

Michigan venture capital pros: Region attracting attention

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Robert Ramey

Panelists at the roundtable, clockwise from far left: Ian Bund, David Parsigian, Linda Fingerle, LeAnn Auer, Tim Petersen and Chris Rizik.

Ten years ago, there was virtually no venture capital financing available from Michigan-based firms.

That has changed dramatically, as 17 VC firms have emerged – 10 of which are located in Ann Arbor – and tech companies have discovered a new avenue for financing deals.

Local investors acknowledge that the area still faces challenges.

Michigan has more than \$1 billion in capital, according to statistics from the Michigan Venture Capital Association. Some \$150 million is available for new investments - and about half of that is directed toward Michigan.

Nonetheless, Ann Arbor's burgeoning sector of life sciences, alternative energy and IT companies is drawing the attention of VC investors here and elsewhere.

VC firms are ramping up fundraising initiatives in an effort to expand their investment capabilities and capitalize on the technological opportunities in this area. But for now, local startups are still forced to compete for a small pool of funds compared with VC hotspots such as Silicon Valley and Boston.

"There are going to be good deals that don't get funded around here for the near term," said Chris Rizik, co-founder of Ardesta, a \$100 million firm based in downtown Ann Arbor.

Nonetheless, Rizik is optimistic that the entrepreneurial opportunities in the region will continue to attract more capital.

Ann Arbor Business Review recently conducted a roundtable discussion with six key players in the local VC community.

Business Review: How has the current crisis in the financial markets affected venture capital and your investment strategies?

Tim Petersen: Short answer for me, not at all. We're health care. We're ... investing for longer time horizons, investing in big trends. ...

I think it might affect fundraising around the edges, because people's asset allocations might change relative to alternatives.

Chris Rizik: The depression of the stock market ... changes fundraising because typically investments made by institutional investors in venture capital funds are a percentage of total assets and so, unfortunately, as their stock market holdings go down, the amount that's allocable to other areas goes down. ...

The one other way it's affected us: Whenever you make an investment, you're looking at what your exit's going to be.

Back (in the late 1990s and early 2000s) there was a far greater chance that your exit was going to be an (Initial Public Offering). Now, as you invest in a company, you have to anticipate that your exit will be usually a (merger & acquisition) situation rather than an IPO.

Ian Bund: This is one of the great times in the cycle to be making investments. ... When the stock market comes down you also expect some of the M&A valuations to come down.

That has happened a little bit, but there's a tremendous appetite among big companies to buy worthy companies, and there's a lot of liquidity.

Petersen: David, you're a good barometer of the local scene. How busy are you on the venture side?

Venture Capital Roundtable panelists

Panelists say Ann Arbor leads Midwest

Chris Rizik of Ardesta (\$100 million)

Tim Petersen of Arboretum Ventures (\$73 million)

Ian Bund of Plymouth Venture Partners (\$21 million)

Linda Fingerle of EDF Ventures (\$170 million)

David Parsigian, attorney specializing in VC deals

LeAnn Auer of the Michigan Venture Capital Association

David Parsigian: Very busy. Busier than I've ever been. ... There's a tremendous amount of activity and these state funds are just going to increase it, because they're putting more money into the system locally than we've ever had.

LeAnn, do the venture firms you talk to see this as a good time to invest?

LeAnn Auer: I don't know that for sure, but one thing I was going to add: Maybe not as a hard link to the financial markets, but really because of the economy itself and people losing their jobs or maybe jumping ship - do you find that there's a little bit more entrepreneurialism as a result, more deals for the VCs to possibly look at, in general and around here?

Rizik: The local economy has created additional opportunities to get talented people at our companies.

Linda Fingerle: People in Michigan ... they've been in situations with high risk. The companies here, they're all restructuring, they're either losing their jobs or moving on.

So to come into a situation where they've got a chance to make a difference, get equity, I think that's very exciting to them.

And I think we're going to see more people taking that leap, because they've already been in a risky situation.

Parsigian: If we can make this cultural transition from a traditional economy to an entrepreneurial economy, it will be the biggest part of what's been missing in the Midwest to make it a successful area for building new companies - particularly technology-based companies.

Everybody always talks about capital, but the real short asset has been the entrepreneurial talent. If the environment creates it because of economic strife, that's the silver lining in that cloud.

Bund: I know a number of us tried to keep (now Quark Inc. CEO) Ray Schiavone in town after Arbortext was sold. He was reasonably patient, but he had family that needed to be paid for, and how long can you run a negative cash flow?

Rizik: We have enough trouble getting strong entrepreneurs here in the first place, but the problem that we ran into with Ray is a big one, which is - there aren't enough funded deals here where it's going to be an easy fit.

Parsigian: But if you build that pool of trained entrepreneurs, the likelihood that those companies are going to get funded in the future is a lot higher, because that's where the people want to put their money with experienced entrepreneurs.

Rizik: Yes, although then we've conquered this one problem of having entrepreneurs, but closely aligned with it is the problem of not having enough capital.

So there are going to be good deals that don't get funded around here for the near term.

What's the biggest difference between you and your Silicon Valley contemporaries?

Auer: There's an energy that's just there. ... It's just vibrant in the whole area.

Fingerle: They view risk as a positive thing. ... Once we establish a culture here where people can believe in it, that they'll continue to get funded, that there are great deals here and that it is a great place to live, then I think we've got a shot at this.

Bund: I would say the issue facing all of us is access to capital. ... If all 17 firms can get to critical mass with capital, you will see a very exciting environment because there's no absence of good ideas and ... there is a reasonable availability of talent.

Auer: Of the 17 venture firms here that we have surveyed, we find that there's over a billion in capital under management. But the real number is that there's about \$150 million available for brand new investment. And maybe \$80 million of that is targeted to Michigan investment.

So there's the real story. That's not a lot of capital in comparison to other areas.

How do we change that?

Rizik: The firms that are here have gone about every traditional and nontraditional way to get capital. ...

The 21st Century Investment Fund and Venture Michigan Fund were huge. We wouldn't even be having the conversation we're having now without those. ...

It is tough moving to that next level of institutional investment, which is the key behind all of it. And the success in the state of getting that institutional investment has been extremely limited. ...

The major institutional investors in Michigan ... have generally been on the sidelines when it came to investing in Michigan venture capital funds.

They're great at investing in funds on the coast, but they have not stepped up to the plate. ...

Institutional investors want to invest in mature funds, but you don't become a mature fund until you've had institutional investors and institutional rounds.

Auer: And you want a fund size of \$150 (million) to \$200 (million). None of our funds here in Michigan have reached that.

Petersen: We talk Michigan, Michigan, Michigan. ... The Michigan venture capital community is largely Ann Arbor venture capital.

Auer: Ten of the 17 firms are here.

Petersen: There's - although it's small - a vibrancy, I think, to the Ann Arbor-based venture community.

Parsigian: If you go to other places and you talk about Michigan, we're sort of low on the totem pole. But the place people talk about is Ann Arbor.

It's not as if the critical mass that's building here is known only in our state. It's known in other places, and I think what's happening over time is the credibility is building. ... You guys are all building funds that are going to be successful, and as a result institutions will start to look at whether they should invest here instead of sending all their money out to the West Coast.

Bund: Strategically, when we look at our own fund, Plymouth, ... we're looking at companies that are much more capital efficient. They are probably a lot less sexy, but nevertheless, you can get from A to B very capital efficiently, and then get to an exit.

Petersen: Certainly that's part of our philosophy, too, is to do ... more capital efficient (deals).

Bund: We're going to see more of a Michigan model in the kind of investments we're going to be doing in Michigan and the Midwest, where we'll be very concerned about capital efficiency.

Does the state's focus on jobs, jobs, jobs irk you at all when you see these studies about how every dollar invested in VC firms turns out this many jobs?

Rizik: The difficulty comes in the time frame you look at. The notion that an investment from the Venture Michigan Fund is going to result in 1,000 jobs this year, that's just looking at the wrong time frame.

Ultimately, the state should be interested in jobs. They just have to deal with a reasonable time frame, which in many cases is going to be more than a decade if we're really building an infrastructure for a venture community.

Parsigian: As the funds mature ... that's where you're going to be able to create more jobs locally. But that's going to take some time. ...

As they build successes, it will create the kind of maturity that will provide the kind of capital necessary to get those larger businesses to stay and create jobs.

Auer: One out of every 10 jobs has been created by companies that are either currently venture-backed or have been venture-backed. That tells a story about what venture capital can do to create jobs. It just takes time.

Petersen: We're trying to create value in these companies and the jobs come when they come. Michigan calls up, they ask for our jobs numbers, we give them to them, and then we immediately forget it. If we create valuable companies, jobs will come.

I understand why they think about it. They're politicians and they should be thinking about it. But does it affect our day-to-day activity? No. We just think about creating value.

Parsigian: You create jobs much more efficiently by building strong businesses than by trying to create jobs directly through economic development.

There's a long, littered path of failed attempts to create jobs just by infusing money through so-called economic development funds, and they just don't work, because you have to have business fundamentals to underpin the outcome.

How do you see the composition of your portfolios changing within the next five to 10 years?

Petersen: We do all health care. ... For health care, there's ... such opportunity because of the fundamental demographics that are going on, that I think it's highly likely that in 15 years Arboretum will still be a health care investor.

Bund: In the next 10, 15 years, we think we're going to continue to find a bunch of companies particularly in Michigan and the Midwest that can grow to that next level.

Rizik: Our investments will be much more focused in the Midwest in the future. ... It will be capital-efficient companies based in the Midwest using the talent here, and from a purely selfish standpoint, this is a place where more money can be made. We're doing it to make more money and there will be benefit to the region because of it.

But initially, because we're asking investors to invest in us, the decision to focus on the Midwest will be because we can make more money here.

Fingerle: I can see the west side of the state kind of being a catalyst to moving eastward. I think our proximity to Detroit, southeast Michigan, is kind of holding us back. We're doing great in Ann Arbor despite of all of it.

But I go to Grand Rapids and I just feel like I'm in a different state and in a different area. There's funding out there - the Van Andels and the DeVoses want to make things happen out there. ... So I see great things coming from that end of the state.

But I also see Tim's thing on health care with us ... There's so much novel technology coming out, people are just going to re-invent things to make them easier, cheaper, better.

In 10 years, where do you see Ann Arbor on the list of venture capital communities?

Petersen: In the Midwest, it's already right at the top.

Rizik: I can't tell you how many times, since we have an office in Chicago, the venture capital firms in Chicago look at Ann Arbor as a model community.

Bund: I think that there's no doubt that the firms here have the leadership and the will to grow their firms. Whether that ends up with more regional investment, or whether those firms become nationally oriented is going to depend on the strategies of those firms.

I think there's no doubt that Ann Arbor will be among the leading centers where venture capital is based.

Parsigian: If you look at the difference between where we were (10 years ago) and where we are now, there's a huge increase in activity.

I can only believe that that's going to grow at more than a geometric rate and the amount of activity is going to be a lot greater in 10 years than it is today, and we'll all be talking about the good 'ole days when there were just a few funds around.

Fingerle: Getting capital into these funds is critical from the institutions in this state and this region and that's what's going to speed it up if you want to see it happen quicker.

Rizik: You're right. That's going to be a huge determinant in whether we're talking about a nice community here in 10 years or a real dynamic community here in 10 years.

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