

Risk Capital in Wisconsin: A Progress Report for 2006

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Executive Summary

Risk Capital in Wisconsin: A Progress Report for 2006 is an annual assessment of the state of risk capital in the State of Wisconsin. Due to cooperative efforts initiated and funded by businesses, private individuals and the state of Wisconsin, we conclude the risk capital market in Wisconsin is expanding and becoming more robust.

2006 vs. 2005 highlights include:

- A total of \$102.9 million in **early-stage risk capital** activity was tracked in Wisconsin, an increase of 54 percent over last year.
- Within that \$102.9 million total, **angel network** investing was up 38 percent to \$7.4 million.
- Also within the \$102.9 million total, investing by **individual angels, early-stage funds and informal angel groups** increased by 56 percent to \$95.5 million
- In addition to the \$102.9 million in early-stage investing, Wisconsin's **venture capital ranking** among the 50 states moved up two places to 33rd, with total 2006 investments of \$61 million. However, that's a decline from \$69 million in 2005.

Highlighted in the Wisconsin Technology Council's *Vision 2020*, a long-term outlook on the state's economic development published in 2002, a concerted effort has been made to focus resources on the growth and importance of many types of risk capital. Part of the purpose of this paper is to report on a broad range of types of risk capital and to establish benchmarks to measure future trends in those areas.

Our findings are summarized below:

- **Early-stage investing:** Total early-stage investing tracked in Wisconsin rose to \$102.9 million, an increase of 54 percent over 2005. The complete early-stage risk capital market includes angel networks, individual angels, informal angel groups and early-stage funds.
- **Angel investing:** Angel investing in Wisconsin rose dramatically in 2006. Data from several sources confirm that angel investing in the state rose much faster than the national average. The number of group angel investing deals and dollars invested increased substantially in 2006 when compared to 2005. The dollar amount of network investing increased 38 percent to \$7,427,170 while the number of deals rose 50 percent from 18 deals in 2005 to 27 deals in 2006.
- **Venture capital investment:** Wisconsin's venture capital ranking rose two spots from 35th in 2005 to 33rd in 2006, as compared to other states. Venture capital invested in Wisconsin companies in 2006 amounted to \$61 million in 19 venture capital deals. This was a decline of \$8 million from 2005, most likely a result of two Wisconsin-based funds being in a fund-raising cycle versus making new investments. These new funds have since become active, which should increase available risk capital in Wisconsin in 2007 and beyond.

- **Initial public offerings:** Two Wisconsin companies began preparation for going public in the first half of 2006. Thus far one IPO has occurred as TomoTherapy raised \$223 million in the second quarter of 2007.
- **Small Business Innovation Research (SBIR) funding:** 2005 is the most recent year in which both Phase 1 and 2 SBIR data by state is available. In 2005, Wisconsin firms won 54 awards and \$17.7 million in funding. Wisconsin ranked 23rd among all states in SBIR awards in 2005. Wisconsin firms also won 13 STTR awards amounting to \$4.7 million. This ranked the state 13th in STTR awards.

Summary:

Concerted efforts through public and private partnerships involving organizations and individuals have resulted in significant gains in the area of risk capital. New and innovative organizations and programs have focused resources on improving the early stage risk capital market for both investors and entrepreneurs. These programs and organizations include:

- Gov. Jim Doyle's "Grow Wisconsin" initiative
- State Legislature's Act 255 initiative, including investment tax credits
- The Wisconsin Technology Council, with its subsidiaries and programs
 - Wisconsin Innovation Network and its six chapters
 - Wisconsin Angel Network
 - Wisconsin Security Research Consortium
 - Governor's Business Plan Contest
 - Wisconsin Entrepreneurs' Conference
 - Wisconsin Early Stage Symposium
- The Wisconsin Entrepreneurs' Network and its partners

Continued success in improving the state's risk capital capacity is dependent on Wisconsin continuing as an innovator in the area of risk capital and maintaining cooperation between the public and private sectors.

Introduction:

In 2000, at Wisconsin Economic Summit I, the lack of risk capital was identified as a key missing ingredient to New Economy growth in Wisconsin. The state lagged behind in terms of venture capital investments and venture capital deals and had only two functioning angel groups.

In 2002, the Wisconsin Technology Council (Tech Council) published *Vision 2020: A Model Wisconsin Economy*, which laid out a number of indicators related to risk capital. *Vision 2020* provided an overall framework for thinking about how Wisconsin could accelerate economic growth through investment in technology related research and commercialization that resulted in new, high growth companies. Investment capital, particularly early stage equity capital, was identified as a critical component to growing the base of technology businesses in the state. *Vision 2020* went on to suggest some goals to improving the availability of equity capital in Wisconsin.

The purpose of this paper is to report on the progress Wisconsin has made in reaching for those *Vision 2020* goals and to provide some other measures that improve the risk capital base in the state. This is the third in a series of reports that monitors the progress on risk capital goals established in *Vision 2020*. This report will address the topic of risk capital and provide measures related to venture capital, angel investing, SBIR grants, and Initial Public Offerings (IPOs).

Context for this Report:

For purposes of this report, we define risk capital as primarily direct equity investment in new and expanding businesses. We also look at some quasi-equity capital in the form of SBIR and STTR grants which are federal sources of money. In this report we will update data on the following types of risk capital:

1. Small Business Innovation Research (SBIR) grants and Small Business Technology Transfer grants.
2. Angel investing by formal angel groups and by individual angel investors.
3. Venture capital dollars invested in Wisconsin companies.
4. Initial Public Offerings (IPOs) involving Wisconsin companies.

Risk Capital Measures

The body of this report will look at benchmarks for four different types of risk capital that come into play at different stages in the start up and growth of businesses. At the very early stages of many businesses, funding comes from founders, friends and families and from research and technology transfer grants such as those offered by the Small Business Innovation Research (SBIR) program. Yet in the early stages of a new firm and in the early expansion and growth stages, the availability of angel investing becomes critical. Following the angel investors and at a later stage in development, a firm needs venture

capital to fuel rapid growth and expansion. Finally, the firm may have an exit event such as an initial public offering (IPO) in which the founders and investors get their investment return as compensation for the risks of investing in a start up or growth business.

For each of these types of risk capital, we will update the information in *Vision 2020* and provide additional risk capital benchmarks that can be used to measure subsequent progress in providing risk capital to Wisconsin businesses.

Angel Investing

Available data shows that angel investing in Wisconsin rose dramatically in 2006. The Center for Venture Research at the University of New Hampshire reported that angel investing in the United States in 2006 increased 11 percent over the level reported in 2005. The data we report below for Wisconsin suggests that angel investing in Wisconsin increased by at least three times that rate of increase.

Prior to the passage of Wisconsin Act 255, which took effect in 2005, the only established source of data on angel investing was an annual survey of organized angel investment groups conducted by NorthStar Economics of Madison, Wisconsin. With the passage of Wisconsin Act 255, it is possible to extract additional data for both group and individual angel investments that are related to investments covered under Act 255. Also for the second year, we are able to look at the total early-stage market, including individual angel and fund investing data through a survey of Wisconsin law firms conducted by the Wisconsin Angel Network (WAN).

Wisconsin Angel Network Survey

In February and March of 2007, the Wisconsin Angel Network surveyed a number of Wisconsin law firms who are involved in aspects of angel investment deals. This survey of seven major law firms was focused on the total early-stage market, including angel networks, individuals and fund investments in 2006. That survey showed the following:

- The total amount of early stage investment from angel groups, individual angels and investment funds was \$102,919,396. This compares to \$66,585,020 reported in 2005.
- There were 46 angel investment deals reported in the survey.
- The leading area of investment was in life science/biotech companies. There were 13 life science deals involving \$35,701,444.
- Investments in energy companies totaled \$14,700,000 in 2006, displacing information technology as the second ranking investment area.
- Investments in information technology totaled \$10,025,000 and involved 6 deals.

It was not possible to cross check the data from the WAN survey to the Act 255 Wisconsin Department of Commerce Act 255 data (see below). Thus we cannot

determine the overlap in the data from the NorthStar survey and the Act 255 data individual angel investment data and the WAN law firm survey. At a minimum, we can conclude that the total early stage investments in Wisconsin firms rose substantially over 2005 levels.

NorthStar Survey Data:

NorthStar Economics does an annual survey of Wisconsin angel investment groups. In the survey, each group is asked to report the total number of investment deals, the deals that qualify for the Wisconsin angel income tax credit, and the total dollars invested for the reporting period. The results of that survey for the last five years are shown in Table 1.

Table 1
Group Angel Deals and Investment in the Period 2002-2005

Year	Deals	Amount Invested
2002	11	\$1,600,000
2003	11	\$1,738,000
2004	10	\$3,713,297
2005	18	\$5,387,496
2006	27	\$7,427,170

Source: 2007 NorthStar Economics Survey of Angel Investing Groups;

The number of group angel investing deals and dollars invested increased substantially in 2006 when compared to 2005. Investments by angel groups increased 38 percent to \$7,427,000 while the number of deals increased 50 percent from 18 in 2005 to 27 in 2006.

Wisconsin Department of Commerce – Act 255 Data

Data from the Wisconsin Department of Commerce related to Act 255 (legislation authorizing tax credits for angel investing) provides additional insight into angel investing activity in Wisconsin. Act 255 provides \$3 million annually in angel tax credits for angel investments in companies that qualified under Wisconsin Department of Commerce rules. Data from Act 255 is related to those angel investments in which investors sought angel income tax credits. The angel group data gathered in a survey by NorthStar Economics includes investments that did not qualify for angel tax credits.

We were able to cross check the NorthStar survey data against the Wisconsin Department of Commerce data to net out duplicate investments. By netting out the duplicate deals we found the following:

- There were 55 reported angel investment deals in Wisconsin in 2006 as reflected in the Department of Commerce data and the NorthStar survey. Some of these

deals were solely financed by individual angel investors. Others were solely financed by angel investing groups. And a number were financed by a combination of individual and angel group investors.

- The net amount of angel investing activity reported in these two information sources was \$22,420,709 as compared to \$19,569,883 in 2005.

Venture Capital

Wisconsin made some progress in 2006 relative to other states in attracting national venture capital as is seen in the state's ranking rising two spots from 35th in 2005 to 33rd in 2006. *Vision 2020* set a 2005 goal of \$200 million in annual venture capital investments in the State of Wisconsin.

Table 2 below shows reported venture capital investments in Wisconsin over the last five years. For comparative purposes, Table 2 also contains venture capital data for Minnesota and for the United States.

Table 2
Venture Capital Investments for Wisconsin, Minnesota,
and the United States in the period 2002-2006

	2002	2003	2004	2005	2006
United States	\$21.7 Billion (3,057 Deals)	\$19.6 Billion (2,865 Deals)	\$21.6 Billion (2,966 Deals)	\$21.7 Billion (2,939 Deals)	\$25.5 Billion (3,416 Deals)
Minnesota	\$378 Million (57 Deals)	\$222 Million (60 Deals)	\$353 Million (50 Deals)	\$228 Million (44 Deals)	\$321 Million (36 Deals)
Wisconsin	\$49 Million (12 Deals)	\$42 Million (11 Deals)	\$58 Million (11 Deals)	\$69 Million (12 Deals)	\$61 Million (19 Deals)

Source: PriceWaterhouse Coopers / Venture Economics / National Venture Capital Association Money Tree Survey

In 2000, overall venture capital investing in the United States peaked at a little over \$100 billion and has since settled back into a range around \$20 billion per year. In 2006, the venture capital market had a year over year increase in total investments and deals of around 20 percent and total venture capital investment in the U.S. was \$25.5 billion.

Venture capital investment in Wisconsin declined slightly in 2006 over levels in the prior year though the number of venture capital deals rose over 50 per cent. Venture capital invested in Wisconsin companies in 2006 amounted to \$61 million in 19 venture capital deals. Despite that modest decrease in venture capital investing, Wisconsin's national venture capital ranking rose slightly from 35th in 2005 to 33rd in 2006.

Wisconsin also saw an increase in the number of active venture funds located in the state and two existing funds successfully raising more investment capital.

Initial Public Offerings

Initial Public Offerings (IPOs) occur when a corporation first offers its stock to public investors. IPOs may involve established private businesses going public for the first time or fairly new businesses that are creating an exit event for founders and venture capital shareholders.

Two Wisconsin companies began preparation for going public in the first half of 2007. Thus far one IPO has occurred, TomoTherapy, which raised \$223 million.

Wisconsin has had a modest but steady record of IPO activity. In 2004, Wisconsin had two IPOs including Great Wolf Resorts and Bucyrus International. These two offerings raised \$407 million. In 2003, one IPO raised \$259 million. In 2002, four Wisconsin IPOs raised \$439 million and in 2001 two IPOs raised \$136 million. One small IPO occurred in 2005. There were no IPOs for Wisconsin companies in 2006.

Table 3
Wisconsin IPOs in the period 2001-2005

	2001	2002	2003	2004	2005
Offerings	2	4	1	2	1
Amount Raised	\$136 Million	\$439 Million	\$259 Million	\$407 Million	\$10 Million

Source: PriceWaterhouse Coopers U.S. IPO Watch; Wisconsin Department of Financial Institutions

Because of the relatively small number of IPOs and the fluctuation or lumpiness in the number of IPOs, it is difficult to assign an accurate ranking number for IPOs in Wisconsin. However the Corporation for Economic Development (CED) in its 2006 Development Report Card for the States does rank states by initial public offerings. The measure used by CED is IPO proceeds per 1,000 firms in the state. Based upon 2004 IPO activity, the CED Development Report Card ranked Wisconsin 21st in IPO activity.

SBIR and STTR Funding

The Small Business Research and Innovation program (SBIR), is a federally funded program that provides opportunities for small business to participate in research and development and to increase US competitiveness. Recent legislative changes in the program put increased emphasis on commercial applications of research.

There are two levels or phases of SBIR grants. Phase 1 awards are smaller (usually less than \$100,000) and intended to fund initial research work. Phase 2 awards are usually much larger (up to \$750,000) and are intended to extend and develop work done in Phase 1. In general, the SBIR grant application process is very competitive.

In 2005, the most recent year in which both Phase 1 and 2 SBIR data by state is available, Wisconsin firms received 54 Phase 1 and 2 awards in the total amount of \$17.7 million. In 2004, Wisconsin firms won 65 grant awards worth \$20.1 million in funding. Despite the drop in funding, Wisconsin's rank in terms of SBIR awards improved from 24th to 23rd.

Wisconsin's rank in SBIR awards is largely unchanged since 2001. In 2001, Wisconsin ranked 23rd in SBIR awards among all states. In 2005, Wisconsin ranked 23rd among all of the states in SBIR dollars received.

A somewhat smaller program, the Small Business Technology Transfer program is aimed at commercializing new technology by assisting with market prototypes and testing. Wisconsin firms won 13 STTR awards in 2005 and total funding for these grants amounted to \$4.7 million. Wisconsin ranked 13th in STTR grants.

Conclusions and Summary

Concerted efforts through public and private partnerships involving organizations and individuals have resulted in significant gains in the area of risk capital.

New and innovative organizations and programs have focused resources on improving the market for both investors and entrepreneurs, such as:

- Governor Jim Doyle's "[Grow Wisconsin](#)" initiatives
- State Legislature's Act 255 initiative, including [investment tax credits](#)
- The [Wisconsin Technology Council](#), with its subsidiaries and programs
 - [Wisconsin Innovation Network](#) and its six chapters,
 - Ashland
 - Fox Valley
 - Centergy (Central Wisconsin)
 - Chippewa Valley
 - Madison
 - Milwaukee
 - [Wisconsin Angel Network](#)
 - 25 investor-member organizations representing over 250 investors and hundreds of millions under management
 - 550 entrepreneurs accounts on the Deal-flow Pipeline (DFP)
 - 170 executive summaries uploaded to the DFP
 - [Wisconsin Security Research Consortium](#)
 - Newly launched in 2007, focused on securing federal homeland security grants
 - [Governor's Business Plan Contest](#)
 - Over 1,000 entries in four years
 - Helped new companies raise over \$10 million in private equity
 - [Wisconsin Entrepreneurs' Conference](#)

- Over 450 participants in 2006
 - [Wisconsin Early Stage Symposium](#)
 - Over 300 participants in 2006
- The [Wisconsin Entrepreneurs' Network](#) and its [partners](#)

Continued success in connecting entrepreneurs with private equity is dependent on Wisconsin continuing as an innovator in the area of risk capital and maintaining cooperation between the public and private sectors. While strong progress is being recorded in early-stage equity, such as angel capital, work remains to be done to attract more venture capital to help bring Wisconsin start-up companies to the next level.