flow by incenting the creation of angel "sidecar" funds

In short, the coalition recommends a state-leveraged fund-of-funds that is privately managed to invest in traditionally structured, experienced venture and angel capital funds across the full capital continuum to accelerate job creation in entrepreneurial startups.

A fund-of-funds is a proven investment vehicle that invests in other funds. It is a "master fund" whose holdings consist solely of shares of other funds. The advantage of the fund-of-funds model is the creation of a diversified portfolio of venture funds. It is important to note that it requires a strategic balance to achieve an internal rate of return (IRR) that outperforms its benchmarks, and business formation and job creation.

Similar models have worked in a number of peer states including Michigan, Ohio and Oregon. The coalition's research has shown that these and a number of other peer states have increased investment capital for entrepreneurs through a fund-of-funds model.

This approach would anticipate one fund-of-funds investing in 14 to 20 recipient funds of varying sizes over the life of the fund with a maximum one-fourteenth (1/14) of the funds given to any one recipient fund.

The recipient funds would commit to offices, staff and investments in Wisconsin. In addition to the venture funds, leveraged angel "sidecar" funds would efficiently invest in companies at the earliest stages of development, ensure consistent deal flow upstream and provide a statewide reach. Angel co-investment is an important component of the coalition's recommendations. {see page 25} For efficiency and manageability, the coalition recommends utilizing a limited number of sidecar funds as opposed to hundreds of individual investments.

In all cases, the recipient funds must make a firm commitment to invest an amount at least equal to the amount received from the fund-of-funds in Wisconsin businesses.

The coalition supports, without hesitation or reservation, the fund-of-funds model described in this white paper. That does

not mean that the model comes with no drawbacks. However, it is the model best suited to accomplish the following important and unifying goals:

- Enhance the overall availability of early stage capital in Wisconsin to facilitate greater economic growth;
- Support a program that enhances capital availability in a way that is fair to the taxpayers of Wisconsin;
- Find a way to invest money across the full continuum of early stage capital, from seed through follow-on rounds, while focusing on the immediate capital needs of emerging companies;
- Encourage emerging seed and venture funds to take root, and;
- Attract out-of-state capital for Wisconsin co-investment deals.

This model allows the state to tap private-sector expertise, catalyze indigenous capital growth, attract investment into Wisconsin from out-of-state, invest in those high-growth sectors companies most likely to succeed for Wisconsin, and ultimately help Wisconsin companies grow and create jobs.

This should be the outcome desired from any model. The primary focus of this program is assisting Wisconsin entrepreneurs and job creators and increasing their access to early stage capital. It is not about increasing investors' return on investment. Most important, it is not an entitlement for investors or a mechanism to make rich people richer.

PUBLIC-PRIVATE PARTNERSHIP:

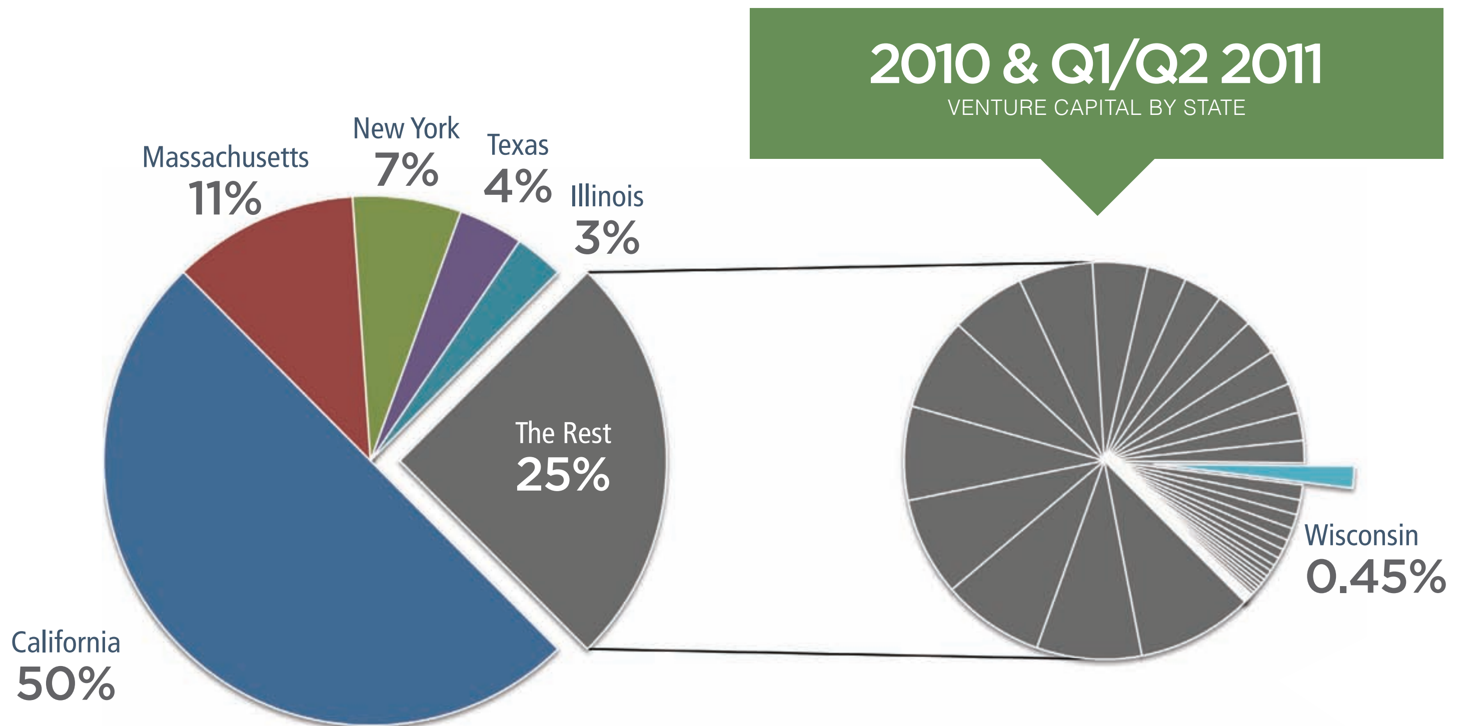
Merging the financial strength and stability of the state with the experience, expertise and portfolio of the private sector allows the state to direct an investment strategy that achieves broad sector and geographic diversification while maintaining an appropriate asset allocation with investments in companies at a diversity of stages.

The coalition recommends the creation of a Venture Capital Authority (Authority), linked to the Wisconsin Economic Development Corporation (Corporation), to oversee the capital-raising mechanism and the capital-deployment mechanism of the fund-of-funds.

STATE-LEVERAGED:

There are several mechanisms for raising the capital for the fund-of-funds. A combination of private placement bonds, backed by contingent tax credits, and other tax credit strategies are available to fund such a program. Each requires the state to act as the umbrella or catalyst. Each alternative has its pros and cons centered on timing of any expenses, and whether it is recorded as debt and expense, or a reduction in revenue.

The coalition's research shows that state-leveraged venture capital programs often borrow money to make their investments. States are able to obtain, or leverage, low-interest



loans from institutional investors by using future tax receipts as collateral. The bond is then used by the state to invest in venture funds. If the state's investments in venture capital funds return all of the invested capital plus interest and management fees, then the state's investment will be cost neutral. However, should the venture funds not provide enough return to cover the loan plus costs, then the state is required to make up the difference by using tax credits.

Typically, the structure outlined is only cost neutral if the investments provide an IRR greater than 10 percent. Similar to traditional retail investments (stock, mutual funds, etc.) the investment involves strategic decisions and the time to allow the investment to growth. Focusing on the IRR before the investments are fully able to mature will yield less than optimal results.

Unlike traditional retail investments there are ancillary benefits that are immediate — job creation, capital expenditures and other localized economic activity begin as soon as the entrepreneur has received the investment. Money invested in Wisconsin stays in Wisconsin.

BACKED BY TAXPAYER GUARANTEES AND TAX CREDITS:

The coalition does not favor the selection of any particular funding source and believes that the program will pay for itself over time with any of the following approaches.

PRIVATE PLACEMENT BONDING BACKED BY CONTINGENT TAX CREDITS:

Under this method, the state grants franchise, income and gross-premium tax credits to the Authority, and the Authority uses them as collateral for a debt offering. The capital is drawn in four or five equal annual installments and invested in the funds. Typically, interest only is paid through year eight, and the investment returns are used to pay the interest and principal in four or five equal installments beginning in year eleven. If there is a shortfall in available cash for payment of interest or principal, the tax credits are used in lieu of cash. The tax credits may be carried forward until fully used or may be transferred or sold.

PROS: This is a tried-and-true method. While the tax credits secure the principal and interest, only a fraction of them are expected to be used over time, and none can be used before the principal is due. Should the tax credits need to be drawn, there is a growing tax revenue stream from the companies funded and jobs created.

CONS: While the Authority is issuing the debt, not the state, a moral obligation pledge is generally needed because it results in lower borrowing rates. This non-binding pledge is an expression of the legislature's expectation and aspiration that the state will make an appropriation to pay the bondholder the amount of principal and interest or other financing charges if the Authority is unable and the tax credits are insufficient to pay on a bond. Conservative modeling of similar programs suggests a realistic expectation of a cost of 30 percent to 60 percent of the amount borrowed, primarily incurred in years 11 through 14 of the fund's life. However, this would be offset by tax revenues from new companies.

PUBLIC BOND ISSUANCE:

Bonds, backed by the full faith and credit of the state, are issued to raise the capital. The repayment of these bonds is funded through GPR expenditures with the expectation that investment returns transferred to the state and increased tax revenue associated with the program mitigates the budgetary impact.

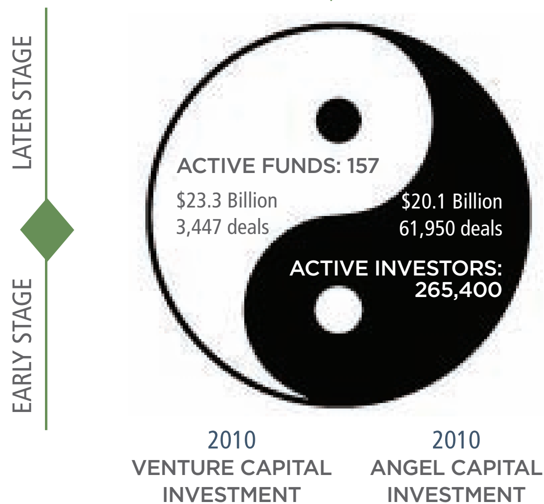
PROS: This is also a proven method. Backed by the state, they result in the lowest interest possible rate. Today's interest rates are among the lowest in history. By the time principal is being repaid, it is expected that the combination of investment returns and growing tax revenue stream from companies funded and jobs created will more than offset the debt retirement.

CONS: This will add to the state's total debt. Unless bonds are staggered over five years, it might result in additional interest costs because the full principal is outstanding longer.

Public and political reluctance to borrow, directly or indirectly, is a significant hurdle in developing a state-leveraged venture capital program. Developing a pay-as-you-go model, based on

THE YIN AND YANG OF CAPITAL MARKETS

ANGEL AND VENTURE FINANCING



the sale of tax credits, could reduce the risk and limit the state exposure associated with borrowing. To be clear, this does not mean that a pay-as-you-go model will be less expensive. It only means that the cost is more predictable and able to be planned for in the budget process.

SALE OF "LIQUID" TAX CREDITS:

Irrevocable, fully refundable and transferable tax credits are offered for sale to entities and individuals regardless of state tax liability. Sale of the credit is at a discount. Face value of credits is guaranteed to the holder but the state only receives a portion of the face value generally between 78 and 83 percent.

PROS: No debt is incurred or guaranteed by the state. No interest expense is incurred that requires payment. Once paid for, it will be budget favorable in all subsequent years.

CONS: These credits are fully "liquid" and could be monetized immediately, which negates the purpose of utilizing the credits. The state would receive less than the face value of these credits, but there will be a dollar-for-dollar, face value GPR expenditure cost to the state within a year or less of issuance during the early years of the program before there is an opportunity to generate returns or achieve meaningful growth in the tax base. These credits, if resold or transferred, are very difficult for the Department of Revenue to track.

SALE OF "TRADITIONAL" TAX CREDITS:

Irrevocable, non-refundable, non-transferable tax credits, with carry forward, are offered for sale to entities and individuals with a Wisconsin income, franchise and gross premium tax liability. Sale of credit is at face value, there is no discount. Principal is fully protected by face value of credits. Owners of the credits become limited partners in state's fund-of-funds with diluted shares. These limited partners share in a portion of the gains from the fund-of-funds.

PROS: No debt is incurred or guaranteed by the state. No interest expense is incurred that requires payment. Once paid for, it will be budget favorable in all subsequent years. Only risk to the purchaser is the "time/value" of money and opportunity cost of the purchase price. There is no GPR expenditure cost to the state budget. Unlike transferable and refundable credits these credits are relatively easy for the Department of Revenue to track.

CONS: There will be a dollar-for-dollar reduction in tax revenue to the state within a year or less of issuance during the early years of the program before there is an opportunity to generate returns or achieve meaningful growth in the tax base.

The sale of tax credits comes with significant policy questions, each with varying administrative and budget impacts. Policymakers should weigh the following choices when considering a tax credit sale:

- Traditional credits (non-refundable) vs. refundable vs. transferable
- Duration of carry forward
- Limits on amount of credits that may be used in a given year
- Type of tax for which credit may be used
- Resalable or transferrable more than once
- Fragmentable (able to be divided for sale or transfer)

It should be noted that the use of these mechanisms is not mutually exclusive. A combination of bonding (private or public) and tax credits (traditional or liquid) could be offered to entities and individuals in a variety of sectors.

Regardless of which capital-raising mechanism or mechanisms are utilized, the fund-of-funds would need the ability to raise capital over five years, creating the availability of up to $70 million a year in amounts of $1 million to $25 million per recipient fund, in three to four funds annually, resulting in the funding of 14 to 20 funds over five years.

PROFESSIONAL FUND MANAGEMENT THAT IS COMPETITIVELY SELECTED:

Sending money out the door is simple. Sending money out the door into smart investments that create jobs in Wisconsin is far more challenging.

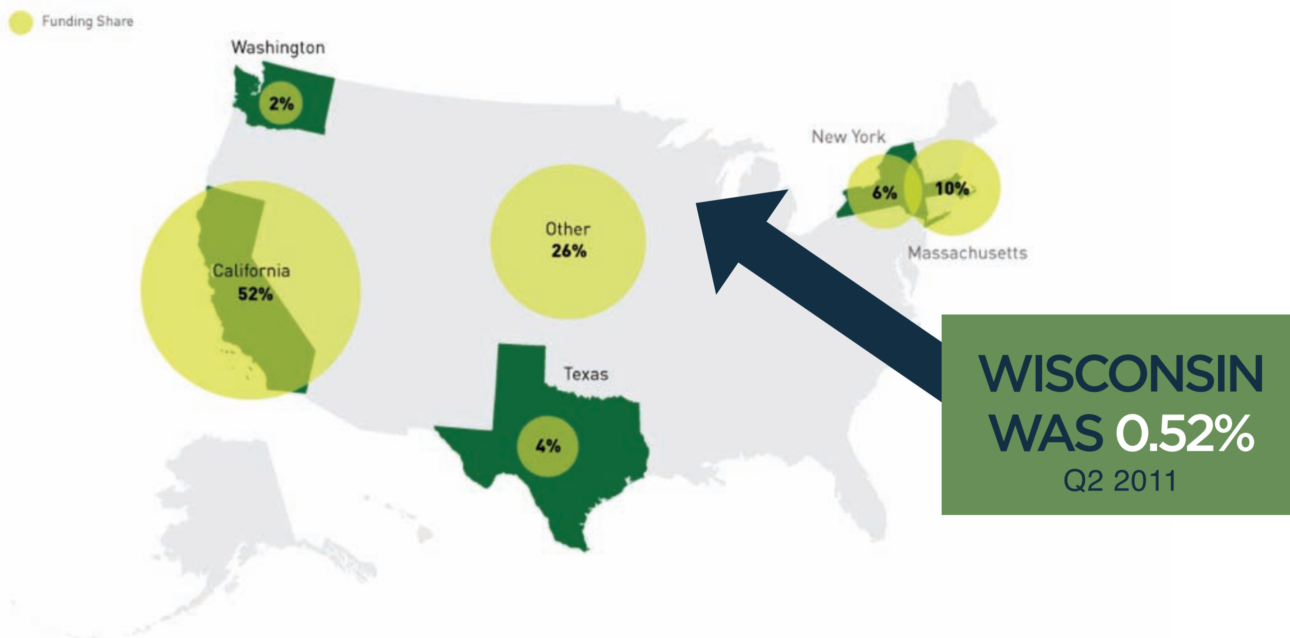
Managing the investments and helping the companies succeed is a highly complex business that requires exceptional analytic, strategic, and leadership skills that only come with sector specific industry knowledge and extensive industry experience. It takes an extraordinary time commitment and private sector experience.

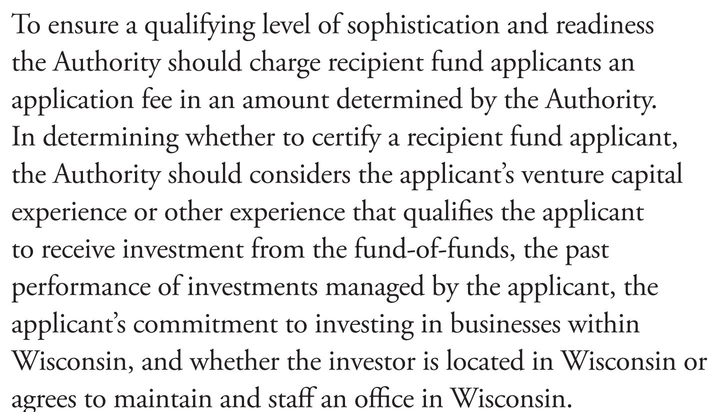
The Authority must hire a qualified fund manager to manage the fund-of-fund's investments. The fund-of-funds manager should be competitively selected by the Authority and required to open and staff a Wisconsin office.

The fund-of-funds manager must establish and maintain an investment policy for the fund-of-funds that the Authority reviews and approves on an annual basis. The fund manager's fees should be capped at 0.5 percent of the fund's committed capital with no carried interest.

By bringing in an experienced fund manager (there are four or five national candidates), the state will benefit by plugging into a deep syndication network of venture firms that co-invest with local and regional funds. Many fund managers have a proven record of bringing in syndication partners that invest in multiples of the lead investment amount.

This model should leverage the existing relationships of the fund-of-funds manager, which should have significant dollars under management and is actively deploying capital into venture funds nationwide. This will create access to capital for Wisconsin entrepreneurs in various industry sectors and different stages of development and plug Wisconsin's venture community into the national syndication market.





To ensure a qualifying level of sophistication and readiness the Authority should charge recipient fund applicants an application fee in an amount determined by the Authority. In determining whether to certify a recipient fund applicant, the Authority should considers the applicant's venture capital experience or other experience that qualifies the applicant to receive investment from the fund-of-funds, the past performance of investments managed by the applicant, the applicant's commitment to investing in businesses within Wisconsin, and whether the investor is located in Wisconsin or agrees to maintain and staff an office in Wisconsin.

SCOPE OF FUND:

The fund-of-funds manager should be directed to make targeted investments in recipient funds that accomplish specific, predefined goals and to generate a superior rate of return for the fund-of-funds.

The scope of the fund-of-funds should address various company stages: idea, pre-seed, seed, startup, expansion and growth, with the most job creation potential clustered toward the later stage or upper end of the spectrum.

The manager would deploy the state-leveraged capital by investing in smaller, indigenous Wisconsin funds and leading national and regional venture capital funds. The manager should be directed to make investments in angel funds, venture capital funds (including funds specifically focused on seed and early stage companies), and private equity growth funds to diversify the portfolio and accomplish the policy goals of the program.

The definition "early stage" should be written in a way that allows maximum flexibility within the full spectrum of funds focused on investing in this stage, specifically seed and angel network/fund investments to other early stage funds.

STIMULATE INDIGENOUS FUNDS:

One reason why Wisconsin fares poorly in venture capital investment is the lack of home-grown or indigenous funds. In fact, Wisconsin has only 0.11 percent of the nation's venture capital under management. To create permanent and sustainable venture capital investment in Wisconsin it is vital to grow our own indigenous venture funds.

This fund should be structured to encourage emerging venture and angel funds in Wisconsin to grow and invest close to home. Possible incentives include fast-tracking of existing, certified Wisconsin venture funds and setting favorable matching requirements for the fund-of-funds investment at a dollar-for-dollar match compared to one dollar for every three dollars raised for other funds.

Another advantage is the reservation of a pre-determined percent of the fund-of-funds' allocation for Wisconsin venture funds. This will have the side benefit of building a local venture capital community that is capable of investing in a variety of sectors at various stages of development.

The coalition recommends that a minimum of one-third ($117 million at the target of $350 million) be committed to "Certified Wisconsin Funds," with the flexibility to exceed that percentage.

The definition of a "Certified Wisconsin Fund" should have the following attributes:

- At least half the members of the general partner live and principally work out of an office in Wisconsin.
- At least half the voting control and carried interest is held by the members of the general partner that live and principally work out of an office in Wisconsin.

Indigenous Wisconsin funds should be eligible for a favorable match of 1:1, compared to the required out-of-state recipient fund match of 3:1. This should not be an entitlement. There should be no guarantee that the fund-of-funds will give any recipient fund the maximum they are eligible to receive.

No fund should be eligible to receive more than one-fourteenth (1/14) of the available pool to assure the diversity of in-state/out-of-state funds, stage focus, and sector focus.

The Authority and fund-of-funds manager should be granted the flexibility to do what is best for the entrepreneurs. This includes avoidance of legislative mandates for stage or sector. It is important to have trust and confidence that the Authority and the fund-of-funds manager will understand the need for an appropriate mix. Legislative investment mandates in this program will reduce flexibility and deployment speed, add complexity, create challenges in establishing definitions and

unnecessarily enhance the risk of investing in Wisconsin. This model should leverage at least 14 funds over several vintage years, multiple stages of development, a variety of industry sectors, funds of different sizes, and a mix of indigenous Wisconsin funds and experienced larger out-of-state funds. In order to ease administrative burden and to provide preference to Wisconsin-based funds, those already certified under the provisions of Act 255 should be exempt from the certification process.

This would allow existing Wisconsin funds, certified by the Corporation, to be "grandfathered." Any application under review for certification, if ultimately approved, and any "pre-qualified" certification by the Corporation should qualify the fund for certification.

These funds have an existing commitment to invest in Wisconsin, requiring them to apply under a new certification process is administratively burdensome to the funds and to the Corporation.

Moreover, it does not recognize and reward the commitment they have already made to Wisconsin. Nor does it create a preference for indigenous funds or an incentive for existing Wisconsin funds to participate in the new program.

ATTRACT OUT-OF-STATE VENTURE CAPITAL:

The coalition believes that Wisconsin would benefit from the presence of multiple, larger out-of-state funds over the next five years. By investing the money into several leading funds across many stages, a greater probability of success is created, while risk is reduced through portfolio diversification. An important goal of a state-leveraged fund-of-funds is to entice the fund-of-funds manager and the recipient funds to open offices in the state.

The fund-of-funds should be designed to attract regional and leading national funds with an interest in investing in Wisconsin. There should be a requirement that those funds invest in Wisconsin an amount comparable to what they receive from the state of Wisconsin and that the fund opens and maintains an office in Wisconsin.

This requirement is based on past experience in Wisconsin with funds such as Frazier Technology Ventures, which failed to invest here despite having receiving a sizable SWIB investment and opening an office in Madison. Wisconsin needs larger funds to invest here because of the size of follow-on rounds, but it cannot afford to invest in funds that won't actually invest here.

QUALIFIED BUSINESSES AND SECTOR TARGETS:

Venture capital is not a fit for every company or sector. The limited resources of the fund-of-funds and recipient funds make it important to focus on sectors that need venture capital versus those that have access to capital from more traditional sources.

That means the state must sharpen the focus of its investment. More important, sectors that "trail" other production sectors and are tied to the multiplier effect of economic growth are usually not efficient investments.

Once it receives investment capital from the fund-of-funds, the recipient funds are expected to invest that capital in certain kinds of businesses, called "qualified businesses." In particular, a qualified business is a business that meets conditions such as the following:

- The business's headquarters are in Wisconsin.
- The business is in need of venture capital and is unable to obtain conventional financing.
- The business is primarily engaged in a targeted sector and is not in a sector excluded from the program.
- The business must agree not to relocate its headquarters outside of Wisconsin and to maintain a significant percentage of its employees or payroll in Wisconsin.

Much like the successful Act 255 investor tax credits, the fund-of-funds should focus on targeted industry clusters where there is significant high-growth, job creation potential. The state's greatest growth potential lies in tech-driven sectors such as information technology, advanced manufacturing, value-added agriculture, life sciences and other fields where technology is an important value-added component. The recipient funds should

focus on the industries in which the state has growth potential and already excels. The target definition in the Act 255 program could serve as a model to be followed by the fund-of-funds manager:

Businesses engaged in developing new products or business processes, are in the manufacturing or agriculture industries, or are processing and assembling products and are conducting research and development activities…

Similarly, the fund-of-fund manager may consider the following definition from Act 255 in considering which recipient funds should be selected based on their investment strategies:

Businesses engaged in real estate development or sales, insurance, banking, lending, lobbying, political consulting, professional services, or retail sales, other than direct sales of products the business itself manufactures are not eligible for the program.

Recipient funds should be required to make investments in qualified businesses based on a specific investment schedule, and after seven years, a fund must have placed 100 percent of its capital received with qualified businesses.

SIGNIFICANT EARLY STAGE FOCUS:

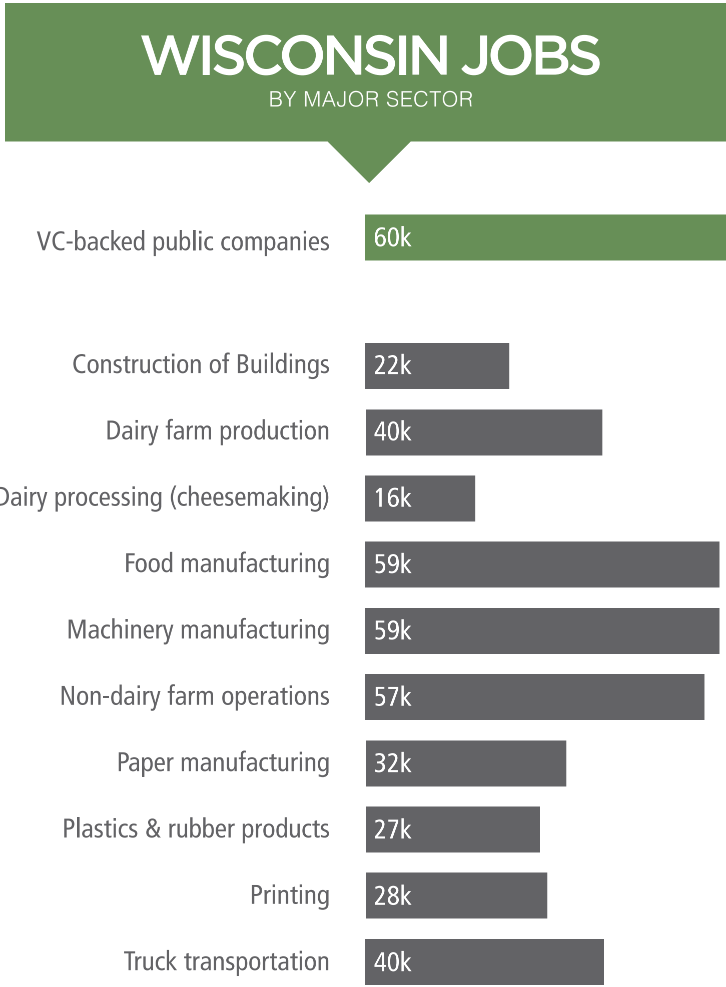
The coalition believes that a significant percentage of the fund-of-funds' investment must be invested in qualified businesses that would legitimately be considered early stage. The fund-of-funds manager could follow these ideas in defining a Wisconsin early stage company:

- Associated gross revenue of $2 million or less in the fiscal year immediately preceding the date of investment
- Seeking equity funding for pre-commercialization activities related to the development of a proprietary new product or process in Wisconsin
- In business for no more than 10 consecutive years
- Principal administrative offices located in Wisconsin
- At least 80 percent of payroll in Wisconsin
- Less than 100 full-time equivalent (FTE) employees
- At least 51 percent of employees work in Wisconsin
- Since inception, received, in aggregate, no more than $10 million of equity investment

FUND SUSTAINABILITY AND "EVERGREEN" FEATURE:

The fund's growth could be supplemented over time through a percentage of tax revenues from the companies receiving fund investments. This can be done through coordination with the Wisconsin Department of Revenue.

The Authority's administration of the fund-of-funds could be supported in part by tax revenue raised from businesses that receives investment from the recipient funds. The Authority and the Department of Revenue (DOR) would coordinate with each other to determine the amount of withholding taxes that each business that receives investment capital paid for the year prior to the first year in which the business received any such investment. Then, each year for 15 years following that first year of investment or until the fund-of-funds is dissolved, whichever occurs first, DOR transfers to the authority an amount equal to 50 percent of the increase, if



any, in withholding taxes paid by the business over the amount determined, as described above, for the year prior to that first year of investment.

Companies funded a recipient firms would have a tax baseline established, consisting of the total payroll withholding, sales and corporate income taxes in the year prior to their first receipt of funding. Any increase in tax revenue generated from the company's activity would be used to pay down the debt of the fund-of-funds or offset the need for additional tax credits, ultimately freeing up the collateral for further borrowing and fund-of fund investments beyond year five.

Once an investment pool of $100 million is established, the diversion of the incremental tax revenue to the fund-of-funds would be discontinued and the fund-of-fund would become self-sustaining from the returns on its venture capital investments.

A more ambitious yet equally beneficial approach similar to the approach of the existing Kansas Biotech Authority could also be used. This "evergreen" mechanism would expand tax-base growth sharing from the taxes generated by individual companies to entire sectors utilizing NAICS codes. This would allow for the re-investment of proceeds not just from the companies that receive direct investment but also the revenues that flow from the economic clustering that occurs.

DECERTIFICATION; DEFUNDING AND PENALTIES FOR NONCOMPLIANCE:

If a recipient fund fails to satisfy the investment schedule, it may be required to refrain from paying any management or similar fee until required investments are made.
The authority must also have the ability to decertify and defund a recipient fund that violates the requirements of the program. The Authority should be authorized to levy a significant and punitive fine against any person that violates the requirements of the program.

INDEPENDENT BOARD OF DIRECTORS:

The Authority should be governed by a small board of directors. To ensure sufficient collaboration and oversight, the board of directors should consist of the chief executive officer of the Wisconsin Economic Development Corporation and the Secretary of the Wisconsin Department of Revenue. The remaining members should represent the private sector. Nominated by the governor and appointed with the advice and consent of the senate, these members must have experience that qualifies them to serve on the board. The members of the board should not be compensated, other than reimbursement for actual and necessary expenses, including travel expenses, incurred in the performance of their duties.

ANNUAL REPORTING REQUIREMENT:

For public accountability and full transparency, the Authority should be required to submit an annual report to the Corporation, the legislature and to the governor that contains information such as:

- An assessment of the success to date of each program administered by the Authority.
- An accounting of the financial status of each program administered by the Authority, including the opinion of an independent certified public accountant.
- Any recommendations the Authority has for the improvement of each of its programs.
- In addition, the Authority could include in its annual report to the Corporation, the legislature and the governor all of the following information specifically relating to the fund-of-funds:
- The current investment policy of the fund.
- The fund-of-funds' internal rate of return from its investments.
- The recipient fund's internal rate of return from its investments.
- An accounting of the withholding tax revenue received by the authority from businesses that received investment capital contributed by the fund.
- An accounting of any compensation, including a management fee, paid to the fund manager during the preceding year.
- An accounting of any compensation, including a management fee, paid to the recipient fund managers during the preceding year.
- An accounting of the value of tax credits awarded to bondholders or sold during the preceding year, including a description of the circumstances leading to the award of the credits and the likelihood that the authority will award or sell additional tax credits in the future.

QNBV AND DOUBLE-DIPPING:

A recipient fund should not be allowed to apply the amount of capital it receives from the fund-of-funds toward certification for purposes of receiving early stage or angel investment tax credits from the Wisconsin Economic Development Corporation.

STRENGTHENING ANGEL INVESTING: WE ARE ONLY AS STRONG AS OUR SUPPLY CHAIN

The focus of the coalition was to enhance venture capital in Wisconsin. The coalition recognizes that an important part of this effort is ensuring a vibrant deal flow from Wisconsin's active angel networks.

The creation of Wisconsin Angel Accelerator Funds would act as "sidecar" funds that would invest alongside angel groups and angel investors in innovative high-growth startups that promise sustained revenue and increased employment in Wisconsin. The funds would be required to provide geographic diversity and be Certified Wisconsin Funds under the state-leveraged venture capital program. The funds would receive a dollar for dollar match to its fundraising.
The goals of the funds would be to:

- Accelerate the growth of companies seeking angel investment;
- Increase the number of investment-grade companies;
- Accelerate angel capital investment in Wisconsin companies;
- Position more Wisconsin-based companies to attract later stage investment and create high-paying, private sector jobs;
- Accelerate the growth and formal structure of more angel groups in Wisconsin;
- Provide angel investors additional capital to close investment rounds.

A sidecar fund can help fill the gap when a round falls a little short as well as provide "dry powder" for follow-on investments in a particular company. If the business is doing well, sidecar capital can help leverage growth. If the business is struggling, there is the potential for capital to help turn the situation around.

A sidecar fund can be a particularly useful and efficient source of capital in a growing entrepreneurial ecosystem and a way to expand investor participation. Adding a sidecar investment to a committed round of angel capital benefits entrepreneurs, angel investors and the entrepreneurial ecosystem.

To ensure the continued viability of the Accelerate Wisconsin program, the coalition also recommends the following changes:

- Make the credits refundable if the investment is held for more than three years.
- Provide the Wisconsin Economic Development Corporation the flexibility to prorate credits if an investment is not held for three years, as long as the exit does not dramatically alter the company's employment base in Wisconsin.
- Allow investments under the state's new capital gains program to be invested in Certified Wisconsin Funds. Currently the program is only for investments directly into qualified Wisconsin companies.
- Direct the Wisconsin Economic Development Corporation to active pursue the creation of tribal venture funds and to incent angel and venture capital investments in tribal companies.

EARLY STAGE INVESTMENT SUCCESS STORIES INVESTMENT

Here are just some examples of how early stage, private equity investments are helping to create companies and jobs in Wisconsin.

LOGISTICS HEALTH INC.

Founded by Don Weber, an entrepreneur whose military service convinced him there was room for a better system of managing the health of armed services personnel, Logistics Health Inc. went from under 20 employees 10 years ago to about 1,000 today. With an investment round led by TA Associates, Logistics Health grew into one of the mainstays of the La Crosse economy. It was recently acquired by UnitedHealth Group Inc.

U.S. TRAILMAPS

This Wausau-based venture was a past finalist in the Governor's Business Plan Contest and is a leading provider of GIS-derived map data for recreational trail activities. Founded in 2005, U.S. Trailmaps provides mapping data to leading GPS-device manufacturers. The company also provides data for map and smart phone application developers and co-develops related social media sites. Financing rounds totaling $650,000 have been led by Fitchburg-based Kegonsa Capital Partners.

IDLE FREE SYSTEMS

Founded in Watertown, Idle Free Systems Inc. is an innovative provider of the only complete, year-round idle-elimination solutions for school buses and trucks. The Kegonsa Seed Fund was the seed round investor and in 2009 Idle Free closed on a first financing round of $1.3 million. The company's 2010 sales results were very strong, exceeding 2009 by more than 200 percent. The company is hiring.

NIMBLEGEN

This Madison-based company produces high-density DNA microarrays used in pharmaceutical research. Baird Venture Partners invested in NimbleGen in 2001, co-led a subsequent financing for the company in 2004, and exited its investment in 2007 when it was sold to Roche for $272.5 million.

MORTGAGEBOT

This is a provider of online mortgage application technology based in Cedarburg. Mortgagebot was founded in 1997 by M&I Bank. Original investors included Banc One Stonehenge Capital Fund Wisconsin and GE Mortgage Insurance. Mortgagebot was spun off in 2001 to a management-led group of investors, backed by $84 million from Spectrum Equity Investors of Boston, Mass. On March 24, 2011, Davis + Henderson, a Toronto-based corporation acquired Mortgagebot, for $231.8 million in cash.

PINSTRIPE

This Milwaukee-based business services firm that provides recruitment process outsourcing. In 2005, Baird Venture Partners exited their investment in Pinstripe after helping the company with its Company Series' A Preferred Stock Financing.

JELLYFISH.COM

This Middleton-based company operates an online comparison shopping site. Jellyfish.com was founded in 2006 with the help of $6.2 million from cash infusions from the founders and two financing rounds led by Fitchburg-based Kegonsa Capital Partners. Microsoft paid a reported $50 million for the company in 2007.

Kelly Fitzsimmons, Harqen

TOMOTHERAPY

This Madison-based company began as a University of Wisconsin-Madison spinout and grew into a major manufacturer of CT scanners for radiation therapy. In March 2011, TomoTherapy announced it will be acquired by Accuray for $277 million. The combined company, which will maintain offices and manufacturing in Madison, will have an installed base of 550 units in 32 countries, and more than 1,100 employees. The combined revenue of the two companies in calendar year 2010 exceeded $400 million, 30 percent of which was generated from service of the installed base. This is one of several Wisconsin companies with a CEO rooted in GE Healthcare, Fred Robertson.

CELLECTAR

This Madison-based radiopharmaceutical company that designs and develops products to detect, treat and monitor human cancers. In 2007, Cellectar raised $7 million in what is believed to be the largest round of funding from angel investors in Wisconsin history. The $13 million round was led by Venture Investors, which invests in early stage Wisconsin companies, and Advantage Capital of St. Louis. Cellectar continues to meet the milestones necessary to complete clinical trials for its lead drug candidate, 131I-CLR1404.

VIRENT ENERGY

This producer of "green gasoline" in based in Madison and has attracted nearly $100 million in funding since it spun out of the University of Wisconsin-Madison about nine years ago. Virent produces advanced sustainable biofuels, including biogasoline that can be run through standard gasoline pumps and jet fuel. In June2010, Virent announced that it had closed on a $46.4 million third round of funding. Investors included Royal Dutch Shell, Cargill and Honda.

NAMEPROTECT

This Madison-based company researches trademarks and monitors the internet for abuse of brand names, such as counterfeiting and "phishing" attacks. Nameprotect was sold in 2007 to Corporation Service Co., Wilmington, Del., for terms not disclosed. It had received venture funding from Milwaukee's Mason Wells and the State of Wisconsin Investment Board.

PROMEGA

This Fitchburg company has been described as the "granddaddy of biotechnology" in Wisconsin, and with good reason. Many biotech companies and managers in Wisconsin today can trace their lineage to Promega, which has grown to more than 1,000 employees in Wisconsin and around the world. Privately held today, Promega grew in part through investments by Venture Investors LLC.

PRODESSE

The rise and sale of Waukesha-based Prodesse Inc. to Gen-Probe of San Diego is a shining "how-to" example for Wisconsin entrepreneurs and investors working toward an exit. After 13 years and $4.5 million of investments, the company was acquired for $60 million and an additional $27 million of incentives, $10 million of which were quickly met. The company's technology came from researchers at the Medical College of Wisconsin and in 2002 it received an initial investment of $1.5 million by a group of angel investors. Further rounds of funding came from others, including the Marquette Golden Angels Network. Even after acquisition, the company's high-paying jobs remain in Wisconsin and Prodesse's investors are investing in more Wisconsin start-ups.

ZBB TECHNOLOGIES

Serial entrepreneur Eric Apfelbach has raised more than $170 million, from grants to loans to venture capital, for the four start-ups he has led. His latest venture is helping to tackle the largest problem for the alternative energy market – reliability. ZBB Energy Corp.'s energy storage technology and power control platforms enable integration of renewable energy sources, providing constant and level power from variable alternative energy sources. When President Obama wanted to visit a company that is making a difference in energy technology, he toured Milwaukee-based ZBB in mid-2010.

ESO-TECHNOLOGIES

Eso-Technologies made its debut to investors during the 2008 Wisconsin Early Stage Symposium's Elevator Pitch Olympics. Not only did co-founder Bonnie Reinke walk away from the contest with the first place trophy, she also pocketed several business cards from angel investors. The next year, she won the statewide Governor's Business Plan Contest. Those company building steps led to an investment of $1 million from DaneVest Tech Fund, Phenomenelle Angels and Wisconsin Investment Partners. Investors were impressed by the management team and the company's life-saving, esophageal cardiac monitoring technology. Since the equity infusion the company has been cleared for initial trials, which are underway.

SOLOGEAR

SoloGear was co-founded by serial entrepreneur Chad Sorenson, whose previous start-up, Fluent Systems, was acquired 18 months after it was founded. SoloGear has developed a patent-pending fuel mixture that it has deployed first as a charcoal alternative called FlameDisk. The company has thus far raised more than $6 million from investors. On April 27, 2011, BIC Corp. announced it had acquired SoloGear for an undisclosed price. The company continues to expand its Middleton, Wis.-based manufacturing and distribution facility to keep up with demand. FlameDisk is available at retailers nationwide including Target, Wal-Mart, The Home Depot and Aldi.

SEMBA BIOSCIENCES

Semba Biosciences was launched in 2005 by members of the management team from EMD Chemicals, formerly Novagen, after EMD's parent company consolidated the work of the Madison plant in San Diego. Then a funny thing happened: Virtually all of 70 EMD employees chose to stay in Wisconsin. A dozen of them are now working for Semba, a Fitchburg, Wis.-based firm that develops scientific equipment used to purify substances used in drug development and research, as well as the food industry. The company hit $1 million in sales for 2010.

AURIZON ULTRASONICS

Aurizon Ultrasonics is a technology spinout from the Fox Valley's Kimberly-Clark Corp. The ultrasonic technology uses sound waves rather than glue to do high-speed bonding of materials such as the plastic in diapers. NEW Capital fund invested in the company's seed round and is a partner alongside Kimberly-Clark. Wisconsin is home to many large companies performing research and development. Aurizon is an example of an emerging model in Wisconsin where technology is transferred from bigger companies to start-ups, providing for a more entrepreneurial commercialization of the technology than available in a larger corporation.

ALICE.COM

"Why doesn't anyone buy toilet paper online?" As simple as that question might seem, it was the spark behind the creation of Alice.com, the latest web-based brainchild of Mark McGuire and Brian Wiegand, two of Wisconsin's serial entrepreneurs. Consumers who sign up at Alice.com can buy toilet paper, toothpaste, laundry detergent and other household essentials at reasonable prices and have them delivered to their homes with no shipping charges. Alice.com raised $4.3 million in 2009 in a first financing round led by Kegonsa Capital and DaneVest Tech Fund. McGuire and Wiegand left Microsoft Corp.'s Madison office to start the company. They joined Microsoft when it acquired their last start-up, Jellyfish.com, for a reported $50 million. This dynamic duo's other startups were Bizfilings.com (sold to Wolters-Kluwer in 2001) and NameProtect.com (sold to Corporation Services Corp. in 2007).

MIRUS BIO

Jim Hagstrom is a small-town kid from Ashland, Wis., who helped land a big-time deal. Hagstrom is one of the founders of Mirus Bio Corp., which was acquired by Roche for $125 million in 2008. The Swiss-based pharmaceutical company is keeping Roche-Mirus is Madison, where the company continues to work on its proprietary RNAi (Ribonucleic Acid interference) delivery platform. This was the second purchase by Roche in the Madison market. A year earlier, the company acquired NimbleGen for $272.5 million.

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Acknowledgements

The Wisconsin Growth Capital Coalition was first organized in 2009 by members of Wisconsin's high-growth economic community to offer suggestions for improving Act 255, the state's investor tax-credit law.

It was reorganized in 2011 through the Wisconsin Technology Council and its Wisconsin Angel Network to provide a larger forum for discussion of a proposed venture capital program for Wisconsin.

The coalition would like to thank those members who worked on two standing committees – Needs and Structure – and others who contributed their time and advice throughout the process of deliberating and writing this white paper.

The coalition's guiding principles, as discussed and adopted by the group, are as follows:

- Enhance the overall availability of early stage capital in Wisconsin to facilitate greater economic growth;
- Support a bill that enhances capital availability in a way that is fair to the taxpayers of Wisconsin;
- Find a way to invest money across the full continuum of early stage capital, from seed through follow-on rounds, while focusing on the immediate capital needs of emerging companies;
- Encourage emerging seed and venture funds to take root, and;
- Attract out-of-state capital for Wisconsin co-investment deals through a fund-of-funds approach

Staff:
Tom Still, president, Wisconsin Technology Council
Zach Brandon, director, Wisconsin Angel Network

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FREQUENTLY ASKED QUESTIONS ABOUT VENTURE CAPITAL

WHAT KIND OF INVESTORS ARE VENTURE CAPITALISTS?

Venture capitalists are professional investors who specialize in funding and building young, innovative enterprises. Venture capitalists are long-term investors who take a hands-on approach with all of their investments and actively work with entrepreneurial management teams in order to build great companies.

WHERE DO VENTURE CAPITALISTS GET THEIR MONEY?

Most venture capital firms raise their "funds" from institutional investors, such as pension funds, insurance companies, endowments, foundations and high net worth individuals. The investors who invest in venture capital funds are referred to as "limited partners." Venture capitalists, who manage the fund, are referred to as "general partners." The general partners have a fiduciary responsibility to their limited partners.

HOW MANY VENTURE CAPITAL FIRMS ARE THERE IN THE UNITED STATES?

There were about 794 venture capital firms in the United States in 2009; these firms manage about $179 billion.

WHAT'S THE AVERAGE SIZE OF A VENTURE CAPITAL FUND?

In 2009, the average venture fund size was $151 million. The average deal size in 2010 was about $6.7 million.

HOW MANY COMPANIES RECEIVE VENTURE CAPITAL FINANCING EACH YEAR?

In 2010, venture capitalists invested about $23.3 billion into nearly 3,500 companies.

WHAT TYPES OF COMPANIES AND INDUSTRIES DO VENTURE CAPITALISTS INVEST IN?

Venture capitalists invest mostly in young, private companies that have great potential for innovation and growth. Venture capitalists have been instrumental in developing sectors such as the computer, biotechnology and the communications industries. Today, the majority of venture capital is invested in high technology companies including software, biotechnology, medical devices, media and entertainment, wireless communications, Internet, and networking. In the last five years, the venture industry has also committed itself to investing in the clean technology sectors, which include renewable energy, environmental and sustainability technologies and power management. However, venture capitalists also invest in innovative companies within more traditional industries such as consumer products, manufacturing, financial services, and healthcare services and business products and services.

WHAT EFFECT DOES VENTURE CAPITAL HAVE ON THE ECONOMY?

Venture capital activity has a significant impact on the U.S and global economies. Venture capital is a catalyst for job creation, innovation, technology advancement, international competitiveness and increased tax revenues. According to the 2009 Venture Impact study, produced by IHS Global Insight, originally venture-backed companies accounted for 12.1 million jobs and over $2.9 trillion in revenue in the United States (based on 2008 data).

HOW ARE VENTURE CAPITALISTS DIFFERENT FROM OTHER INVESTORS?

Venture capitalists are long-term investors who take a very active role in their portfolio companies. When a venture capi-

talist makes an investment he/she does not expect a return on that investment for seven to 10 years, on average. The initial investment is just the beginning of a long relationship between the venture capitalist and entrepreneur. Venture capitalists provide great value by providing capital and management expertise. Venture capitalists often are invaluable in building strong management teams, managing rapid growth and facilitating strategic partnerships.

HOW DO VENTURE CAPITALISTS REALIZE A RETURN ON THEIR INVESTMENT?

The companies that venture capitalists invest in are private enterprises. Typically, the venture capitalist realizes a return on their investment when the company goes public (IPO) or is merged or purchased by another company (M&A).

WHAT PERCENTAGE OF VENTURE-BACKED COMPANIES SUCCEED?

Venture capitalists invest in high-risk enterprises. However, venture capitalists manage that risk through portfolio risk management. It is estimated that 40 percent of venture backed companies fail; 40 percent return moderate amounts of capital; and only 20 percent or less produce high returns. It is the small percentage of high return deals that are most responsible for the venture capital industry consistently performing above the public markets.

WHAT'S THE DIFFERENCE BETWEEN VENTURE CAPITAL AND PRIVATE EQUITY?

Venture capital is a subset of the larger private equity asset class. The private equity asset class includes venture capital, angel capital, buyouts, and mezzanine investment activity. Venture capital focuses on investing in private, young, fast-growing companies. Buyout and mezzanine investing focuses on more mature companies. Angel capital can be invested by individuals, networks or funds. Venture capitalists also invest cash for equity. Unlike buyout professionals, venture capitalists do not use leverage in their transactions.

Sources: National Venture Capital Association; State Science and Technology Institute; Wisconsin Technology Council

DEFINITIONS AND GLOSSARY OF TERMS

Angel financing is risk capital invested by high net worth individuals or angel networks and funds into firms primarily at the seed, startup, early and expansion stages.

Corporate or "strategic" venture capital most often refers to direct investments that are aligned with the primary business or mission of a non-financial corporation.

Fund-of-Funds is a master fund whose holdings consist solely of other funds.

GPR (General purpose revenue) is revenue generated from taxes in the State of Wisconsin.

Initial public offerings, or IPOs, are public offerings of common stock that create market value and a public market for trading the shares of a corporation.

IRR (Internal rate of return) is an interest rate giving a net present value of zero when applied to expected cash flow. It is the rate of growth a project is expected to generate.

Private equity and buyout funds/mezzanine finance provides capital to later-stage companies to expand or acquire businesses, to solidify working and investment capital structure, and to liquidate the investments of owners and early investors.

Seed, early and expansion stage venture capital firms make up the bulk of professional venture capital entities and resources in the United States, and generally make investments across the financing continuum.

Sidecar funds are committed capital that "rides" alongside the individual capital invested by angel groups and angel investors.

Venture finance addresses the funding needs of entrepreneurial companies that do not generally have the size, assets and operating histories necessary to obtain capital from traditional sources, such as public markets and banks.

Venture capitalists foster growth in companies through their hands-on involvement in the management, marketing and planning of their portfolio companies. Venture capitalists invest alongside management and other stakeholders through an assortment of equity and equity-like financing positions. As equity and board members, venture capitalists succeed when the portfolio company succeeds.

Venture finance firms or funds generally are private partnerships or closely held companies funded by private and public pension funds, endowment funds, major corporations and commercial banks, foundations, wealthy individuals and the venture capitalists themselves.

APPENDIX:
STATE-BY-STATE EXAMPLES

Here are examples of states that have employed various fund-of-funds models, some of which are described in brief below:

In **Arizona**, $200 million was authorized in 2009 to be placed in a fund-of-funds under the Arizona Economic Resources Organization (AERO), which was replaced in 2010 by the Arizona Commerce Authority. Sun Mountain Capital manages the fund, meant for seed to mezzanine stage companies. The fund remains in the planning stage.

Arkansas: $45 million was authorized to be placed in the Arkansas Institutional Fund, managed by Cimarron Capital Partners, in 2001. Investment in seed to later stage companies began in 2003.

The **California** Public Employees' Retirement System's in-state investments fed an estimated $15.1 billion into in-state economic activity in 2006, a recent study reported, and created 124,000 jobs – more jobs than that state's motion picture industry.

In 2004, **Colorado** authorized the establishment of a venture capital authority "fund of funds." Managed by High Country Venture LLC, investment of $23 million in seed and early stage companies began in 2005.

Delaware established the Venture Capital Program in 2005 and investment of $3 million into companies at any stage of development began in 2006.

Florida authorized the Florida Opportunity Fund for $29.5 million in 2007. A joint venture between Milcom Venture Partners, Inc. and Credit Suisse, the fund will be managed by Florida First Partners and invest in companies at the seed and early stages of development. Florida authorized the Florida Growth Fund in 2009. The fund, to be managed by Hamilton Lane, began investment of its $250 million into companies at the venture capital, growth and buyout stages in 2010. Florida also established the $100-million Florida Fund in 2009. Florida's governor signed legislation in 2008 that allowed the state to invest up to $1.95 billion from its pension fund in tech-based companies. That figure represented 1.5 percent of the fund's total assets at the time. Technology and growth investments include, but are not limited to, space technology, aerospace and aviation engineering, computer technology, renewable energy and life sciences.

In 1990 **Hawaii** authorized the Hawaii Strategic Development Corporation to be managed by High Technology Development Corporation, a state agency. Investment of the $31 million fund began in 1995 and focused on seed to mezzanine stage companies.

Illinois authorized the $5.5 million Finance Authority Technology Development Bridge fund of funds, managed by the Illinois Finance Authority, in 1983. Illinois also authorized the Illinois Equity Fund-Angel Seed Fund in 2006. Investment of the $3 million fund into seed stage companies began in 2006. Illinois authorized the $75 million Technology Development Account in 2002. Investment began in 2004. The Illinois state treasurer, along with an external advisor and a non-partisan advisory board (selected from industry specialists) manage the investments. Investments have an early stage focus. As of May 2011, the majority of funds had been committed and a TDA II was being discussed.

Iowa authorized the Iowa Fund of Funds in 2005. The $100 million, managed by Cimarron Capital Partners LLC, was invested in seed and later stage companies beginning in 2005 as well.

In **Indiana**, the public pension funds collaborated with state universities and various health-based companies to launch the Indiana Future Fund, an investment fund designed to benefit Indiana companies, especially in the life sciences and high technology arena. The fund, composed of $73 million, is managed by Credit Suisse Customized Fund Investment Group. The fund is also affiliated with Biocrossroads, an organization that acts as a catalyst for developing Indiana-based life sciences companies. Indiana has established the Indiana Investment Fund of $155 million, which is financed from its Public Employees Retirement Fund and managed by Credit Suisse.

The **Kansas** Technology Enterprise Corp. makes direct equity investments in early-stage companies that commercialize unique technologies and have the potential to create high-paying jobs in Kansas. It is funded by a $1.5 million annual allocation from the state.

Kentucky authorized the Commonwealth Seed Capital Fund in 2001. Investment of the $26 million fund by fund manager Growth Services LLC also began in 2001. Seed and early stage companies are the focus of investment.

Louisiana authorized the $38 million Venture Capital Match Program in 1989. Managed by the Louisiana Economic Development, the fund was invested in early to later stage companies in 1989. Applicants must have already obtained at least $5 million of private capital to be eligible.

Maine authorized and began the investment of the $3 million Venture Capital Revolving Investing Program in 2000. Managed by the Finance Authority of Maine , companies at any stage may receive investment. As of 2010, five VC funds were in the fund's portfolio. An additional $1 million was made available September 2009 from past investment returns.

The **Maryland** Technology Transfer Fund, run through the state's Technology Development Corporation, makes non-equity investments of up to $75,000 in companies that partner with federal laboratories or universities to develop early-stage technologies with potential for commercialization or government procurement. No repayment is required unless and until the company receives revenue

from sales. Maryland authorized the $20 million Maryland Venture Fund in 1994. Managed by the Department of Business and Economic Development, the fund is available to seed and early stage companies and is also invested in other venture capital funds.

Michigan capitalized its Invest Michigan! Fund with $300 million from the state's pension fund. It was divided into two capital pools: one targeting smaller companies with high growth characteristics and another targeting more mature companies seeking a change of control through a buyout transaction. Michigan also authorized the Venture Michigan Fund in 2006. Investment in seed to early stage companies began in 2007. In 2006, Michigan also authorized the $109 million 21st Century Jobs Fund. Direct investment in companies at any stage of development as well as in other venture capital funds began in 2007. Both funds are managed by Credit Suisse.

Minnesota authorized the $16 million RAIN Source Capital fund of funds in 1998. The managers of RAIN Capital began investing in companies at the seed through expansion stages of development in 1998.

In 2006, **New Jersey** authorized the Edison Innovation Funds. Managed by New Jersey's Economic Development Authority and Commission on Science & Technology, the $65 million fund was invested beginning in 2006 in seed to early stage companies. The fund offers a mix of grants, interest free loans and convertible loans.

New Mexico authorized NMIC Fund of Funds in 1994. Sun Mountain Capital, manager of the fund of funds, began investing the $400 million in seed to growth stage companies in 1995.

New York held $403.6 million in in-state investments as of March 2009 through its Common Retirement Fund with another $500 million available to invest in New York-based businesses.

North Carolina's State Treasurer announced the NC Innovation Fund in spring 2010. The Innovation Fund is a $232.3 million commitment to Credit Suisse to create and manage a Fund of Funds. The NC Innovation Fund was created and funded by the State Treasurer. Investment in companies at multi-stage VC, growth equity, mezzanine and buyout stages began in 2010.

North Dakota authorized the $10 million New Venture Capital Fund in 2003. The fund, available through the Bank of North Dakota, began investing in early stage companies in 2003.

Ohio passed a $700 million bond issue on its May 4, 2010 ballot to renew for five years the state's largest economic development project, the Ohio Third Frontier, which invests in research and commercialization of technology in five industry sectors. The Ohio Business Roundtable's independent assessment of the first $473 million invested from Third Frontier since its creation in 2003 shows the program providing an annualized return of 22 percent. The December 2010 report revealed product sales of Third Frontier projects already equal $440 million alone, nearly matching the state's investment. An additional $3.2 billion of follow-on funding has been secured for Third Frontier projects, as well. The rapid rate of return on Third Frontier's initial investments suggests receipts from derived activities will surpass the state's investments as early as 2014. Third Frontier investments have created an estimated 41,300 jobs from 2003 through 2008. Previous Ohio funds, authorized in 2005, totaled about $260 million. The Ohio Research and Commercialization Grant Program, a component of Third Frontier, provides firms that have won federal SBIR, STTR, or Advanced Technology Program grants up to $350,000 over two years to commercialize their technology.

Oklahoma authorized the $100 million Oklahoma Capital Investment Board in 1991. Managed by a governor-appointed Board of Trustees and Institutional Equity Associates, the fund is invested in seed to mezzanine stage companies. Investment began in 1993. Oklahoma's i2E's Seed Capital Fund is a $7 million fund capitalized by the state of Oklahoma and private investors. It provides equity investments to early stage companies. The fund typically makes 10 investments of $100,000 each per year.

Oregon authorized the $150 Oregon Investment Fund in 2003. Investment by Credit Suisse, the manager of the fund began in 2005. Companies in the early seed stage, venture and buyout stages are all eligible for the funds. Oregon Investment Council creating the Oregon Investment Fund.

Pennsylvania authorized the $8 million Ben Franklin (BTDA) Venture Investment Program in 2000. Managed by the Ben Franklin Technology Development Authority (affiliated with PA Department of Community and Economic Development), the fund favors early stage companies. In 2005, Pennsylvania authorized the $60 New PA Venture Capital Investment Program. The PA Department of Community and Economic Development manages the fund and began investing in early stage companies in 2006.

South Carolina authorized the $48 million South Carolina Venture Capital Fund in 2007. Investment, managed by InvestSC began that same year. Formed by Jobs-Economic Development Authority to assist the Venture Capital Authority (VCA) of South Carolina in meeting their goals and objectives the fund focuses on seed to late growth companies.

Utah authorized the $100 million Utah Fund of Funds to be managed by Utah Capital Investment Corporation in 2003. Investment in companies at any stage of development began in 2006.

The **Utah** Centers of Excellence Program helps start-up companies commercial-izetechnologies developed in Utah universities. Applicants apply for $50,000 to $100,000 grants, with the opportunity to apply for additional funding up to a maximum of $500,000 over two years. Start-ups are required to match state funds dollar-for-dollar, but may use other sources of capital, such as angel investments, to meet the match requirement.

Washington held $1.4 billion in Washington-based investments at the end of 2008, using the money to leverage additional capital from other sources to invest in the Pacific Northwest state.

Minnesota, Illinois and Nebraska have enacted investor tax credit laws patterned after Wisconsin's successful law.

WISCONSIN GROWTH CAPITAL COALITION MEMBERSHIP