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# Building High-Impact Entrepreneurship and Investing Communities in Flyover Country | Part I: The Risk Capital Conundrum

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There are a lot of promising high-impact entrepreneurs in flyover country, including here in my corner of it, Northeast Wisconsin. Not as many as in Silicon Valley, of course, but plenty enough to support a high-impact entrepreneurship and investing community that could make a significant positive change in the region's economic outlook. So far, though, that hasn't happened, even if you can make a case that it is starting to happen in nearby places like Madison.

A lot of folks believe that the problem is a lack of risk capital; that if only a bunch of our big corporations and wealthy families would get their checkbooks behind our entrepreneurs, everything would come up roses. There's some truth in that, but a lot of danger as well. We need a special kind of risk capital tailored to the particular task at hand: let's call it "situationally aware and suited risk capital."

Looking at Silicon Valley today, it sometimes seems as if venture capital investing is mostly about throwing trainloads of cash at half-baked ideas. How else do you explain venture capital funds throwing several hundred million dollars at dog-walking startups over the last couple of years? What is so smart about that?

Well, a lot of the ideas may seem half-baked (and more than a few are, but that is a topic for another day), but if you look a little deeper you usually find that the money is coming from "been there, done that" high-impact investors and is usually being invested in "been there, done that" high-impact entrepreneurs and management teams. Which is to say "proven money" is being showered on (it sure seems like that to me) "proven entrepreneurs."

And that distinction, one of relevant experience, makes all of the difference when you consider that here in Northeast Wisconsin (and most other venture capital backwaters), there are probably more palm trees than “been there, done that” risk capital investors, and more Chicago Bear fans than proven high-impact entrepreneurs.

Fortunately, our dearth of “been there, done that” high-impact investors and entrepreneurs does not mean that we can’t build a self-sustaining, difference-maker, high-impact entrepreneurship and investing sector here in the New North. The key is looking not at today’s Silicon Valley headlines for our game plan – not focusing on what works in today’s mature Silicon Valley ecosystem dominated as it is by repeat players – but studying how Silicon Valley worked in its own infancy period, when capital and talent were both much scarcer than they are today.

Way back when Silicon Valley was getting started – think roughly 1950-1980 – venture capital was a very different business than it is today. Venture “funds” were small, often informal pools of money that made small, hands-on investments in a limited number of startups. As late as 1980, total venture investing in Silicon Valley amounted to well under one-half billion dollars in less than 250 emerging companies (or less than $2 million per company across all stages of development).

The key insight here is that in the formative years of Silicon Valley, the nurture model of venture capital investing was dominant. The nurture model of venture investing, which still plays a small role in Silicon Valley, is quite different from the “manager” model of venture investing that gets most of today’s headlines.

Herewith, the two critical features of the nurture venture investing paradigm:

1. “Hands-On” Investors

Most of the pioneers of Silicon Valley venture capital (well, most of those that did not end up with arrows in their back) were engineers by training, and had significant high-impact operating experience before entering the investment side of the business. They brought modest amounts of capital to the table, and got their hands dirty – not just after, but often before investing – mentoring their portfolio entrepreneurs in the basics of launching, building, and exiting high-impact ventures. Eugene Kleiner – ultimately a founder of what is now the iconic venture firm Kleiner Perkins (and an investor in my first startup) – is a prototypical example.

2. Focus on Profitability

Whether by design (as quaint a notion as it may seem these days) or necessity (the supply of risk capital wasn’t sufficient to support hundreds of millions of dollars of losses), well into the 1980s the venture investing industry placed a heavy emphasis on portfolio companies achieving profitability sooner rather than later. The “standard model” of venture investing in those times was something like three rounds of venture investing roughly to fund the research; demonstrate the product/market fit; and achieve profitability (two consecutive quarters of the same being the key bogey). Voila! If the exit window was open, exit; if not, get some mezzanine venture money in to support some growth until it opened.

Today’s Silicon Valley is dominated, in terms of capital deployed (and headlines grabbed), by something very different from nurture venture investing. Today the “manager model” dominates, with a plethora of funds with hundreds of millions of dollars under management. (More than $50 billion of venture capital was invested in Northern California last year.) The typical “seed” round exceeds $6 million, and there were close to one hundred venture rounds of more than $100 million last year. Still-private, Uber lost several billion dollars in 2018 and dozens of companies burned through hundreds of millions of capital. Folks like Kleiner, circa 1980, would likely not recognize the game.

The goal for “manager model” venture investors is still 10x+ cash-on-cash returns on early stage investing, but the aggregate payoffs (as the amounts invested) are orders of magnitude bigger. It’s a model based on allocating capital among startups led by repeat players who look for network leverage from their venture investors more than hands on advice and counsel. Finally, growth trumps profit as the preferred success/exit metric. (The cynical explanation being that “profitability doesn’t scale”).

What all this means is that when we say, here in the New North, that what we need is more risk capital, and we must be very careful how we think about the term risk capital. Both in terms of quality and quantity. What we don’t need – what in fact is more likely to poison the high-impact entrepreneurship well then prime it – is a big pool of manager model risk capital, no matter how well intended and how well pedigreed. We need nurture model risk capital. Risk capital managed (not necessarily supplied by) repeat high-impact entrepreneurs and investors who themselves come to the table already immersed in the high-impact entrepreneurship and investing space. Investment managers who are ready, willing, and able to make do with smaller pools of capital, and provide raw entrepreneurs, before as well as after investment, the kind of hands-on portfolio company support that folks like Gene Kleiner provided in the 1970s. Advice and guidance aimed at achieving profit-driven 10x+ exits on the limited amounts of venture capital that will characterize our little corner of paradise for at least the next decade and probably more.

Next time, what we need beyond nurture risk capital to make it happen here in the New North.

## Related People

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