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Financing tomorrow's economy now

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If the prospective clients had the money to do it, Jim Medsker figures his business would generate a lot more revenue than it does today.

A principal at **Keystone Product Development**, Medsker has seen people approach his firm with good ideas that he believes could become products. They just can't get the capital they need to take it toward commercialization.

"If a few of these projects that we've danced with had launched because they did find capital, think about where we would be today," Medsker says, glancing at his partner, Mike Zamora, as they talk about their new venture in Grand Rapids to produce, assemble, package and distribute medical devices.

"If a few of these projects that we've danced with had launched because they did find capital, think about where we would be today," says Jim Medsker (left), with Mike Zamora of Keystone Product Development. | Photo by Jeff Hage

While the Kalamazoo-based Keystone Product Development has been able to grow with self-provided capital, Medsker's story of prospective clients illustrates a major hurdle in Michigan's painful economic transition: Providing adequate capital for emerging and knowlege-based sectors.

"It's a great challenge," said Zamora, whose company recently expanded into Grand Rapids to become part of a growing medical device cluster. "We talk to a lot of companies that have great ideas. They can't get over the funding hurdle."

A Michigan Economic Development Corp. study that examined small-business lending in the state draws further attention to the issue, particularly in regards to the life sciences industry.

Michigan has experienced tremendous growth in recent years in the number of life sciences companies, the study notes, though it has "not yet translated into a marked increase in conventional lending to that sector," which relies heavily on venture capital and angel investors.

Michigan's capital mix instead is oriented toward traditional businesses with more collateral and cash flow than emerging sectors.

"Given that emerging sectors often require nontraditional underwriting standards and risk capital, Michigan's current capital mix is suboptimal for the growth in emerging sectors the state wishes to see," the lending study concluded.

The conclusion is certainly no surprise and Michigan's situation "is not that much different from other states," said Ned Staebler, MEDC's director of capital markets development.

Staebler notes that Michigan has made strides in the last decade in venture capital and angel investing generated within and flowing into the state. Michigan is doing its share as well with a number of initiatives under the 21st Century Jobs Fund, including the recently announced $300 million Invest Michigan fund, he said.

But given the relative infancy of industries such as life sciences, technology and alternative energy, the development of a fuller capital infrastructure to support emerging and knowledge-based sectors won't occur quickly, Staebler said.

"It takes a while, and it's coming," he said. "Rome wasn't built in a day, and Michigan's 21st century economy won't be built in a day."

Looking at the situation from the upside, Staebler said that, even with the state's economic situation, the very fact that people are talking about improved access to capital for emerging-sector companies is itself a sign of progress.

"It's great that we're having the conversation now and so many people are having this conversation," he said.

The MEDC study provides more fodder for that conversation and the role of banks in Michigan's economic transition.

Businesses interviewed for the MEDC lending study said that banks, because they are so focused on traditional sectors such as manufacturing, don't understand emerging sectors "that have assets that are harder to underwrite."

Bankers say their institutions, for good reasons, are far more cautious to lend to emerging-sector companies, especially startups, that lack tangible assets, cash flow and earnings and are considered too risky.

"I believe banks are appropriately prudent, but not reluctant, in regard to certain sectors based on the risks associated with those industries. That doesn't mean we don't support the sector; it means in many instances, banks are better suited to provide financing after the successful venture has been established," said Michelle Van Dyke, CEO for **Fifth Third Bank** in Michigan.

Banks have an obvious interest in keeping up with emerging sectors and helping to fashion tomorrow's economy, **National City Corp.** Regional President Sean Welsh said.

"These are constantly changing industries, and we need to keep constantly up to date on it," Welsh said. "We, as a corporation, are constantly trying to position ourselves out there and be prepared."

But that doesn't mean emerging-sector companies are right for traditional lending, Welsh and other executives say.

Bankers say they readily steer emerging-sector companies to the kinds of capital for which they are suited because of the risk involved, whether via venture or angel investors or private equity.

"Capital finds its way into good projects that provide a good return," said Dan Terpsma, market executive for Michigan for **Bank of America.** "That expertise and that capital can be found in the state of Michigan."

And though it's challenging for a start-up business to find, Terpsma said, it's not impossible.

Yet he and others agree that much more venture capital, angel investing and other forms of risk capital are needed in Michigan to further drive an economic transition.

The MEDC study also cites a need for more "niche banks" that target or cater to specific industries. One example is the Bank of Ann Arbor, a $180 million-asset bank formed in 1996 that targets life sciences and technology.

"The bank has been an important capital resource to the state's emerging technology and life sciences sectors," the MEDC study stated.

Though she shares the frustration and impatience of the entrepreneurs seeking capital, **Right Place Inc.** President Birgit Klohs believes progress is occurring. Like Staebler, and given where the state started a decade ago, she prefers to focus on the long term as the infrastructure to support emerging sectors continues to build.

"It's coming along. It's beginning to germinate," Klohs said.