4 lessons Wisconsin's proposed $100 million VC fund can take from other states

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Wisconsin is in the process of creating a $100 million venture capital fund of funds program as a vehicle to attract investment in early-stage companies in Wisconsin.

Governor Tony Evers' "Wisconsin Fund" was approved by the Republican-controlled Joint Finance committee, but the fund of funds program would still need to be approved in the final budget.

The proposed fund of funds program **has been criticized** by organizations who contend that there are more efficient and less risky ways of using taxpayer money to spur entrepreneurial growth in Wisconsin. However, the Wisconsin Fund has also drawn support from several startup advocacy organizations in the state.

The following executives involved in Midwestern VC ecosystems weighed in on how Wisconsin can best structure its proposed $100 million fund of funds to succeed during the Wisconsin Technology Council's Entrepreneurs' Conference on Thursday.

- Aaron Gillum, vice president of **50 South Capital**, the program manager for Illinois Growth and Innovation Fund, an Illinois' state-sponsored fund of funds program, and the Indiana Next Level Fund, Indiana's state-sponsored fund of funds program.
- Brian Birk – **Sun Mountain Capital** partner and partner at Badger Fund of Funds, Wisconsin's state-sponsored fund of funds program.
- Chris Rizik, CEO of **Renaissance Venture Capital**, a Michigan-based fund of funds.
- John Austin, director at the **Michigan Economic Center**.

Here are some of the key lessons they've learned from their work in the venture capital world:

Investments can fuel talent attraction and retention

Gillum sees fund of funds programs as not only a way for Midwestern states to attract capital from the coasts, but as a tool for talent retention. Without fund of funds programs in the Midwest, it will be hard to compete the country's largest VC ecosystems, Gillum said.

"It's almost looked at as table stakes," Gillum said. "We need to do this to ensure that we're keeping entrepreneurs, founders and all the best ideas from our campuses in our state."

The coronavirus pandemic also revealed that coastal VCs and companies are interested in planting roots in Midwestern cities. Because of this trend, and the growth that Midwestern VC ecosystems have experienced, he expects the region to go on the offensive to retain talent and attract outside capital.

"Recruiting companies from the coasts more openly as well as further capitalizing the fund managers that we have so that they can continue to grow and hopefully develop even more unicorns, which have such a long term and generational benefit to the landscape we're trying to stay here," Gillum said.

Be thoughtful in portfolio construction

As Indiana launched "The Next Level Indiana Fund," the state-backed fund of funds considered the expertise of prospective fund managers, and how their knowledge aligned with industries in the state that possessed the most deal flow. 50 South Capital found that Indiana contained several software as a service and marketing tech companies – Salesforce, for example, has its second largest office in Indianapolis.

50 South Capital also found strength in Indiana's agriculture tech and bioscience industries and understood that 70% of the state's economy relies on agriculture. Identifying funds with the expertise and those that are willing to invest in those sectors was an important step in the process of creating Indiana's VC program, Gillum said.

"You're showing off the best and brightest to everyone in your network in Silicon Valley and New York and everywhere in between so they'll come and take a look," Gillum said. "If they see something, that's the spark, that's all they need. Now they're going to be in town for a board of directors meeting and they tell their friends. So, it's just a network effect that is the catalyst for everything we've done so far in Illinois and Indiana."

Limit the number of rules put on funds

Rules on venture capital funds may seem logical but can have unintended consequences, Rizik said. Prospective funds may view requirements on how much a fund must invest in a state, or how many employees must work in a state as onerous, preventing funds from co-investing.

The goal of a fund of funds model is to attract the best funds in the country to participate in a state's VC ecosystem. Access to state-backed venture capital is not enough of a draw to attract outside fund participation because the best funds can easily raise capital, Rizik said. Therefore, if the Wisconsin Fund is laced with too many rules, the best funds in the country will not be interested.

However, Rizik admits this is a challenge because a state wants some level of commitment from funds that they will spend time looking for investment opportunities in a state. The Renaissance Venture Capital Fund does not have any of the aforementioned capital or employee requirements. However, Rizik's fund does require its funds to spend the time to look at opportunities in Michigan. These funds will provide Rizik with a plan on when and how they expect to visit Michigan to look for investment opportunities.

"If you have the kind of research going on in your state like Wisconsin, Michigan, Indiana or Illinois has and you have the talent, you have to be comfortable that given the opportunity, the market will work," Rizik said. "These funds will find opportunities, and, on the whole, you'll get the kind of benefit you want without putting so many rules where you end up hurting yourself."

Be careful with financing mechanisms

Many states have used debt as a mechanism for funding their fund of funds programs, and that's a recipe for disaster, Rizik said. Returns on investments in venture capital typically take five to eight years and if the company fails, there may never be a ROI.

"To the extent that there is a coupon to be paid, some future governor is going to find a hole in their budget because suddenly they have to pay back debt because returns haven't come yet," Rizik.

The financing mechanism for a fund of fund programs can influence the decisions that fund managers make, Birk said. If the interest clock is ticking, investment managers may make decisions that are not necessarily aligned with the goals of a fund of funds program.

“By having an equity base of financing be that through the Legislature, a pension fund or a sovereign wealth fund, no matter what it is, there’s an understanding that we’re doing what’s in the best interest of the state or the program that will have the biggest impact.”

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