



## 05 Financing an Incubator



Trainee Manual Part 2



Innovate. Connect. Transform.

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# Introduction to the Training Program



## INTRODUCTION TO THE TRAINING PROGRAM

This is the trainee manual for Module 5 Part 2 - out of 11 modules in total - of *infoDev*'s State-of-the-Art Business Incubation Training Program for Business Incubator Managers in Developing Countries.

*infoDev* ([www.infodev.org](http://www.infodev.org)) is a research, capacity building and advisory services program, coordinated and served by an expert Secretariat hosted by the World Bank Group. It helps developing countries and their international partners use innovation and information and communication technologies (ICT) effectively as tools for poverty reduction and sustainable social and economic development. *infoDev* is a leader in business incubation of technology-enabled enterprises. *infoDev*'s global business incubation network reaches close to 300 business incubators, more than 20,000 small and medium enterprises, and has helped create over 200,000 jobs across 87 developing countries.<sup>1</sup>

*infoDev* has found that high quality leadership is a key factor determining the probability of success for an incubator. *infoDev* therefore seeks to increase the capacity of business incubation managers – and their stakeholders – through one-on-one technical assistance, regional and topical peer-to-peer networks, the bi-annual Global Forum on Innovation and Entrepreneurship, and its web-based networking and knowledge-sharing tool [www.idisc.net](http://www.idisc.net). This training program was designed in direct response to repeated requests from *infoDev*'s technology entrepreneurship community for an in-depth business incubation training program relevant to the developing country context.

This training program is the first-of-its-kind, drawing from the lessons, models, and examples in business incubation from across Africa, East Asia and the Pacific, Europe and Central Asia, Latin America & the Caribbean, Middle East & North Africa, and South Asia. More than 30 experts contributed directly to the writing of the training modules, and the materials were tested with more than 300 professionals in developing countries all of whom provided inputs to the final design.

This training program is designed for business incubation managers and other business incubation stakeholders wishing to increase their understanding and know-how of the business incubation process. It consists of 11 training modules ranging from basic introductory topics designed for professionals new to business incubation, to specialized topics such as Technology Commercialization and Virtual Business Incubation Services.

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<sup>1</sup> Source: *infoDev* activities from 2002 to 2009 - <http://www.infodev.org/en/Article.473.html>

The modules include:

#### SUITE 1 – BUSINESS INCUBATION BASICS

##### **Module 1 – Business Incubation Definitions and Principles**

This module provides an introduction to business incubation. It introduces key definitions and presents the main principles and good practices of business incubation. It aims to equip current and future incubator managers and policy makers with the knowledge, skills and understanding of the fundamentals of business incubation in order to effectively foster and encourage businesses.

##### **Module 2 – Business Incubator Models, Including Success Factors**

This module aims to illustrate various business incubator models based on practical examples of incubators from all over the world. The ultimate goal of this module is to empower current and future incubator managers with a thorough understanding of the various business incubator models and their critical success factors as well as to help them identify the best model to adopt for their own incubator to be successful.

#### SUITE 2 – BUSINESS INCUBATOR OPERATIONS

##### **Module 3 – Planning an Incubator**

This module, which divided in two parts, covers assessing the feasibility and designing the business model for an incubator. The first part is aimed at providing a thorough understanding of developing a feasibility study. This includes the steps to undertake a pre-feasibility study, the components that it should address, as well as how to gauge the market need and decide whether an incubator is the most appropriate solution. The second part of the module focuses on business planning to establish the incubator business model.

##### **Module 4 – Marketing and Stakeholder Management**

This module is designed to support efficient and effective communication of the incubator with key customers and other stakeholders based on a good understanding of the market place. This is important since it will help the incubator to establish and increase its reputation as a sustainable organization that fulfils its mission.

The first part of the module focuses on identifying, assessing, and reaching customers/ stakeholders, as well as potential ally organizations providing business support services to enterprises; while the second part is dedicated to defining the incubator's value proposition and engaging marketing channels.

##### **Module 5 – Financing an Incubator**

The first part of this module aims to guide current and future business incubator managers through mastering the incubator's financial data (such as costs and revenues) in order to enable them to identify the financing needs of the organization as well as to explore potential sources of financing.

Building on the first part, the second part of the module is dedicated to demonstrating, to current

and future business incubator managers, how to develop a fundraising strategy and to monitor the financial performance of an incubator.

#### **Module 6 – Managing the Incubator**

This module provides current and future business incubator managers with an overview of sound management practices for a successful incubator.

The first part addresses the topics of incubator policies and governance and the second part is dedicated to operations and human resources management.

#### **Module 7 – Monitoring, Evaluation and Benchmarking**

This module aims to provide incubator managers with the required information, skills and insights to develop their own monitoring and evaluation system and to carry out benchmarking activities.

The first part of the module is dedicated to helping the incubator manager understand the added value of monitoring and evaluating the performances of his/her incubator; defining relevant and adequate performance indicators; and exploring how to monitor and evaluate, notably by studying existing tools and methodologies.

The second part focuses on empowering the business incubator manager to use the data collected through monitoring and evaluation activities to compare the business incubator's performance with those of similar organizations.

### **SUITE 3 – ADVANCED INCUBATOR MANAGEMENT**

#### **Module 8 – Implementing a Mentoring Program**

This module provides, in its first part, a conceptual framework for gaining a thorough understanding of the mentoring process and its purposes from three perspectives: that of the business incubator, the mentor, and the mentee.

The second part of the module focuses on how to implement a mentoring program.

#### **Module 9 – Deals and Financing for Incubator Clients**

This module aims to provide a thorough understanding of the alternative sources of financing for incubator clients by notably describing programs and processes that will enable the incubator manager to assist his/her clients in accessing financing.

The first part focuses on preparing incubatees to engage in the process of accessing financing while developing the capacity of the incubator to assist incubatees in accessing financing. The second part of the training module explores financing from the perspective of both the incubatees and the incubator.

#### **Module 10 – Technology Commercialization through Incubation**

This module describes technology commercialization divided in two parts. The first relating to

challenges and lessons learned associated with this process as well as how to manage expectations regarding the results of technology commercialization. This part also concerns the role of the incubator in facilitating technology commercialization in the pre-incubation phase.

The second part of this module focuses on the role of the incubator in technology commercialization in both the incubation and the growth phases.

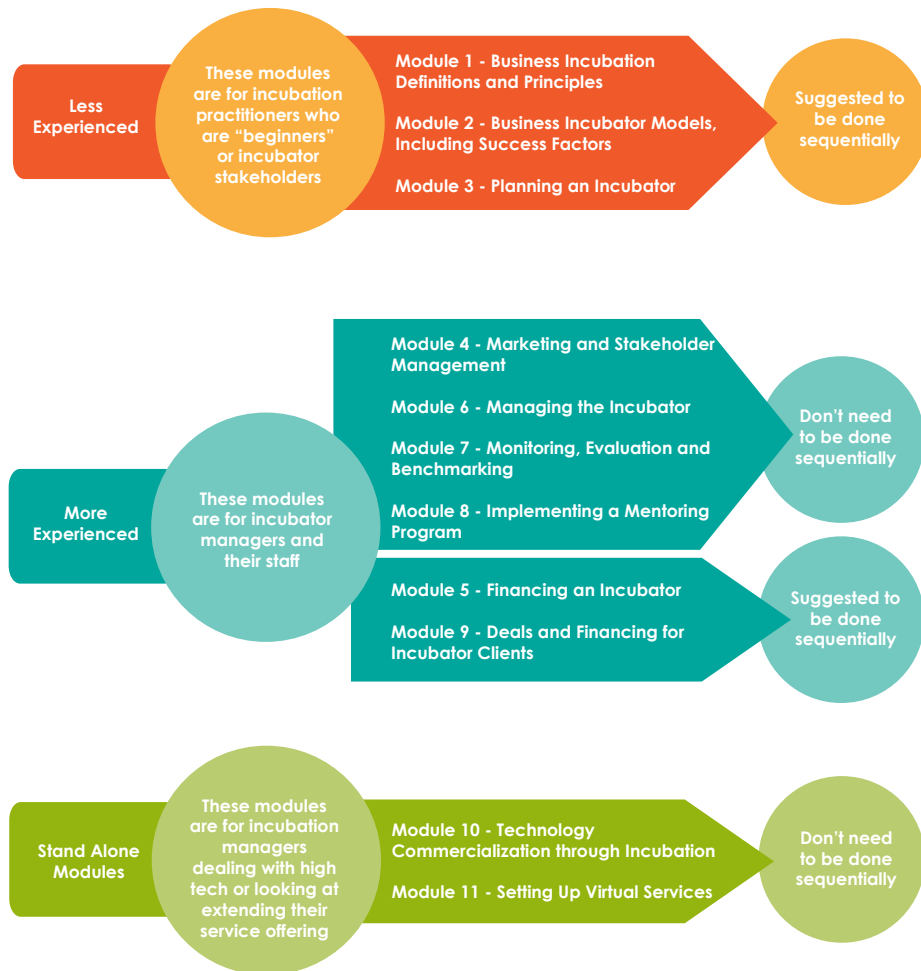
### **Module 11 – Setting Up Virtual Services**

The first part of this module provides a conceptual framework for understanding virtual services. It is designed for current and future business incubator managers who are considering virtual incubation either as a stand-alone business model or as part of their overall incubator service portfolio to extend their current service offering.

In its second part, the module aims to guide current and future business incubator managers and help them to decide if virtual incubation is the right solution for their incubator. The module then explores the most common challenges and how to address them.

Figure 1 groups the modules by preferred level of experience and suggested module sequence.





**Figure 1 – Module Selection and Sequence**



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# Module Objectives



This module is divided into two parts, each with two main objectives. The objectives of Part 1 are (1) to provide incubator managers with the tools they need to identify the incubator's funding requirements and (2) to explore potential sources of financing. The objectives of Part 2 are (1) to explain important aspects for developing a fundraising strategy and (2) how to monitor the financial performance of the incubator.

#### TRAINEE TRAINING OBJECTIVES

By the end of this training, the trainee (an incubator manager or staff member) will understand how to:

- Set up spreadsheets outlining the incubator's costs and revenues;
- Identify the funding needs of the incubator and the corresponding available funding resources;
- Develop an adequate fundraising strategy; and
- Monitor the financial performance of the incubator towards financial sustainability.



# Introduction to this Module





Incubators need to secure and carefully manage financial resources. Financial resources are needed to:


- Establish the business incubator;
- Start its activities;
- Operate efficiently and in a manner that contributes to achieving the incubator's overall goals; and
- Ultimately, reach sustainability.

Hence, a business incubator should be managed with an entrepreneurial mindset.

By exploring the different funding opportunities available in their catchment area, an incubator manager may develop a targeted fundraising strategy in order to secure the most appropriate sources of funding to meet the incubator's funding requirements. This also involves determining the most appropriate revenue streams to cover the costs generated by the incubator's activities.

In addition to bringing in funds and revenues, managers must carefully manage how these financial resources are used. Operations need careful attention and strict record keeping. An effective incubator manager will monitor cash flow, projected and real revenues, investments and expenditures.

By applying the information contained in this module, incubator managers will learn how to determine the incubator's investment and revenue needs as part of an accurate budget. To this end, business incubation practitioners will have access to the adequate tools and sources of financing to efficiently manage the incubator's financial position and drive the organization towards sustainability.



Note: The module has been designed following a “keep it simple” approach in order to ensure the uptake of the significant amount of terms and concepts, which are illustrated by templates in the manual. Moreover, the definitions of all terms and concepts addressed in the current module can be easily found in the Glossary of Terms provided along with the manual.

Nonetheless, specific training material, such as Business Edge and the SME Toolkit (referred to in the next pages), provide more detailed resources for business incubation practitioners to refer to for an in-depth hands on implementation of the learning outcomes from the training module.



# Component 3 (Part 2 Training):

## Developing a Fundraising Strategy



## COMPONENT INDEX

### **Section 3.1.:** Assessing Funding Challenges in Developing Countries

#### **Section 3.1.1:** Cost of Financing and Bureaucracy

#### **Section 3.1.2:** Information Gaps

#### **Section 3.1.3:** Lack of Institutional Development

#### **Section 3.1.4:** Political and Economic Instability

#### **Section 3.1.5:** Corruption

#### **Section 3.1.6:** Unreliability of Government and Donor Funding

### **Section 3.2.:** Developing the Appropriate Fundraising Strategy

## COMPONENT OBJECTIVES

This component is designed to support the trainee in defining the appropriate fundraising strategy in response to the incubator's identified funding gap. By highlighting the particular challenges of fundraising activities in developing countries, the aim of this component is to enable incubator managers to define the most appropriate fundraising strategy for their incubator.

At the completion of this component, trainees should be able to identify and overcome the specific fundraising challenges in their area and adopt the most relevant strategy in order to secure the necessary funds for the incubator to operate efficiently.

## Section 3.1: Assessing Funding Challenges in Developing Countries



Note: The following challenges and obstacles do not represent all possible factors impacting the availability of capital funds in developing countries, but are instead a summary of the most relevant obstacles.<sup>49, 50</sup>

There are several challenges and obstacles to gaining access to financing sources in developing countries. An incubator manager must overcome these challenges and obstacles in order to achieve the necessary financing. Therefore, it is important to understand what these challenges and obstacles may be in order to overcome them.

### Section 3.1.1: Cost of Financing and Bureaucracy

The cost of financing and bureaucracy are considered to be two of the most constraining features of the business environment in developing countries. The main obstacles faced are high collateral requirements, bank paperwork, high interest rate payments, the need to have special connections and the general lack of bank resources.

These obstacles are serious threats to the growth and investment plans of business incubators in developing countries, thus making it hard for them to contribute to the economic development of the region where they are located.

### Section 3.1.2: Information Gaps

Information gaps between borrowers and lenders make the task of obtaining financing in developing countries very difficult. This is an obstacle that is especially relevant for business incubators. The business incubator is perhaps less well-known than other ventures and financing institutions in many developing countries often do not have sufficient knowledge about its function and operation. This lack of knowledge makes assessing the risk of investment difficult for the lender.

**The risk is perceived as very high by the lender and the costs of financing increase proportionately if:**

- The incubator manager is overly secretive or incapable of explaining the purpose of the incubator and its business plan; and/ or
- The lender is not knowledgeable about, or able to, understand the incubation industry.

<sup>49</sup> Source: Beck, T. (2007) - Financing Constraints of SMEs in Developing Countries: Evidence, Determinants and Solutions, World Bank, Development Research Group

<sup>50</sup> Source: Zavatta, R. (June 2008) - Financing Technology Entrepreneurship and SMEs in Developing Countries: Challenges and Opportunities, *infoDev*

### Section 3.1.3: Lack of Institutional Development

The lack of institutional development in developing countries is a major problem for businesses trying to obtain financing in these countries.<sup>51</sup>

#### For instance:

- The inefficiency of the legal system is a severe discouragement for investors in any country. At the developing country level, this has a strong impact on foreign direct investment, since foreign investors will be reluctant to send funds into a country where the legal system is inefficient, corrupt or slow.
- The intellectual property legislation and its enforcement can negatively influence financing opportunities. Inefficiencies in this field may lead to a decrease in a country's attractiveness to investment in technology related industries. This affects the availability of funds for technological start-ups that could be possible tenants of business incubators, thus affecting incubators indirectly.

### Section 3.1.4: Political and Economic Instability

Political and economic instability has a significant influence on the availability of capital funds in a country. In this case, the issue should be analyzed mostly from a perspective of foreign investment. For example, how willing are foreigners to invest in a developing country, when developing countries are more-likely than developed countries to suffer from economic and political instability?

### Section 3.1.5: Corruption

An incubator manager in a developing country may be affected by corruption within the financial sector. Unfortunately, corruption may make it more difficult for businesses to access financing due to a lack of confidence in bankers and other financiers in a country's institutions and legal system. Naturally, corruption exists in many other ways, including "correct" political alignment, all of them causing an increase in the cost of doing business, thus leaving less funds available for investment in the growth and prosperity of businesses.

### Section 3.1.6: Unreliability of Governmental and Donor Funding<sup>52</sup>

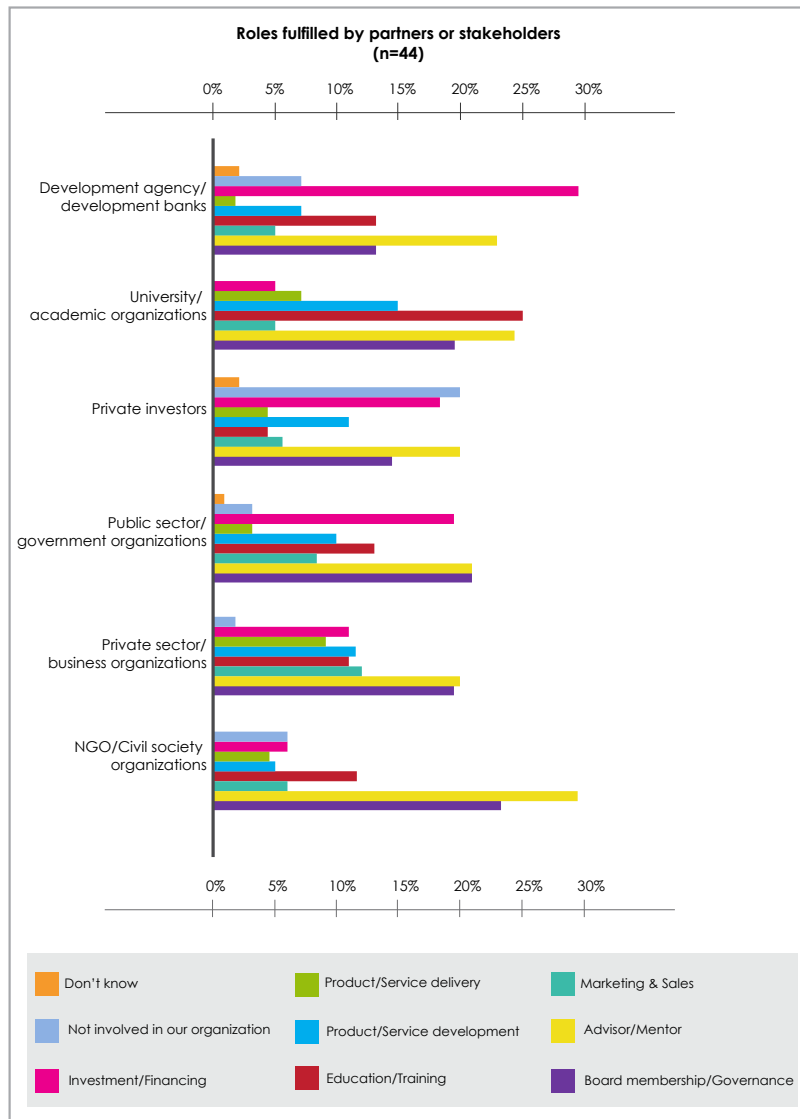
Most financing constraints indicated so far are related to financing private business ventures. The reality, however, is that many business incubators in developing countries are dependent on the government and donor funds alone to survive. An incubator manager should always look for other funding, or sources of revenue, to reach sustainability. A fully government or donor supported business incubator may have to deal with the lack of reliability and uncertainty, particularly about when funds will be received, as well as whether government agendas change following political change, such as elections. This is important at many levels including the fact that incubatees need to have rigorous budgets, timelines and disbursement plans, thus need constant support and a good example set by the incubator. Delays in funding can, therefore, result in the failing of otherwise viable businesses.

<sup>51</sup> Source: CollegeMogul.com - Directory of Incubators & Seed Funding Venture Programs - <http://www.collegemogul.com/content/directory-incubators-seed-funding-venture-programs>

<sup>52</sup> Source: Ndede-Amadi, A. (April 2007) - Funding Incubators for Sustainability, The Financial Standard, Ghana

## Section 3.2: Developing the Appropriate Fundraising Strategy

The MEIA Study<sup>53</sup> interestingly reveals that “reflecting the range of interested parties, incubator founders represent the public, private, NGO, financial and academic communities. The private sector is the most-likely platform to use to launch an incubator, followed closely by the public and then academic sectors. Private sector founders include individual entrepreneurs such as Mark Davies of BusyInternet<sup>54</sup> and corporate managers who believe they are investing in the long-term health of communities, countries and markets. Public sector founders include government leaders representing the economic interests of regions and countries, often both driving and acting on changes in national economic strategy. For the most part, the motivation for involvement across sectors is long-term social and economic impact. Few founders seem to see the effort as a short-term, profit-making endeavor” as illustrated by Figure 10.



**Figure 10 – The Importance of Fundraising Activities per Stakeholder<sup>55</sup>**

<sup>53</sup> Source: infoDev - Monitoring, Evaluation & Impact Assessment Study - <http://www.idisc.net/en/Page.MEIA.Study.Overview.html>

<sup>54</sup> Source: Busyinternet: <http://www.busyinternet.com/>

<sup>55</sup> Source: infoDev - Monitoring, Evaluation & Impact Assessment Study - <http://www.idisc.net/en/Page.MEIA.Study.Overview.html>



When approaching financiers, incubator stakeholders may use different arguments and data to convince them to fund the incubator. Depending on the financier, the arguments and data should be customized. Table 2 gives an indication of which arguments can be applied in order to convince different types of financiers.

TYPE OF FINANCIER	ARGUMENTS FOR FUNDING AN INCUBATOR
<b>Development Agency / Development Bank</b>	<ul style="list-style-type: none"> <li>• Investing in the long-term wealth of communities, countries and markets within the framework of changes in national economic strategy that aim at improving the social and economic conditions of specific regions and countries.</li> <li>• Investing in growing new successful businesses and creating jobs that provide social economic development.</li> <li>• Facilitating the incubator’s access to other sources of funding.</li> <li>• Influencing the business environment and managing key operating risks (e.g. changes in regulatory investment) in order to contribute to the national incubation strategy.</li> </ul>
<b>University / Academic Organization</b>	<ul style="list-style-type: none"> <li>• Investing in building trusted relationships for the achievement of a shared vision (e.g. as a member of the Board of Directors of the incubator).<sup>56</sup></li> <li>• Influencing the business environment and managing key operating risks (e.g. changes in regulatory investment) in order to contribute to the national incubation strategy.</li> <li>• Developing mechanisms for technology transfer via spin-outs.</li> <li>• Becoming a recognized player in the national system of innovation.</li> </ul>
<b>Private Bank</b>	<ul style="list-style-type: none"> <li>• Investing in building trusted relationships for the achievement of a shared vision (e.g. as a member of the Board of Directors of the incubator).</li> <li>• Facilitating the incubator’s access to other sources of funding.</li> <li>• Building a future client base for the bank.</li> </ul>
<b>Private Investor</b>	<ul style="list-style-type: none"> <li>• Investing in the long-term wealth of communities, countries and markets through investing in incubatees.</li> <li>• Facilitating the incubator’s access to other sources of funding.</li> <li>• Investment in their own future deal flow by creating the value chain.<sup>57</sup></li> <li>• Influencing the business environment and managing key operating risks (e.g. changes in regulatory investment) in order to contribute to the national incubation strategy.</li> </ul>

<sup>56</sup> Note: The Ayala Foundation in the Philippines actively works to develop mutually beneficial stakeholder relationships by hosting regular “Kapihan” or coffee talks that bring stakeholders together informally to build trust and shared vision. Source: <http://www.ayalatbi.org/>

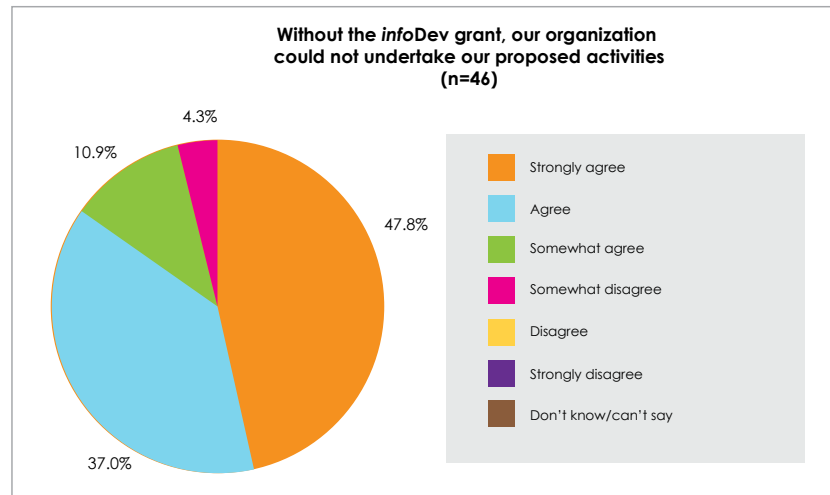
<sup>57</sup> Note: A non-profit organization focused on early-stage entrepreneurs, the CRC Incubator has had particular success partnering with later stage investors to create a technology incubation value chain in Vietnam. FPT Technology Development, Vietnam’s leading private ICT incubator, and IDG Ventures, a local VC firm, are both helping to finance the CRC as part of an explicit investment in their own future deal flow.

TYPE OF FINANCIER	ARGUMENTS FOR FUNDING AN INCUBATOR
<b>Public Sector/ Government Organization</b>	<ul style="list-style-type: none"> <li>• Investing in the long-term wealth of communities, countries and markets within the framework of changes in national economic strategy that aim at improving the social and economic conditions of specific regions and countries.</li> <li>• Investing in growing new successful businesses and creating jobs that provide social economic development.</li> <li>• Becoming an active facilitator in developing a national system of innovation, required for moving into the global knowledge economy.</li> <li>• Ensuring the registration of businesses and hence reducing the amount of companies operating in the grey market.</li> <li>• Facilitating the incubator's access to other sources of funding.</li> <li>• Influencing the business environment and managing key operating risks, such as changes in regulatory investment, in order to contribute to the national incubation strategy.</li> </ul>
<b>Foundation</b>	<ul style="list-style-type: none"> <li>• Investing in the long-term wealth of communities, countries and markets.</li> <li>• Investing in building trusted relationships for the achievement of a shared vision, such as a member of the Board of Directors of the incubator for example.</li> <li>• Investing in growing new successful businesses and creating jobs that provide social economic development.</li> <li>• Facilitating the incubator's access to other sources of funding.</li> </ul>
<b>NGO/Civil Society Organization</b>	<ul style="list-style-type: none"> <li>• Investing in the long-term wealth of communities, countries and markets within the framework of changes in national economic strategy that aim at improving the social and economic conditions of specific regions and countries.</li> <li>• Investing in building trusted relationships for the achievement of a shared vision, such as a member of the Board of Directors of the incubator for example.</li> <li>• Investing in growing new successful businesses and creating jobs that provide social economic development.</li> </ul>

**Table 2 – Arguments for Funding, Detailed by Each Type of Financier**

In order to illustrate the effects that added value funding received by business incubators might bring to their catchment area, the *infoDev* grants are used as an example. Observations and data related to the contribution towards the overall economical and social improvements made by the *infoDev* grant can be used in order to convince financiers to fund an incubator, selecting the most relevant data and arguments for each specific incubator as per Table 2.

Furthermore 48% of *infoDev* grantees strongly agree and a further 37% of grantees agree that their organization could not undertake proposed activities without the *infoDev* grant, as shown by Figure 11.



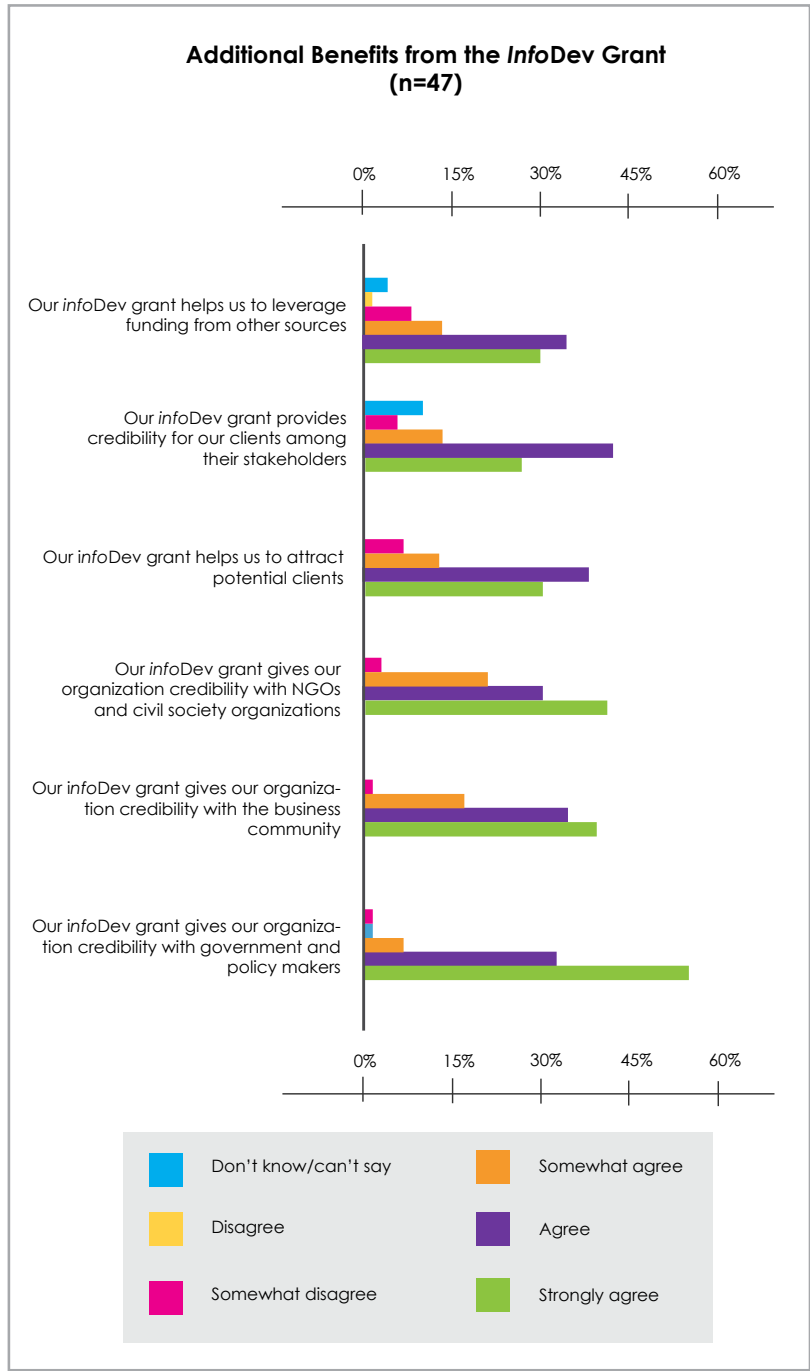
**Figure 11 – The Impact of *infoDev* Grants on the Implementation of Business Incubation Activities<sup>58</sup>**

Because of the significant impact grants can have on incubator financial capabilities, they are typically regarded as a critical component of the sustainability model of not-for-profit incubators. These types of incubators often operate in uncertain financial environments, requiring grants and soft-loans in order to stimulate the development of high-growth companies. Once such companies have been successfully established and graduate from the incubator, the private sector generally engages as new viable opportunities for investment present themselves and at this stage public sector/government intervention is no longer required.

*infoDev's* focus on encouraging and strengthening incubators in developing countries often includes more than just the grant – it also includes training, mentoring and 'co-branding' in the short, medium and long-term in order to lend credibility, both domestically and internationally, for the incubators they support. These direct and indirect actions by *infoDev* have measurable outcomes on their grantees as shown by Figure 12, and including:

- Almost 90% of grantees reporting that *infoDev's* support increased their credibility among policymakers; and
- Over 70% of grantees agreeing or strongly agreeing that they were able to secure funding from other sources because of their *infoDev* grant.

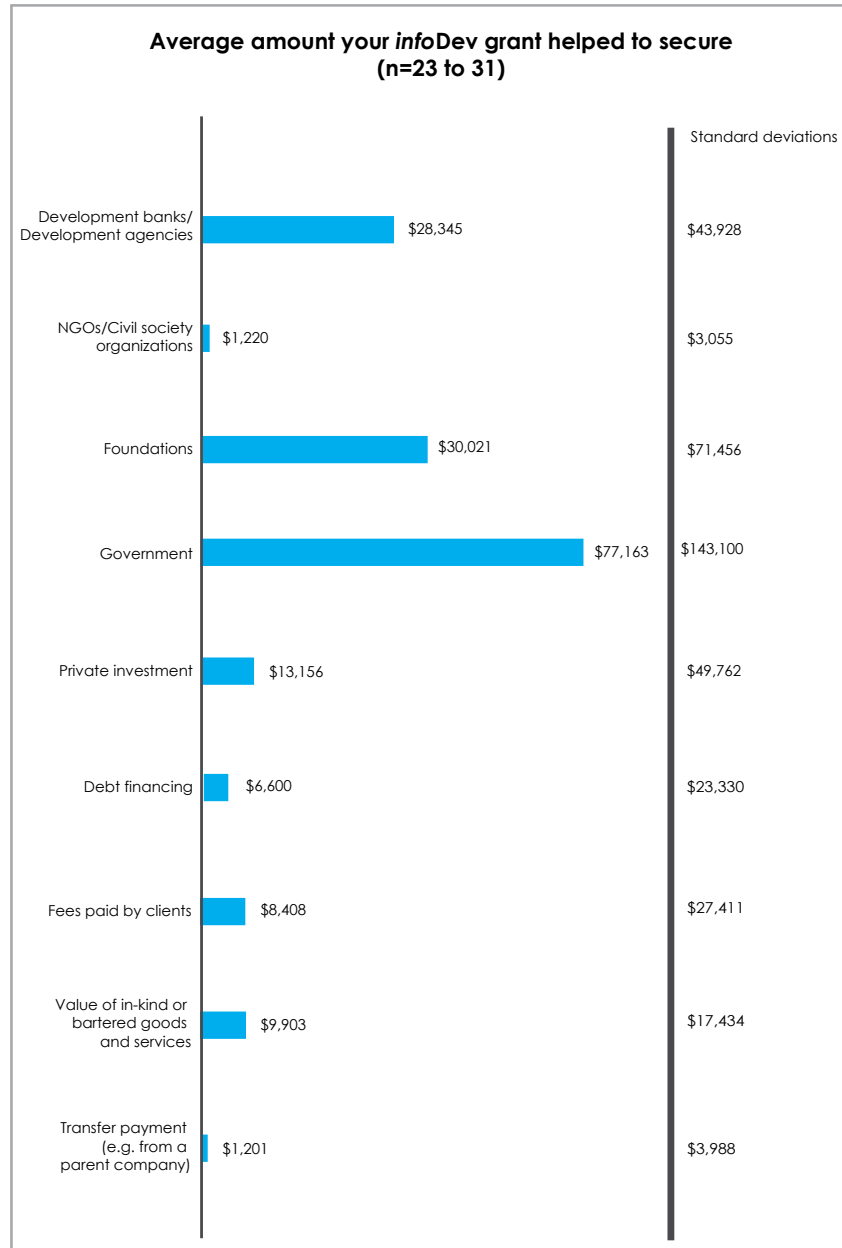
<sup>58</sup> Source: *infoDev* - Monitoring, Evaluation & Impact Assessment Study - <http://www.idisc.net/en/Page.MEIA.Study.Overview.html>



**Figure 12 – Additional Benefits of an *infoDev* Grant for the Incubator’s Activities**<sup>59</sup>

Particularly relevant is the fact that *infoDev*'s grants help secure other funding from government sources or foundations because of the credibility provided by the *infoDev* grant, as demonstrated in Figure 13.

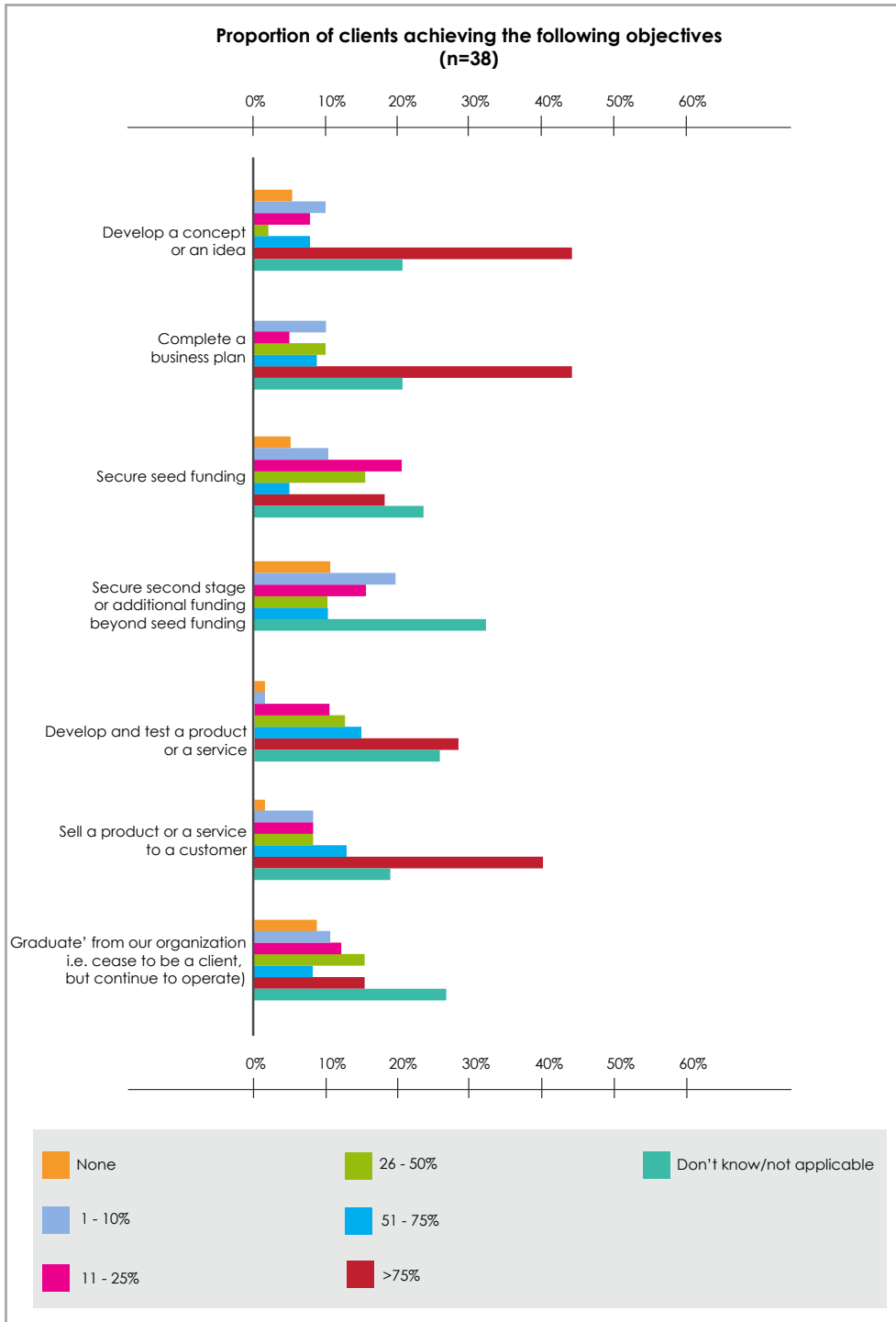
<sup>59</sup> Idem



**Figure 13 –Average Amount an *infoDev* Grant helped Secure for the Incubator’s Fundraising Activities<sup>60</sup>**

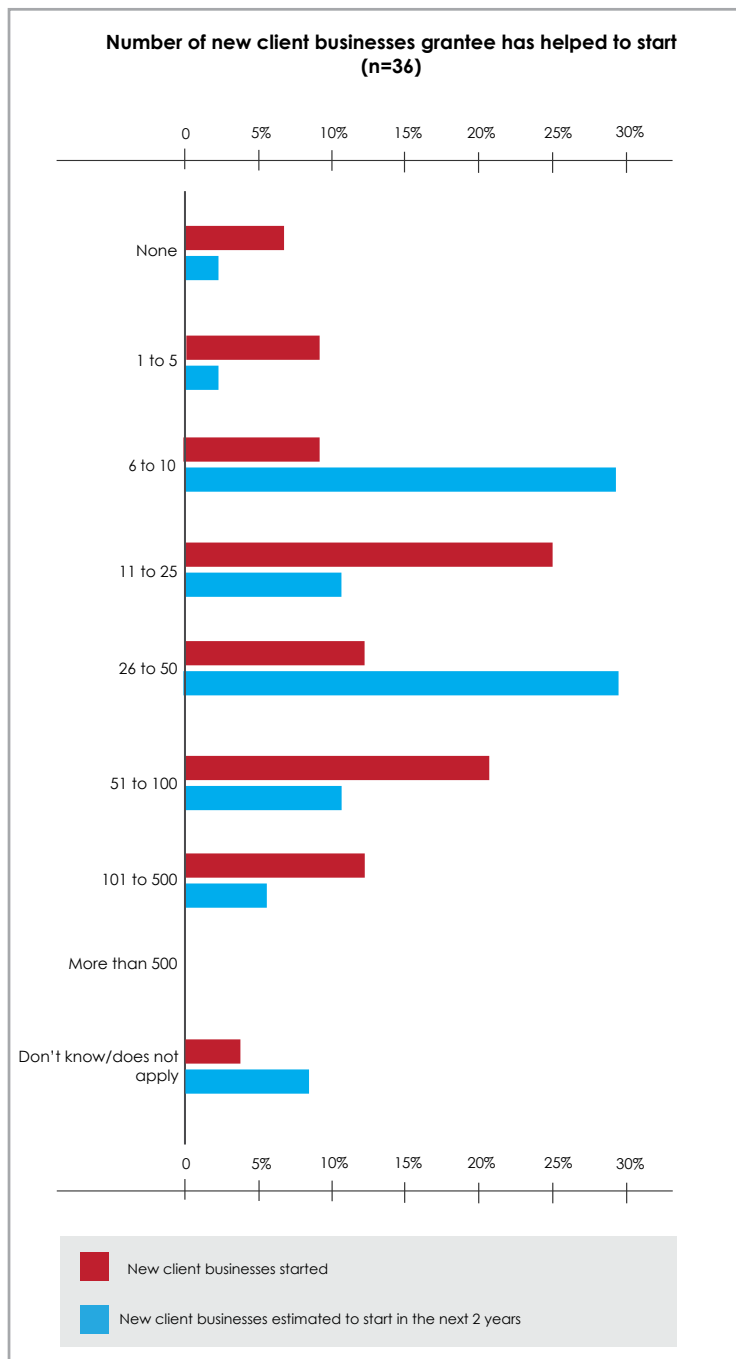
The grantees’ accomplishments are not just due to financial assistance, but a combination of many factors including the leadership and vision of their founders and managers, the contributions of public and private sector stakeholders and the efforts of entrepreneurs. Grantees reported a wide range of their own outcomes and impacts, reflecting the diversity of their environments, growth stages and strategic focuses. The outcomes and impacts are a reflection of the grantees’ specific objectives as shown by Figure 14.

<sup>60</sup> Idem



**Figure 14 –Activities Undertaken by Clients of Incubators Receiving *infoDev* Grants<sup>61</sup>**

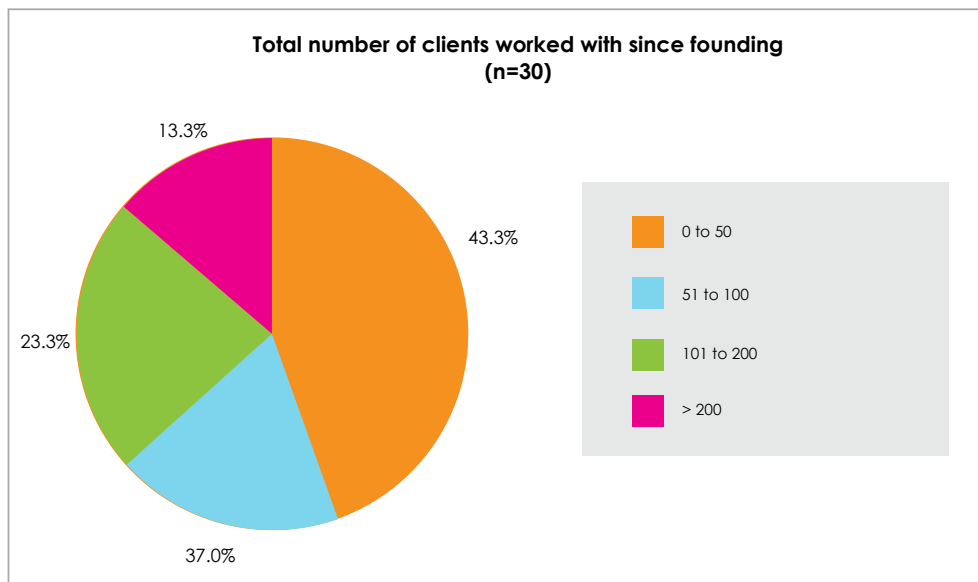
<sup>61</sup> Idem



**Figure 15 – Number of New Client Businesses whose Start was Supported by *infoDev* Grant Recipients<sup>62</sup>**

<sup>62</sup> Idem

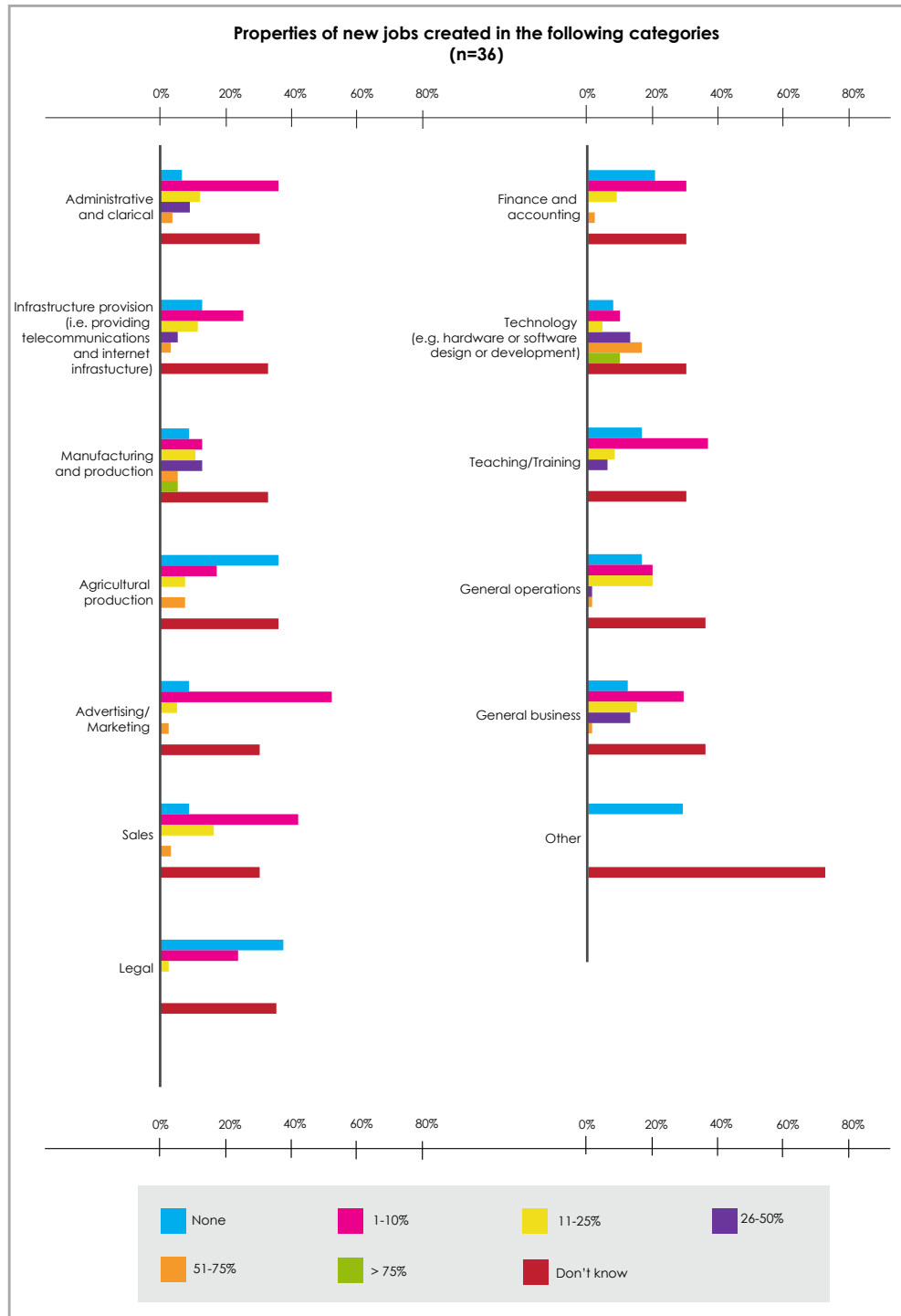
In an attempt to quantify impact, grantees were asked how many clients they had worked with since their founding. The total number was found to be over 8,000. Similarly, 19% of grantees indicated that their clients have created more than 1,000 jobs in their own businesses and 14% indicate that clients have created this same number of jobs beyond their businesses, the so called “ripple effect”. 16% of grantees indicate that clients have created 101 to 250 jobs. While these results cannot be directly attributed to the *infoDev* grant, there is evidence of some significant impact as a result of the work of these grantees and their clients and the role played by *infoDev* in furthering their success.



**Figure 16 – Total Number of Clients *infoDev* Grant Recipients have Worked with since their Founding** <sup>63</sup>

<sup>63</sup> Idem





**Figure 17 – Contribution of Business Incubation for the Creation of Jobs<sup>64</sup>**

<sup>64</sup> Idem

#### COMPONENT CONCLUSIONS

Raising funds is a lengthy and demanding process, but essential to enable the business incubator to carry out its operations.

Hence, the key is to develop a robust fundraising strategy by approaching the most suitable financiers with the relevant data and arguments to convince them to fund the incubator.

Once the required funds are secured, it is fundamental to monitor and assess the financial performance of the business incubator to make sure that the funding gap identified has been appropriately filled by the different sources of funds and revenues in order to progress towards incubator sustainability.

# Component 4 (Part 2 Training):

## Monitoring The Incubator's Financial Performance



## COMPONENT INDEX

### **Section 4.1:** Indicators of Successful Financial Management

#### **Section 4.1.1:** Net Profit Margin

#### **Section 4.1.2:** Self-Sustainability Ratio

#### **Section 4.1.3:** Capacity for Generating Taxes

#### **Section 4.1.4:** Tax Generated by Graduated Enterprises

#### **Section 4.1.5:** Cost of Employment Generation

#### **Section 4.1.6:** Non-Finance Related Indicators

### **Section 4.2:** Opportunities & Success Models for Sustainability

#### **Section 4.2.1:** The Issue of Self-Sustainability

#### **Section 4.2.2:** Empowering Incubator Staff to Carry Out Efficient Financial Management

## COMPONENT OBJECTIVES

This component is designed to ensure that trainees are enabled to (1) monitor their incubator's financial performance and to (2) identify the success, or otherwise, of the organization's financial management.

At the end of this component, the trainees should be able to define the most appropriate financial model to support their business incubator's financial self-sustainability.

## Section 4.1: Indicators of Successful Financial Management

There are some important indicators that enable a manager to track the incubator's financial health and value to the community. Monitoring the values of these indicators can help a manager to better organize and plan for the future. Monitoring and reevaluating the incubator performance as a whole is discussed in greater detail in Module 7 "Monitoring, Evaluation and Benchmarking".

### Section 4.1.1: Net Profit Margin

The net profit margin measures the difference between an incubator's revenues and its profits after tax. It is equal to the amount of net revenue the incubator retains as a profit balance to be carried forward and is normally expressed as a percentage of the incubator's revenues.

$$\text{Net Profit Margin} = \text{Net Profit} / \text{Revenues} * 100\%$$

The net profit margin is very useful when comparing organizations in similar industries, or when analyzing one organization over a period of time. A higher profit margin indicates a more profitable organization that has better control over its costs.

### Section 4.1.2: Self-Sustainability Ratio

The self-sustainability ratio measures the relative size of the incubator generated revenue compared to third party generated revenue.

$$\text{Self-Sustainability Ratio} = (\text{Incubator Generated Revenue}) / (\text{Third Party Generated Revenue})$$

Incubator generated revenue is considered to be more sustainable than third party generated revenue; thus, the larger the self-sustainability ratio the more sustainable the incubator.

### Section 4.1.3: Capacity for Generating Taxes

The Incubator's Capacity for Generating Taxes (CG21) enables a manager to determine how much the incubator generates in taxes for each monetary unit, such as U.S. dollars, that is invested in the incubator.<sup>65</sup>

Managers can calculate this number by assessing what portion of each incubatee's income and its employees' income is taxable. The tax generated by the incubator, incubatee and related employees can represent a substantial financial contribution to the community.

<sup>65</sup> Source : *infoDev* - Financial Management - <http://www.idisc.net/en/Article.170.html>

#### Section 4.1.4: Tax Generated by Graduated Enterprises

Tax generation by graduated enterprises shows the total taxes paid each year by an incubator's graduates, which are the companies that move out of the incubator as they mature.<sup>66</sup> As a successful incubator develops, the amount of taxes its previous incubatees generate should steadily grow.

Tax generated by graduated enterprises can be counted as a benefit as long as the graduate remains in the local community, since the incubator attracted the start-up and nurtured it through the difficult initial years. One could argue that without the incubator the company would not exist in the local setting.

#### Section 4.1.5: Cost Employment Generation

Cost of Employment Generation (CEG) measures the amount required for the incubatees to create a vacancy.<sup>67</sup> This includes costs such as the employee's salary, benefits and office space.

#### Section 4.1.6: Non-Finance Related Indicators

In addition to financial benefits, there are ways in which the local community benefits from the incubator's presence. Therefore, other important non-finance related indicators can also illustrate how an incubator is benefitting a community. Such indicators include a rise in entrepreneurial activity, as measured by the level of new business registrations, an increase in international attention resulting from foreign investors and an increase in development projects in the region, for example in infrastructure or ICT; the number of new policies implemented that are favorable to small company development. These result from the incubator's success and ability to attract interest as a state-of-the-art facility as well as the incubator's advocacy role. Finally, incubators often increase local employment by hiring locally and training these individuals in new fields.

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<sup>66</sup> Idem

<sup>67</sup> Idem

## Section 4.2: Opportunities & Success Models for Sustainability

As discussed in detail in Module 3 “Planning an Incubator”, there are three main aspects that must be addressed to become a financially self-sustainable incubator:

- Deal flow - the need for an ongoing critical mass of quality clients;
- Incubator financial viability - the ability of the incubator to stay in business by covering its operational costs through income generated from its clients; and
- Public sector support - government and policy relevant support for achieving the incubator’s mission and conducting its activities.

### Section 4.2.1: The Issue of Self-Sustainability

Self-sustainability is a perennial issue for business incubators across the globe. A business incubator needs to maximize the revenue that it earns from its clients. Even if the business incubator relies upon ongoing funding from the government, it still needs to be managed with an entrepreneurial mindset. Many long-term business incubation practitioners are wary of ongoing funding, as it is well known that as governments change so do their priorities. Thus, funding might suddenly cease. Hence, incubation may never be 100% financially self-sustainable and may need to rely upon on-going financial subsidies, particularly in smaller states, and/ or integrate business incubation with other related activities. For example, in Europe, 37.3% of costs are met by subsidies<sup>68</sup> and in the USA only 29% of business incubators do not receive subsidies.<sup>69</sup> Good practice dictates that the issue should be addressed from the outset and not once the business incubator has been established when initial, and often public, funding is running out.

The strategies to be used and the extent to which the incubator can be financially self-sufficient need to be addressed carefully in the design and planning phases of development. Taking a global perspective, not all business incubation environments are expected to be financially self-sufficient. Business incubation environments in some countries, such as the USA and Australia for example, are expected to be financially self-sufficient after initial seed funding for the first two to three years often in buildings for which they do not pay the capital costs, or commercial rental. Moreover, incubators serving poor communities, such as the majority of those found in developing countries, face greater challenges in reaching financial sustainability than those located in richer communities. Incubators in developing countries have specific challenges, such as less access to financing, they are more likely to be impacted by economic and political uncertainty, the costs for basic infrastructure requirements may be more significant than in developed countries, and the dealflow of quality clients may be low.

In order to be sustainable, it is vital that the incubator maintains a healthy cash flow and steady sources of revenue. Incubators have a hard time achieving these objectives on their own during the first 3 - 5 years of their life. During this period, and often beyond it, incubators need to rely on many funding

<sup>68</sup> Source: Central and Eastern Europe Statistics (CSES) - Benchmarking of Business incubation environments (2002) Table 23, pp 50.

<sup>69</sup> Source: National Business Incubation Association (2002) - State of the Business Incubation Industry - <http://www.nbia.org/>



sources to complement the revenue they are able to bring in.

#### Section 4.2.2: Empowering Incubator Staff to Carry Out Efficient Financial Management

Incubator managers may not be familiar with financial aspects of managing business-like units such as a business incubator. In this case, they have to learn more about financial management when they take their position and not limit themselves, as is often the case, to relying on accountants. However, it is not expected that a business incubator manager should be an economist, although they should be able to calculate incomes and expenses, in order to balance the incubator's budget, as detailed in Component 1 of this module.

**When looking for the right business incubator manager candidate, it may be helpful to ensure that:**

1. Private sector salaries are offered in order to attract the right people;
2. The candidate has a private sector orientation;
3. The candidate can manage a business. As the incubator should be run with an entrepreneurial mindset, the candidate needs to be an entrepreneurial leader if the incubator is to thrive; and
4. The candidate demonstrates a thorough understanding of accounting and tax regulations and how to implement them in the context of managing an incubator even if there is an in-house accountant.

**The financial management skills can be assessed by asking the candidate to:**

1. Outline the design of a financial management system for an incubator including the critical aspects and indicators, and
2. Outline the approach to be taken for assessing the financial situation of an existing incubator.

**Once the business incubator manager is hired:**

- If they do not have the capacity to efficiently manage the financial part of the business incubator, due to political or other reasons, then the incubator must employ someone else who does.
- It is advisable to make sure that the incubator can make use of the services of a good accountant, from whom the manager may learn and most of all, in whom the manager is confident.

## COMPONENT CONCLUSIONS

One of the characteristics of successful business incubators is, in similarity to any other business, the efficient and effective management of their financial situation.

Monitoring an incubator's financial performance is fundamental in order to establish if the financial assumptions made were realistic or not. This includes activities such as the identification of the necessary costs and expenditures for the incubator's operations, the determination of the funding gap and investments required, and the making of assumptions about the revenues to be generated through the different activities.

If the incubator aims to achieve its overall goals and have a significant impact on its area, it needs to be sustainable. Once the incubator is sustainable, having secured the adequate funds and revenues, the team can focus on its core business of supporting the creation and growth of successful businesses.



# Case Studies





## Subsidization Financing Model

**Incubator Name:** PSG-Science & Technology Entrepreneurial Park (PSG-STEP)

**Sector:** Technology-based Incubator

**This Case Study Examines:** Grant/Donor Financing and Sponsorship

**Date:** September 2009

### PART I

#### SUMMARY

##### Problem

An incubator needs funds to be able to operate efficiently. Planning the funding requirements for each stage of development of the incubator, both in terms of the amount required and the potential source of financing is crucial to enable the incubator to start well and remain sustainable by achieving its goals and mission.

##### Solution

Leverage sponsorships to receive solid financial backing from government agencies focused on the Science and Technology industries. This funding will enable the incubator to establish its operation as well as provide a boost when the incubator is looking to expand incubation capacity and offer services.

### PART II

#### BACKGROUND

PSG-STEP was established in 1998 at PSG College of Technology with support from the Indian government's Department of Science and Technology (DST) in Coimbatore, southern India. PSG-STEP evolved from its predecessor in incubation, which was the Entrepreneurship Development Cell. This cell was founded in the late 1980's with a mission similar to incubation and enjoyed support provided by DST. As the cell grew, it decided to become a fully-fledged incubator. To make the upgrade to this new mission of incubation, the cell leveraged funds of the National Science and Technology Entrepreneurship Development Board, a division of DST, and transformed into today's PSG-STEP.

DST's initial investment in PSG-STEP was approximately USD 200,000. This investment provided the initial capital required to establish the IT incubator. PSG-STEP's management estimates that their own work in securing the building space and facilities totaled an equivalent amount. DST financing was used to develop facilities, marketing strategies, services, expertise and the management team. PSG-STEP's services included:

- Incubation support for IT incubatees;
- Infrastructural support;

- Learning resources;
- Networking support with government agencies, NGOs, and entrepreneurship promotion organizations;
- Voice and data connectivity; and
- A transit house.

Establishing these critical components including the management team, infrastructure and services was completed in the incubator's initial phases. In addition to the start-up investment, DST provided around USD 20,000 annually as an operational grant to PSG-STEP.

On top of this cash sponsorship and the managements' involvement in PSG-STEP's establishment, the incubator receives very valuable support from the PSG College of Technology. The college connection provides PSG-STEP with infrastructure, laboratories, and other resources including learning resources, access to the faculty and student community and amenities that include a cafeteria and transit house. This support is critical to the incubator's self-sustainability and growth. Indeed, the college is heavily involved in the incubator's management decisions as well. Management describes the connection between the college and the incubator as a partnership.

### Self-Sustainability

In 2003, PSG-STEP became self-sustainable. The incubator relies upon the College of Technology for infrastructure support, but it also brings in revenue from its incubatees through rental fees. These fees provide the funds to pay for yearly salary increases and to maintain the incubator's facilities. Rental fees depend upon the structure of support and office space an incubatee chooses. The different options available to a potential incubatee are:

#### Option 1:

- Amenities and Services: Space, Furniture, Network, AC, UPS, DG Power Backup & Computer Facilities
- Cost: USD 40 per month per seat for above facilities

#### Option 2:

- Amenities and Services: Space, Furniture, Network, AC, UPS & DG Power Backup
- Cost: USD 20 per month per seat for above facilities

#### Option 3:

- Amenities and Services: Space – US 0.50 per square foot per month
- Electricity Charges (extra based on consumption)
- The incubatee should bring in all the furniture, networking, UPS etc.
- 24x7 DG Power Backup will be provided by PSG-STEP.



Each option comes with PSG-STEP's incubation support, including laboratory facilities and other equipment housed by PSG College of Technology, student internships, trade show and exhibition participation, data connectivity, cafeteria, transit house and business support from the incubator staff. The different options enable incubatees of varying means to receive the incubation support and services PSG-STEP offers.

This example shows how an incubator can leverage a modest amount of funding as well as a host institution to achieve sustainability. PSG-STEP, however, is aiming for more and has further leveraged its donor organizations.

### **Expansion**

In 2009, after 6 years of self-sustainability, PSG-STEP received a second financial boost from DST. This capital expenditure of USD 200,000 is being leveraged to add an electronics incubation facility to the IT incubator, expanding the incubator's client base from IT into electronics as well. PSG-STEP was able to leverage this financing as a result of the incubator's good record and its established relationship with DST. In addition to this one time capital investment, DST, has granted PSG-STEP a further USD 200,000 through its Technology Development Board, under the Seed Fund Support System to distribute seed funds to its incubatees. This seed fund will allow PSG-STEP to give promising incubatees bursts of needed cash, ranging from 5 year loans of USD 50,000 at a rate of 5% with a 1 year freeze on payments to grants of USD 12,500 for individuals with innovative business ideas. PSG-STEP also supports its incubatees in securing larger grants directly from the Indian government.

This example clearly shows that a successful incubator can return to a sponsor several times, provided the incubator can demonstrate success and has developed a close relationship with the sponsor. PSG-STEP leverages its sponsorships during times of growth and has, until now, a very successful record. It has, as of September 2009, 33 incubatees, 26 of which are in the IT industry and 3 of which are in the newly created electronics division of the incubator. PSG-STEP houses these incubatees and their 900 employees in facilities spanning 3 buildings and 3,500 m<sup>2</sup> of space.

### **TIMELINE OF EVENTS**

PSG-STEP first leveraged DST funds in 1998. Those funds ended in 2003, as PSG-STEP became self-sustainable. PSG-STEP has now received two new influxes of cash from DST, one for its own growth into the electronics incubation area and another to be disbursed to its promising incubatees.

### **OUTCOME AND CONCLUSIONS**

PSG-STEP is a good example of an incubator leveraging sponsorship financing to establish itself in the incubation industry. It utilized the initial cash investment of its sponsor to begin operations and then became self-sustainable.

In its new ventures, PSG-STEP, illustrates how a sponsorship can last longer than the end of one investment and can be leveraged repeatedly to advance the incubator's goals. Since its founding, PSG-STEP has graduated 85 firms. In 2008 alone, the incubator had 7 graduates.

### PART III

#### LINKS

PSG-STEP Website: <http://www.psgstep.com>

#### REFERENCES

The material for this case study was obtained from phone conversations with Mr. K. Suresh Kumar, manager of PSG-STEP, in September 2009.

Additional supporting details were obtained from the following sources, which can provide more information to interested readers:

<http://www.psgstep.com>

<http://www.idsic.net/en/Incubator.249.html>

## The Journey to Self-Sustainability

**Incubator Name:** TREC-STEP

**Sector:** ICT-focused Business Incubator

**This Case Study Examines:** Revenue from Incubated Enterprises

**Date:** September 2009

### PART I

#### SUMMARY

##### Problem

An incubator is on the verge of losing its initial subsidies and sponsorships. The incubator now needs to raise funds to become self-sustainable. Revenue can come from many sources. An incubator must devise and implement a strategy that will bring in sustained revenue and place it in the best strategic position with respect to its objectives and envisaged core goals as expressed in its charter/ mission statement.

##### Solution

A strategy bringing in revenue from multiple sources through direct incubation and through other activities related to incubation as expressed in the charter is created. The strategy must evolve with the incubator's needs and expertise, provide for growth and have a long-term vision for revenue generation. Strategic planning must also constantly refine the incubator's revenue strategies and guide the incubator towards the best strategic position given any circumstance.

### PART II

#### BACKGROUND

Tiruchiarappalli Regional Engineering College – Science & Technology Entrepreneurs Park (TREC-STEP) was founded in 1986 in the Tiruchiarappalli district of the Tamil Nadu state of India. In its initial phase, it was the Science and Entrepreneurial Park, promoting ventures in science and technology. TREC-STEP had a head start on the incubation industry, being the first of its kind in India.

TREC-STEP was founded as a joint venture between federal and local governments, banks and academics. Since its founding, it has graduated nearly 200 incubatees. For the first decade of its existence, TREC-STEP relied upon sponsorships from its unique mix of stakeholders both for capital expenses as well as for recurring support. In 1997, those sponsorships ended, forcing TREC-STEP to pursue new avenues of revenue. TREC-STEP has successfully done so and since 1997 has been self-sustainable.

**Self-Sustainability: Training**

When TREC-STEP's initial funding came to an end, the incubator decided to adopt a mixed model for income. TREC-STEP is located outside an urban center, and as such it cannot rely on fees from incubatee rent alone. TREC-STEP, therefore, moved to training and development projects as funding sources. At that point in time these were the closest strategic options available for TREC-STEP. Fortunately, these options were identified as objectives in the Memorandum of Association.

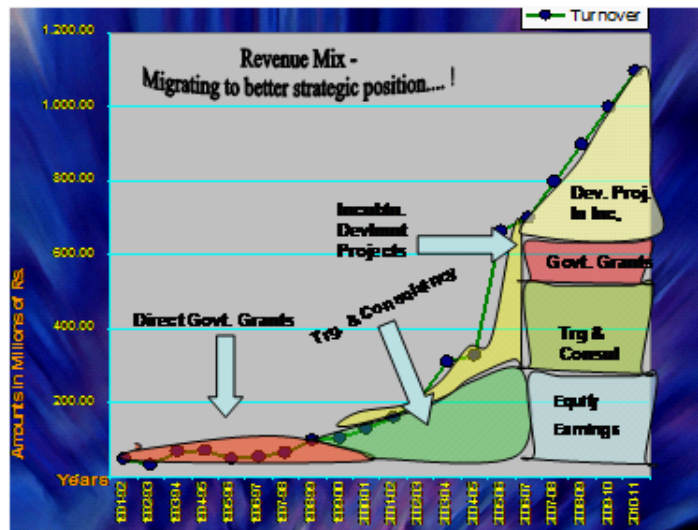
TREC-STEP's spectrum of training programs include:

- IT skills training;
- Artificial intelligence training;
- Business incubation training;
- Entrepreneurship training; and
- Training in the repair of modern appliances.

TREC-STEP was initially able to leverage the recognition enjoyed by its parent institution by launching new training programs, which were not available elsewhere. Later, a focus on program quality ensured the growth of the training programs implemented through public private partnerships. These programs provided up to 80% of TREC-STEP's revenue during the period from the end of the sponsorships, 1997, to 2002. TREC-STEP used its expertise to train all segments of Indian society. In this five year period, from 1997-2002, TREC-STEP brought in the rest of its funding through development projects. These development projects, as opposed to the training programs, are more in line with the core objectives of the organization and brought in increased revenue to TREC-STEP as well.

**Self-Sustainability: Development Projects**

Since 2002, TREC-STEP has shifted its funding mechanisms. Now, in a reversal of the previous five years, around 80% of revenue comes from TREC-STEP's development projects, while only 20% or so is derived from training programs. These development projects always relate to components of business incubation and its derivatives. Some recent examples include a World Bank program to set-up entrepreneurial ventures, 'Developing ICT Synergies for incubating start-ups' in India, as well as a European Union project to increase the connections and networks between incubators in the EU and India for cross cultural venture promotion and knowledge sharing. Currently, TREC-STEP runs around 3 projects yearly, bringing in total revenue of up to USD 1.5 million. Through these revenue mechanisms, training programs and development projects, the revenue has increased by nearly sixteen times since 1999. The figure below shows TREC-STEP's actual and projected revenue.



**TREC-STEP's Financial Evolution**

**Self-Sustainability: Equity**

TREC-STEP, however, is not content with a model based upon development projects and training and is looking for more financial opportunities. In 2007, the incubator established a seed fund, which has, as of 2009, funded 6 start-ups and is targeting 10 further new ventures for 2010.

The seed fund was established through a grant of USD 225,000 from the Technology Development Board of the Indian government. This fund operates as an angel fund for start-ups enabling TREC-STEP to buy equity in the firms and/or provide convertible loans. TREC-STEP hopes to gain financially from the IPOs of these technologically innovative firms, which come from industries such as healthcare, manufacturing, and engineering. TREC-STEP estimates that this model will replace the current revenue model in the next decade. At that point, around 80% of revenue is anticipated to come from investments, with development projects providing the bulk of the remaining 20%, and training programs accounting for the rest. TREC-STEP estimates that this could increase revenue five or ten fold within a decade. A further USD 450,000 has in principle been agreed to be granted to TREC-STEP by the National S&T Entrepreneurship Development Board and will likely fund more incubatee projects.

**TREC-STEP Today**

As a result of its initial funding and ability to generate revenue through training, development projects, and equity, TREC-STEP has developed into a self-sustainable incubator.

TREC-STEP occupies 18 buildings with approximately 8,000 m2 of space. It offers clients three incubation options with different office environments and floor space. TREC-STEP also has a number of common facilities, including a central manufacturing facility, a design innovation theatre, and an administrative block, conference rooms, laboratories through their host institution, a cafeteria, and a library with over 2,300 specialized books focused on the needs of entrepreneurs, including product finders, manufacturer and supplier catalogues, project profiles, market survey and trends, management

concepts and tools, technology books and IT kits. To effectively run this sizeable incubator, TREC-STEP employs 25 individuals in direct support of its 10 current incubatees and their combined 60 employees.

### Lessons Learned

TREC-STEP is constantly evolving its revenue model. It is growing and bringing in funds from different sources, while always looking at future financial opportunities. Some key learning points that TREC-STEP has shared regarding this process of establishing, leveraging, and running a self-sustainable incubator are worth mentioning.

The first lesson is that achieving self-sustainability has enabled the incubator to better help its clients. The culture of an entrepreneurial incubator is one of innovation, growth, and initiative. This gives the incubator credibility and an atmosphere of business success. This culture translates into better services and credibility for incubatees. Incubatees see the success, take in this culture and can grasp new innovations in the work place.

The other important lesson is to pace growth evenly. Incubators cannot sustain constant high-speed growth, which might cause burn outs and also governance issues, since resources, both human and otherwise, are stretched too far. Each incubator should, therefore, find its own optimal pace for growth. As evident from TREC-STEP, the incubator should set goals far in advance and pursue them cautiously and yet expeditiously. Its long-term plan to convert from a model in which the majority of its funding comes from development projects to one in which the majority comes from investments in incubatees is a good example of setting a plan and pace for sustainable growth.

### TIMELINE OF EVENTS

TREC-STEP leveraged sponsor funds for 10 years. Since 1997, it has been self-sustainable, first primarily leveraging training programs for funding and then migrating to an alternative that proved more profitable and in line with its strategic goals, development project work. Since 2007, TREC-STEP has begun initiating a seed fund approach to invest in incubatees. It expects to rely heavily on this new model of funding by 2019.

### OUTCOME AND CONCLUSIONS

By bringing revenue in from training programs and development projects, TREC-STEP has been able to move from being dependent upon sponsor funds to a self-sustainable entrepreneurial incubator. Its pattern of growth and evolution changed to relying more on projects than training. TREC-STEP hopes to further evolve its funding mechanisms by moving from development project based revenue sources to investments in incubatees. TREC-STEP has undergone a measured strategic process of revenue seeking, evolving and leveraging different opportunities as the incubator has grown.

TREC-STEP's development demonstrates that the end of a sponsorship can also be an opportunity. Its example also teaches us that all revenue sources must be sought and dependence on a single source has to be avoided as far as possible, in particular dependence on government sources that might dry up instantly with a change of policy. Incubators must always look for the next opportunity, the next funding source, and the next revenue stream.

### PART III

#### LINKS

TREC-STEP Website: <http://www.trecstep.com>

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The material for this case study was obtained from a phone conversation with R. M. P. Jawahar, Executive Director of TREC-STEP, in September 2009.

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