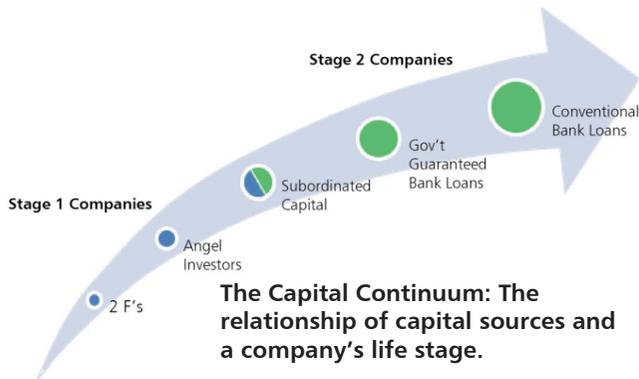




As a community banker for more than 20 years, I have reviewed many business plans from entrepreneurs seeking to finance the start-up of a new company. My role is to review and underwrite each loan request and provide counsel to the prospective borrowers.

If it is determined that a borrower's request is a need for capital versus a loan, I use the opportunity to advise the borrower on the various sources of potential capital. Capital typically does not carry repayment terms and is a long-term or permanent investment in the company.



The Two Fs

The Capital Continuum begins with the 'Two Fs' (Friends & Family) for Stage 1, or start-up companies. This capital source is typical for funding start-ups. The capital takes the 'new idea' and aims to develop it into a marketable product or service.

Many partnerships are formed at this point by combining the cash resources of the new owners and investors. The new product or service has yet to be accepted in the marketplace.

Angel Investors

Angel investors are the next source of capital available to Stage 1 companies. Michigan angel investors seek to provide necessary capital for new Stage 1 and Stage 2 companies that have a market-accepted product or service and are generating sales at a modest level.

The Northern Michigan Angels is a recently formed Traverse City investment group. These investors review business plans, interview owners, and aim to determine the success rate of the new company.

Angel investors use their capital, past business experiences, and expertise to assist small business owners in taking their company to the next level. Typically angel investors do not require interest on their investment but desire an ownership stake or penny warrants. Penny warrants may be converted to a minority ownership in the future.

Another funding option for Stage 1 and 2 companies is the Traverse City Area Chamber of Commerce. Through their

partnership with Northern Initiatives, the Chamber acts as a conduit for local entrepreneurs to find needed capital and debt. The various sources of funds are accessible through the Chamber's website at <http://tcchamber.org/economic-development/need-money/financing/>.

Subordinated Capital

The third source of capital in the continuum is derived from subordinated capital. Mezzanine finance companies and/or private equity firms are typical sources for subordinated capital or subordinated debt. Subordinated debt instruments usually carry a high interest rate (4-6% above typical bank loan rates) and penny warrants that can be converted later into an ownership position.

Mezzanine lenders and private equity firms look for companies that are entering Stage 2 and have intent and potential for growth. Stage 2 companies are defined as companies with 10 to 99 employees and generate \$1 million to \$50 million in annual revenues.

Government-Supported Loans

Government-supported loans are the next level of funding in the capital continuum. At this stage, sources change from capital to loans. Unlike capital, loans are typically shorter term in nature and have a formal repayment schedule where the borrower pays interest to the lender to compensate for the risk.

These loans are funded directly through commercial banks and guaranteed by a governmental agency. SBA loans, USDA business and industry loans, and State programs such as the MEDC guaranty programs are examples. Also included are 'gap loans' that are supported by the Chamber, such as the Grand Traverse County Revolving Loan Fund.

Conventional Bank Loans

The last source of funding in the continuum is conventional bank loans, typically funded directly from commercial banks. These loans fund growth and asset acquisition, and are structured to be repaid based on the life of the financed asset. Corporate borrowers typically are Stage 2 and beyond and report consistent and positive cash flow.

How a company progresses through its various life stages is not always a straight line. Internal and external changes often require companies to 'back up.' For example, after reaching Stage 3, a company may seek to utilize various sources of capital along the continuum to (a) recapitalize a deteriorated balance sheet, (b) fund a large project that leverages the company's balance sheet beyond normal ratios, and (c) fund acquisitions and shareholder buyouts.

One thing remains the same, whatever the stage of the company various funding sources exist to complement its needs.

Editor's note: Wade Van Houzen is the vice president of business banking for The Bank of Northern Michigan.