

Risk Capital in Wisconsin: A Progress Report

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Executive Summary

Risk capital is an important component in establishing new high tech businesses and expanding growing firms. The lack of availability of risk capital in Wisconsin was noted at the very first Wisconsin Economic Summit in 2000. Subsequently, *Vision 2020: A Model Wisconsin Economy* was published by the Wisconsin Technology Council and a goal of increasing the amount of venture capital investment in the state was established.

Since the publication of *Vision 2020*, the growth and importance of other sources of risk capital has been noted and part of the purpose of this paper is to report on those other types of risk capital and to establish benchmarks to measure future trends in those areas.

In this report, we will update the venture capital goals outlined in *Vision 2020* and offer three other measures of risk capital: SBIR funding, angel investing, and initial public offerings (IPOs). These additional measures provide a more comprehensive picture of the overall risk capital situation in Wisconsin.

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.

Our findings are summarized below:

- **SBIR funding:** 2004 is the most recent year in which both Phase 1 and 2 SBIR data by state is available. In 2004, there were 6,348 SBIR grants that funded a little over \$2 billion in research. Wisconsin firms won 65 awards and \$20.1 million in funding. Wisconsin ranked 24th among all states in SBIR awards in 2004.
- **Angel Investing:** The number of group angel investing deals and dollars invested increased substantially in 2005 when compared to 2004. The dollars amount of group investing increased 65 percent to \$5,587,496 while the number of deals more than doubled from 9 in 2004 to 20 in 2005. For the first time, we have data on individual angel investing from two sources. Based upon those sources, we estimate that individual angel investing was in excess of \$50 million in 2005.

- **Venture Capital Investment:** Venture capital investment in Wisconsin rose slightly in 2005 over levels in the prior three years. Venture capital invested in Wisconsin companies in 2005 amounted to \$69 million in 12 venture capital deals. Despite that modest increase, Wisconsin's venture capital ranking slipped from 26th among the 50 states in 2004 to 35th in 2005.
- **IPOs:** Wisconsin has had a modest but steady record of IPO activity. The state has averaged 2 IPOs per year over the last five years. Based upon 2004 IPO activity, the Corporation for Economic Development ranked Wisconsin 21st in IPO activity.

Summary:

Wisconsin ranks in the middle of the pack with respect to risk capital investing in SBIR awards, venture capital investments, and initial public offerings (IPO). State rankings put Wisconsin at 24th in SBIR awards, 35th in venture capital, and 21st in IPO activity.

Group angel investing activity appears to be on the rise and for the first time we are able to set benchmarks on individual angel investing which will be useful in measuring this area in future years. The increases in deals and dollars invested by angel groups and the strong investment numbers for individual angel investors provide a growing base of companies that may grow to the next level and attract more venture capital to Wisconsin.

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. The purpose of this paper is to report on the progress Wisconsin has made in reaching for those goals.

This is the fourth in a series of reports that monitors the progress on goals established in *Vision 2020*. We previously reported on Knowledge Worker/Human Capital measures, and they were for the most part encouraging. In a second report, we analyzed Wisconsin's progress in knowledge and technology and found some very positive trends. A third report dealt with business investments, exports and entrepreneurship in Wisconsin and for the most part, Wisconsin is well on its way to meeting the goals set forth in *Vision 2020*.

This final report in this series will address the topic of risk capital and provide measures related to venture capital, angel investing, SBIR grants, and private equity activity. All of the benchmarks and milestones for this series of reports are contained in the table on page 45 of *Vision 2020*.

Context for this Report:

The dot.com bust, the recession of 2001, the events of Sept. 11, 2001, and a very slow economic recovery have had a major influence on the Wisconsin and U.S. economies. Despite these factors, both the U.S. and Wisconsin economies began to show strong growth in early 2004 and high-tech businesses are emerging as an area of high economic growth. That growth has continued in 2005 despite major challenges posed by hurricanes Katrina and Rita and resulting soaring oil prices.

Wisconsin's transition to the New Economy has tended to lag many other states. Some states, notably Minnesota, experienced robust growth in high-tech businesses in the mid-1990s and that growth has continued into the 21st century. Wisconsin's challenge is to build on its solid economic base and to expand its economy through investment and support in high-growth areas.

Risk Capital Measures

In *Vision 2020*, there were two primary financial measures are presented: Annual Venture Capital Investment and Foreign Direct Investment. The latter measure was reported on in the third paper in this series.

In this report, we will update the venture capital goals outlined in *Vision 2020* and offer three other measures of risk capital: SBIR funding; angel investing; and initial public offerings (IPOs). These additional measures provide a more comprehensive picture of the overall risk capital situation in Wisconsin.

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.

SBIR 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 U.S. 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. The SBIR grant application process is very competitive.

2004 is the most recent year in which both Phase 1 and 2 SBIR data by state is available. In 2004, there were 6,348 SBIR grants that funded a little over \$2 billion in research. Wisconsin firms won 65 awards and \$20.1 million in funding. Wisconsin ranked 24th among all states in SBIR awards in 2004.

Wisconsin rank in SBIR awards is largely unchanged since 2001. In 2001, Wisconsin ranked 23rd in SBIR awards among all states.

Angel Investing

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 first time, we are able to look at individual angel investing data through a survey of Wisconsin law firms conducted by the Wisconsin Angel Network (WAN).

The number of group angel investing deals and dollars invested increased substantially in 2005 when compared to 2004. The dollars amount of group investing increased 65 percent to \$5,587,496 while the number of deals more than doubled from 9 in 2004 to 20 in 2005.

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

Year	Deals	Amount Invested
2002	10	\$1,545,000
2003	9	\$1,638,000
2004	9	\$3,392,500
2005	20	\$5,587,496

Source: 2006 NorthStar Economics Survey of Angel Investing Groups; Wisconsin Department of Commerce data on Act 255.

Data from the Wisconsin Department of Commerce related to Act 255 further enlarges the picture of angel investing activity in Wisconsin. Act 255 provided \$3 million in angel tax credits for angel investments in companies that qualified under Wisconsin Department of Commerce rules. Individual angels and angel groups were awarded the full \$3 million and the reported angel investment amount related to Act 255 was \$15,550,042.

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:

- In this category alone (angel network deals cross-checked against Act 255 data from Commerce), there were 40 angel investment deals in Wisconsin in 2005. 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 \$19,569,883. That represents the \$5,587,496 from reported network deals plus the \$15,550,042 from Act 255 credits, minus duplicate deals.

These deals appear to represent only the tip of the angel investing iceberg, however. In February of 2006, the Wisconsin Angel Network surveyed a number of Wisconsin law firms who are involved in aspects of angel investment deals. This survey of six law firms was focused on individual angel investments. That survey showed the following:

- The total amount of individual angel investment reported was \$66,585,020.
- There were 43 angel investment deals reported in the survey.
- The leading area of investment was in life science companies. There were 17 life science deals involving \$23,975,714.
- Investments in information technology totaled \$14,420,000 and involved 8 deals.
- Other sectors with angel investments, according to the law firm survey, were real estate, medical instruments, business services, telecommunications, energy, manufacturing and homeland security.

It was not possible to cross check the data from the WAN survey to the NorthStar and Act 255 Wisconsin Department of Commerce data. Thus we cannot determine the overlap in the individual angel investment data. But even assuming a complete overlap in individual angel investment data between the Wisconsin Department of Commerce data and the WAN survey data, individual angel investing activity in Wisconsin in 2005 exceeded \$50 million.

Future surveys by WAN and data from individual angel investment activity related to Act 255 will allow future year to year comparison of total angel investment activity in Wisconsin.

Venture Capital

Vision 2020 set a 2005 goal of \$200 million in annual venture capital investments in the state. 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 2001-2005

	2001	2002	2003	2004	2005
United States	\$41.3 Billion (4,712 Deals)	\$21.7 Billion (3,057 Deals)	\$19.6 Billion (2,865 Deals)	\$21.6 Billion (2,966 Deals)	\$21.7 Billion (2,939 Deals)
Minnesota	\$542 Million (93 Deals)	\$378 Million (57 Deals)	\$222 Million (60 Deals)	\$353 Million (50 Deals)	\$228 Million (44 Deals)
Wisconsin	\$94 Million (25 Deals)	\$49 Million (12 Deals)	\$42 Million (11 Deals)	\$58 Million (11 Deals)	\$69 Million (12 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. Wisconsin's venture capital numbers continue to lag behind and for the sake of comparison we have included venture capital investment and deals numbers for neighboring Minnesota.

Venture capital investment in Wisconsin rose slightly in 2005 over levels in the prior three years. Venture capital invested in Wisconsin companies in 2005 amounted to \$69 million in 12 venture capital deals. Despite that modest increase, Wisconsin's venture capital ranking slipped from 26th in 2004 to 35th in 2005. We would caution drawing too much from the state rankings given the small number of deals and dollars invested in most states. Year-to-year variations in a few deals and amount of dollars invested will dramatically changed rankings for those states not ranked in the top ten venture capital states.

Wisconsin has not reached the goal of \$200 million in annual venture capital investments, the goal set for 2005. Progress toward this goal needs to be evaluated with the following considerations:

- The base for venture capital investing in high-tech investing, tech transfer and new startups, has been slow to develop in the state. Thus the investment opportunity curve has been fairly constricted.
- The goals in Vision 2020 were set at a time when there was a venture capital investment bubble in 2000 and 2001 and may have been set too high.

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.

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.

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.

Conclusions and Summary

Wisconsin ranks in the middle of the pack with respect to risk capital investing in SBIR awards, venture capital investments, and initial public offerings (IPO). State rankings put Wisconsin at 24th in SBIR awards, 35th in venture capital, and 21st in IPO activity.

Angel activity is not ranked on a state by state basis and it is difficult to gauge comparative activity even in surrounding states because of a lack of consistent data. However we can see an increase in angel group investing activity in 2005 and for the first time we are able to gauge and benchmark the individual angel activity in the state.

We think that Act 255 has helped to create a positive climate for angel investing in Wisconsin. Though it is difficult to isolate the effect of Act 255, feedback from angel investors indicates that the availability of angel tax credits and certified new business ventures has helped to increase the number of angel deals and the formation of angel investing groups.

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