

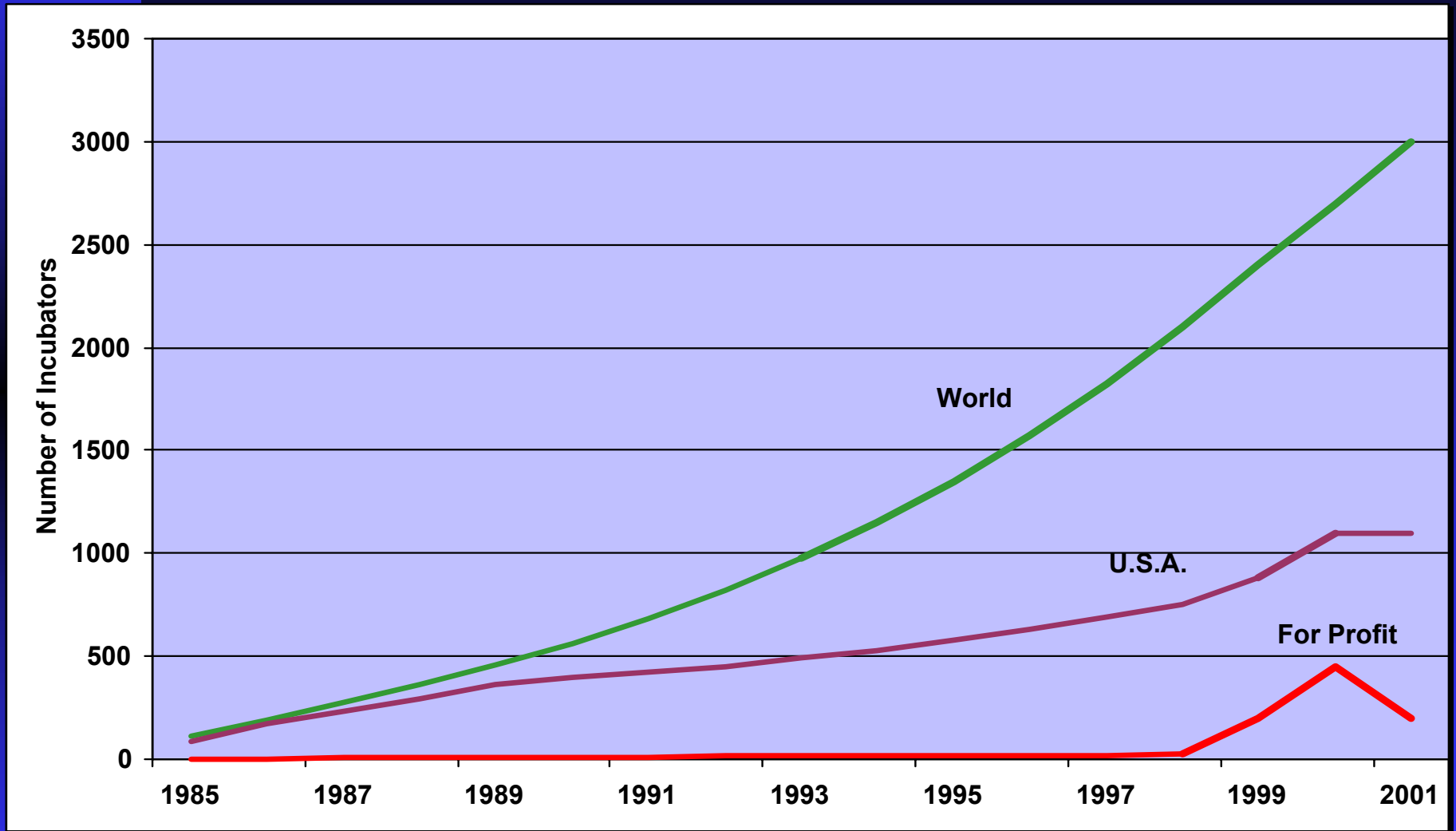
# Incubation in the New Century - International Developments and Conditions for Success

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# Incubators Have Grown Rapidly



# Presentation Topics

1. External Success Factors
2. Internal Success Factors
3. Incubator Generations & Evolutions
4. Business Models & Financial Self Sustainability
5. International developments
6. Subtleties, ambiguities & intangible outcomes

# External Success Factors

1. Government policy favorable to business development
2. Knowledge base (network)
  - ◆ Learning, R&D
  - ◆ Networks of business professionals
3. Private sector growth
  - ◆ From corporate to small and micro

# External Success Factors

## 4. Financial sector

- ◆ Equity and debt finance

## 5. Entrepreneurial culture

## 6. Other business development programs

## 7. Public incubator investment

All influence an incubator and make the task more or less difficult

# Market Failure

- Justifies public intervention
- Important to analyse

## Australia

- Property (real estate) market
- Professional business support
  - ◆ New businesses cannot afford the support they need
- Early stage finance and unsecured debt

# Internal Success Factors

1. Good planning
  - ◆ Feasibility to business planning
2. Linkages
  - ◆ Knowledge base
  - ◆ Finance – equity and debt
    - ◆ &/or in house investment fund
  - ◆ Markets
3. Public Private partnership
  - ◆ Pulling stakeholders together

# Internal Success Factors

4. Quality management team
5. Champion
6. Appropriate physical facility & ICT infrastructure
  - ◆ “Easy in easy out”
  - ◆ Scale
  - ◆ Broadband

# Internal Success Factors

7. Quality business development program
  - ◆ On site
  - ◆ Linked to external professional services & \$
  - ◆ Pre-incubation program
8. Good client selection
9. Graduation
10. Post incubation

# Internal Success Factors

11. Run as a business in its own right

- ◆ Role model
- ◆ Entrepreneurial professional & innovative management

12. Empathy with clients

- ◆ Helping clients with personal growth

13. Social capital generator

- ◆ Linkages and trust and a catalyst in the community

# Incubator Generations/Evolution

Generation	Determinant
1 <sup>st</sup> Generation	Real estate and shared services Reactive business help
2 <sup>nd</sup> Generation	+ business development program and coaching Proactive business help
3 <sup>rd</sup> Generation	+ in house equity/debt finance for clients or channels to external providers Partnering with the business

# 3<sup>rd</sup> Generation Incubators

- Incubators as a tool to lever finance for clients
  - ◆ Venture capital and debt finance
    - ◆ 33% of USA incubators have in house investment funds
  - ◆ Minimising the risk & transaction costs for an investor
  - ◆ Incubation or venture finance?
    - ◆ Where is the line?
    - ◆ Conflict of interest?

# Virtual incubators?

- Not as powerful as with walls
- Using ICT to link clients and management and deliver services
- Outreach from a physical incubator
- Depends on the state of other services available
  - ◆ E.g. Australia – most incubators are physical because numerous other business development and finance programs exist

# Incubator Models?

- Principles for adaptation rather than models
  - ◆ Despite differences all share common characteristics
- Incubators will vary between countries and regions depending on the local conditions, culture and the range of other business development services available

# Business Models: by Revenue Sources

- 3 revenue sources for incubators
  1. From tenants or clients, by way of rent and service charges
  2. On-going funding
  3. Profit on investments in tenants

Business Model	Key Features
<p>1. Revenue from tenants</p> <p>Rent (40 to 60%)</p> <p>Most common &amp; Proven</p>	<p>Often Financially Self sufficient</p> <p>“Free” buildings</p> <p>Minimum economies of scale</p> <p>(Australia 1,500 sqm, USA 3,000 sqm, China 6-10,000 sqm)</p>
<p>2. Ongoing Funding</p> <p>Rare</p>	<p>Focus on incubation rather than financial viability</p>
<p>3. Reliant upon revenue from investment in tenants</p> <p>Not proven</p>	<p>Very deep and patient pockets required (\$)</p> <p>Not a reliable revenue source, but can be good investments</p>

Business Model	Examples
1. Revenue from tenants	Most European , USA & Australian incubators
2. Ongoing Government Funding (typically only for a proportion of costs)	Israeli incubators, NZ technology incubators ■ Good arguments exist for ongoing funding
3. Reliant upon revenue from investment in tenants	New economy private incubators ■ Mostly failed Building IT Strengths Incubators (BITS) in Australia ■ Not independently viable

# Ideal Business Model?

- A combination of all 3 business models
  1. Rent & charges for services as the foundation
  2. Investments in tenants/clients for future growth, but not annual cash flows
  3. Funding, sponsorship for projects and to improve incubation
- Many successful incubators combine all 3

# Keys to Financial Self Sustainability

## 1. Planning

1. Feasibility study

2. Business planning

■ “Failing to plan is like planning to fail”

■ Understanding the market failure

## 2. Scale

◆ Scale required varies between countries

# Keys to Financial Self Sustainability

## 3. Market

- Understanding the market and having a large enough market
- Customer service
- Pricing (rent and services)
  - Often too cheap initially

## 4. “free” buildings are often required

- Typically peppercorn rental, or funding to purchase or build, or another body paying the rent

# Keys to Financial Self Sustainability

## 4. Funding

- Adequate seed funding for the incubator is critical
- Often a “cocktail”

## 5. Good Management and Governance

# International Developments

- Back to Non Profits
  - ◆ Internet/new economy private incubator models were not sustainable in developed western economies
- Back to buildings
  - ◆ Vs virtual or incubators without walls
- Improving performance (e.g. World Bank, UK, Germany, USA, Australia)
  - ◆ Improved business development programs

# International Developments

## ■ Sectoral Specialisation?

- ◆ Where the market is large enough (critical mass/deal flow)
  - ◆ % only or on site clusters and themes
- ◆ ICT & Biotechnology
- ◆ General/Mixed use still largest % in UK, USA Australia
  - ◆ USA (2002 data)
    - Technology 37% (1995 –30%, 1998 – 25%)
    - Mixed use 47% (1995 –42%, 1998 –43%)
    - Manufacturing 7%, Services 6%, Other 4%

# International Developments

- Focus on growth businesses
  - ◆ Growth categorisation/triage
    - ◆ May be a better typology than technology or non-technology
- Social inclusion/community based vs. Technology
  - ◆ Creating employment in disadvantaged areas
  - ◆ Rather than wealth creation by technology commercialisation
- Regional incubator networks
  - ◆ Building upon existing capacity

# International Developments

## ■ Back to Basics

*“Today's thriving incubators are still modeled on the more classic models”*

*“Mixed use incubation programs always dominate the field. They remain an enduring type that allows an incubation program to serve many, if not all types of early stage companies” (NBIA 2002 State of the Industry Report)*

*“Lessons not learnt” (Lalkaka)*

## ■ Global Public Investment

# Subtleties

- Skepticism and public knocking of the real estate aspect
  - ◆ Derogatory perception of 1<sup>st</sup> generation
    - ◆ Although it is the main reason clients initially locate in an incubator (unless the incubator provides finance for the clients)
  - ◆ Walls allow higher intensity of support
  - ◆ 1<sup>st</sup> & 2<sup>nd</sup> generation should be seen as the basics of incubation
- Focus on business development and finance
  - ◆ Should not exclude the important basics

# Ambiguity

- Most business models rely upon rent for survival
  - ◆ Tension regarding graduation
  - ◆ Bums on seats
    - ◆ Low quality tenants may pay rent but will not deliver wealth and employment outcomes
- Business development programs are costly but enhance critical non financial outcomes
  - ◆ Not always appreciated by tenants initially
    - ◆ If they are successful it is all their initiative
    - ◆ If they fail it is poor incubator services

# Ambiguity

- Focus on process, manuals
  - ◆ Makes management easier, but
  - ◆ Tension regarding innovation and entrepreneurship which are not ultimately process or manual driven
  - ◆ Good managers will be entrepreneurs
    - ◆ Intuition as well as process
    - ◆ Will throw out or re-write the rule book and change the board as required
- Empathy with tenants is fundamental
  - ◆ Incubation is about psychology and social processes as much as the hard aspects of business

# Intangible Outcomes

- Major long term benefit of university related incubators may be change in the business culture in the university
  - ◆ Not tenant and graduate outcomes (UKBI Best Practice 2001)
- Other incubators - the major long term benefits may be:
  - ◆ Social capital
    - ◆ Linkages and trust (1999 OECD review)
  - ◆ Development of entrepreneurial and innovative attitudes
- Perhaps politicians and public leaders realise this intuitively when they interfere in funding.