

# **Entrepreneurship: A Keystone of Wisconsin's New Economy**

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## **1. Introduction and Summary**

The purpose of this paper is to provide a brief review of what we know about entrepreneurship in Wisconsin, with a particular focus on the findings of *The Entrepreneurial Network Study 1999*, a joint research project between the Wisconsin Department of Commerce (COMMERCE) and the University of Wisconsin-Extension Small Business Development Center (SBDC). It has been prepared as background information for the *Wisconsin Economic Summit* sponsored by the University of Wisconsin System and the Board of Regents.

**What is entrepreneurship?** According to the Kauffman Center, “Entrepreneurship is the ability to amass the necessary resources to capitalize on new business opportunities.” The term is frequently used, however, to refer to the rapid growth of new and innovative businesses.

There are varying opinions about what constitutes entrepreneurship, especially the distinction between entrepreneurship and small business. Small businesses play a significant role in the overall economy. It is through small businesses that we obtain many basic products and services. And many small business owners and employees exhibit entrepreneurial qualities as they address product demand and customer satisfaction.

For the purposes of this paper we focus on entrepreneurship. Entrepreneurial firms play a unique role in the new economy. With an eye for attracting individuals who blend innovation with sound business practices to commercialize new products and services, the Small Business Development Center is increasingly targeting its assistance toward high-growth, entrepreneurial firms.

**This paper contains seven sections.** After an introduction, Section 2 presents some facts about Wisconsin’s entrepreneurial energy and puts them into national and historical perspective. Section 3 examines what factors help entrepreneurial firms succeed. We then discuss who benefits from entrepreneurial growth and how in Section 4. Then we summarize the steps of business development in Section 5 and itemize what works and what does not through the findings of *The Entrepreneurial Network Study 1999* in Section 6. Our concluding Section 7 summarizes our recommendations and conclusions.

## 2. Wisconsin's Recent Entrepreneurship Report Card in Perspective

This section addresses the rating that Wisconsin received for business vitality in 1999 from the Corporation for Enterprise Development (CFED). The CFED; a Washington-based, non-profit economic development, consulting firm; publishes an annual *Development Report Card for the States* (Report Card). The Report Card uses state-by-state comparisons based on 50 socioeconomic data measures to assess the strengths and weaknesses of each state's economy and its potential for future growth. This assessment – a comparative benchmarking – evaluates each state's performance relative to the performance of all other states.

The 1999 Report Card contained much good news for Wisconsin. Specifically, the Report Card indicated that:

- Wisconsin again earned an "A" for its **Economic Performance**, ranking 3<sup>rd</sup> in the United States. Again referring to the national ratings within this category, Wisconsin ranked 2<sup>nd</sup> nationally in the **Equity** subcategory, which measures poverty rate, income distribution, income distribution change and rural/urban disparity. Wisconsin's **Quality of Life** ranked 4<sup>th</sup> nationally.
- It is in the **Business Vitality** area that Wisconsin scored its biggest gain, moving from an "F" in 1998 to a "C" in 1999. Wisconsin fared reasonably well in the **Competitiveness of Existing Business** subcategory. But, the most significant improvement was in the **Entrepreneurial Energy** subclass, which measures new company formations, job growth, technology companies and the number of initial public offerings (IPOs). In this subcategory, Wisconsin rose to No. 35 nationally from its 46<sup>th</sup> place in 1998.
- The state earned an "A" in **Development Capacity** and a 9<sup>th</sup> place position nationally, as compared to 1998's "B" and 12<sup>th</sup> place. This category entails human resources (with a national ranking of No. 3), financial and infrastructure resources, as well as amenities and natural resources, and innovation assets.

Wisconsin can be very proud of these significant achievements. At the same time, the state must remain alert to the areas in which improvements are needed. Among these, access to people and access to business capital, especially venture capital, continue to be a driving concern. Some would argue that we in Wisconsin are less entrepreneurial minded and positioned than people in some other parts of the country, despite our significant gains. The authors urge continued diligence in addressing these needs at every level, both public and private.

### **3. What factors help entrepreneurial firms to succeed?**

In this section we review the main determinants of entrepreneurial growth and development, relying on the best evidence from the current literature. In turn, we briefly discuss:

- Access to people;
- Access to seed capital;
- Access to information and infrastructure.

#### **Access to people**

According to the National Commission on Entrepreneurship, finding and retaining quality people in all positions – management, technical and entry-level – are the biggest challenges facing entrepreneurs. This finding is not a huge surprise, but access to qualified workers is also part of a larger economic transformation that is increasing the importance of knowledge workers to business success and regional economic development. Leading high-technology growth regions are now characterized by high concentrations of knowledge workers and an ability to attract and retain those workers. For example, 85 percent of Internet executives in Silicon Valley cited access to talent as a key factor in determining their firm's location. Conversely, states with fewer concentrations of talent and no critical mass will find it increasingly challenging to recruit talent into communities where knowledge workers might not be able to find another job should the job for which they moved into the community fail to work out.

#### **Access to seed capital**

Anyone who has worked with entrepreneurs for some time becomes an expert in issues related to access to capital. In Wisconsin, access to financing is a concern for small businesses and entrepreneurs. For the right company, venture capital can be the key to rapid, successful growth. For more than 30 years, venture capital firms have provided financing for many start-ups that have blossomed into leading corporations in science, technology, manufacturing and commerce. As deals have grown in size, investors have shifted away from funding new start-ups and increased their financing of later-stage growth companies. As a result, Wisconsin entrepreneurs face a real challenge obtaining smaller amounts of seed capital. Entrepreneurs frequently identify difficulties in obtaining seed capital investments in the range of \$300,000 to \$3 million.

Venture capital is important for some entrepreneurial start-ups. Most start-up businesses, however, do not rely on equity investments. Nationwide, in fact, few firms receive venture funding. In 1999, only 3,600 U.S. firms received venture funding. Meanwhile, the U.S. averages anywhere from 600,000 – 800,000 new businesses per year. In Wisconsin the scenario is even more disproportionate. While 120,000 businesses with employees were reported in 1998, of which 98% are small (by the U.S. Small Business Administration definition of a small business as a business with fewer than 500 employees), the number of venture “deals” in Wisconsin is less than ten per year. Thus, the presence of venture

capital is not necessarily the sole indicator of a strong entrepreneurial region nor an indicator of success. Consider this: The October 17, 2000, issue of *Inc. 500* includes the magazine's list of "America's fastest-growing private companies;" of those 500 companies, 68% (340) started with less than \$50,000 in seed capital.

While formal equity investment resources are important, most Small Business Development Center clients receive their financing from traditional sources, such as banks and "friends and family." Specific regions, like the Midwest, often face their own capital-access challenges. Because "angel" networks, networks of individual investors looking to invest in high-growth start-ups, can be extremely informal and are often built by established entrepreneurs with a history of doing business together, these networks can be invisible to new entrepreneurs. To compound the problem, access to venture funding is often dependent on introductions by lawyers, accountants, and angels in these very same networks.

### **Access to infrastructure and information**

In entrepreneurial hotspots (like Massachusetts and California), funders frequently point to a shared history of the region and a vision for the future with entrepreneurs they invest in. This sense of shared history was strongly expressed in a recent visit by key Wisconsin policymakers to the North Carolina Research Triangle Park (RTP), where all of the interviewees could recite background on the founding of the RTP and the emergence of cornerstone companies, like SAS Institute, Glaxo and others. There was also a remarkable unanimity among the interviewees in their opinions on North Carolina's path for future development and on the central challenges facing the state and the region.

One of the more striking observations of SBDC clients is the importance of formal and informal networks of and for entrepreneurs. Although such findings are not completely unexpected, these observations are underscored by the recently published *Global Entrepreneurial Monitor* (GEM) and Arthur Andersen LLP's *Venture Capital: Myths and Reality*. The GEM, a joint research initiative by Babson College and the London Business School sponsored by the Kauffman Center for Entrepreneurial Leadership, reports the annual start-up of 600,000 – 800,000 new companies in the United States that create real jobs. The GEM reports that right now 16 million Americans are trying to start a business of their own. (According to the Yankelovich survey *Life in the Year 2010*, 37% of current employees say they will own their own business in 2010.) The GEM also reports that strong entrepreneurial regions provide networks, a breadth of education, information, mentoring and services.

Arthur Andersen supports that opinion: "Ironically, both entrepreneurs and investors say that the cash supplied by venture capital groups is often the least significant aspect of their contribution to the success of their portfolio companies. Far more important is their help in recruiting key executives and board members, introducing their companies to potential customers and strategic partners, and providing advice when the management team runs into trouble." We believe the

significance of these networks is not well understood or appreciated yet, but we know networks link entrepreneurs to potential sources of capital, new employees, strategic alliance partners, and service providers such as lawyers, accountants and consultants. Through educational and professional networks, entrepreneurs share information and assessments of markets and technology as well as lessons learned from their own experiences. Best practice assistance programs of training and education are then implemented with the advice of entrepreneurial companies in the state.

#### **4. Who benefits from entrepreneurial growth and how?**

While the study of entrepreneurship is booming, it is only recently that we began linking entrepreneurial activity and economic prosperity. The recently published GEM co-authored by former UW Milwaukee faculty member Paul Reynolds states, "Variations in rates of entrepreneurship may account for as much as one-third of the variation in economic growth."

The new economy is being propelled by growth in small, high-growth companies, commonly called "gazelles." Typically created and driven by entrepreneurs, gazelles account for nearly 70 percent of current economic growth. New and growing firms are a major source of new jobs in the current economy. Although Fortune 500 companies have lost more than 5 million jobs since 1980, more than 34 million new jobs have been added to the economy in the same period. Entrepreneurs and small businesses created the majority of these jobs.

#### **5. What are the steps of business development?**

To better understand the process of business formation and entrepreneurship, we are using a model that outlines the life cycle of a business and pinpoints the barriers to business entry and continued growth. Developed by UW Emeritus Professor James Stone, this conceptual model focuses on the problems and obstacles an entrepreneur might encounter at each critical step of development. We believe the model provides many useful insights into the special nature of small business and the unique qualities of Wisconsin's business environment that help or hinder entrepreneurs.

Stone suggests that businesses tend to grow in a sequential fashion. His model details both the pre-venture and venture phases of a new business.

##### **Pre-Venture Phase**

A successful new business begins with a motivated entrepreneur who has a good idea. Entrepreneurs dream about their idea and create a plan for a new business in the pre-venture phase of development.

There may be different motivations behind each venture. Some entrepreneurs will be driven by an idea that must be brought to fruition, others are motivated by

being their own boss and seek a new business idea that will provide that opportunity, and still others seemingly stumble into the opportunity to start a new business.

Regardless of whether the initial motivation is dissatisfaction, opportunity, or initial encouragement by friends, all entrepreneurs engage in some sort of formal or informal evaluation in this stage. This first phase is where the entrepreneur assesses the social and psychological impact of starting a new business, seeks financial and technical support, evaluates personal traits, and may even begin formal market research and product development. The entrepreneur eventually makes the decision to abandon or begin the business venture. A decision to start a business moves the entrepreneur into the venture phase of the conceptual model.

Because an uninformed decision in the pre-venture phase can result in a plan never becoming a business, it is critical for the entrepreneur to have access to experienced and informed assistance in the initial evaluation process. In Wisconsin the UW-Extension network of Small Business Development Centers, located throughout the state through the UW System, is one of several organizations that can and often does fill this role.

### **Venture Phase**

The formalization of a business, or the venture phase, includes four developmental stages: start-up, maintenance, expansion, and maturity.

#### **start-up**

The entrepreneur's managerial ability is the key to success in the start-up stage. If a venture fails at the beginning, it is largely a function of lack of general management experience. One U.S. Small Business Administration study of business failures attributed 41 percent of initial business deaths to lack of entrepreneurial knowledge and another 52 percent to entrepreneurial lack of experience in business, management or both.

Other barriers to success in the start-up stage include the attraction of customers, availability of credit and capital, and the array of government regulations and taxes. The greatest number of business failures occurs in this stage of development.

#### **maintenance**

Successful start-up businesses move to the maintenance stage of development. Businesses in this stage seek a status quo and become oriented toward basic survival; in fact, many never leave the maintenance stage. Although the job generation potential of businesses in this stage is low, the overall importance of these businesses is significant because they represent models of potential entrepreneurs who are considering starting their own business.

## **expansion**

When firms begin to add employees and structure, they enter the expansion stage of business development. Expanding businesses are growth-oriented and become complex. Their need for management development, market research, new products and outside professional help grows in this stage.

## **maturity**

Firms that have moved through maintenance and expansion reach maturity. Large size and complex organizational structure characterize this stage. Mature businesses are oriented toward maintaining markets and profitability.

## **6. Entrepreneurial Assistance - What works? What doesn't work?**

*The Entrepreneurial Network Study 1999* (COMMERCE/SBDC Study) is a collaborative project of the Wisconsin Department of Commerce and the Small Business Development Center. The COMMERCE/SBDC Study was designed to improve knowledge of the environment supporting entrepreneurial development in Wisconsin. It focused on identifying:

- Patterns of small business assistance and referrals throughout the state;
- Any gaps in these business assistance practices that warrant policy initiatives;
- Positive factors contributing to entrepreneurship that need to be sustained;
- Significant barriers to business start-up that should be rectified;
- Specific problems impeding entrepreneurial access to capital.

The COMMERCE/SBDC Study sponsors engaged the University of Wisconsin-Madison Survey Center to guide survey design and methodology. The Center edited and mailed a questionnaire to a survey population consisting of 740 organizations, representing 15 different groups providing various small business and entrepreneurial assistance services.

Overall, according to the COMMERCE/SBDC Study results, businesses and the organizations that assist them make active use of Wisconsin's business assistance network.

**Most Common Services.** The three most-frequently-provided services were assistance with site selection/business expansion, business start-up, and financial packaging/funding application.

**Least Common Services.** The two least-commonly-provided services were assistance with foreign trade and technology transfer. Only nine percent of respondents primarily provide foreign trade services. Only 10% primarily provide technology transfer services.

**Service Importance.** Although respondents considered all business assistance categories important, business start-up services were considered the most important for their clients by the largest number of respondents. Rated next in importance were financial packaging/funding application services, marketing/marketing research, and financial/cash flow management services.

**Service Gaps.** Service gaps occur when business assistance providers need to make a referral but lack an adequate referral resource for this service. Survey respondents reported the highest service gaps in technology transfer, information technology, and foreign trade. These findings corroborate concerns about the availability of local services for technology-based business and international development.

**More Emphasis on Certain Sectors.** Eighty-five percent of respondents reported serving retail clients; 87% serve manufacturing and distribution clients; and 90% assist service firms. However, emphasis on the manufacturing sector is evident. This most likely reflects Wisconsin's strong industrial development policy.

**Little Emphasis on High-Tech Clients.** Only one percent of respondents indicated that 50% or more of their clients could be classified high technology or R&D-intensive. Of all survey respondents, 60% did not work at all with high technology clients. These findings suggest that the infrastructure for technology development is either very concentrated or underdeveloped, or both.

## **7. Recommendations and Conclusions**

### **Recommendations:**

*The Entrepreneurial Network Study 1999* highlights several weaknesses that may limit entrepreneurial activity in Wisconsin, including levels of assistance for pre-venture clients and emerging firms, and access to capital for types of financing that remain difficult -- in particular for equity capital. The COMMERCE/SBDC Study also raises some concerns about Wisconsin's present capacity to support a policy of technology business development. Finally, the COMMERCE/SBDC Study suggests areas for improving the skill levels of business assistance providers and the abilities of these organizations to communicate more effectively with clients and one another. The following recommendations address these findings:

**Provide a new approach to technology business development.** Wisconsin should consider implementing Small Business Technology Development Centers (SBTDC) in conjunction with its Small Business Development Center system of outreach. North Carolina offers a model SBTDC system that can be adapted to the Wisconsin environment.

- In the SBTDC model, a technology business specialist with strong business and financial management skills helps the technology entrepreneur navigate effectively through an unfamiliar business landscape. This specialist is a facilitator throughout enterprise formation and commercialization, leveraging business relationships useful to the entrepreneur.
- To be effective, SBTDCs need to partner with key organizations and activities, such as university technology transfer offices, local entrepreneurial support organizations, venture fair activities, and Small Business Innovation Research (SBIR) support programs. The SBTDC functions as a facilitator in this web of partnerships, supplementing and bringing a new level of coordination to previously fragmented technology support activities.

**Improve the process for assisting pre-venture and emerging businesses.**

Working with pre-venture clients and emerging businesses is generally regarded as a time consuming endeavor. Many organizations are unable to devote the time necessary to more intensive levels of service, such as one-on-one counseling with start-ups. However, some Wisconsin programs specialize in pre-venture and early-stage assistance and have developed methodologies, tools, and information libraries that improve the effectiveness and efficiency of client assistance.

**Develop additional pools of equity capital for Wisconsin businesses.** To successfully implement a technology development strategy, Wisconsin policy makers must find ways to attract or generate additional local pools of investment capital, especially early-stage capital, that can be targeted to Wisconsin technology businesses. If the available pools of equity capital remain predominantly out of state, emerging technology businesses are at risk of being relocated near their investors. (For more on this important topic please see the Wisconsin Economic Summit white papers: *Seed & Venture Capital Formulation: Essential to High-Tech Business, Job Growth*, Dick Leazer, Chair, Wisconsin Technology & Entrepreneurs Council; *Improving Wisconsin's Performance in Attracting Venture Investor Attention & Action*, John Byrnes, Chairman and Managing Director, Mason Well (Milwaukee); *Developing an Entrepreneurial Climate in Wisconsin*, Bob Pricer, Director, Weinert Center of Entrepreneurship (UW-Madison).

**Conclusions:**

As this brief review has shown, we do know a number of useful things about Entrepreneurship in Wisconsin:

- First of all, we know that Wisconsin's new company formations and the subsequent "churning" of going in-and-out of business is markedly below the national average.

- Second, we know which key factors entrepreneurs identify as critical to their success, including the availability of qualified workers, equity finance, cost and access to professional services, and provision of suitable education and training.
- Third, we know through the Wisconsin Department of Commerce/SBDC *Entrepreneurial Network Study 1999* that existing business assistance programs, with current levels of technology transfer services, may be inadequate to support emerging technology policy goals.
- Last, we know that entrepreneurs using existing programs, such as SBDC training, are more likely to successfully launch a business and subsequently expand it.

Some business development factors that matter are hard to measure, such as improving the entrepreneurial climate of Wisconsin. Still missing are appropriate and reliable benchmarks for measuring the level of entrepreneurial activity and comparable benchmarks for gauging the success of entrepreneurial assistance services.

According to the National Commission on Entrepreneurship, to have a strong entrepreneurial community, lots of threads must be woven together: public policy that supports entrepreneurship, people, money, technology, customers, transportation, a supportive environment and services, to name a few. In today's environment, regional development strategies must include entrepreneurial policies and programs targeted specifically at the entrepreneur. As we develop a statewide strategic plan for economic development, our challenge is to find ways to give more Wisconsin regions the option to pursue this path to economic development. Government, educators, and opinion leaders must play a key role in creating a culture that validates and promotes entrepreneurship throughout Wisconsin.

**Note:** The Small Business Development Center, which provides counseling and management education to small business owners, completed 20 years of service to Wisconsin's entrepreneurs in 1999. During its first two decades of operation, the SBDC delivered one-on-one counseling and relevant educational programs to nearly 280,000 entrepreneurs statewide.

The SBDC is operated with support from a broad-based partnership which includes the U.S. Small Business Administration, the University of Wisconsin-Extension, 12 UW campuses, the Wisconsin Department of Commerce, and many other local partners statewide. Wisconsin's SBDC offices are supported

through UW-Eau Claire, UW-Green Bay, UW-La Crosse, UW-Madison, UW-Milwaukee, UW-Oshkosh, UW-Parkside, UW-Platteville, UW-River Falls, UW-Stevens Point, UW-Superior, UW-Whitewater and the Wisconsin Innovation Service Center on the Whitewater campus.

The SBDC provides counseling services and a wide variety of continuing education workshops, courses, and short programs to meet small business needs. Programs for both the novice and experienced business owner are included in the SBDC offerings. They are easily accessible across the state in a variety of formats, including one-on-one counseling, traditional classrooms, computer software, and at a distance over the World Wide Web. The educational programs provide a balance between traditional business topics and new information in response to current trends.

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