

# **“Practical Steps to Improving Wisconsin Venture Performance”**

**John Byrnes  
Executive Managing Director,  
Mason Wells Funds**

## **Introduction:**

The first step toward improving Wisconsin’s venture performance is to recognize that new venture formation is anything but practical. Over 70% of all new businesses fail within the first 3 years. Practical people are uncomfortable with these odds. Practical people don’t understand the entrepreneurial impulse. Entrepreneurs are more like entertainers. The steps to improving Wisconsin’s venture performance are more like a dance than a march. Loosen up!

## **Step #1: Dancing with Angels**

We must convince Wisconsin’s wealthiest individuals to “waste” some of their money on high-tech start-ups. Rather than buy an airplane, yacht, or another home in some tony location that they almost never visit, I suggest they find a local entrepreneur and give something back to the community by helping him/her to start a new business. Fortunately for Wisconsin, some of its wealthy citizens are beginning to do just that.

## **Step #2: Rock & Roll with VC’s**

We must promote the formation of several large venture capital funds, each with enough capital under management to serve as a lead investor for “large cap” start-ups. On both coasts it is now commonplace for a new venture to raise \$20 - \$50 million from private venture capitalists. The sad reality in Wisconsin is that until recently, the maximum amount of money available from local venture capitalists for investment in a single deal was \$3 million. This year we witnessed a tenfold increase in the amount of venture capital available for Wisconsin entrepreneurs. If local venture capitalists use this new funding to take a more active role in new venture strategy, we will see a dramatic improvement in Wisconsin’s venture performance.

## **Step #3: Waltzing with Institutional Investors**

We must persuade Wisconsin’s institutional investors to use their influence to help local venture capitalists to attract additional funding commitments from leading national and international sources. If we can somehow enlist the local institutional investors, who are already supporting local venture capital funds, to introduce Wisconsin’s venture capitalists to their friends around the world, it would dramatically accelerate the process of gathering commitments needed to fund Wisconsin’s “new economy” opportunities.

## **Step #4: The Entrepreneur Boogie**

We must convince the “best and brightest” students coming out of Wisconsin’s educational institutions to become entrepreneurs. These young men and women are the entrepreneurs who will lead Wisconsin into the new high-tech economy of the 21<sup>st</sup> Century. We need to remove the layers of discouragement which frequently prevent these young people from starting businesses.

We must create incentives to stimulate their entrepreneurial interests and we must provide a support system to help them move efficiently into successful start-up companies.

### **Step #5: The Band**

Finally, we need to create a better atmosphere for young people with an entrepreneurial impulse. We need to reward students with good ideas. We must become more tolerant of mistakes. We must give young people the freedom to fail. We must honor success. We must encourage interdisciplinary study, combining engineering and business subjects. We must encourage more creative thinking and more intuitive decision-making. We must try to have more fun.

### **Conclusion**

Improving Wisconsin's venture performance is a top-down responsibility. Those who control access to the funding must make it happen. The entrepreneur cannot force others to part with their money. All he/she can do is go where the money is available. Our challenge is to keep Wisconsin's would-be entrepreneurs here by making it easy for them to get the capital they need.

## **“Practical Steps to Improving Wisconsin Venture Performance”**

### **Introduction:**

The first step toward improving Wisconsin’s venture performance is to recognize that new venture formation is anything but practical. Over 70% of all new businesses fail within the first 3 years. This has been the case for decades, in good economic times and in bad. Those with a practical frame of mind are unlikely to get comfortable with these odds. Practical people begin everything they do by asking a lot of questions; they identify a long list of concerns; they require answers to everything before they act; they make decisions only at the last possible moment when forced to do so. Consequently, practical people are often slow to act and frequently reach a decision when the opportunity is long gone. Practical people often say things like, “Gosh, I should have invested in Cisco Systems five years ago.”

Practical people don’t understand the entrepreneurial impulse. When was the last time you heard an entrepreneur say, *“Well, I decided to start my company after making a thorough examination of market needs and available technologies; I concluded that there was a big need in an important customers segment of a huge market that nobody else was satisfying; so with sufficient financing and a strong team of experienced managers, I embarked on a tightly focused business plan to achieve positive cash flow within 18 months and produced an internal rate of return on invested capital of greater than 50% compounded annually.”*?? Right, it never happens!

Entrepreneurs don’t think that way—they are decidedly impractical. In this respect entrepreneurs are more like entertainers, artists and professional athletes. They are driven by a desire to achieve something special, to be different, to be a “star”. They also want to be rich. Yes, they want money. They see a start-up, high-tech business as a stage. If they perform well, they expect both fame and fortune. For this and other reasons I will touch on later, the best high-tech entrepreneurs tend to be young—usually under 35.

Some people might say that entrepreneurs start companies because they don’t know any better. People in the venture capital business know this is true about entrepreneurs, and defend them for it. The reason entrepreneurs need to be “impractical” is that starting a new company involves a lot of guesswork. Nobody is smart enough to accurately anticipate all the features that will make a product sell. Consequently, the only way to find out is to try something and see if it works. This kind of guesswork requires intuitive thinking, it isn’t logical, but it works. The best entrepreneurs are those who can make the right decisions with the least amount of relevant information—good entrepreneurs are good guessers!

Those of you who clicked on this article hoping to find suggestions that will make you comfortable may want to go “back”. This article is about being reckless, about taking risk and living on the edge. It is about experimentation, creativity and improvisation. For the adventuresome with a desire to help, I hope you find it useful. For the “practically” minded people who read this, please allow me to suggest that you think of this as entertainment. The “steps” I have in mind to improve Wisconsin’s venture performance are more like a “dance” than a “march”. So loosen up!

### **Step #1: Dancing with Angels**

We must convince Wisconsin’s wealthiest individuals to “waste” some of their money on high-tech start-ups. Rather than buy an airplane, yacht, or another home in some tony location that they almost never visit, I suggest they find a local entrepreneur and give something back to the community by helping him/her to start a new business. Fortunately for Wisconsin, some of its wealthy citizens are beginning to do just that.

In the past it was fashionable for those with money to seek safe investments that could be easily managed. Those who accumulated wealth were advised to make secure, marketable investments that would produce steady income to support an easy life of golf, tennis, travel and noshing with old friends and new neighbors. Preserve the principal for emergencies and avoid taxes—municipal bonds were the hands down favorite. But today more and more people are acquiring wealth at younger and younger ages only to discover that they never liked golf and tennis, that modern methods of globe-trotting aren't as much fun as advertised, and cocktail parties are basically boring. So what can they do for fun? In increasing numbers wealthy individuals are helping others to start new businesses—not all are high-tech companies, but the trend is toward high-tech.

These people are called “angel investors”. They are usually the first people on the dance floor. Angel investors get involved with start-up companies because they enjoy working with young people, it gives them a chance to make a contribution, and it provides them with some of the variety they may have lacked in their earlier business careers. Angel investing allows experienced businessmen to stay in touch with business without making a full-time commitment. In sectors such as biomedical, angel investing can be viewed as a form of philanthropy. Many important medical research projects are now being funded by angel investors with an eye toward making money. If the research proves successful, the angels make a profit. If not, the angels get the same tax deduction they might have gotten with a charitable contribution (this is not exactly correct, but close). We need more of this kind of thinking.

Today there are at least five angel networks being formed to invest in local start-ups in Wisconsin. If these fledgling organizations achieve their potential, we will have made an important first step toward improving new venture performance in the state. Each group will no doubt develop its own policies and procedures, but the successful angel networks have several things in common, as follows:

1. The angels organize a new company by purchasing common stock (a minority position) in a newly-formed corporation at a low price relative to the expected later rounds of financing.
2. The angels help the entrepreneurs to negotiate technology transfer agreements with research institutions and give suggestions on how to design the product or services of the new company. Usually one or more of the group's members will serve as a director and may become an interim manager.
3. During the first 6-12 months of operation of the new company, the angels help the entrepreneurs write a formal business plan, set up accounting, recruit additional members of the management team, and they introduce the company to potential customers and business partners.
4. The critical step for the angel investors is to introduce the “improved” deal to one or more professional venture capitalists. The first VC round typically involves a financing of \$2 - \$5 million at a substantially higher value than the earlier angel rounds. The hand-off to the VC's increases the probability of ultimate success of the venture. When the hand-off is complete, one of the angel investors may remain on the board, but typically the lead VC's will repopulate the board with individuals who will aid in the execution of the business plan.

5. Successful ventures will ultimately receive several rounds of additional VC financing before the company is cash flow positive or makes an initial public offering (IPO).

Sometimes angel investors have enough resources to take the start-up all the way to positive cash flow and/or IPO, but most of the time they prefer to pass the deal on to professional VC's to take the company all the way. Most experienced angel investors have concluded that their job is finished when the venture capitalist round is complete. Done properly, the angel investors provide a service to both the entrepreneur and the VC's. For that service angels are rewarded with a substantial increase in the value of their stock. Obviously, angels make money if and when the venture is ultimately sold or goes public. If the deal fails, the angels avoid the headaches of winding down the company by letting the VC's deal with the problem.

In San Jose, California there is a group of angel investors called the "Band of Angels". This group has been responsible for thousands of start-ups on Sand Hill Road. They work closely with the leading VC's in the area and they are rewarded for their good work with returns of 10 to 100 times their money. Angel investing is not only fun, it can be highly profitable. For those interested in learning more about Angel networks, there is a national organization that conducts forums on the subject. Information can be obtained at [AngelSociety.com](http://AngelSociety.com).

Angel investing begins with the recognition that the entire investment may be lost. In fact, most angel investments result in a complete loss. The angel networks now forming in Wisconsin will not achieve their potential unless people with money are willing to take the risk of losing it all. Of course, some will be successful. The best deals will be highly successful. So successful in fact that the winners will out-weigh the losers. If the new angel investors stick with it they will find that early stage, high-tech investing is a good way to "waste" money!

### **Step #2: Rock & Roll with VC's**

We must promote the formation of several venture capital funds ( VC's) in Wisconsin, each with enough capital under management to serve as a lead investor for local "large cap" start-ups. Local lead investors must be able to invest up to \$10 million in a single deal in order to effectively lead the venture transactions that are being done today. On both coasts it is now commonplace for a high-tech start-up to require \$40 - \$50 million of private equity funding from VC's. The sad reality in Wisconsin is that until recently, the maximum amount of money available from local VC's for investment in a single deal was \$3 million. Over the last 15 years, the average investment per deal in Wisconsin has been less than \$1 million. The total amount of money invested by local VC's in all of Wisconsin's early stage deals since 1982 (approximately 20 transactions) has been less than \$20 million. This is pathetic!

How pathetic is it? Well, there have been several attempts to estimate the amount of venture capital that should be available in Wisconsin by comparing the amount of available capital to Wisconsin's share of the U.S. Gross National Product (GNP). Wisconsin accounts for about 4% of GNP but less than 1% of the professionally managed venture capital. If Wisconsin got its share, we would have over \$300 million under management within the state. Furthermore, Wisconsin's research institutions receive approximately \$225 million in research grants annually from agencies of the Federal Government, including NIH, NSF and DOD. From this perspective the pool of Wisconsin venture capital should be closer to \$600 million.

Why has the performance been so bad? Do we lack good ideas? Are there no entrepreneurs in Wisconsin? Are the local venture capitalists the problem? How can we change things to improve our performance? These questions can be answered in a number of different ways. Here are a few of them.

Each year Wisconsin's VC's see hundreds of potential deals. Most of the deal flow comes in from local research scientists, entrepreneurs, lawyers, accountants and bankers. In the end, local VC's take on the deals they can afford to do. The biggest problem facing local VC's has been the lack of enough money to do all the good deals they see. Wisconsin's VC's have simply not had enough funding to support all the venture deals in the local environment. Furthermore, the deals that get done require more money than Wisconsin's VC's can afford to commit. As a result local VC's have had to resort to structural gimmicks to entice VC's from outside the Midwest into local deals, frequently resulting in a chaotic jumble of small investors in each deal, or the loss of local control to a large VC from out-of-state.

Why does this happen? The typical risk management provisions of a venture capital fund require the managing partner to limit the amount of money committed to a single investment to less than 20% of the fund. As a practical matter most VC's establish lower limits, called "house-limits", of perhaps 10 -15% of the committed capital in their funds. The point is that a \$10 million venture fund would not invest more than \$1-2 million in a single deal. If a VC wants to make a single deal investment of \$10 million, he needs a \$75-100 million fund.

Until recently there has been no Wisconsin venture fund larger than \$15 million. But that's changing. A quick glance at the chart below shows the recent improvement.

**Funds Available from Leading Wisconsin VC's**  
(in millions)

	1980-90	1990-99	2000
Wisconsin Venture Investors	\$ 10	\$ 5	\$ 0
Venture Investors of Wisconsin	8	15	45
M&I Capital Markets Group, Inc.	3	10	0
Mason Wells	0	0	75
Totals	\$ 21	\$ 30	\$120

As you can see from the chart, the pool of available capital has been static for the last two decades. This year Wisconsin witnessed the creation of two new funds that, for the first time, will permit local VC's to act like lead investors. These new funds, alone or working together, will be able to make substantial commitments to local venture deals.

Local VC's took this big step forward when the State of Wisconsin Investment Board (SWIB) announced its intention to commit approximately \$50 million to local VC's. Venture Investors of Wisconsin (VIW) and Mason Wells received early commitments from SWIB with the stipulation that the funds be invested in biotech and other high-tech start-ups located in Wisconsin. With its commitment from SWIB, the principals at VIW have now closed on a total fund of \$45 million. Mason Wells has closed on \$29 million and expects to reach its \$75 million target by the end of February 2001. If successful, Mason Wells will be the first Wisconsin-based VC firm capable of committing \$5-10 million to a single deal. This is a major breakthrough.

More money is not the only change needed to improve the performance of Wisconsin's VC's. Local VC's must also now change the way we do business. In the past local VC's have functioned more like angel investors than true venture capitalists. With limited funds, local VC's were forced to make small bets and hope to attract other VC's the way angel investors do. Now that local VC's have money, they need to start acting like leading VC's from other states. They need to move up to a position of leadership. Wisconsin's VC's must now sponsor deals in their own right, rather than hand them off to the large national players. This sponsorship will require local VC's to become more aggressive, more focused, more knowledgeable about technology and more top-down in their investing process.

In the past Wisconsin's VC's waited for deals to come to them. In the future local VC's must proactively develop deals using "playbook" ideas developed from their own analysis of market opportunities. With these "playbook" opportunities in hand, local VC's must identify local technologies and combine them with qualified managers. In some cases local VC's may need to license technology from Wisconsin research institutions and combine it with technology licensed elsewhere to create a powerful competitive position for the new company. It may also happen that local VC's will acquire an existing high-tech company, move it to Wisconsin and combine it with newly-licensed technology from a local research institution. Local VC's must be prepared to do what ever it takes to create strong new companies capable of achieving and maintaining a dominant position in rapidly developing high-tech markets. Wisconsin's VC's need to start thinking "big".

What are the "big" ideas? The conventional wisdom is that "big" investment opportunities emerge from a convergence of two forces: new technology and changes in governmental regulation. The Internet revolution that has been unfolding over the past five years and telecom revolution that has just begun are good examples. Both involve the combination of information technology and government deregulation. The next revolution to roll through the U.S. economy may well be a biomedical revolution resulting from the confluence of genetic engineering technology and changes in the way the federal government regulates the delivery of medical services. The remarkable advances being made in genomic science and the sequencing of the human genome are likely to produce dozens, maybe hundreds, of "blockbuster" discoveries. The human genome has approximately 100,000 genes currently believed to code for about 1,000,000 proteins. Each protein is a potential new drug, if we can just figure out how to make it. The possibilities are mind boggling.

The Midwest, particularly Wisconsin, has a great opportunity to take a leadership position in the new bio-economy. But we must act now! Events are moving very fast. Competitive positions are already being staked out by the leading national VC's in broad areas of genetic engineering, bio-informatics and medical information systems. Several California VC's have already licensed some of the most promising biomedical technology under development at the University of Wisconsin. Why does this happen? Because the California VC's understood the significance of the technology, they moved quickly and they had enough money to make the deals happen.

To compete with these national players local VC's need more money and more talent. The problem with local venture capitalists is that we lack the technical experience necessary to be good venture capitalists. Local VC's make investments without knowing much of anything about the underlying technology. Because we know very little about the science, we are not good at making judgements about the quality of the technology or the products that can be made from it! In states where venture capital is flourishing, it is common for VC firms to have biochemists, engineers, and electrical and computer scientists on their team. These people are highly educated in scientific fields, making them capable of evaluating the underlying technology and making judgements about market needs.

Many of the individuals involved in the local venture capital community have finance and business backgrounds, but they lack a good understanding of high-tech, particularly biotech. In the short term this can be corrected by augmenting the VC's decision-making process with consulting resources and scientific advisory boards capable of properly assessing technology. Ultimately, Wisconsin's VC's must bring in the necessary talent to compete on a national level. The larger budgets associated with larger funds will help in this regard, but the leadership of the VC firms must make the commitment to raise their overheads rather than their own salaries.

Some steps are being taken today to improve the situation. More attention needs to be given to the technology gap that exists in the local investment community. Across the board changes must be made in the thinking about the importance of technologist in our culture. Until it becomes more common for technical professionals to participate in business decision-making, we will not see a robust new venture environment in Wisconsin. If local VC's make these changes, Wisconsin could become a real factor in the new economy of the 21st century.

### **Step #3: Waltzing with Institutional Investors**

We must persuade Wisconsin's institutional investors (referred to below as II's) to use their influence to help local VC's to attract funding commitments from other national and international sources. Until recently, Wisconsin's VC's have been unable to qualify for investments by out-of-state II's because they were too small and lacked experience. Large pension funds and insurance companies frequently refuse to invest in "first-time" funds. II's frequently have \$20 million minimum investment amounts for venture capital funds. The combined effect of these rules is that the big get bigger: Success breeds success!

What can be done? Institutional investors are serious people, and well they should be. They are managing other people's money. The "other people" are retirees and insurance policy holders who depend on their pension funds and insurance companies to have cash available for them when they need it most. Like most serious-minded investors, II's manage their investment portfolios using a technique called "asset allocation". This technique distributes the available investment dollars across the full range of available investment alternatives anywhere in the world. Each alternative, called an "asset class", differs from the others in terms of liquidity, volatility, risk and return. Most large II's have investments in every asset class, but to varying degrees depending on their view on the direction of interest rates, stock market prices, and growth rates in the leading economies of the industrialized world. At any point in time, the allocation of investment dollars to a particular asset class can change dramatically. The conventional wisdom is that II's will not invest in a given asset class unless they commit at least 5% of the portfolio. This practice reflects the need to maintain a team of full-time people to manage the class.

What does all this have to do with the venture capital performance in Wisconsin? First, it is important to understand that venture capital falls into an asset class commonly referred to by II's as "alternative assets". Alternative assets are those that cannot be classed elsewhere. Investments in this class share the characteristics of being illiquid (not easily sold for cash) and high-risk (speculative as to earnings and subject to possible loss of principal). The allocation to "alternative assets" usually hovers around the minimum, i.e., 5-10% of total assets under management. For these reasons, II's have scarce resources for investing in venture capital funds. Furthermore, II's understandably concentrate their investments on the very best opportunities they see in the market. Large II's look at hundreds of venture capital funds every year and choose only a dozen or so for investment. This makes it a particularly tough market for new funds.

Wisconsin has two large II's routinely making investments in venture capital funds—the State of Wisconsin Investment Board (SWIB) and Northwestern Mutual Life Insurance (NML). Both are very active on a national and international level. Together, SWIB and NML represent over \$130 billion of assets under management. Fortunately for Wisconsin, these Wisconsin II's have been willing to help local, first time funds to get started. The problem is they cannot do it alone. We need to develop a better network of II's from other states and around the country as a source of capital for local VC's. This is Wisconsin's biggest challenge.

If we can somehow enlist the local institutional investors, who are already supporting Wisconsin's venture capital funds, to introduce the local VC's to other II's in other parts of the U.S. and around the world, it would make a huge difference. The sources of funding for VC's are

widely dispersed and hard to access without proper introductions. The community of II's consists of a few thousand people who know one another and frequently compare notes on fund managers. For this reason they tend to think along the same lines, at least they share opinions about the quality and performance of their investment partnerships. The process of accessing the large pools of capital required if Wisconsin is to have better venture capital performance, means that Wisconsin's II's need to introduce local VC's to other dance partners.

While still young and less experienced than California's VC's, Wisconsin's VC's are emerging as serious venture capitalists. The recent round of new fundraising will have a major impact on the way local VC's operate and how they relate to out-of-state investors. As local fund managers work to establish their networks of II's, there will be opportunities for SWIB and NML to assist the local VC's with introductions to their friends and acquaintances in the league of II's. By providing references for local VC's, Wisconsin's leading II's can help to accelerate the gathering of commitments from the other II's currently channeling money to VC's in California and Massachusetts.

#### **Step #4: The Entrepreneur Boogie.**

We must convince the "best and brightest" students coming out of Wisconsin's educational institutions to become entrepreneurs. These young men and women are the entrepreneurs who will lead Wisconsin into the new high tech economy of the 21<sup>st</sup> Century. We must remove the layers of discouragement which frequently prevent these young people from starting businesses. We must create incentives to stimulate their entrepreneurial interests and we must provide a support system to help them move efficiently into successful start-up companies.

Where to begin? Lets start with the culture. The first layer of discouragement usually comes from the family. Spouse, parents, and relatives unwittingly conspire to channel Wisconsin's young men and women into professional and traditional business careers. Most Wisconsin natives believe that every young person should begin at an entry level in an established firm or company with good employee benefit plans. This sort of conservative thinking encourages people to seek positions in large corporations where they have very little chance to learn about the realities of running a business, much less about how to make good business decisions. Most large corporations insulate their young employees from responsibility, requiring years of experience before assuming any significant level of authority. This is not good.

If an entrepreneur overcomes the discouragement from his family, he/she usually talks to a lawyer or accountant about the mechanics of starting a company. The members of the professional service industry can be enormously helpful to young entrepreneurs but too often the preliminary feedback from local professionals on the dos and don'ts of organizing a company turns decidedly negative. The practical tips on how to do it often become a long list of horror stories about unsuccessful ventures. Well-intentioned lawyers and accountants, because of their personality and training, tend to focus on risks and problems. They see potholes instead of the road ahead. Sometimes these remarks are part of a self-serving sales pitch to convince the entrepreneur that in order to do it properly, he needs their advice every step of the way. The truth is a lot of the things that people do in business that make them successful are common sense, things for which an accounting degree or law degree are totally unnecessary. As a general proposition, lawyers and accountants are not risk takers and they do not understand how to analyze risk. Their view of the risks generally leads them to a very conservative course of action where they can be certain of the outcome.

Finally, the entrepreneurs who do get started frequently get bad advice about how to structure their company. Too often, inexperienced lawyers establish companies that are improperly formed and have the wrong capital structure. The companies issue securities that are inconsistent with the type of securities typically used by venture capital firms and therefore the initial organization is tainted by potential securities violations and corporate governance issues. The most common mistake is to use debt securities rather than common stock. Sometimes advisors will encourage the entrepreneur to issue complex securities to several different classes of shareholders, producing endless disagreements whenever more money is needed. Simplicity is a virtue in start-up companies. Those who seek to control the start-up, rather than support it, end up crippling the company before it learns to walk.

Many would-be entrepreneurs look to established companies for an opportunity. They take positions in local companies hoping to learn about business. Sometimes it works well. There are many established Wisconsin companies with strong entrepreneurial cultures. But the opposite is more common. Many of the most respected companies in Wisconsin are very slow to develop people precisely because they are not growing and therefore have few openings to offer them. Older employees with more experience get the best jobs. Seniority is an important concept, even in management positions. We need other alternatives in Wisconsin for our ambitious young people. If we don't provide these alternatives, young people seeking this kind of environment will continue to leave Wisconsin to find it.

If we had a robust start-up environment, some of these talented young people would quickly step into challenging jobs where they would be forced to learn or lose. In start-up companies there are no organizational bureaucracies, no policy manuals, no mentors to guide them. In start-up companies, intelligence, intuition and common sense rule. In fact, previous experience doesn't necessarily help. People with experience tend to think along very predictable lines, which doesn't help in a high-tech start-up where employees must think out of the box. The process of creating new products to meet the customer's need requires much experimentation—false starts, blind alleys and failed attempts. Young managers have the drive, creativity and flexibility to persist when more experienced people would give up.

The best place for a young entrepreneur to learn about business is from another entrepreneur. That is why angel networks are so important. Angel investors are able to give a more balanced view of the risks as well as the opportunities. They also serve as an example of how to succeed. Young ambitious people learn more by winning than by losing. Early interaction with successful businessmen is the best way to increase the odds of succeeding and thereby inspire young entrepreneurs to do more. If done properly, these young people will soon realize that being an entrepreneur is a profession too. It is something that can be repeated again and again.

In other parts of the country there are people who move from deal to deal serving as start-up entrepreneurs. Their role is to organize the company, recruit a management team, and design new products. As the company grows, the entrepreneur may hand it over to a new leader who will help to expand the business further and perhaps take it public. People who make a profession of doing start-ups are called "serial entrepreneurs" (no, they are not criminals). We need more of this type of entrepreneur here in Wisconsin.

The "serial entrepreneur" is focused on one thing: making the company successful. He does not have proprietary motives; he does not seek to own the company. The best entrepreneurs understand the challenges of start-up companies. They know how to prioritize activities. They know how to marshal the resources necessary for success. The best entrepreneurs understand three basic facts about building successful companies: 1) *they focus on customers and markets first*; 2) *they know that the job involves a lot of hard work*; 3) *they are determined to make the company financially successful*. Against these three standards, many entrepreneurs fall short.

The most frequent failing of local entrepreneurs is that they focus first on a product, rather than a market. They take for granted that their new product is going to appeal to a mass market of buyers. They tend to think that the product is so sensational that it will sell itself. Unfortunately products never sell themselves. Every new product needs to be refined to meet all the needs, not just most of the needs, of the customer. The working prototype of the new product invariably provides about 60% of the ultimate solution demanded by the customer. So, the best entrepreneurs are those who listen carefully to their customers and do what they ask.

Most successful entrepreneurs begin every speech with the statement, "Our customer is the most important part of our business." Entrepreneurs listen carefully to everything the customer says, time and time and time again. This process, this habit of paying close attention to what the customer says, provides the entrepreneur with the input he needs to design products that people will buy rather than products that technologists think are fun to make. All successful entrepreneurs have an innate ability to find the attributes of a product that will satisfy the needs of the customer.

The entrepreneur's obsession with the customer is driven by his desire to create competitive advantage. It isn't enough to simply sell your product, you must also stop your competitors from selling theirs. There is an old saying in the venture business: "Better, faster, cheaper—pick two!" The message here is that the customer's needs are currently being met in some fashion by some product or service that is already in the marketplace. Every new product must displace an existing product. The attractive force that is necessary to displace current technology must be substantially greater than the force holding the current technology. That difference needs to be at least 30-40%.

A really powerful technology breakthrough is several orders of magnitude better, faster and cheaper than pre-existing technology. Personal computers running packaged software have largely displaced the mainframe as a computational tool because the costs of use are hundred times less. Too often local entrepreneurs are convinced that their product will take over the market when the real value improvement is less than 10% over what is currently in place. A 10% improvement in price, speed or quality is not sufficient to cause anyone to change. In fact, a 10% advantage can be off-set with pricing. So understanding the needs of the customer and developing products that deliver substantially better value to the customer is the starting point for every entrepreneur.

Succeeding as an entrepreneur is also hard work! There are many would-be entrepreneurs who fail to appreciate how hard it is, or how hard other entrepreneurs are working on their companies. Competition is fierce. Too often local entrepreneurs decide to start a company because they are frustrated with their current job or they find themselves unemployed and are seeking a new challenge. These "late-life" entrepreneurs are having a mid-career crisis and are not good candidates for leading high-tech companies.

The best entrepreneurs are individuals who have been highly successful in their current career and have a very difficult time making the switch because of the opportunity cost of giving up a successful career that is well underway. There is an old saying that busy people get things done and it is certainly true in the venture business. Good entrepreneurs are high-energy individuals with a high appetite for work and high standards of accountability. It goes without saying that good entrepreneurs are workaholics. They love stress—they thrive on it. Recently one entrepreneur when asked how he handled the stress, replied "I don't handle stress, I create it." The best entrepreneurs set an example by working 60-70 hours every week, week-in, week-out, and sometimes more than that.

Finally, good entrepreneurs are committed to making the company successful. Success to an entrepreneur means building a company that is growing and profitable, that has market value. Good entrepreneurs clearly understand that their mission is to create wealth. This is another weakness of some of the local entrepreneurs. While they understand the customer and they are willing to work hard, they don't necessarily equate success with creating financial value. They are often driven by altruistic objectives that sometimes interfere with their ability to make the right decisions about the business. Successful entrepreneurs understand that growth and profitability are the prerequisites for achieving all the other laudable purposes. Building a socially conscious work force that is sheltered in a highly supportive environment by family-friendly employee benefit plans, is wonderful if it makes the company financially successful.

Value is created by rapid growth in revenue and profits. A rapidly growing, highly profitable business is the result of an interaction between a product or service and a group of customers who pay for those products and services. The increasing rate of sales is indicative of the economic value of the product or service being provided. On the other hand if a product isn't selling, it is because it lacks utility. Therefore, by focusing on the products and services that are easiest to sell, the entrepreneur creates the highest economic utility and produces the best financial result. Those entrepreneurs who are determined to succeed are also determined to do whatever it takes in terms of designing, changing and improving the product until it does create the kind of excitement that propels a high-growth business.

Focusing on making money sharpens the decision-making process. That same entrepreneur does not get distracted with nice-to-have ideas driven by the desire to create an elegant solution. He listens rather to what the customer wants and he gives him what he wants. In his determination to be successful, he eliminates extraneous and distracting activities that do not promote sales or earnings. His determination to be successful also encourages him to see the whole picture. The entrepreneur recognizes that to provide products, he has to have good people, and to get good people, he has to have financial strength. That financial strength is based on sufficient equity capital and later on positive cash flow. With positive cash flow comes all the other things necessary to the prosperity of the business, its customers, employees and shareholders.

The good entrepreneur doesn't see himself as the center of activity, he sees the customer as the center of activity and he organizes everything else including his own activity around satisfying those requirements. He is concerned about making the company successful, not about making it his. He doesn't have the kind of identity with the company that causes him to slow its growth to achieve personal objectives. He doesn't let his own ego get in the way of his decision making as it relates to the success of the company. He recognizes that he is important but not the only part of the equation for success. His determination to be successful is what keeps him humble.

### **Step #5: The Band**

The final aspect of the dance I have been describing is the band. The music of the band surrounds the dancers and helps them to organize their movement and maintain their tempo. The members of the band are all the hundreds of supporting performers who influence the entrepreneurs. The band motivates the dancers and reinforces their efforts with encouragement and praise. At times, they simply get out of the way. Some suggestions for the band are as follows:

1. Stop handing out awards to old hands with over-stocked trophy cases. We need to give awards to the new players—to the young people with good ideas. Each year in San Jose, California the local businessmen contribute to a fund for prizes which are given to students at Bay Area colleges and universities. The prizes of \$10 –20,000 each are awarded to students who submit the best business plans. There are no strings attached—the recipients can spend the money as they wish.

2. We must become more tolerant of youthful excesses, mistakes and miscalculations. So what if an entrepreneur failed in his last business? Everyone makes mistakes. The important question is whether his new deal will succeed. It is part of learning. We need higher tolerance for failure: If you fall down seven times, get up eight!
3. We must honor success. Most people in Wisconsin try to hide their wealth. Many are secretive because they don't want to be an easy target for government regulators, tax collectors and journalists who seek to embarrass them personally and impede their efforts. It is a crazy world out there and in it are some people who don't understand economics, misread history and therefore believe that behind every great fortune is a great crime. They find it impossible to believe, for example, that Bill Gates could become that wealthy without cheating somebody. This attitude must change.
4. We must encourage interdisciplinary study at the college and post-doctorate levels with degree programs that combine engineering with business, finance and international programs. For the last 50 years, the best and brightest minds in America who have gone into scientific fields, where higher order mathematics is the language of daily intercourse. The rest of us have pursued careers in the so-called "humanities". Business schools have been filled with students who are uncomfortable with math and science. These same people now insulate themselves from technology by vainly insisting that they can hire other people who can interpret the new technology for them. They say they get paid to manage not to do. The truth is just the opposite.

Jack Welch, the most respected executive in America today, is first-of-all an engineer. Andy Grove at Intel is a physicist who never went to business school. Bill Gates left Harvard to start Microsoft and recently turned over the management of the company so he could focus on software development. Most successful, high-tech CEO's have technical backgrounds. The truth is that it is easier to teach a talented scientist the rules of accounting and business than the other way around. Let's face it, the "business" of business is intellectually simple and it is easy to find professional service firms to help you with accounting, finance, marketing and personnel problems. The challenge for a CEO of a new economy company is to stay ahead of the technology, an impossible task if you don't understand it in the first place. Scientists deserve a lot more respect than they typically get from local business leaders. Without technology to propel innovative solutions for its customers, every business will devolve to the lowest profit point in the industry and then disappear—the record is clear on that!

5. Encourage more intuitive thinking by businessmen. The conventional wisdom is that the best decisions are the result of a rational process—one that is linear and deductive. Wrong! The best entrepreneurial decisions are intuitive and the best-run high-tech companies operate using a large amount of sheer guesswork. Throw out ideas and see what sticks! Experiment: encourage what works; stop what doesn't work and cut your losses. Less study—more action.
6. Finally, I suggest we all loosen up—not take ourselves so seriously. Business can be fun, too.

## Conclusions:

Those who read this entire piece should by now understand one thing very clearly: Improving Wisconsin's venture capital performance is a "top-down" process. It starts on the top with institutional investors, venture capitalists and "angel" investors. The entrepreneur cannot make it happen – all he can do is go where the money is, and that's exactly what they have been doing! We have been steadily losing young talent to California because that is where things are happening.

It all starts with money. If angel investors encourage young entrepreneurs, institutional investors support local venture capitalists and local venture capitalists show leadership by taking the time to understand the technology and the markets, then things will start to improve. Talented young people will stop leaving for the coasts, others will get the word that things are happening here and start arriving. The most promising technology being developed at local research institutions will be assigned to local companies first. Real estate that is designed for incubating new companies will flourish. Law and accounting firms will expand their Wisconsin offices to handle the surge of new business. Out-of-state venture capitalists and investment bankers will be lurking everywhere looking for deals! Twenty-eight year olds will be driving around in BMW's and buying prime lake property at inflated prices.

Wouldn't it be great!