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Encouraging Growth Companies in Wisconsin

REPORT FROM THE PRESIDENT:

As economic development has become the new hot issue in Wisconsin, we thought it would be important to have someone examine Wisconsin's current economy and what is needed to increase our job growth, particularly in high-tech businesses over the next decade. We contracted with Richard Chandler, the former Secretary of Revenue and Director of the Budget for the State of Wisconsin.

This study provides data and directions about what Wisconsin must do to create strong growth for its economy. Chandler's format for this study is impressive. He surveyed a broad-based panel of thirty experts. Their expertise included investments, business development and research. Their conclusion was that Wisconsin generates its share of ideas that are the foundation for new growth companies, what is missing is that Wisconsin is lacking a robust growth center. Their view is that it is a combination of a lack of venture capital and a lack of management expertise.

Finally, the reason why we studied growth companies is because those are the type of businesses that will stir economic growth and produce good-paying jobs in the twenty-first century. These are the Harley-Davidsons and the Epic Systems of tomorrow. Chandler's study suggests some specific ideas that could help increase the prospect for future growth companies. In particular he documents the need for generating additional capital investments for new companies. He also demonstrates the impact of attracting entrepreneurs to Wisconsin who could successfully manage growth companies here.

Simply put, rhetoric is not going to attract these companies. Wisconsin must create an environment where these companies can flourish in a world-wide economy. The challenge now is to translate good intentions for economic development into serious public policies that provide jobs and growth for the future.

James H. Miller

WISCONSIN POLICY RESEARCH INSTITUTE, INC.
P.O. Box 487 • Thiensville, WI 53092
(262) 242-6409 • Fax: (262) 242-6459
E-mail: wpri@wpri.org • Internet: www.wpri.org

ENCOURAGING GROWTH COMPANIES IN WISCONSIN

RICHARD CHANDLER

Executive Summary

The Wisconsin economy faces an insidious challenge. The state's economy is stuck in the middle of the pack among states–both income levels and job growth remain stubbornly just below average. Signs point to more of the same middling performance in the future.

Eliminating the capital gains tax on investments in growth companies could provide the spark needed to ignite Wisconsin's future economic growth. Without this type of tangible change, the prospect for raising the economy into the top tier of states appears dim.

This report should serve as a dose of reality for those interested in the future performance of the Wisconsin economy. Many of the state's political and business leaders have lofty aspirations for Wisconsin's economic performance. However, unless some dramatic changes are made, it is unlikely that Wisconsin will move up the economic ladder and there is a real possibility that the economy will retrench.

One of the best indicators of a state's future economic performance is the number of growth companies located in the state. Growth companies are those that have annual growth of 20% or more. It is these companies that tend to define the nature and the quality of a state's economy. Familiar names of past growth companies dot the Wisconsin landscape: Kohler, Harley-Davidson, Manpower, Epic Systems and Promega to name a few. It is the development of small growth companies today that will define the future economy of Wisconsin. Unfortunately, Wisconsin has a relatively small presence of growth companies, a factor that will constrain the future economic prospects of the state.

This report shows that Wisconsin is lacking a few of the key elements required for a state to foster growth companies. Specifically, the state lags behind other states in the capital available to early-stage companies and the people experienced in managing growth companies.

As a way to determine what Wisconsin needs to do to create an environment conducive to growth companies, a broad-based panel of thirty experts was polled. The panel included experts in investments, business development and research. Most members of the panel focus their business activities in Wisconsin, but several are experienced with the investment environment in several states.

The panel observed that Wisconsin generates more than its share of the type of ideas that are the foundation of new, growth companies. However, certain impediments make it less likely that these ideas will yield growth companies and jobs in Wisconsin. The panel verified what other studies have documented; that the Wisconsin economy is lacking a robust growth sector. Many of the ideas generated in Wisconsin are not turned into Wisconsin companies and thus Wisconsin jobs. Due to the lack of two overriding factors, many potential start-up companies are forced to go elsewhere. Two key deficiencies are:

- Lack of early-stage capital, especially at the angel investor stage (less than $5 million).
- Lack of management expertise suited to managing growth companies.

The panel of experts found that Wisconsin does well in generating ideas and in supplying qualified workers, but the state needs to do better in the money and manager areas.

The panel of experts also identified some bold moves that would increase the prospects for future growth companies in Wisconsin.

- Eliminate the capital gains tax for investment in qualified new business ventures. Currently 60% of long-term capital gain is exempt from taxation. A full exemption would signal investors that they can unlock an existing investment with a capital gain and move the money to a qualified new Wisconsin business without any state tax "toll booth" in between to collect a tax on the transfer. The cost of this initiative would be a small fraction of the $100 million to $125 million the Department of Revenue estimates is collected annually from taxes on capital gains.
- Actively recruit and develop managers for Wisconsin growth companies. The state should involve worldwide executives with ties to Wisconsin in mentoring new Wisconsin companies and should support programs at state universities geared toward creating future entrepreneurs.

If Wisconsin does not take these tangible steps, it is unlikely that the state will realize significant improvement in its future economic standing. As the Corporation for Enterprise Development noted, Wisconsin's economy is performing reasonably well, however the state's future competitiveness is threatened by poor performance in entrepreneurial energy and innovation.

INTRODUCTION

The health and vigor of the Wisconsin economy, now and in the future, is clearly crucial to the state's quality of life. It determines the resources Wisconsin's citizens have to meet the current needs of their families and how much they can save for their retirements and their children's educations. It affects how much revenue governments at the state and local levels have to provide services. The rate of growth of the state's economy determines what kind of job opportunities Wisconsin's citizens have now and, perhaps most importantly, what kind of career opportunities their children and grandchildren will have in the future.

This paper provides a brief review of Wisconsin's overall economic strengths and weaknesses and then focuses on policies Wisconsin can pursue to enhance the environment for growth companies in the state. It argues that:

- Wisconsin's overall economic performance is in the middle of the pack among the fifty states. While there are a number of bright spots in the state's economic performance, there is clearly room for improvement.
- Many different factors affect a state's overall economic performance. New business growth, including the rate of business formation and capital investment, is a critical determinant of a state's long-term economic success. It is important for a state to have a healthy presence of "growth companies" to be economically healthy over the long term. ("Growth companies" are defined as companies whose sales grow at a rate of 20% per year or more for at least four years, meaning companies that roughly double in size every four years.[1])
- Wisconsin ranks well in some areas that are important to a state's economic performance but does not rank well in the rate of formation of new companies that will grow rapidly and generate significant new jobs and income growth in the future. The relatively small presence of growth companies in the state is a major gap in Wisconsin's performance. Hence, looking to the future, there are reasons for concern about the state's long-term economic prospects.
- There has been significant progress in recent years in improving the environment for growth companies in Wisconsin as a result of a number of public and private initiatives. However, more work needs to be done to create a dynamic environment for growth companies in Wisconsin.

In order to move up the economic ladder, Wisconsin needs to intensify its efforts to create an environment where growth companies can flourish. To come up with ideas for doing that, a broad-based group of individuals with knowledge about the Wisconsin economy and familiarity with growth companies was interviewed to assess why Wisconsin lags in the growth company area and to discuss measures to improve the state's performance.

Based on these discussions, two areas were identified as most in need of improvement in Wisconsin: generating additional capital investment in early-stage companies, and increasing the presence of entrepreneurs who can successfully manage growth companies. This paper suggests several initiatives to address these issues, notably a complete capital gains exemption for gains invested in Wisconsin growth companies, and additional efforts to actively involve Wisconsin residents and people with ties to Wisconsin in supporting entrepreneurial activities in the state.

The presence of growth companies helps define the nature and quality of a state's economy. A strong presence of growth companies stamps a state's economy as dynamic and its future prospects as bright. While Wisconsin lags other states in the presence of growth companies now, that is eminently changeable. Given the strengths Wisconsin has, further initiatives to improve the environment for growth companies could significantly improve the state's long-term growth trajectory.

WHY GROWTH COMPANIES ARE IMPORTANT

The future health of the economy will be determined to a significant degree by the formation of new businesses and the growth of companies that are small today. Small businesses, and especially small businesses that are growing fast enough to be categorized as "growth companies," account for a large share of new jobs and economic growth. A recent National Governors Association report stated:

- According to the Small Business Administration, during the 1990s small businesses generated between 60% and 80% of net new jobs.
- An estimated 70% of economic growth can be attributed to entrepreneurial activity.

- Entrepreneurial companies are greater engines of growth and innovation than other firms and hold greater potential to enhance local and regional economies.
- Smaller firms offer accessible opportunities to groups that are not well represented in proportion to their share of the population in traditional larger businesses.[2]

The Federal Reserve Bank of Minneapolis notes that a report by the Global Entrepreneurship Monitor, an international research project analyzing data from twenty-one industrialized countries sponsored by the Kaufmann Foundation of Kansas City, which funds research and activities related to entrepreneurship, found that growth companies accounted for one-third to one-half of the gross domestic product variation among countries.[3]

Looking at the economic history of Wisconsin, many of the leading companies in the state are companies that were founded over 100 years ago and then grew rapidly, such as Kimberly-Clark, Kohler and Harley-Davidson. Other leading companies were founded around fifty years ago and then grew rapidly, such as Manpower and Schneider National. Still others were started about 25 years ago, such as Epic Systems Corporation and Promega. It is important to foster the development and growth of companies that will provide jobs and economic leadership five, ten, 25, 50 and 100 years from now.

Hence, there are compelling reasons for any state to focus on policies that enhance the environment for growth companies, especially a state like Wisconsin, which lags other states in this area. What do growth companies look like? Research has found that they have varied characteristics. Many of the most visible are high-technology companies; overall, about 50% are in high-tech fields. About 30% are in wholesale or retail trade and another 30% are in services (some of these can be characterized as high-tech and some are not). Some get venture capital investments but many do not. Many are relatively young, but others have operated for many years before expanding rapidly. Most are relatively small but some are of significant size.[4]

A focus on growth companies is not meant to detract from other types of companies or diminish the importance of other areas that contribute to economic growth. Jobs in all sectors are important, whether in traditional manufacturing companies, agriculture, tourism, service businesses, growth companies or anywhere else. The point here is that jobs at growth companies are a crucial part of the overall mix, especially when it comes to a state's future economic prospects. Growth companies can be found in all areas of the state, although areas with strong research bases and a growing nucleus of growth companies tend to have more of them than other areas.

Measuring the presence of growth companies in a state's economy is not easily done. There are a number of quantifiable factors that are related to a good growth company environment but most of them are indirect measures, such as new company formations. Venture capital investment is often the focus of discussion about growth companies because it's the most visible and concrete measure of investment activity. While venture capital investment is one important measure of the presence of growth companies, it's only one element of a larger environment that encourages or discourages business formation and growth, and is as much a byproduct of a healthy growth company environment as a cause of it.[5]

There are limitations with many of the measures used to gauge growth company activity. Reporting of information takes time, so there is a data lag in the available information. When it comes to venture capital investing and especially angel investing (investing at early stages by sophisticated investors), the level of actual activity is broader than the reported activity. Nevertheless, a review of the available measures along with discussions with knowledgeable observers, investors and businesspeople makes it possible to assess where Wisconsin stands in creating a good environment for growth companies.

WISCONSIN'S ECONOMIC PERFORMANCE

Wisconsin's economic performance has been discussed in depth in recent years in such venues as the University of Wisconsin Economic Summit conferences held from 2000 through 2003 and the Building the New Wisconsin Economy series of forums held around the state in 2003 and 2004.[6] In addition, periodic surveys by different national and state organizations and analysts evaluate how well Wisconsin is performing in relation to other states. Overall, Wisconsin's economic performance is in the middle of the pack among the fifty states, judging by the key indicators of personal income and job growth, by rankings on national surveys and by other evaluations of Wisconsin's economic performance.

Wisconsin's position in relation to other states is important. The national economy performed well in 2005, and projections for 2006 are also good.[7] Wisconsin's economy can be expected to perform reasonably well when the national economy is good. However, an important question is whether Wisconsin's future growth can match or outpace national growth, or whether the state will fall short of its potential and lag the nation in income levels and job growth in the future.

The assessments of Wisconsin provided by key objective measures and the surveys of state economic performance are instructive. Two basic measures of economic performance, covering income levels and job growth, show:

- Wisconsin's personal income per capita is below the national average. The Wisconsin Taxpayers Alliance (WTA) reports that as of 2004, the most recent year for which figures are available, Wisconsin's personal income per capita was $32,063; 3.0% below the United States as a whole. The gap has narrowed in the past fifteen years (in 1990, Wisconsin trailed the nation by 7.2%) but the closing of the gap has slowed in recent years.[8]
- In job creation, Wisconsin has been underperforming other states over the past five years. The WTA reports that Wisconsin's five-year change in nonfarm employment from 2000 to 2004 showed 0.7% growth, compared with the national average of 1.9%.[9]

In order for Wisconsin to match or exceed the national average in career opportunities and personal income, growth of jobs and income in Wisconsin will have to exceed the national growth rates in the future. What areas should the state focus on to make this happen? A review of several comprehensive studies can help answer this question.

Studies by national policy organizations

Several national policy organizations prepare studies of the different factors that affect economic development in states and where states rank on those factors. One comprehensive study is done by the Corporation for Enterprise Development (CFED), which presents portraits of each state's economy by using three broad indexes based on a variety of subindexes. The 2006 CFED study, issued in January 2006, gave Wisconsin the following grades:

- A grade of A in performance, which addresses how well a state's economy is currently providing opportunities for employment, income and an improving quality of life, based on measures of employment, earnings and job quality, equity of opportunity, quality of life and efficiency of use of natural resources. This grade was helped by grades of A in equity and quality of life. However, Wisconsin received a grade of D in employment performance, based in part on below average ranks in short-term and long-term employment growth.
- A grade of B in business vitality, which addresses how dynamic a state's large and small businesses are, based on measures of the competitiveness of existing businesses and entrepreneurial energy. Wisconsin received an A in competitiveness of existing businesses, but this was offset by a D in entrepreneurial energy.
- A grade of B in development capacity, which addresses a state's capacity for future development, based on measures of workforce education and skill levels, capital availability, infrastructure, innovation and research assets, and availability of natural resources and other amenities. This included a grade of C in innovation assets.

Overall, then, the CFED rankings indicate that Wisconsin has a good quality of life and the state's economy is performing reasonably well at present. Existing businesses are rated as competitive. However, the rate of job growth is below average and concerns for the state's future competitiveness are reflected in poor to average grades in the areas of entrepreneurial energy and innovation.[10]

The Progressive Policy Institute (PPI) periodically produces a report assessing how well states are doing in adapting to the new economy. In its most recent report in 2002, Wisconsin was ranked 40th overall.[11] The overall ranking reflected the following rankings in five broad indexes:

- 46th in economic dynamism, reflecting new job creation, "gazelle" jobs (jobs in growth companies or "gazelle companies" that are seeing sales growth of 20% per year or more), and initial public offerings.
- 29th in innovation capacity, reflecting the number of high-tech jobs, the number of scientists and engineers, and the number of patents granted in the state, plus the amount of research and development taking place and the amount of venture capital investment in the state.

- 35th in knowledge jobs, which measures information technology jobs, managerial, professional and technical jobs, and workforce educational attainment.
- 27th in adapting to the digital economy, primarily reflecting the degree of Internet use in the population.
- 39th in globalization of the state's economy, based on export sales and foreign investment.

The PPI study ranks Wisconsin significantly below average overall in how well the state has adapted and is prepared to adapt in the future to new economy trends. Like the CFED study, it raises concerns about Wisconsin's future competitiveness. Wisconsin ranks well below average in entrepreneurial vigor and knowledge jobs, and about average in innovation capacity. While ranking well above average in the education level of the manufacturing workforce, Wisconsin ranks well below average in managerial, professional and technical jobs.

Another report to note is done by the Milken Institute, which issues periodic reports about which states are best positioned to take advantage of opportunities for growth in the new economy. Its 2004 State Technology and Science Index, issued in March 2004, ranked states based on their research and development capacity, risk capital and entrepreneurial infrastructure, human capital investment, technology and science workforce, and technology concentration and dynamism. Wisconsin was ranked 27th. Compared with other Midwest states, Wisconsin ranked below Minnesota (which was eighth), Illinois, Ohio and Michigan, but ahead of Indiana and Iowa. The report notes: "The degree to which a state's knowledge assets are harnessed and converted into successful innovations, products and services will determine its economic future."[12]

Studies by Wisconsin organizations

The Wisconsin Taxpayers Alliance prepares an annual report titled "Measuring Success: Benchmarks for a Competitive Wisconsin," which ranks Wisconsin on a number of measures in the categories of economic health, educational and workforce qualifications, public sector factors, quality of life and business climate.

The most recent measures, compiled in February 2006, contain these observations:

- Wisconsin's economic health rankings show areas of concern. In particular, personal income per capita and employment growth levels are below the national average.
- Wisconsin's educational performance and workforce qualifications are generally above average. Wisconsin ranks above the national averages in K-12 education test scores, ACT/SAT college entrance exam scores and high school graduation rate, but below average in the percentage of the population holding at least a bachelor's degree.
- In the public sector category, state and local taxes as a percentage of personal income are above the national average.
- Wisconsin ranks well on quality of life, reflecting above average rankings on measures of home ownership, crime rates and health insurance coverage.
- In the business climate category, Wisconsin is competitive in the infrastructure area, using measures such as energy costs and highway condition. Wisconsin is above the national average in patent activity. However, Wisconsin lags the national average in the areas of research and development spending, venture capital activity, college-educated workers in the workforce and high-tech employment.

Looking in more detail at the measures that show how well Wisconsin is adapting to the new economy, the WTA benchmarks study raises concerns.

- Wisconsin has above average patent activity. The number of patents issued to Wisconsin residents was 359 per one million residents, above the U.S. average of 321 patents per million population.
- The state lags in research and development activity. Wisconsin's public and private R & D activity represents 1.83% of gross state output, below the national average of 2.71% and below all but one of the surrounding states.
- The state lags in venture capital activity. Venture capital disbursements per worker in Wisconsin were $20.37 in 2004, below the national average of $163.57 and behind all but one of the surrounding states.
- Wisconsin is below average in the percentage of the population with college degrees and the percentage of technology workers in the workforce.[13]

The overall picture is of a state that has a good quality of life at present but that may not have an economy that is dynamic enough to maintain that quality of life in the future. The WTA summarized Wisconsin's standing on the key benchmarks by saying in its 2005 report, "Our quality of life is an attractive and valuable asset. On the whole, our schools perform well; the social safety net is generally strong here; our streets are safe. Yet, Wisconsin lacks the college-educated brainpower to fill the 21st Century jobs, and the capital necessary to spark ventures that create quality high-paying jobs." Looking at the future, the WTA further observed, "Wisconsin's high school students are among the nation's brightest and attend college at high rates. However, we need to improve our occupational mix to keep them here."[14]

The WTA has also raised concerns about Wisconsin's economic performance based on patterns of migration to and from Wisconsin. A January 2006 report from the WTA described Wisconsin migration patterns based on a study of census data for the 1995 to 2000 period:

- Wisconsin had a substantial net out-migration rate for people in their 20s. The most common destination for them was Minnesota.
- Wisconsin had a net in-migration rate for people aged 5-19 and 30-49. Young families in their 30s are attracted to Wisconsin by good schools, reasonable housing costs and low crime rates.
- Wisconsin experienced net out-migration for people with incomes above $75,000; especially those in the $100,000-$200,000 income range.
- Wisconsin also experienced net out-migration for those with bachelor's degrees and advanced degrees.
- The highest rates of out-migration by industry sector were for people in the information technology, professional, science, management, finance and insurance categories.

The WTA noted that overall Wisconsin is importing young people with less education and exporting those with more education. The state loses higher-income, better-educated individuals due to a relative lack of good-paying professional, managerial and technical jobs, and also due to high income and property taxes.[15] All of this points to a pressing need to generate more high-paying jobs in companies in the technical and professional fields where job growth is highest.

The Wisconsin Technology Council, in conjunction with NorthStar Economics, issued a comprehensive report on Wisconsin's economic performance and prospects titled "Vision 2020" in 2002.[16] The Technology Council and NorthStar issued updates to that report in 2005 reviewing where Wisconsin ranks in human capital, knowledge and technology indicators.

- In terms of education levels in the workforce, Wisconsin's population has a greater percentage of people with high school degrees and associate degrees than the national average, but a lower percentage with bachelors degrees or higher (25.6% of the population in Wisconsin, compared with a national average of 27.7%).
- In terms of high-tech employment, Wisconsin had 4.34% of its workforce in high-tech occupations in 2004, about 12% below the national average of 4.96%.

The updates are summarized by saying,

> To be competitive in the New Global Economy, Wisconsin must expand and apply its knowledge and technology base. . . . Wisconsin's transition to the new economy has tended to lag many other states. . . . Wisconsin's challenge is to build on its solid economic base and to expand its economy through investment and support in high-growth areas.[17]

Overall conclusions

Different studies of where Wisconsin stands in the areas that contribute to a good business climate and a growing economy all have different areas of emphasis and are conducted by groups with different viewpoints and perspectives. However, several patterns emerge when the studies are reviewed together.

Wisconsin clearly has areas of strength. In particular, the state has a workforce with an excellent work ethic and good basic educational qualifications. The state's good quality of life is also an asset. However, several qualifiers should be noted. While the workforce has good basic educational qualifications, Wisconsin ranks below average in the proportion of college graduates in the population due to the "brain drain" of college graduates leaving the state.

Also, while Wisconsin residents recognize that the state is a good place to live, and while there are objective measures that confirm that subjective impression, there are many other states that also have a good quality of life. As Reed Coleman, Chairman and CEO of Madison-Kipp Corporation, put it, in terms of competition with other states "the quality of life is good here, but we should put that off to the side, because the quality of life is good in many places." Wisconsin has to be competitive in as many areas as possible, not just quality of life.

The areas in which Wisconsin needs to improve are consistently identified in the studies. In particular, the following issues were frequently mentioned:

- The amount of entrepreneurial activity and the level of venture capital investments are concerns. Wisconsin clearly needs to work to encourage more entrepreneurial ventures and to create more availability of capital.
- The below-average number of workers Wisconsin has in the managerial, technical, professional and information technology areas is a concern, because this indicates a lower presence of growth companies, because these are among the highest-paying jobs and because these are the jobs that attract the best-qualified young workers.

Much evidence demonstrates that Wisconsin ranks below average in the area of new business formation and capital investment in newer companies, as indicated by new company formations, venture capital investments, and the number of scientific and technology employees, which can be attributed to having a lower proportion of the types of faster-growing, technology-intensive companies that have the greatest numbers of these workers. John Byrnes, Executive Managing Director of the Mason Wells Funds in Milwaukee, which makes venture capital investments, notes that Wisconsin has a strong and diversified traditional economy, with stable agricultural, manufacturing, transportation, distribution, retail and financial services sectors, but Wisconsin is missing one critical element: a robust high-technology sector which will grow rapidly. This, then, is one of the areas in which Wisconsin needs to improve its performance.

The Environment Needed for Growth Companies to Flourish

Wisconsin clearly lags behind a number of other states in the presence of growth companies, but why? What environment needs to be created for growth companies to flourish? What initiatives would help improve the environment for growth companies in Wisconsin?

To get answers to these questions, a group of individuals with knowledge about and experience with growth companies was surveyed in the fall of 2005 to gather background information for this paper. Participants in this informal panel of experts included entrepreneurs and business managers, including those with direct experience with growth companies; investors, including angel investors and venture capital investors; university researchers and professors with business expertise; attorneys and accountants with direct experience with growth companies and investors; and leaders with business and public policy associations, including those that work primarily with growth companies and investors. Over thirty individuals responded to a letter asking for input for this paper; some responded in writing, while others provided input through personal meetings or telephone interviews.

The panel was asked the following open-ended questions to gather information about improving Wisconsin's performance in the growth company area:

- What are the major reasons why Wisconsin does not have more growth companies?
- What one, two or three initiatives would have the greatest impact on increasing the presence of growth companies in Wisconsin and increasing the state's economic dynamism and entrepreneurial energy?
- What initiatives to increase the presence of growth companies would help dramatically improve people's perceptions about Wisconsin's business climate?
- Are there state statutes or regulations that inhibit, restrict or discourage investment in Wisconsin growth companies?
- Does Wisconsin's tax structure act to inhibit or discourage investment in Wisconsin growth companies?

The findings presented in this paper are drawn from these interviews and presentations on the topic of encouraging growth companies in Wisconsin made at a strategic planning conference held by the Wisconsin Biotechnology and Medical Device Association on October 13, 2005; the Wisconsin Early Stage Symposium presented by the

Wisconsin Technology Council on October 19-20, 2005; and a hearing of the Senate Economic Development Committee on August 23, 2005.

Several factors were identified as being necessary for growth companies to flourish:

- **Ideas**. There needs to be a plentiful supply of good ideas being generated in the state that can be developed into products. These ideas can come from private research and development efforts or university research.
- **Entrepreneurs and growth company managers**. There needs to be an adequate supply of entrepreneurs and managers who are capable of taking the ideas that are generated and turning them into commercially viable products and services being produced by commercially successful companies.
- **Capital**. There needs to be adequate capital available to fund product development and for entrepreneurs to use to develop businesses at all stages of development, from the early seed capital stages on through the venture capital stage and beyond.
- **Workers**. There needs to be a supply of workers with the appropriate skills and productivity to staff the companies as they grow.
- **Culture**. Overall, there needs to be a business culture that encourages and supports entrepreneurs who start growth companies.

Comments from the people who were surveyed about where Wisconsin stands were varied, as would be expected from a group of independent thinkers with different experiences, but several broad themes emerged.

Culture

In terms of the general environment for growth companies, several of the people surveyed pointed out that the environment for growth companies reflects the overall environment for all types of companies. The most frequently mentioned positive factors for Wisconsin's general economic climate were the state's high quality of life and good workforce. The most frequently mentioned negative factors were high taxes, burdensome regulations and lengthy government approval processes. In addition, several people mentioned that Wisconsin has a business culture that is not oriented to encouraging entrepreneurialism.

Most of the experts agreed that one key element missing in Wisconsin's economy is a robust growth sector. A number of people commented that Wisconsin has a risk-averse, non-entrepreneurial culture. Most agreed that Wisconsin does a good job of generating ideas but a poor job of turning those ideas into jobs due to a lack of entrepreneurial activity and a lack of capital investment. Other comments were that Wisconsin has a "provincial" mindset and is not as welcoming to new ideas as other places, and that Wisconsin's largest population center, Milwaukee, and other areas of the state have been dominated for decades by large manufacturing companies rather than by smaller companies and are therefore not as amenable to entrepreneurs as other areas. Among the impediments to business growth that were cited by one expert who has lived in other states besides Wisconsin were high taxes (especially high personal taxes that affect business decision makers), hostility to wealth creation and an overly burdensome regulatory climate.

Another comment was that Wisconsin has old-line families who are very caring but tend to be risk-averse and not inclined to reinvest their wealth in new businesses. They need to be encouraged to see early stage investing as a good investment alternative and also as a social good for the state.

It was pointed out that Wisconsin has had vigorous entrepreneurial activity in the past and should be able to foster more entrepreneurial activity in the future. Several people pointed out that creating a good environment for growth companies is a complicated, long-term process, and a comprehensive approach is needed. For example, in a detailed 2002 report, the State of Wisconsin Investment Board (SWIB) noted that geographic areas that are particularly good for growth companies develop gradually over time; areas such as California's Silicon Valley, Boston's Route 128 and North Carolina's Research Triangle took decades to develop the supporting infrastructure (researchers, successful larger companies, investors, support firms with marketing, personnel and legal expertise) and the critical mass of companies to be highly attractive areas for growth companies. The SWIB report noted that Wisconsin has many of the characteristics associated with technology development, including research centers and major technology companies such as medical imaging and medical device companies, computer design companies, data processing service companies and control system firms.[18]

The panel participants said that there are certainly reasons for some optimism. Several people said that the state is making progress but that change takes time. A recent survey by the Wisconsin Entrepreneurs' Network (WEN) and the University of Wisconsin-Extension Small Business Development Center found that a large proportion of the Wisconsin population (almost one out of every two people) has thought about starting a business.[19] As more people do so and there are more success stories, it will lead to a virtuous cycle which will breed more success in the future.

Ideas

The consensus among the experts surveyed was that Wisconsin does well in producing ideas and discoveries that can form the basis for growth companies. The University of Wisconsin-Madison ranks well among United States universities developing life science, physical science, engineering and computer science technology, the areas in which the investment industry is most interested. Ross De Vol, Director of Regional Economics for the Milken Institute, noted that the University of Wisconsin is among the U.S. leaders in science research, but says the creative assets in the state have not been leveraged adequately for the state's economic benefit.[20] Several people said that the main challenge is to figure out how to convert ideas to successful companies. Dr. William Hendee, Dean of the Graduate School of Biomedical Sciences and President of the Research Foundation at the Medical College of Wisconsin, said at an October 2005 conference of the Wisconsin Biotechnology and Medical Device Association that Wisconsin needs to do more with the intellectual capital in the state, noting that Wisconsin has a "brain drain" because it has an "idea drain," with ideas that are created in Wisconsin being marketed and developed elsewhere. "We don't lack ideas coming out of the lab," said Jim Burgess of Madison, a private investor in small companies and the former publisher of the *Wisconsin State Journal*.

Entrepreneurs and managers

The consensus among the panel members surveyed was that one of the major reasons the development of growth companies lags in Wisconsin is because the state does not have enough entrepreneurs and managers who can head up growth companies as they move from the stage in which products and ideas are in the initial development or conceptual phase to the stage in which those products and ideas are brought to market. Entrepreneurs and managers who can do this are often people who have had prior experience at growth companies and can use that experience to lead other companies to success. "Many companies have brilliant people" who have come up with promising ideas or inventions, "but they don't know how to administer things," said Jim Burgess. The talents needed are the abilities to find markets for products, assemble a team of workers, managers and marketing people who can provide the skills needed as a company grows, and attract investors who will have enough confidence in the company's leaders and its team and its plans to provide the necessary capital.

There was a strong consensus among the people surveyed that more entrepreneurs and growth company managers with experience are needed in Wisconsin. Terry Sivisend, co-founder of Wisconsin Investment Partners, a Madison-based angel investing firm, said that incentives for capital investment are helpful but there are a lot of deals that don't get done due to a lack of management. He emphasized that improving the management capabilities in the state is a lengthy process that has to be worked on over time. One of the biggest issues for Wisconsin is how to get people with talent and experience to move to Wisconsin (or move back to the state). They have to be enticed to leave their current jobs and the areas in which they're currently located and take chances on Wisconsin early stage companies. Several people said that this will happen more and more over time, but it's not easy to figure out how the process can be jump-started.

Why aren't there more people like this in Wisconsin? Among the factors that panel members cited are a culture that has not been entrepreneurially-oriented, the fact that Wisconsin lacks the critical mass of companies that's needed to attract experienced entrepreneurs from elsewhere, a shortage of enough capital to convince entrepreneurs that companies have enough resources to succeed, and also high property tax and income tax levels. Several people said that anything that can be done on the regulatory front that makes forming companies easier and less risky would be good. "A lot of it comes down to attitude," said one venture capital investor, who said Wisconsin needs to make it as quick and easy as possible to form companies in order to get businesses to decide to grow in Wisconsin rather than somewhere else.

Capital

There was broad consensus among the experts surveyed that Wisconsin lacks sufficient investment capital. Growth companies need capital, at the early stage when investments from family members, friends and angel investors are needed and then at later stages when larger amounts of outside capital, including venture capital, are needed. Typically, companies need investments of $5 million or less in their earliest stages. These funds can be provided to some extent by family and friends, but they are often provided by angel investors, typically individuals with net worth's of over $1 million who have experience running their own companies or experience investing in, advising or mentoring new companies. Above the $5 million level of investment venture capital funding becomes a feasible source of funds. (Later, if companies grow further, funding will come from investment bank funding or funding from a public securities offering or from a company that may acquire the growth company.) Angel investing is a major source of early stage financing; by some estimates, the amount of money invested annually by angel investors equals the amount of venture capital investment nationwide.[21] SWIB has noted that the bulk of the capital investment opportunities in Wisconsin were in companies needing $5 million or less in investment rather than in companies with $5 to $10 million or more in investment needs.[22]

Wisconsin has a lower level of venture capital investment per capita compared with the national average and with neighboring states.[23] Angel investments are more difficult to measure. Many of the experts said we need more seed capital. Some felt that capital availability continues to be the biggest obstacle to growth of our entrepreneurial sector and said that the growth in angel activity is a positive sign. Tod Linstroth, an attorney with Michael Best & Friedrich and a member and former board chair of the Wisconsin Technology Council, pointed out that without adequate seed capital at the right time, development stretches out longer and overall state growth is delayed.

It was pointed out that there is a lot of "old wealth" in Wisconsin that could be tapped for investment. There need to be continued efforts to raise the awareness of people who have investment resources about the benefits of early-stage investing. Continued work needs to be done to unlock funds from investments in public companies and other investments and channel it to opportunities in small, private companies. Several people emphasized that there needs to be as much focus on angel investing as on venture capital investing. Tom Still, President of the Wisconsin Technology Council, and Joe Kremer, Director of the Wisconsin Angel Network, report that Wisconsin has a lot of wealth that can be tapped all over the state, but a lot of work needs to be done to introduce people to the concept of early stage investing and draw their attention to the advantages of this type of investing.

Workers

The feeling among the experts surveyed was that Wisconsin generally has a good supply of skilled workers who can provide the skills, the work ethic and the productivity needed by growth companies. The laboratory technician programs at the state technical college campuses were cited as examples of programs that do a good job of providing Wisconsin growth companies with the supply of qualified workers they need. Several people said that Wisconsin has a very well-trained workforce. Reed Coleman says that Madison-Kipp Corporation has a great workforce, with a long average tenure on the job. Moreover, it was pointed out by several people that there are quality workers with Wisconsin roots who are living in other states who would be interested in moving back to Wisconsin if there were good job opportunities in the state.

Summary

Tom Shannon, President and CEO of Prodesse, Inc., a biotechnology firm in Waukesha which develops and manufactures diagnostic tests for diseases, summed things up by saying that the ingredients needed to build a company include ideas, managers, money, and employees. Wisconsin does well in generating ideas and Wisconsin companies do not have major problems finding good employees, but the state needs to do better in the money and manager areas. There are many people who want to find good companies to invest in. Their search needs to be directed to Wisconsin, and Wisconsin needs to figure out how to create more investment opportunities. Tod Linstroth said culture, capital and entrepreneurs are the weak links in Wisconsin's efforts to encourage growth companies. Wisconsin needs a more entrepreneurial culture and seasoned people who can do the job of managing growth companies. Dick Leazer, a principal in the Madison-based angel investing network Wisconsin Investment Partners, summed things up by saying, "We have quite a lot of science to generate ideas for companies, but we are short on entrepreneurs and then early stage capital. . . . The basic concept is that it takes a good technology or business idea, good people and investment capacity. The part of the formula we need is the experienced entrepreneur part, followed by investment capacity." Tom Still put it this way: "Policy makers have long asked why Wisconsin cannot attract more private equity investment. . . . The answer from the investors themselves has been relatively simple: Wisconsin is a great state for generating technology ideas, but barely average at creating technology companies with business plans that stand a chance of paying off over time."[24]

A widely held view was that Wisconsin needs to recruit more people with management, marketplace and product development experience, and work on making more funding available. The people who are needed are those with some practical experience; getting advice from people who haven't worked with startup companies before isn't as helpful as getting advice from people with direct experience with startup businesses. One expert said that Wisconsin is an attractive place for companies, with a good lifestyle and plenty of ideas, although it's expensive for the Midwest (primarily due to taxes); what Wisconsin needs most are more capital and more experienced managers. Several people mentioned that a large part of the challenge is getting people to move to Wisconsin; however, as Tod Linstroth and others noted, once people come to Wisconsin, they usually do not want to leave.

Existing Efforts to Encourage Growth Companies in Wisconsin

There have been a number of public and private initiatives to encourage growth companies in Wisconsin in recent years. Taken together, they represent a broad-based effort to fill needs in Wisconsin's economic development efforts. Perhaps the most noteworthy was the passage in the spring of 2004 of 2003 Act 255, authored by Senator Ted Kanavas (R-Brookfield) and adopted with support from many other legislators and from Governor Jim Doyle and his administration. This legislation established two types of investment tax credits: an early-stage seed investment credit for individual and corporate income tax payers equal to 25% of a taxpayer's initial investment paid to a fund manager that the manager invests in a business certified as an early stage seed investment by the Department of Commerce; and an angel investment credit for individual income tax filers equal to 12.5% of a taxpayer's investment in an angel investment, made either by an individual or a network of individuals. The Department of Commerce certifies qualified new business ventures (QNBVs) whose investors are eligible for these tax credits. Eligible businesses are those less than seven years old, with Wisconsin headquarters, a majority of their employees in Wisconsin, less than 100 employees overall, and engaged in manufacturing, agriculture, or processing or assembling products, and/or performing research and development. The maximum amount of credits available is $35 million for the early stage investment credit and $30 million for the angel investment credit.[25]

As an example of how the credits work, a venture capital fund making a $2 million investment in a QNBV gets a 25% tax credit, or $500,000. (The amount of investment eligible for a credit is capped by rule at $2 million.) Since this reduces the amount of money at risk, it increases the return if the business makes money. An advantage of this approach is that it does not require that the investment go to any specific type of business, so the state is not getting into the business of "picking winners and losers." It relies on the market to make investment decisions and provide the investment capital. The fact that the investments eligible for the credit are capped at $2 million and that there is an overall cap on the amount of credits available somewhat diminishes the impact of the program.

Act 255 also established a technology commercialization grant and loan program, which makes grants and loans to help small businesses do early-stage planning and research and obtain financing. The bill also provided for grants to support the creation of a network to provide entrepreneurial and technology transfer assistance to small companies throughout the state, which has resulted in the formation of the Wisconsin Entrepreneurs' Network (WEN) to provide support and assistance to entrepreneurs and to promote entrepreneurship. Erica Kauten, State Director of the Small Business Development Center at the University of Wisconsin-Extension and managing director of WEN said, "Act 255 has been very successful." Over 30 organizations have joined WEN, which is building a support system for entrepreneurs and enhancing communication among those with an interest in seeing growth companies advance.[26] Kauten feels Wisconsin is ahead of other states in these efforts. There's a lot going on in Wisconsin, she said, but it would help if there were more ways to dramatize and publicize the important things that are happening.

Comments on Act 255 by the panel members who were surveyed were very positive. It is widely believed to have had the desired stimulating effect on the investment climate. Angel investing networks report that its provisions are prominently mentioned when the benefits of early stage investing are discussed. One expert said simply, “Act 255 was great legislation.” There is money in Wisconsin to be invested and Act 255 makes the potential return better and makes investing more enticing. Another expert said that conceptually, Act 255 is a great framework. It offers a carrot for investing directly as an angel or into a venture capital fund without the stick that requires an advance commitment to invest in certain types of entities.

Some criticism of Act 255 has been voiced, mainly because some see it as too small-scale and complicated at this point to be driving enough investment decisions. One observer said that it has been spread so thinly that it may not alter more than a few decisions to invest in venture capital funds. Act 255 looks and sounds good but complying with all its provisions can be difficult, said Jim Burgess, explaining that an overly complex process takes the “wow” out of the incentives. By the time all the requirements are met, Burgess said, “the firecracker gets wet,” and the full impact that was hoped for is lessened. Some people said that the Act 255 credits are good but may not always be enough to “move the needle,” and more incentives would be helpful. Act 255 does make the benefits of investing more compelling and does help reduce the risk. There have been criticisms that the mechanism for allocating the credits has not allowed them to be apportioned evenly among all investors, a shortcoming that was addressed by the enactment of 2005 Senate Bill 290, which was signed by the Governor in January 2006.

In addition to Act 255, there have been a number of other recent public and private initiatives, including:

- The formation of the Wisconsin Angel Network (WAN) in 2005 to encourage early-stage angel investors by promoting angel investing and encouraging individuals to become angel investors, helping investors in communities and regions across Wisconsin form angel investing networks, and connecting Wisconsin entrepreneurs with angel investors. As one panel member observed, the angel network is one valuable way to stock the farm team with promising prospects by providing financing for $1 million to $2 million deals that can grow and become suitable for $5 million to $20 million investments in the future.[27] WAN is funded by the Wisconsin Technology Council with financial assistance from the state.
- Efforts to promote ideas and facilitate contacts among researchers, entrepreneurs and investors by the leaders of private organizations such as the Wisconsin Technology Council and the Wisconsin Biotechnology and Medical Device Association.[28] The Technology Council provides policy advice and research findings to government officials, promotes networking to foster innovation and entrepreneurship through the Wisconsin Innovation Network (WIN), and presents conferences and programs designed to provide information about business opportunities for technology companies and investors. The Biotechnology and Medical Device Association promotes research into and manufacturing of health products through conferences, networking, policy advocacy and public promotion.
- Work by the Wisconsin Alumni Research Foundation (WARF) to commercialize University of Wisconsin inventions and assist growing companies. WARF supports scientific research at the UW-Madison by moving inventions from university laboratories to the marketplace for the benefit of the university, inventors and society, and manages an endowment generated by research license agreements and equity positions in companies to produce income to help fund university research facilities, research projects, professorships and fellowships.[29]
- Ongoing efforts by the Department of Commerce and the Department of Financial Institutions to assist smaller companies and promote angel investing. For example, the Department of Commerce has online links to an entrepreneurs’ toolkit to direct new businesses to information and assistance and has been active in implementing the provisions of Act 255 and launching the Wisconsin Entrepreneurs’ Network. The Secretary of the Department of Financial Institutions, Lorrie Keating Heinemann, has made it a top priority to encourage more angel investing activity in Wisconsin.[30]
- Work in the Milwaukee area by the Medical College of Wisconsin, the Milwaukee School of Engineering, UW-Milwaukee and others to connect researchers with companies, including work by the TechStar Early Ventures organization to stimulate entrepreneurship and facilitate business formation and growth by identifying promising early-stage companies and assisting them with business planning and funding in order to develop a pipeline of early-stage businesses that are prepared for venture capital funding and growth.[31]
- Work by the University Research Park in Madison and other similar groups to provide space for new companies with laboratory facilities and support services.[32]

- Work by entities such as the UW-Madison Office of Corporate Relations to connect businesses with UW resources in areas such as technology licensing, faculty assistance with technology development, executive education about markets, and information about resources for entrepreneurs.[33]

In addition to these efforts, there have been steps taken by the State of Wisconsin Investment Board (SWIB) to take advantage of good investment opportunities in Wisconsin. SWIB manages one of the largest concentrations of investment funds in the country and has created a pool of money to be invested at the venture capital stage in Wisconsin and Midwest growth companies in conjunction with four venture capital investment firms. This Wisconsin private equity program started with a total commitment of $45 million to two firms (Mason Wells of Milwaukee and Venture Investors of Madison) in 2000 and continued with a total commitment of $90 million to two additional firms (Baird Venture Partners and Frazier Technology Ventures) in 2003 and 2004, for a total commitment of $135 million. These funds are focused on investing the money committed by SWIB first in Wisconsin-based companies and then in Midwest companies. A total of $58 million of this had been invested or drawn for pending investments as of September 30, 2005. SWIB's goal is to have the money invested within a five- or six-year period from the initial commitment. In December 2005 SWIB announced a total commitment of an additional $50 million to Mason Wells and Venture Investors.[34]

In commenting on the additional investment, SWIB said that Wisconsin universities rank high in inventing products but the state ranks low in raising capital to create businesses to sell them. The lack of capital for starting companies is one thing holding back the conversion of Wisconsin research into marketable products. SWIB said it sees great opportunities to reap good returns on its investment because there is a wealth of technology being developed in Wisconsin. The impact of SWIB's efforts goes beyond the money SWIB invests; the funds in which the SWIB money is invested have raised additional money from institutional investors, and the fact that SWIB is involved sends a signal to other investors that Wisconsin has good investment opportunities.

Clearly there are many valuable efforts under way to encourage technology transfer, provide incentives for investment and assist entrepreneurs. People who work in the growth company area believe that these efforts have resulted in much progress in the past several years. Still, while there has been perceived improvement, both objective measures and comments by knowledgeable observers indicate that Wisconsin is still in the middle of the pack. There are always difficulties in measuring progress in this area. There is a time lag in collecting the data to update the key measures, and there is a time lag before recently implemented initiatives will be fully effective. Nevertheless, many experts believe that more needs to be done. There is certainly a risk that Wisconsin will drift sideways or slide backwards, and so there is a feeling that more steps need to be taken to find ways to significantly raise the state's growth trajectory.

One of the issues facing Wisconsin is that the state has either a lackluster image or a non-image for people around the country. To the extent that people think of Wisconsin, they may think of it as comfortable but unexciting, with some negatives such as high taxes and burdensome regulations. They don't often enough think of the state as a research leader with a great quality of life. Ideally, Wisconsin would be able to find a way to catch people's attention and demonstrate that the state is a good place for growth companies and investments.

In the mid-1970s, Wisconsin was faced with the challenge of finding ways to promote economic growth in a sluggish national economy at a time when the state economy was very heavily dependent on manufacturing jobs in traditional industries. In response, the state passed legislation exempting manufacturing machinery and equipment from the personal property tax. This legislation ended burdensome taxation of direct production assets of manufacturers, but also was extremely effective in sending a signal to people that Wisconsin was willing to take dramatic steps to make the state a better location for businesses.

Are there things that Wisconsin could do now that not only would directly encourage growth companies to locate and expand here, but also would have the same positive public relations and psychological impact as the M & E exemption had in the 1970s? What noticeable, high-impact steps can Wisconsin take? How can the state leverage its existing assets and address its areas of weakness?

New Initiatives to Encourage Growth Companies in Wisconsin

Wisconsin has made a lot of progress in implementing measures to encourage growth companies in recent years. Still, it seems clear from objective data and the comments of experts that more needs to be done and that the areas in which Wisconsin needs to do the most are the entrepreneur and manager area and the capital area.

The National Governors Association (NGA) issued a “Governor’s Guide to Strengthening State Entrepreneurship Policy” in 2004 discussing how states can establish and implement policies to support the growth of entrepreneurial firms, noting that addressing the unique needs of these firms is an increasingly important economic development strategy.[35] This document can provide useful guidance as Wisconsin evaluates current efforts and considers additional initiatives in this area. One key point in the NGA guide is that states cannot and should not be exclusive providers of entrepreneurship support services but should often serve as “brokers” to bring together the resources of private, academic and not-for-profit entities, besides adopting state policy changes to support entrepreneurial efforts.

The five strategies identified by the NGA are:

- Integrate entrepreneurship into state economic development efforts.
- Use the education system to develop and encourage entrepreneurs.
- Create networks that support and help incubate entrepreneurial companies.
- Provide diverse sources of risk capital for entrepreneurial growth companies.
- “Get out of the way” through regulatory reform and streamlining.

Policies to support entrepreneurs have relatively low costs, the NGA study noted. As often as not, it pointed out, barriers to entrepreneurship are attitudinal or cultural and therefore cannot be easily addressed with traditional policy instruments.

In the capital area, several recommendations were made by the experts who were surveyed. These ranged from recommendations for modifying and enhancing the Act 255 provisions to recommendations for more sweeping and dramatic changes in Wisconsin’s tax structure.

Capital gains tax exemption

The most dramatic recommendation is a proposal that Wisconsin should completely eliminate the capital gains tax for certain investments to stimulate investment in growth companies in the state. Now, long-term capital gains in Wisconsin are taxed at a favorable rate, with 60% of the gains exempted from being taxed. This exemption could be expanded to help growth companies in several ways. There could be a complete exemption at the time of an initial investment for any capital gains that are reinvested by Wisconsin taxpayers in a Wisconsin company that meets specified criteria for growth companies, using criteria similar to those for Qualified New Business Ventures (QNBVs) established in Act 255. Legislation along these lines has been introduced by Senator Kanavas and others as 2005 Senate Bill 65. Alternatively, there could be an exemption for gains from investments in growth companies at the time the gains are realized.

Providing the exemption at the time of the initial investment has several benefits. It tells investors that they can unlock an existing investment with a capital gain and move the money to a qualified new business venture in Wisconsin without any state tax “toll booth” in between to collect a tax on the transfer. It removes any state-created incentive to keep money locked up in existing investments in order to continue to defer taxes on unrealized gains.

Many of the panel members surveyed were very enthusiastic about this proposal for both policy reasons and public relations reasons. One said, “A capital gains exemption would be an enormous positive for Wisconsin,” and pointed out that the state has a lack of private equity capital and needs to get people to take money out of public company investments and put it into private growth company investments. Philip Greenwood, a professor at the UW-Madison School of Business, said Wisconsin needs to lower individual taxes to keep investment capital and people with investment resources in the state, and then needs to give people incentives to invest.

The policy argument in favor of this exemption is that, by reducing the tax burden for investments in Wisconsin growth companies, the risk/reward ratio for those investments is improved. That is, since the tax burden for those investments is less, the return is improved, making them more attractive than alternative investments. The public relations argument is that enacting a complete exemption from the capital gains tax for certain investments would send a very strong signal to investors that Wisconsin is a good place for investing and wants to create a positive environment for growth companies. This proposal could attract the kind of positive attention that the M & E exemption created in the 1970s. Tod Linstroth said that Wisconsin needs something to break through to potential investors so they notice that a distinctively good climate for investments has been created.

The experts surveyed thought that a complete capital gains exemption for growth companies would definitely help raise the awareness of people about early stage investing. It would help persuade people to unlock money tied up in previous investments and put it into growth companies. It would help put additional focus on angel investing by making it very clear that there would be no Wisconsin tax disincentive for a potential angel investor who may want to move money from a current investment to an angel investing opportunity. The fiscal effect of the elimination of the capital gains tax for investments in Wisconsin-based growth companies would be modest, much less than $100 million per year and probably in the low tens of millions of dollars per year. (The Legislative Fiscal Bureau and the Department of Revenue estimate that the fiscal effect of the complete elimination of the capital gains tax on gains from all sources would be $100 to $125 million per year, so eliminating the tax only for gains that are reinvested in Wisconsin growth companies would be much less.[36])

Improving current investment incentives

In addition to the proposal to provide a complete capital gains exemption, the current laws covering investments in growth companies could be changed to streamline the process and expand the effectiveness of the laws. Many of these ideas were presented at a hearing of the Senate Committee on Job Creation, Economic Development and Consumer Affairs in August of 2005 by Terry Grosenheider of U.S. Bank and lawyers Joe Hildebrandt of Foley & Lardner and Joe Boucher of Neider & Boucher, all of whom were involved in the development of Act 255 and previous legislation.[37] Among the more important were proposals to double the annual allocation of investment tax credits to angel investors under Act 255 from $3 million to $6 million; to permit unused venture capital tax credits to be reallocated to angel investors; to increase the number of security holders, security offers and security sales that can be made without prior state approval; and to expand the definition of Qualified New Business Ventures under Act 255 (by increasing the maximum number of employees from 100, the length of existence for companies from seven to ten years, and the amount of prior capital raised from $5 million to $10 million). These changes would increase flexibility, reduce paperwork and expand the range of people who could take advantage of the provisions meant to facilitate growth company investments. As Terry Grosenheider put it, there are more restrictions on investing in legitimate emerging growth companies in Wisconsin than there are on gambling in the state. Reducing these restrictions would heed the NGA's advice that the state needs to "get out of the way" of investments in growth companies. Joe Hildebrandt explained that perceptions of Wisconsin have to improve among investors elsewhere. Wisconsin in the past had very restrictive securities laws. The state's securities laws and corporate law have been improved, said Hildebrandt, but many people don't yet know that. Act 255 has helped, but further noticeable changes need to be made to try to get people to look at Wisconsin as a good place for investments.

These changes would represent an evolving change in the mindset and attitude in Wisconsin toward growth companies. Instead of being hyper-cautious, the approach should be to clear away obstacles for investors who have the means and knowledge to help Wisconsin growth companies.

Encouraging entrepreneurs

There is a strong sense that, in addition to encouraging more capital investment, Wisconsin needs to "bridge the entrepreneur gap," as Tod Linstroth put it. There was a strong consensus among the experts who were surveyed that Wisconsin needs to figure out ways to get more entrepreneurs who have the skills to bring new products to market, find investors and develop long-term winning strategies for their companies. There was less consensus about what should be done to make this happen. Some people believe that Wisconsin simply needs to continue to produce ideas and work to improve the supply of investment capital, and if a sufficient supply of ideas and money exists here, entrepreneurs will naturally follow in due course. Others, however, think that Wisconsin should try to find ways to accelerate the process of creating a larger pool of effective and experienced entrepreneurs in the state.

Among the ideas that were advanced for consideration and that should be pursued are the following:

- Involve the members of the "Wisconsin diaspora" in the effort to create more growth in Wisconsin. Several of the experts noted that there are many experienced entrepreneurs and managers with ties to Wisconsin (either because they grew up or went to school in the state) who have had successful careers with growth or technology businesses elsewhere, especially on the east and west coasts. (A recent survey reported that UW-

Madison tied with Harvard for first place in educating the most CEOs of companies included in the Standard & Poor's 500.[38]) These people have a loyalty to and an affection for Wisconsin and many would devote time and resources to helping Wisconsin companies if there was a plan to ask them and channel their participation. The trick is to figure out a mechanism that could be used to mobilize their talents. A council could be formed, perhaps under the auspices of a private group, to work on this idea. There do not seem to be efforts like this under way in other states. This would be a promising approach in Wisconsin due to the large number of successful people with Wisconsin roots at the top levels of successful businesses, the strong loyalty of current and former Wisconsinites to the state, and the opportunity created by the fact that many people with Wisconsin ties are now at a point in their careers where they would be interested in spending more time helping and advising others and investing some of their money with new businesses. In addition to this, a high-level policy council of people who have "seen life beyond Wisconsin" could be formed to advise the Governor and legislators. "We need mentors to provide guidance and business savvy," said Jim Burgess.

- Enhance the entrepreneurship programs at Wisconsin's universities. The Weinert Center for Entrepreneurship program at the UW-Madison School of Business is regarded as a solid program but there is sentiment that it could increase its stature. Several people mentioned the successes of the UW-Madison business school Applied Security Analysis program founded by Professor Stephen Hawk and the Real Estate program led for many years by Professors James Graaskamp and then Kerry Vandell and suggested that a similarly stellar program in entrepreneurship could be built. David J. Ward of NorthStar Economics, a former UW professor and administrator, called these programs "home runs." A more-prominent Weinert program could benefit from an advisory board of all-star alumni. Ideally, donors could be found who would be prepared to contribute to the entrepreneur program. Other business schools around the state could be involved as well. Tom Still and Joe Kremer pointed to a program at the Georgia Institute of Technology that invites venture capital investors to campus and has them bring their contacts for visits, and said that Wisconsin universities could consider emulating this program.
- Do everything possible to facilitate entrepreneurial activities by faculty members in the University of Wisconsin System. Any statutes or university policies that discourage or slow down entrepreneurial activity should be changed, says Mark Bugher, Director of the University Research Park in Madison.
- Make college and university students, and workers in other states with Wisconsin ties, aware of the opportunities that exist in the state, of all the efforts underway to stimulate growth companies through capital availability and entrepreneurial support, and of success stories about Wisconsin companies. Letters could be sent to all public and private college and university students as they approach graduation. Letters could be sent to young workers with Wisconsin ties who have moved to other states. Erica Kauten says there's a lot going on in Wisconsin, but it needs to be made appealing to young people.

Looking back at the five strategies recommended by the National Governors Association in the entrepreneurship area, and at Wisconsin's existing efforts, it can be said that Wisconsin is taking steps to implement all five strategies. However, there are clearly opportunities to accelerate and intensify the state's efforts.

- The Legislature and administration (through the Departments of Commerce and Financial Institutions) are integrating entrepreneurship into state economic development efforts.
- The higher education system is being used to develop and encourage entrepreneurs, but an enhanced focus on entrepreneurship programs could help in this area.
- Networks have been established to support entrepreneurial companies, but more involvement of high-powered, experienced people with Wisconsin ties could help in this area.
- Efforts have been made to facilitate the availability of diverse sources of capital, but a capital gains exemption for investments in growth companies would help greatly in this area.
- There have been some regulatory streamlining measures but more could be implemented.

Wisconsin has initiatives in place that cover many of the basics in these areas, such as providing support services for entrepreneurs, making sure that there are mechanisms in place to link university research with entrepreneurs and providing some tax credits. At this point, some more steps to make sure all the basic opportunities are being addressed would help, and then some more dramatic steps such as a complete capital gains exemption could help attract attention to the opportunities in Wisconsin. Bold measures would dramatize to Wisconsin's citizens and outsiders alike that the state is striving to create a great environment for growth companies. A capital gains exemption would be controversial in some circles, but Wisconsin needs to stop worrying about playing things safe and do more to try bold initiatives with potentially significant rewards.

How can these ideas be moved to implementation? There could be an ad hoc task force to review these issues in depth and then make recommendations about how to implement them. Jim Burgess suggested that a private business association could work to convene a council of experienced business professionals with Wisconsin ties.

How can the success of initiatives like these be measured? Several key indicators should be tracked over time, including the rate of formation of new companies, the amount of money invested by angel investors and venture capital companies, and the percentage of "knowledge workers" in the state's workforce.

Conclusion

In order for Wisconsin's economy to grow at a healthy rate in the future, the state needs to work to create an environment in which many new companies are being founded, funded and managed so they grow and provide plentiful career opportunities. Wisconsin needs to be a place where many ideas are generated, many entrepreneurs build viable companies from those ideas, ample capital is available to help those companies grow, and workers are available to provide the skills these companies need.

Wisconsin currently does not rank well compared with other states on many indicators of a healthy environment for growth companies. The areas that are in the most need of improvement are the supply of entrepreneurs and the availability of capital. A capital gains tax exemption for investments in Wisconsin growth companies, along with the improvements to the angel and venture capital investment credits included in 2003 Act 255, would demonstrate clearly that Wisconsin is a state with a good investment climate. Efforts to attract entrepreneurs at all levels of experience, from individuals at the outset of their careers to experienced entrepreneurs and managers, are also important. These could range from enhanced entrepreneurship programs at the state's universities to organized efforts to organize the seasoned executives in the "Wisconsin diaspora" to provide their time and talent to assist Wisconsin companies.

Wisconsin has tremendous assets that can be built upon to make the state's economic future bright. As Tod Linstroth said, "There's a lot more potential here than we've realized." Taking advantage of as many opportunities as possible to improve Wisconsin's economic environment will enable the state to take full advantage of its strengths and reach its full growth potential.

NOTES

1. See discussion of growth companies in John Case, "The Gazelle Theory," *Inc. Magazine*, May 2001.

2. National Governors Association, "A Governor's Guide to Strengthening State Entrepreneurship Policy," NGA Center for Best Practices, 2004.

3. Ronald Wirtz, "The Entrepreneurial Stool: Capital is important to entrepreneurs but other legs are important and often ignored," *Fedgazette*, *The Regional Business and Economics Newspaper of the Federal Reserve Bank of Minneapolis*, July 2001.

4. See discussion of growth companies in John Case, "The Gazelle Theory," *Inc. Magazine*, May 2001.

5. Ronald Wirtz, "The Entrepreneurial Stool," *Fedgazette*, July 2001.

6. See background papers for the University of Wisconsin System Economic Summit conferences at www.wisconsin.edu/summit/archive and background papers for the forums held during Phase 1 of the Building the New Wisconsin Economy project at www.bnwe.info.

7. See, Wisconsin Department of Revenue Economic Outlook Report, November 2005.

8. "Measuring Success: Benchmarks for a Competitive Wisconsin," prepared by the Wisconsin Taxpayers Alliance (WTA) for Competitive Wisconsin, Inc., 2006.

9. "Measuring Success: Benchmarks for a Competitive Wisconsin," WTA, 2006.

10. Development Report Card, Corporation for Enterprise Development, 2006. See, www.cfed.org.

11. State New Economy Index, Progressive Policy Institute, 2002. See, www.neweconomyindex.com.

12. State Technology and Science Index, Milken Institute, 2004. See publications section at www.milkeninstitute.org.

13. "Measuring Success: Benchmarks for a Competitive Wisconsin," WTA, 2006.

14. "Measuring Success: Benchmarks for a Competitive Wisconsin," WTA, 2005.

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Sources

The individuals who responded to a questionnaire and were interviewed for this paper included the following:

Dan Andersen, Certified Public Accountant and Partner, Virchow Krause & Co., Madison.

Todd Berry, President, Wisconsin Taxpayers Alliance, Madison.

Joe Boucher, Attorney, Neider & Boucher, Madison.

Mark Bugher, Director, University Research Park, Madison.

Jim Burgess, private investor and former publisher of the Wisconsin State Journal, Madison.

John Byrnes, Executive Managing Director, Mason Wells Funds, Milwaukee.

Lawrence Casper, Assistant Dean of Research and Technology Transfer, University of Wisconsin-Madison College of Engineering.

Reed Coleman, Chairman and CEO, Madison-Kipp Corporation, Madison.

Philip Greenwood, Senior Lecturer, Weinert Center for Entrepreneurship, UW-Madison School of Business.

Terry Grosenheider, Private Client Group, U.S. Bank, Madison.

Roger Hauck, private investor, Madison.

Charles Hoslet, Managing Director, UW-Madison Office of Corporate Relations, Madison.

Monica Jaehnig, Portfolio Manager, State of Wisconsin Investment Board, Madison.

Tim Keane, Director, Marquette Golden Angels Network, Milwaukee.

Michael Knetter, Dean, UW-Madison School of Business.

Joe Kremer, Director, Wisconsin Angel Network, Madison.

Dick Leazer, Principal, Wisconsin Investment Partners, LLC, Madison.

Tod Linstroth, Attorney, Michael Best & Friedrich, Madison.

David Lubar, President, Lubar & Co., Milwaukee.

Dr. Laurence Marton, Chief Scientific Officer, Cellgate, Inc., Redwood City, California, and former Dean of the UW-Madison Medical School.

David Mills, Executive Director, State of Wisconsin Investment Board, Madison.

John Neis, Senior Partner, Venture Investors, LLC, Madison.

Nick Seay, Attorney, Quarles & Brady, Madison.

Tom Shannon, President and CEO, Prodesse, Inc., Waukesha.

Terry Sivisend, Co-Manager, Wisconsin Investment Partners, LLC, Madison.

Tom Still, President, Wisconsin Technology Council, Madison.

Dan Thome, Partner, Edgemoor Partners, LLC, Appleton.

David J. Ward, President, NorthStar Economics, Inc., Madison.

Paul Wrycha, Attorney, Foley & Lardner, Madison.

Peter Zaballos, Vice-President, Frazier Technology Ventures, Madison and Seattle.

About the Institute

The **Wisconsin Policy Research Institute** is a not-for-profit institute established to study public-policy issues affecting the state of Wisconsin.

Under the new federalism, government policy increasingly is made at the state and local levels. These public-policy decisions affect the life of every citizen in the state. Our goal is to provide nonpartisan research on key issues affecting Wisconsinites, so that their elected representatives can make informed decisions to improve the quality of life and future of the state.

Our major priority is to increase the accountability of Wisconsin's government. State and local governments must be responsive to the citizenry, both in terms of the programs they devise and the tax money they spend. Accountability should apply in every area to which the state devotes the public's funds.

The Institute's agenda encompasses the following issues: education, welfare and social services, criminal justice, taxes and spending, and economic development.

We believe that the views of the citizens of Wisconsin should guide the decisions of government officials. To help accomplish this, we also conduct regular public-opinion polls that are designed to inform public officials about how the citizenry views major statewide issues. These polls are disseminated through the media and are made available to the general public and the legislative and executive branches of state government. It is essential that elected officials remember that all of the programs they create and all of the money they spend comes from the citizens of Wisconsin and is made available through their taxes. Public policy should reflect the real needs and concerns of all of the citizens of the state and not those of specific special-interest groups.