



## 05 Financing an Incubator



Trainee Manual Part 1



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# Introduction to the Training Program



## INTRODUCTION TO THE TRAINING PROGRAM

This is the trainee manual for Module 5 Part 1 - 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.

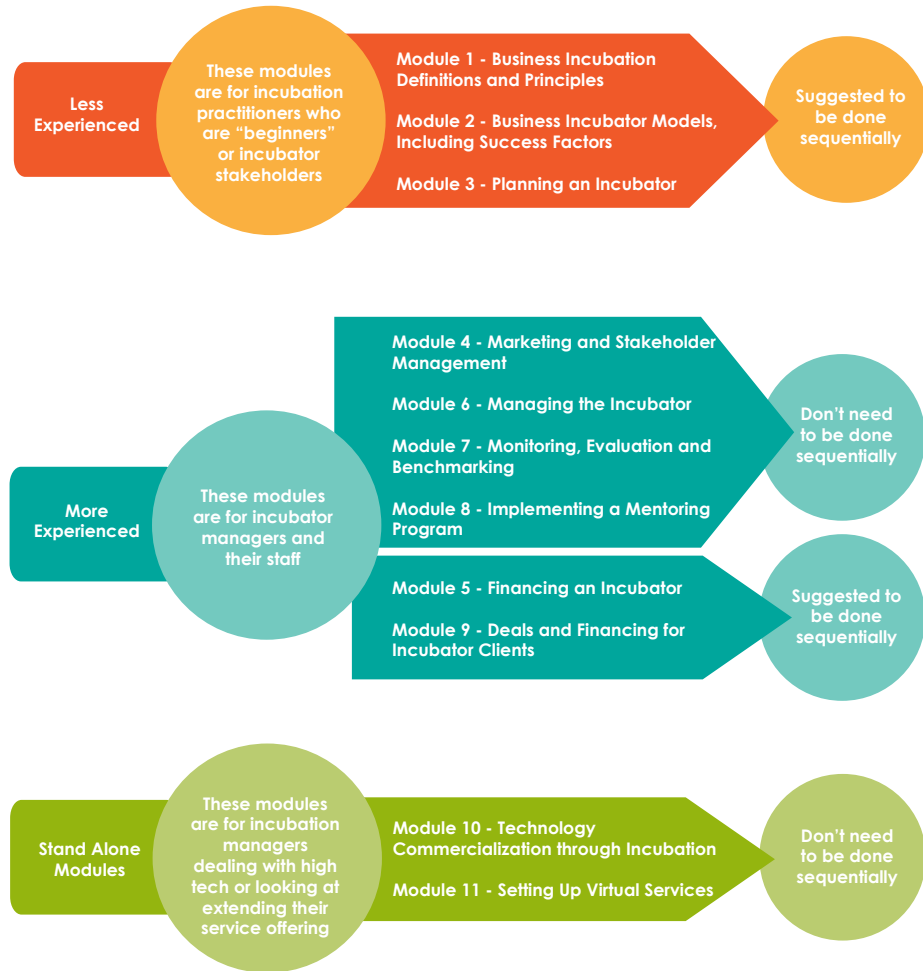
### **Module 11 – Setting Up Virtual Services**

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 Index





<b>INTRODUCTION TO THE TRAINING PROGRAM</b>	<b>3</b>
<b>ACKNOWLEDGEMENTS</b>	<b>11</b>
<b>MODULE INDEX</b>	<b>15</b>
<b>TABLES AND FIGURES</b>	<b>18</b>
<b>MODULE OBJECTIVES</b>	<b>19</b>
<b>INTRODUCTION TO THIS MODULE</b>	<b>23</b>
<b>COMPONENT 1 (PART 1 TRAINING): IDENTIFYING THE REQUIRED FINANCING TOWARDS BREAKEVEN</b>	<b>27</b>
COMPONENT INDEX	29
COMPONENT OBJECTIVES	29
SECTION 1.1: INVESTMENT SPREADSHEET	30
SECTION 1.2: COST AND EXPENDITURE SPREADSHEET	34
SECTION 1.3: REVENUE SPREADSHEET	37
SECTION 1.4: COMPARING REVENUES AND COSTS	39
SECTION 1.5: THE IMPORTANCE OF INCUBATOR CASH FLOWS	42
COMPONENT CONCLUSIONS	44
<b>COMPONENT 2 (PART 1 TRAINING): UNDERSTANDING THE VARIOUS FINANCING SOURCES AVAILABLE TO FILL THE FUNDING GAP</b>	<b>45</b>
COMPONENT INDEX	47
COMPONENT OBJECTIVES	47
SECTION 2.1: INITIAL CAPITAL INVESTMENT (HOW MUCH AND WHERE FROM?)	48
SECTION 2.2: GRANT/DONOR FINANCING AND SPONSORSHIP	58
SECTION 2.3: DEBT FINANCING	60
SECTION 2.4: EQUITY FINANCING	61
SECTION 2.5: REVENUE FROM INCUBATED ENTERPRISES	63
COMPONENT CONCLUSIONS	67
<b>CASE STUDIES</b>	<b>69</b>
SUBSIDIZATION FINANCING MODEL	71
THE JOURNEY TO SELF-SUSTAINABILITY	75
<b>BIBLIOGRAPHY</b>	<b>81</b>

TABLES AND FIGURES

TABLE 1 – SOURCES OF BUSINESS INCUBATORS’ INITIAL CAPITAL INVESTMENT	54
FIGURE 1 – MODULE SELECTION AND SEQUENCE	9
FIGURE 2 – INVESTMENT SPREADSHEET	32
FIGURE 3 – EXAMPLE OF AN ANNUAL COST AND EXPENDITURE SPREADSHEET	36
FIGURE 4 – EXAMPLE OF AN ANNUAL REVENUE SPREADSHEET	38
FIGURE 5 – EXAMPLE OF AN ANNUAL COMPARISON OF COSTS AND REVENUES SPREADSHEET	40
FIGURE 6 – <i>infoDev</i> GRANTEES AVERAGE REVENUE BY CATEGORY (ACTUAL VS. BUDGETED)	49
FIGURE 7 – <i>infoDev</i> GRANTEES AVERAGE EXPENSES BY CATEGORY (BUDGETED VS. ACTUAL)	50
FIGURE 8 – <i>infoDev</i> GRANTEES’ WAYS TO SECURE FACILITIES	51
FIGURE 9 – NATURE OF PRIVATE INCUBATORS MEMBERS OF EBN	54

# 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 1 (Part 1 Training):

## Identifying the Required Financing Towards Breakeven



## COMPONENT INDEX

- Section 1.1:** Investment Spreadsheet
- Section 1.2:** Cost and Expenditure Spreadsheet
  - Section 1.2.1:** Operating Costs
  - Section 1.2.2:** Other Costs
  - Section 1.2.3:** Cash-Flow Accounting
- Section 1.3:** Revenue Spreadsheet
- Section 1.4:** Comparing Revenues and Costs
- Section 1.5:** The Importance of Incubator Cash Flow

## COMPONENT OBJECTIVES

This component is designed to (1) guide the trainee through setting up a spreadsheet, outlining pre-operating costs, operating costs and revenues in order to identify the financing needs of the organization, and to (2) enable the trainee to master the financial dynamics of managing a business incubator.

At the completion of this component, trainees should have a thorough understanding of the costs and revenues of a business incubator and the investments required to cover these.

## Section 1.1: Investment Spreadsheet

Incubator managers are advised to use an investment spreadsheet to collate and assess financial information regarding the uses and disbursement periods for investments needed to develop an incubator.<sup>5</sup> For the purpose of this module, disbursement refers to any payment made by the incubator. These investments will most likely aim at covering the costs incurred by activities such as: running a feasibility study, building and/or establishing the incubator's physical location, the purchase of the initial business equipment, as well as the initial operational and staff recruitment costs until the management team has defined and earned the revenues required to cover the daily operational costs of the incubator.

**The incubator manager is advised to use the following six critical breakdowns when constructing an investment spreadsheet:<sup>6</sup>**

1. Pre-operating expenditures;
2. Physical facilities;
3. Equipment;
4. Human Resources;
5. General expenditures; and
6. Reserves.

Doing so will ensure that investments are properly monitored without overlap and with sufficient detail.

**1. Pre-operating Expenditures:** This category should cover disbursements prior to the incubator's establishment on site, such as a feasibility study or use of legal services and any other applicable professional services.

**2. Physical Facilities:** This category should encompass disbursements required for the adaptation and/or construction of the physical facilities of the incubator. Some examples of such costs may include construction costs of a new building or modification of an existing space.

**3. Equipment:** The equipment category includes disbursements required for the purchase of items that are necessary to start-up and continue the activities of the incubator. Such costs may include furniture, computer and copy machine purchases.

<sup>5</sup> Source: *infoDev* - Financial Management - <http://www.idisc.net/en/Article.170.html>

<sup>6</sup> Note: The following breakdown is, with slight modification, from: *infoDev* - Financial Management - <http://www.idisc.net/en/Article.170.html>

**4. Human Resources:** This category is designed to list all the expenditures made by the incubator in relation to its staff, including possible recruitment costs and consultancy fees. For the second and third years, it is also recommended to take into account possible increases in the number of staff, so that they might deal with the greater number of clients.

**5. General Expenditures:** This category may serve as a miscellaneous grouping. It can include expenditures that may be required for the implementation and establishment of the incubator.

**6. Reserves:** This category is vital to the incubator. It is the amount set aside to build up cash reserves in case unexpected expenditures are required or if revenue falls short of projections.

Figure 2 provides an example of such a spreadsheet. As an incubator manager, keeping spreadsheets like this is vital to efficient financial management. The total investment expenditures are added from the five categories. The reserves are not included, as the funds will not be disbursed, but rather maintained for the incubator at a later stage.

	YEAR 1			YEAR 2			YEAR 3		
	Predicted	Actual	Variance	Predicted	Actual	Variance	Predicted	Actual	Variance
<b>Pre-operating</b>									
<b>Expenditures</b>									
Feasibility study									
Real estate agency									
Legal services									
Licenses and Permits									
Consultancy Fees									
Etc.									
<b>Physical Facilities</b>									
Building purchase (loan or lease payment)									
Building decorating/ remodeling									
Fixtures and Fittings									
Etc.									
<b>Equipment</b>									
Furniture									
Computers and printers									
Telecommunication Equipment (Ethernet, routers, etc)									
Fax/ Photocopier									
Desks									
Seating									
Etc.									
<b>Human Resources</b>									
Recruitment									
Wages									
Consultancy Fees									
Social Security Costs									



Staff Training									
<b>General Expenditures</b>									
Adversiting									
Insurance									
Maintenance									
Telecommunications									
Supplies									
Banking Services									
Utilities									
Etc.									
<b>Total Disbursed</b>									
<b>Investment</b>									
<b>Reserves</b>									
Reserve Fund									

**Figure 2 – Investment Spreadsheet**

## Section 1.2: Cost and Expenditure Spreadsheet

After the incubator is established, managers will want to monitor all costs and expenditures that occur. The Cost and Expenditure Spreadsheet is critical to understanding where the incubator's funds are going and where they are needed. The spreadsheet is, in essence, a marker of the incubator's financial outflows and crucial for sound management. The spreadsheet should be kept accurately and updated on a monthly basis.

**Incubators will experience several different costs and expenditures that can be commonly categorized by the following:**

- Operating Costs; and
- Other Costs.


### Section 1.2.1: Operating Costs

Also called on-going costs, operating costs are normally expenses that occur on a regular basis, such as employee salaries, utilities, office rent and supplies. They are simply the day-to-day expenses due to running the incubator.

The most common operating costs for an incubator include:

- **Staff:** Staffing is normally one of the highest costs of a business incubator. Within the staff costs, the incubator has to account for the salaries of the incubator's management and other staff, including outsourced expertise such as human resource functions, legal advice, accountancy functions, and the related social security/retirement benefits, and medical aid payments. (Social security payments are often a percentage of the salaries, and are paid to the state.)
- **Utilities and Fuel:** Utilities and fuel include the electricity, water, and gas (or other such fuel) and security. If there is a sewage treatment cost, this would be included under this operating cost. The utilities and fuel costs are significantly impacted by the type of companies that are incubated. Technology based companies will, on average, cause the incubator to have higher utilities and fuel costs compared to non-technology companies, for instance due to laboratory and manufacturing equipment that may be required.
- **Transportation:** Transportation refers to the use of a vehicle, taxi, train or airplane in order to conduct activities in support of the incubator.
- **Rent:** This operating cost refers to the rental of space. If the incubator has invested in real estate, then the real estate investment is a capital investment that would be tracked by the Investment Spreadsheet.

- **Insurance:** Insurance would include coverage on business property and products with regard to fire, liability, worker’s compensation, and so on. A decision should be made as to whether this should also cover the property belonging to the incubatees.
- **Information and Communications Technology:** Communications costs include office and mobile telephones, internet, and video conferencing usage costs.
- **Publicity, Communications and Advertising:** To attract new incubatees to use the incubator and to distribute information on the successes of the incubatees and profile them, many incubators will incur ongoing publicity and advertising expenditures.
- **Entertainment:** Entertainment may include costs associated to an incubator manager attending social events or hosting targeted individuals in order to attract investors and business opportunities for the incubator or its incubatees.
- **Rental equipment:** In many cases the incubator manager may decide it is more cost effective to rent equipment rather than purchase it. This could include computers, printers, copiers, and furniture.
- **Repairs and Maintenance:** This would include large costs such as painting, decorating and the repairing of broken equipment.
- **Business Materials:** It is likely that incubators will require business materials such as stationery and related products to operate. The costs of such materials are included in this category.



Note: Loans are not a good way to finance a business incubator, which should be apparent if budgeting is realistic.

### Section 1.2.2: Other Costs

Other costs are often variable costs that cannot be easily attributed to the operating costs, such as taxes. It is important to identify these costs, estimate and record them. For instance, depreciation, loans and interest rates from time saving deposit or negotiated with banks generate other costs that must be recorded using standard accounting principles. When establishing income statements, as well as cash flow budgets, depreciation must be taken into account.

### Section 1.2.3: Cash-Flow Accounting

In this component we focus on the cash costs of the incubator. More sophisticated accounting systems employ a methodology in which the date at which a cost is incurred is important, for example the date in which the incubator receives an invoice from its telephone provider. To keep our basic concepts of monitoring costs as simple as possible, we will only record the cost on the date that the incubator actually pays, for example when the incubator pays its telephone provider that may be after the invoice is received. This simple methodology can be termed “cash flow accounting”.

Figure 3 is an example of a Cost and Expenditure Spreadsheet with the cost categories discussed shown on an annual basis. As an incubator manager, it is important to track the costs per year to understand which cost items are increasing and might require closer attention and monitoring. It is also possible to use different time periods, for instance recording costs and expenditures on a monthly or quarterly basis.

	YEAR 1	YEAR 2	YEAR 3
<b>OPERATING COST</b>			
<b>Staff</b>			
Management salaries			
Other salaries			
Social security payments			
Training			
Outside services (e.g. consultants)			
Etc.			
<b>Utilities and Fuel</b>			
Electricity			
Water			
Gas			
Security			
Etc.			
<b>Transportation</b>			
<b>Rent</b>			
<b>Insurance</b>			
<b>Information &amp; Communication Technology</b>			
Telephone			
Internet			
Etc.			
<b>Publicity, Communications and Advertising</b>			
<b>Entertainment</b>			
<b>Rental Equipment</b>			
<b>Repairs &amp; Maintenance</b>			
<b>Business Materials</b>			
Paper			
Other stationary			
Etc.			
<b>Total Operating Costs</b>			
<b>OTHER COSTS</b>			
Taxes			
Etc.			
<b>TOTAL COSTS</b>			

**Figure 3 – Example of an Annual Cost and Expenditure Spreadsheet**

## Section 1.3: Revenue Spreadsheet

The Revenue Spreadsheet measures the funds that the incubator is bringing in. Similar to the Cost and Expenditure Spreadsheet, it is critical that an incubator manager keeps the Revenue Spreadsheet updated, as it is important to understand changes in revenue over time. For instance, by keeping track of the revenue, the incubator manager can identify sources of revenue that may be decreasing and manage the impact this will have on the incubator.

In the same way as with the monitoring of costs and expenditures, to keep our discussion of monitoring revenues as simple as possible, we will record the revenue at the time at which the incubator actually receives the revenue, for example when an incubatee pays its rent to the incubator, thus focusing on actual cash flow.

**It is advisable that a Revenue Spreadsheet has at least two separate categories that identify the source of the revenues:**

- Incubator Generated; and
- Third-Party Generated.

The revenues directly generated by the incubator are kept separate from the revenues which result from outside sponsorships or incentives (third parties). This is important because by separating these revenues, a manager can see how much revenue the incubator is bringing in on its own. Generating its own revenue is a more stable way for an incubator to operate in the long-term than bringing in outside funding.


Figure 4 shows the revenues on an annual basis. It is also possible to use different time periods, for instance recording revenues on a monthly or quarterly basis.

REVENUES	YEAR 1	YEAR 2	YEAR 3
<b><i>Incubator Generated</i></b>			
Rent from incubatees			
Consultancy services			
Royalty agreements			
Etc.			
<b>Total Incubator Generated Revenue</b>			
<b><i>Third Party Generated</i></b>			
Government Grant			
International Development Agency Grant			
Corporate Sponsorship			
Etc.			
<b>Total Third Party Generated Revenue</b>			
<b>TOTAL REVENUE</b>			

**Figure 4 – Example of an Annual Revenue Spreadsheet**

## Section 1.4: Comparing Revenues and Costs

Once the incubator manager is able to track costs and revenues, it is beneficial to compare the two, as illustrated by Figure 5.



Note: As indicated previously, items such as depreciation and loan payments are not discussed in great detail. Nonetheless, these can have a significant impact on the incubator's overall earnings and would need to be determined for a more sophisticated analysis. It is advised that trainees refer to the Business Edge and SME Toolkit materials in order to understand balance sheets, income and cash flow statements in further detail, and get a more thorough understanding of how these may affect an incubator's performance.

	YEAR 1	YEAR 2	YEAR 3
<b>Incubator Generated Revenue</b>			
Rent from incubatees			
Consultancy services			
Royalty agreements			
Etc.			
<b>Total Incubator Generated Revenue (A)</b>			
<b>Third Party Generated Revenue</b>			
Government Grant			
International Development Agency Grant			
Corporate Sponsorship			
Etc.			
<b>Total Incubator Generated Revenue (B)</b>			
<b>TOTAL REVENUE (C=A+B)</b>			
<b>Operating Costs</b>			
Staff			
Utilities and Fuel			
Transportation			
Rent			
Insurance			
Information & Communication Technology			
Publicity, Communications and Adversiting			
Entertainment			
Rental Equipment			
Repairs & Maintenance			
Business Materials			
Other Operating Costs			
<b>Total Operating Costs (X)</b>			
<b>Other Costs (Y)</b>			
<b>TOTAL COSTS (Z=X+Y)</b>			
<b>NET PROFIT (CASH FLOW) (C-Z)</b>			

**Figure 5 – Example of an Annual Comparison of Costs and Revenues Spreadsheet**

Spreadsheets can also be used to show predicted financial performance, for instance to help the incubator manager to predict revenues and sources of revenues for the following year(s). Such projections are critical to business planning. Nonetheless, projecting revenues and costs is a difficult undertaking. Managers are met with many difficulties in making accurate predictions.



**Such difficulties include:**<sup>7</sup>

- **Forecasting:** When starting a business, it is hard to forecast the income and expenditures resulting from some activities, for instance because the manager may not have the specific market knowledge to develop accurate forecasts.
- **Uncertainties:** Business, like life, is not predictable. Uncertainties in business outcomes, demand and many other factors make predicting future revenues and costs difficult.
- **Risk:** All business-like organizations are subject to risks. These may include incubatees delaying payment on their bills for rent or incubator services, or an incubatee may fail and leave the incubator with unpaid charges. A common scenario is when public subsidies are not received on time. If the incubator is dependent on these subsidies, these late payments can cause a significant cash flow problem for the incubator.

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<sup>7</sup> Note: The following points are adapted from: *infoDev* -Financial Management - <http://www.idisc.net/en/Article.170.html>

## Section 1.5: The Importance of Incubator Cash Flow

Cash flow is essential to all business-like organizations. There are many businesses that appear profitable “on paper”, but experience financial problems because they fail to adequately monitor the actual flow of cash in and out of the organization. For example, if an incubatee does not pay its rent when it is due, then the incubator may not have sufficient funds in its account to repay loans to the bank or pay utility bills.

Constant monitoring of cash flow allows the incubator manager to identify potential hazards early on, to make alternative plans to bring in more cash or cut certain expenditures. This helps to guide the incubator towards financial success. In essence, managers who monitor cash flow can promote the financial sustainability of the incubator by identifying problems early and finding timely solutions. By properly and diligently analyzing the incubator’s cash flow, a manager will thus improve the possibility that the incubator succeeds.

### Successful analysis requires that a manager:<sup>8</sup>

- Monitors the overall financial performance and consequently is aware of progress towards financial sustainability;
- Monitors the accounts payable (the incubator’s obligations to pay what it owes to others) and accounts receivable (amounts owed by incubatees or other entities to the incubator) on a regular basis;
- Develops a strategic approach for controlling bank balances, reserves, and investing funds; and
- Requires all operational areas to be familiar with their activities, needs and responsibilities.

If a manager does the above, financial management can become a smooth process of regular updates and analysis. This daily work keeps a manager aware of the incubator’s needs and alert for potential trouble. If a manager notices financial trouble ahead, such as a shortage of funds, they can act to rectify the situation.

<sup>8</sup> Note: The following points are adapted from: *infoDev* -Financial Management - <http://www.idisc.net/en/Article.170.html>

Options available to a manager with a well-managed and well-maintained financial monitoring and evaluation system include:<sup>9</sup>

- **Injecting funds from a reserve account:** Managers can use the reserve account to provide the incubator with badly needed cash in the event of an imminent need.
- **Postponing commitments:** Managers can delay the execution of contracts or begin scaling back certain peripheral services.
- **Bringing projects forward:** Managers can move the timetable forward on a project that will bring in funds.
- **Drawing up alternative strategies:** Managers can update the incubator's business model to account for the unexpected circumstances, by changing the revenue model for instance.

Note: It is important to remember that these actions will be likely to have an impact on expenditures and revenues. Managers should thus update the relevant spreadsheets to allow for this impact.



<sup>9</sup> Note: The following points are adapted from: *infoDev* -Financial Management - <http://www.idisc.net/en/Article.170.html>

## COMPONENT CONCLUSIONS

As an organization that should be run with an entrepreneurial mindset, understanding the fundamental basics of financial management is critical for the success of a business incubator.

An incubator manager who is able to master key financial data such as costs, expenditures, revenues and investments related to the organization, through tools such as spreadsheets, will be able to compare the revenues against the costs generated by the incubator's activities.

This has to be done in the perspective of identifying any funding gaps and adequately managing the lifeblood of the incubator, for example the cash flow.

A thorough understanding of the incubator's financial dynamics is the first and foremost important aspect to master in order to be able to understand the various sources of funding available and to choose the most adequate to meet the incubator's financing needs.

## Component 2 (Part 1 Training):

Understanding the Various  
Financing Sources Available  
to Fill the Funding Gap



## COMPONENT INDEX

### **Section 2.1:** Initial Capital Investment (how much and where from?)

#### **Section 2.1.1:** Securing the Incubator's Building

#### **Section 2.1.2:** Sources of Initial Capital Investment According to the Nature of the Incubator

### **Section 2.2:** Grant/ Donor Financing and Sponsorship

#### **Section 2.2.1:** Grants

#### **Section 2.2.2:** Sponsorship

### **Section 2.3:** Debt Financing

#### **Section 2.3.1:** Commercial Loans

#### **Section 2.3.2:** Subsidized Loans

### **Section 2.4:** Equity Financing

### **Section 2.5:** Revenue from Incubated Enterprises

#### **Section 2.5.1:** Rental Fees

#### **Section 2.5.2:** Consulting Services

#### **Section 2.5.3:** Profit Sharing Agreements

## COMPONENT OBJECTIVES

This component is designed to explore three aspects with the trainee, (1) the capital needed to establish an incubator and support the starting of its activities, (2) three sources of incubator funding, and (3) how to generate revenue with a focus on the possibilities of producing income from incubated enterprises.

At the completion of this component, trainees should understand the costs associated with the establishment and running of an incubator, ways to acquire the necessary resources and how to gain revenue from incubatees.

## Section 2.1: Initial Capital Investment (how much and where from?)

As explored in Module 3 on “Planning an Incubator”, the feasibility study should also aim at identifying the available resources in the incubator’s area and those required for its establishment. Once the decision to go ahead with the incubator has been made, this information may contribute to its successful establishment and initiation of activities. Identifying the amount of financing needed and the means by which this will be achieved is critical to making the decision on establishing an incubator or not. For example in cases where there are not enough resources available to establish and appropriately run the incubator, the idea should be re-considered.

At the start-up stage, a business incubator does not only need financing for capital investments. It also needs financing to cover operational costs until the incubator has earned the required revenues to cover its operational costs. Hence, the incubator’s development team must prepare a business plan that identifies and estimates the various capital investments<sup>10</sup> and revenues<sup>11</sup> against the incubator’s estimated ongoing costs.<sup>12</sup>

The total initial capital investment should include sufficient funds to allow the incubator to operate in its early months when it is still building its initial client base.

### The capital investment required may vary significantly based on several factors:

- The overall objectives of the incubator;
- The sector(s) targeted, for example agro processing incubates may require refrigeration space and outsourcing incubatees may require broadband and large server capacity;
- The targeted number of incubatees; and
- The location of the property.

*infoDev* commissioned a Monitoring Evaluation and Impact Assessment Study<sup>13</sup> that “chronicled the outcomes, impacts and lessons learned from *infoDev*’s Incubator Initiative and, more generally, the

<sup>10</sup> Note: Capital investments are normally one-time expenses such as office furniture, equipment, and real estate. The total initial capital investment should include sufficient funds (operational expenses) to allow the incubator to operate in its early months when it is still building its initial client base.

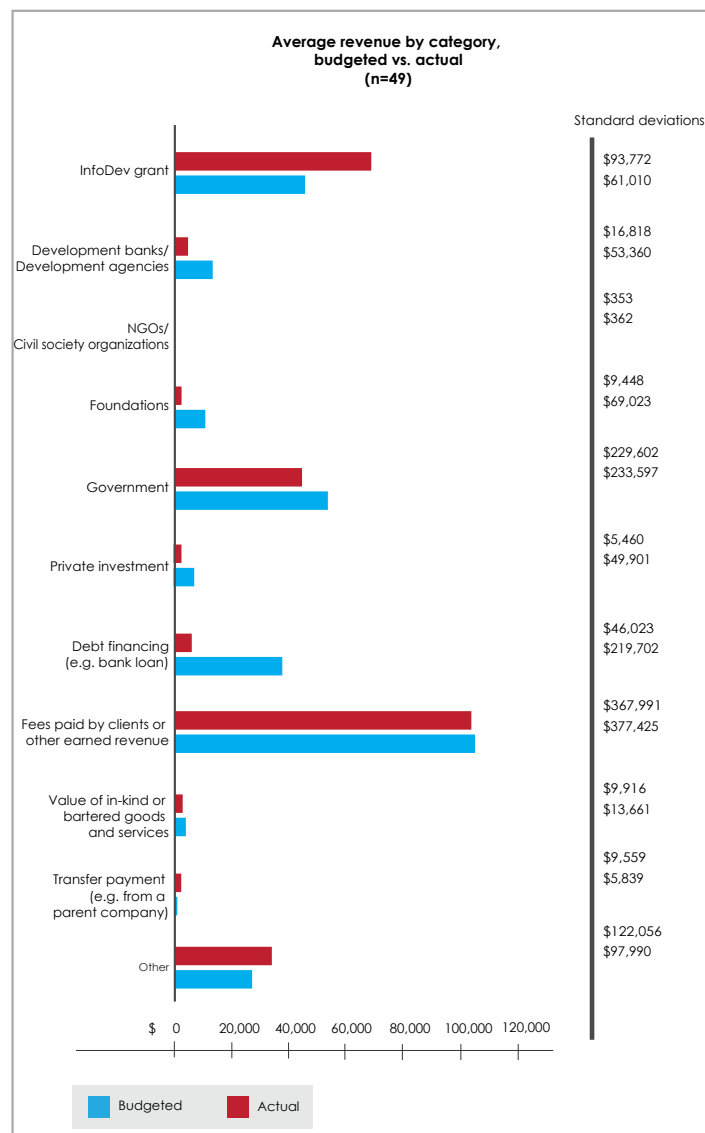
<sup>11</sup> Note: Revenues refer to the income generated by the business incubator’s activities.

<sup>12</sup> Note: Ongoing costs (also called operating costs) are normally expenses that occur on a regular basis such as employee salaries, utilities, and office rent and supplies. They are simply the day-to-day expenses due to running the incubator.

<sup>13</sup> Source: *infoDev* - Monitoring, Evaluation & Impact Assessment Study - <http://www.idisc.net/en/Page.MEIA.Study.Overview.html>

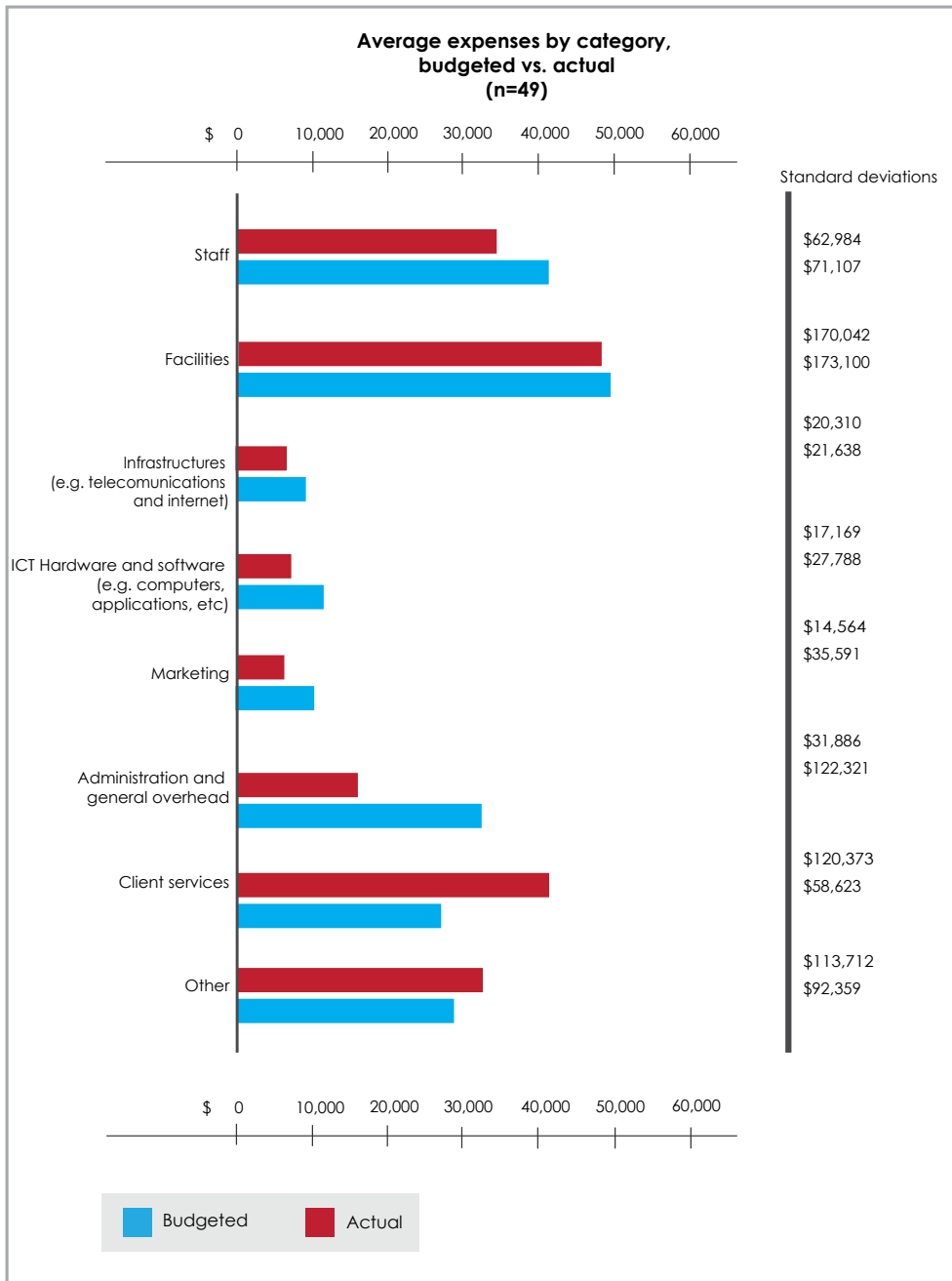


work of its business incubation grantees. The assessment team was asked to determine the broad relevance, effectiveness, efficiency and sustainability of infoDev’s support for business incubators, as well as the performance lessons that can be learned about how business incubation fosters entrepreneurship and innovation.” Within the framework of this study, infoDev established relevant statistics from its network of early-stage incubators based in developing countries. “Grantees were asked about organizational sustainability and risks, and how they are mitigating them. Grantees most often cited a lack of financial resources as their biggest risk. There were a number of different ways of managing this risk including diversifying revenue sources and increasing the amount of earned revenue. 27% of grantees indicate that more than 75% of their revenue is earned and 16% indicated that this amount is between 1-10%.”<sup>14</sup> The relevant graphs are reproduced over the following pages.



**Figure 6 – infoDev Grantee: Average Revenue by Category (actual vs. budgeted)**

<sup>14</sup> Source: infoDev - Monitoring, Evaluation & Impact Assessment Study - <http://www.idisc.net/en/Page.MEIA.Study.Overview.html>



**Figure 7 – infoDev Grantee: Average Expenses by Category (budgeted vs. actual)**

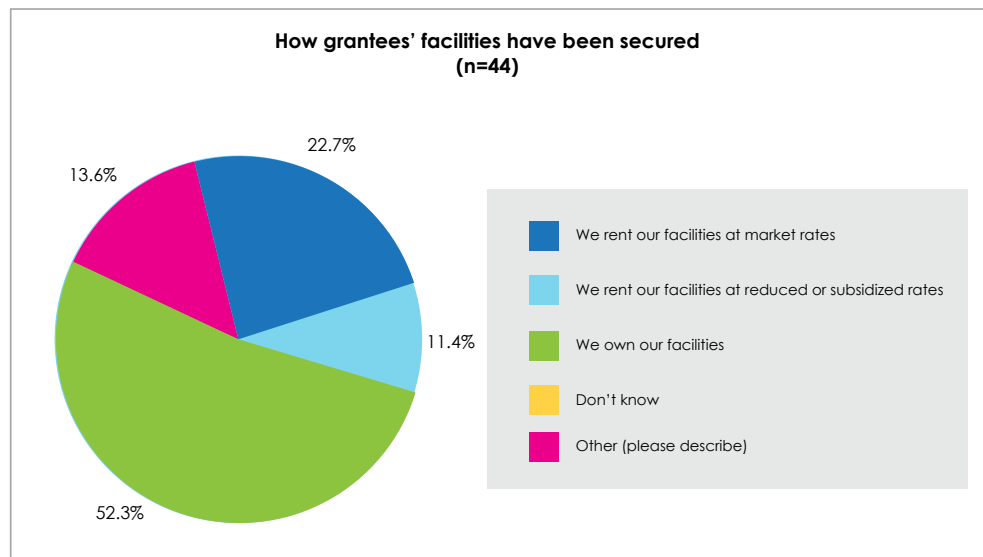
Section 2.1.1: Securing the Incubator’s Building



Note: Building and facility related issues are explored in greater detail in Module 3 “Planning an Incubator” of the current training program.

The incubator’s building is usually the highest capital expense for which different financing mechanisms exist. The *infoDev* MEIA study establishes the most

helpful indicators on the different financing mechanisms used by their grantees in order to secure their building, as represented in Figure 8.<sup>15</sup>



**Figure 8 – infoDev Grantees: Ways to Secure Facilities**

Owning the building represents advantages for a business incubator. The main advantage is that there is no debt or rent attached. If the incubator facility is of the necessary size, it is a good source of rental revenue, which can make the incubator financially self-sufficient. However, as soon as the incubator pays commercial rent or has to pay the capital cost, this advantage is lost. There are many examples. TREC-STEP<sup>16</sup> in India, for example, had their facilities paid for with Government funds. Another example is the Ayala Foundation Inc (AFI)<sup>17</sup> in the Philippines which got its facilities paid for through a deal with developers and the University of the Philippines. A negative experience is the case of the Technology Innovation Center<sup>18</sup> in Jamaica, which has a new building of adequate size, paid for by a multi-million dollar loan from the Caribbean Development Bank that it cannot afford to repay. As it is to be expected, this issue is causing endless problems for the incubator that is not in a good position to carry on its activities.

Note: There is a difference between the ownership of a building and the contractually secured right to use (part of) a building.

Another advantage worth mentioning includes the flexibility in making use of the building without having to go through the hurdles of negotiating with third-parties. While governments in developed countries can

Note: A “building for free” is not a “must” for incubator sustainability, but it can/will make the development of an incubator much easier, increasing the chance of reaching sustainability.

<sup>15</sup> Source: infoDev - Monitoring, Evaluation & Impact Assessment Study - <http://www.idisc.net/en/Page.MEIA.Study.Overview.html>  
<sup>16</sup> Source: Tiruchirappalli Regional Engineering College - <http://www.trecstep.com/>  
<sup>17</sup> Source: Ayala Foundation - <http://www.ayalafoundation.org/default.asp>  
<sup>18</sup> Source: Technology Innovation Centre, Jamaica - <http://www.ticjamaica.com/>

often provide a disused building at no cost, this is far more difficult in a developing country where disused buildings are far harder to find, especially if they are in a reasonable location. This point needs to be stressed as there are major differences between developing and developed countries. There are examples of incubators that obtained government financed buildings (not necessarily old unused ones), such as the BIC from Bahrain.<sup>19</sup> As for paying the capital cost for a new building, such as that for TREC-STEP in India or the Shanghai Innovation Center<sup>20</sup> in China, only a minority of developing country governments can afford the expense.

From a government perspective, the advantage of giving a building (ownership and/or right to use) to an incubator is that the government “buys out” the need to provide continuous support to an incubator, instead the incubator uses the rental income to cover its operating costs created through its business incubation services. If the building/space is large enough and the term is long enough, this really can be a basis for developing a sustainable incubator.

**Real life creates many variations of the above principle:**

- The incubator covers an increasing portion of the building costs year after year;
- The incubator can buy the building by paying an increasing amount year after year;
- The incubator may pay an increasing rent for the space used until commercial rent level is reached; and
- There are also “mixed” models where the government provides land and the private investor provides the building with mixed use part of the building for incubators, such as the BusyInternet model in Ghana that follows the same model as the BIC Bahrain except that in this case the investment for the building is made by the governmental development bank.

It should also be mentioned that paying for the building requires many years, normally between 10 and 20 years.

Additionally, the incubator building needs to be of a sufficient size, usually a few thousand square meters (sqm) rather than a few hundred, to make such a model work. Often in trying to find ‘free’ buildings in developing countries, compromises are made on buildings that are far too small to ever generate adequate rental revenues or that are in a terrible location.

If royalty and equity are planned as the main revenue streams in the future to underpin sustainability, then ‘free’ buildings are not so important. Incubator finance that is linked with the business success

<sup>19</sup> Source: BIC BAHRAIN - <http://www.bbicbahrain.com/>

<sup>20</sup> Source: Shanghai Technology Innovation Center - <http://www.tic.stn.sh.cn/en/>

<sup>21</sup> Source: Busyinternet - <http://www.busyinternet.com/>

of its clients is a logical and better option; although, the equity model has its obstacles, not just in developing countries. As for royalty models, there are currently not too many successful examples available. This will be explained in more detail in the following sections of this component.

Besides governments, universities are often in a position to provide or pay for new buildings.

**The reasons for such an investment could be to:**

- Help commercialize research, but this is rare in a developing country;
- (More likely): Position and brand the university in the innovation and entrepreneurship local ecosystem, particularly to attract more paying students as seen by the Lighthouse Innovation Center at the Sunshine Coast University in Australia;<sup>22</sup>
- Help forge relationships with the private sector and make academics more business oriented;
- Help graduates start businesses, such as the PSG-STEP and the Vellore Institute of Technology Incubator<sup>24</sup> in India; and
- Enrich the teaching experience with internships in the incubator companies, for example the Environment and ICT Cluster incubators in San Jose<sup>25</sup> are heavily supported by San Jose State University to create internship opportunities for higher level students.

Often this is done in the context of planning to develop a Science or Technology Park for which an incubator might be the first step, as is the case with the Lighthouse Innovation Center at the Sunshine Coast University in Australia. Universities can make, or enlarge, space available rent free, or at low rents. The University of Al Akhawayn<sup>26</sup> in Morocco is a good example of a business minded university that made some space available in new buildings to host an incubator.

**Section 2.1.2: Sources of Initial Capital Investment Against the Nature of the Business Incubator**

Depending on the nature of the incubator, each incubator will have a different level of required initial capital investment influenced by the entrepreneurship and innovation ecosystem it operates in, as well as the services it offers to incubatees that may require specific equipment and operational means.

**Not-for-profit incubators** imply that shareholders do not generally expect to gain financial profits from the incubator. The not-for-profit business incubators can be profitable, but they re-invest their profits in the business incubator.

<sup>22</sup> Source: Innovation Centre Sunshine Coast - <http://www.innovation-centre.com.au/>

<sup>23</sup> Source: PSG – Science & Technology Entrepreneurial Park - <http://www.psgstep.com>

<sup>24</sup> Source: Technology Business Incubator, Vellore Institute of Technology - <http://www.vittbi.com/>

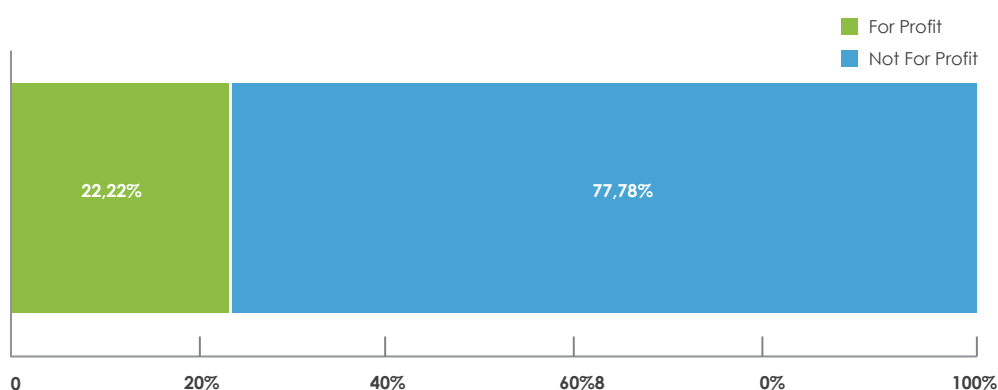
<sup>25</sup> Source: Environmental Business Cluster - <http://www.environmentalcluster.org/>

<sup>26</sup> Source: Al Akhawayn University - <http://www.aui.ma/>

**For-profit incubators** aim to maximize their return on investment. The shareholders expect to gain financial profits from the incubator's activities. For-profit does not mean that these incubators do not utilize public finance. Some are profitable only because they receive public funds.

In general, for-profit incubators are a very small percentage of the global incubator community. For example, in Germany they represent less than 3% of incubators, while in the Middle East and North Africa they comprise only 4% of incubators. Throughout *infoDev*'s network, a total of 37 incubators of 280, or 13% were found to have for-profit models.<sup>27</sup>

To emphasize this statement, it is interesting to look at the EBN 2008 data, which recorded that among the 14% of incubator members of the network that reported to be privately-held, almost 78% of them were not-for-profit, meaning that they reinvested the profits in the incubator's activities.



**Figure 9 – Nature of Private Incubator Members of EBN<sup>28</sup>**

Table 1 presents the most-likely sources of initial capital investment according to the nature of the business incubator:

SOURCE OF FUNDING	NOT-FOR-PROFIT INCUBATOR	FOR-PROFIT INCUBATOR
Private Grants	X	
Local Private Investment		X
Corporate Social Responsibility	X	X
Government Subsidies	X	
Multilateral Programs	X	X
Non-Governmental Organizations Financing Mechanism	X	
Debt Financing		X
In-kind Financing	X	X

**Table 1 – Sources of Business Incubator Initial Capital Investment**

<sup>27</sup> Data derived from: *infoDev* - Africa - <http://www.idisc.net/en/Region.1.html>

<sup>28</sup> Source: European Business and Innovation Centre Network - BIC Observatory 2009 - The BIC Network in 2008: Facts and Figures - <http://quality.ebn.be>

**Private Grants** can come from a wide range of entities that include private citizens and corporations. They are usually awarded by benefactors and philanthropists to entities perceived as valid contributors to the welfare and development of a community. In this regard, university incubators and non-profit incubators are usually more-likely candidates to be funded by private grants.

**Local Private Investment** comes primarily from companies or wealthy individuals interested in making a return on their investment or taking advantage of developed services or technologies. This form of investment, when available, can be interesting for incubator client businesses.

**Corporate Social Responsibility** is the deliberate inclusion of public interest into corporate decision-making. It focuses on adherence to law, ethical standards and international norms, and includes the promotion of public interest by encouraging community growth and development, voluntarily eliminating practices that could negatively affect these aspects. Initiatives can take many forms, such as training programs and activities for improving qualification levels, contribution to sustainable development by adopting environmentally responsible practices, promotion of equality and non-discrimination, or a policy of honoring commitments with local suppliers and clients that include business incubators. Corporate social responsibility, in this context, aims at developing the business and entrepreneurial climate of the local environment in the long run through such activities.

**Government Subsidies** refer to public funding for economic and other development purposes of public interest, often facilitated and distributed through local, regional, or national government agencies. These agencies frequently have an interest in creating jobs and local community development, upgrading skills, and retaining their human capital (stemming the tide of brain drain). In some countries, the government strongly supports incubation through different programs, such as in New Zealand, India or South Africa.

- The New Zealand Trade and Enterprise Incubation program defined a high growth incubation strategy at the beginning of the year 2000. In this strategy New Zealand Trade and Enterprise would provide funding to 10 incubators over a 10 year period, after which they should be self-sufficient. In the implementation of this strategy, the average funding provided per incubator is of USD 220,000 per annum awarded through annual competitive funding rounds that focus on the growth of companies. The vision of the strategy is to make the business incubators a key part of the economic development infrastructure to help improve the economic situation in New Zealand through the creation of new, high growth businesses.
- The National Science & Technology Entrepreneurship Development Board (NSTEDB), established in 1982 by the Government of India, is an institutional mechanism to help promote knowledge-based and technology-driven enterprises through different institutional mechanisms for entrepreneurship development, such as Technology Business Incubators (TBIs).<sup>30</sup> The host institution has to play an important role not only in the establishment of the TBI project, but also in its smooth and efficient functioning. Only those institutions/ organizations that can provide land and buildings for TBIs, and are also willing to share

<sup>29</sup> Source: New Zealand Trade and Enterprise - <http://www.nzte.govt.nz>

<sup>30</sup> Source: Technology Business Incubator, India - <http://www.nstedb.com/institutional/tbi.htm>

available facilities and expertise, would be considered for setting up of the TBI. Other related and interested agencies can also be involved as sponsors. The TBI should itself represent a dynamic model of sustainable business operation and generate revenue as well as profits. Each TBI should prepare a detailed project proposal and work out the cost, based on current requirements. A project implementation schedule may be prepared covering the key activity of the project. Each TBI is expected to become self-sufficient within a period of five years from the date of project approval. The TBI should, however, start generating revenue from the very first year of its operation.

- **The SEDA Technology Program (STP)**<sup>31</sup> in South Africa provides funds to 18 out of the 28 Business Incubators or Technology Business Centers (TBC). STP funding varies from as little as USD 65,000 to as much as USD 780,000 per annum. The average funding per center is estimated to be USD 325,000.<sup>32</sup> The funds are mainly used for operational costs and include salaries for the center's personnel. The period of funding is not fixed and funds are distributed annually based on business plans submitted each year and taking into account its track record. Funding is also made available on request/ application for "special projects", such as the expansion of facilities.<sup>33</sup>

**Multilateral Programs** refer to programs supporting international or cross border development, which can include entrepreneurship, for example. In comparison with bilateral programs that are based on a bilateral relationship between one donor and one beneficiary nation, multilateral programs are managed by groups of countries, multi donors supporting several beneficiary nations. Multilateral donors are often financial institutions that provide financing for national development. The best-known multilateral donors are development banks like the World Bank, the African Development Bank, the Asian Development Bank, the Inter-American Development Bank and the European Bank for Reconstruction and Development. Many of these banks belong to groups that include other institutions with specific missions and objectives. For example, with regard to private enterprise financing, the World Bank Group possesses the International Finance Corporation, while the Inter-American Development Bank includes the Inter-American Investment Corporation. Both institutions offer loans and grants to private sector stakeholders in developing countries to assist them in developing their businesses.

**Non-Governmental Organizations Financing Mechanisms.** Non-governmental organizations (NGOs) often have the objective to promote and stimulate development, entrepreneurship and the creation of wealth in developing countries, while supporting their goals with financing mechanisms. If the incubator has similar objectives, an incubator manager may find such organizations to be of interest as a potential source of financing for the incubator. These institutions may include foundations, such

<sup>31</sup> Source: SEDA – Small Enterprise Development Agency - <http://www.seda.org.za/>

<sup>32</sup> Note: Indicative amounts calculated on the basis of the average conversion rate between South African Rand and American USD of April 2010.

<sup>33</sup> Adapted from Julian Webb and Leon Lourens, "Country Incubator Policy Case Study – South Africa", p. 5



as the Bill & Melinda Gates Foundation, or in a more specific area the International Foundation for Entrepreneurship Science and Technology. Many NGO's exist all over the world, covering most fields of action and intervention areas. To search for the one that best serves an incubator's purposes, the incubator manager can check the link below that provides access to numerous NGO grant makers across the globe.

Link: <http://www.foundationcenter.org/getstarted/topical/international.html>

For some regions of the world, websites are available for a quick search.

- In Africa: <http://www.africagrantmakers.org/index.asp?PageURL=24>
- In Europe: <http://www.efc.be/>
- In Latin America and the Caribbean: <http://www.indicedonantesal.org>

**Debt Financing** refers to the acquisition of capital by a firm that signs a promissory note requiring the repayment of the principal amount plus a payment of interest. Debt financing through the banking industry is possible if the incubator or incubatee can demonstrate sources of revenue.

**In-kind financing** gathers all types of donations, for instance a building, furniture, equipment and the availability of services at subsidized rates such as internet, telecommunications, training, technical advice and mentoring.

Essentially, managers should remember that financing options are there and they are available, it is just a matter of knowing where and how to look. When it comes to financing, it is always advisable to explore all your options. The financing instruments discussed above may be of great importance for business incubators in developing countries, but relying on them too much can lead to financial difficulties, as their availability in the long-term is unpredictable. Therefore, it is absolutely essential that business incubators seek revenue streams, as well as financing to reach sustainability.

## Section 2.2: Grant/Donor Financing and Sponsorship

A potential way incubators can raise funds is through grants and sponsorships.

### Section 2.2.1: Grants

Grants refer to a transfer of funds to a venture without requirement of repayment, but with conditions, often in order to support the venture in advancing the objectives of the grantee. Grants are usually one-time transfers of funds and can come from many sources. Government agencies, foundations and corporations are good potential sources of grants.

In exploring the possibility of obtaining a grant as a means of raising funds for the incubator, it is first necessary to find a suitable donor, an entity that gives grants, which has an interest, mission, and/or objective related to the incubator's goals. For example, an incubator that supports women entrepreneurs would do well to approach government agencies that deal with equal opportunities, commerce and/or labor. Foundations that were set up specifically to promote women in business

should also be approached. Private companies that sell products primarily to women would be another potential source.



Note: Grants can be difficult to win. Donors are, after all, giving free funding. Because of this difficulty, it is not ideal to rely solely upon grants for initial investments in an incubator. A good alternative is to pursue a number of grants while also keeping other funding options open.

When seeking a grant, it is critical to stress how the donor will benefit from the grant. Examples of such benefits include supporting the donor's mission, creating jobs, creating linkages to government, supporting the transfer of technology, helping to transfer "innovation" into the local business community and generating good press and goodwill.

### Section 2.2.2: Sponsorship

Having a sponsor is a good way for an incubator to raise money. Sponsorships are similar to grants, though they are often carried through a number of years. Sponsors can be government agencies, individuals, universities, foundations and corporations. Sponsorships can be important tools in keeping an incubator operating after initial investments are made.

Investors can be persuaded to sponsor an incubator in a number of ways. For instance, with government sponsors, the promotion of the public good is often a sufficient reason. Such public benefits include job creation and new technology development.

Corporate sponsors can be used provided the incubator's goals and mission match the corporations' interests. For example, an energy company may be interested in sponsoring a clean energy incubator, as the technologies developed by the incubatees could be useful to the company. In addition, a growth in energy-related companies around the sponsor would create an energy cluster in the region and contribute to creating economies of scale, thus valuing the sponsor's position in the market. Universities and other similar types of organizations, such as institutes of technology might also be

interested in funding an incubator provided that the incubator aligns with the university's mission statement or field of expertise.



Note: Relying upon a third party for funds may be risky. Third parties have their own agendas and may stop or reduce their funding at any point. Sponsorships, therefore, cannot be relied upon as sole sources of funding.<sup>34</sup> Incubators can mitigate potential sponsor losses by having a number of sponsors. By mixing government, university, private corporations and other sponsors, incubators can further reduce the negative effects of having a sponsorship unexpectedly end. There is a trade-off, however, as sponsors generally prefer that they are either the sole sponsor or part of a small group of sponsors of an incubator.

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<sup>34</sup>Source: *infoDev* - Revenue Models for Business Incubators - <http://www.idisc.net/en/Article.38388.html>

## Section 2.3: Debt Financing

Debt financing implies the acquisition of capital by a firm that signs a promissory note requiring the repayment of the principal amount plus a payment of interest. Debt financing through the banking industry is possible if the incubator can demonstrate sources of revenue.

The amount borrowed, known as the principle, must be repaid over time by the incubator along with interest charged by the lender. Generally, lenders also require collateral. This is property and/ or assets that are offered to secure a loan and which can be seized by the lender if the incubator defaults on its repayments.<sup>35</sup>

**There are two forms of loans that are relevant to the discussion:**

- Commercial Loans; and
- Subsidized Loans.

### Section 2.3.1: Commercial Loans

A commercial loan is the traditional option of raising funds through debt. Such loans, generally offered by banks, require contracts and collateral.<sup>36</sup> Incubators that are able to afford the interest rates and monthly payments that come with a commercial loan should consider this option. It should be noted, however, that commercial loans often have a higher cost than other debt financing options, although they are more readily available.

### Section 2.3.2: Subsidized Loans

A subsidized loan is usually operated by commercial banks and/or financing agencies, but with funds that originate from the government.<sup>35</sup> The loans are often used to foster political goals by offering advantageous financing terms. Incubators can use this option, when available, as an alternative to traditional loans. Like conventional financing, subsidized loans usually require collateral.<sup>35</sup> The subsidized loans are more attractive to the incubator because they often offer lower interest rates and more favorable maturity terms. Maturity is the time given to pay back the principal amount borrowed i.e. how long an incubator is given to repay the loan.

<sup>35</sup> Source: Investopedia – Collateral - <http://www.investopedia.com/terms/c/collateral.asp>

<sup>36</sup> Source: *infoDev* - Venture Capital and Financial Institutions - <http://www.idisc.net/en/Article.208.html>

## Section 2.4: Equity Financing

Equity financing refers to the financing of a venture in which the venture gains the financial resources from the equity investor in exchange for an ownership position acquired by the equity investor. It raises cash in exchange for ownership in the incubator. This financing solution is best suited to an incubator with a manager capable of dealing with investors, as well as a strong knowledge about the economic environment.<sup>37</sup>

In most socio-economic frameworks, and given the business nature of an incubator, this method is not as viable as governmental subsidies or donor grants. Therefore, equity financing is not often pursued by incubator managers.

Equity financing works through the offering of an ownership stake to a potential investor, who pays for it with a cash investment. The funds raised can then be used to develop the incubator. Incubators can do this with several investors to raise amounts of cash. Investors should be warned, however, that no incubator has guaranteed success. Incubator managers should be upfront with their investors about this potential. The incubators that are likely to have success with this financing system are those associated with high-growth incubatees. Investors will see the potential for gains and be willing to invest.

Incubators that fit this model for rapid potential growth are most commonly technology incubators, thus equity investors are often particularly attracted to technology incubators. Incubators that have a large number of onsite clients may generate interest from real estate investors. This is another possible path towards equity financing. In this case, the incubator uses the cash generated by selling the building to expand the facilities and grow the incubator. Managers who adopt the model of financing their incubators by acquiring equity in their incubatees' businesses are often serving two valuable purposes. On the one hand, they are increasing the incubator's assets and possible revenue sources. On the other, they are contributing to increasing the credibility of their incubatees by sharing risks with them, which may encourage external investors to do the same.

### **There are a number of points to consider with equity financing:**

- It is not a renewable source of funds. Once equity, a percentage of the organization, is sold it cannot be sold again to raise further funds.
- A potential drawback to equity financing may result from the concentration of an incubator's equity under one investor or group of investors. While this may not be a concern itself, having a group of outside investors with significant ownership in the incubator can lead to management disputes and uncertainty in decision making.

<sup>37</sup> Source: *infoDev* - Revenue Models for Business Incubators: <http://www.idisc.net/en/Article.38388.html>

Incubators can overcome this potential problem by making sure that the incubator developers themselves control a majority of the incubator's assets (>50%). Incubators may also be able to set terms in which they sell their equity that include clauses which do not allow the investors to manage or influence operations. Investors will agree to such terms and be willing to invest in an incubator if the model is proven, if the management staff is competent, and if the investors see potential for gains in the future. Emphasizing these factors is an essential part of attracting equity financiers. With this in mind, an incubator can put its own equity to good use.



Note: This model does not often apply to developing countries, as it is sometimes difficult to cash in on equity stakes. In fact, it is seldom applied by incubators in developed countries. Furthermore, incubator management needs to have very specific knowledge and experience, and may start to favor companies in which the incubator has equity, creating a disadvantage for others. This may harm the credibility of the incubator.

## Section 2.5: Revenue from Incubated Enterprises

By finding ways to bring in revenue from incubated enterprises, incubator managers can minimize the need for external ongoing funding sources. Most importantly, by generating revenue from incubated enterprises the incubator will be in a better position to ensure long-term financial sustainability.

**The three most commonly known ways of bringing in such revenue are:**

- Rental fees;
- Consulting services; and
- Profit Sharing Agreements.
  - Royalty agreements
  - Brokerage fees
  - Equity agreements

### Section 2.5.1: Rental Fees

The first and perhaps the most well known of the models is the acquisition of free or low-cost real estate (i.e. a free building) that is rented to tenants. The adoption of this model often means that the income generated from rent can be used to subsidize services to tenants, who are usually less willing to pay for these than for office space. In addition, the incubator would ultimately be helping itself because providing these services to clients is absolutely vital for their growth and prosperity.

Note: Rental fees and consulting services are the most common of the three revenue streams since they support a common need of all incubatees. Profit sharing agreements are much less common, due to their complexity.

Globally, a very high percentage of incubators are based partly on rental income, as it can provide an incubator with a steady stream of revenue. The fees are most often due on a monthly basis and can provide a sizeable contribution to an incubator's total revenue stream. The rental fees in Europe plus incubator services average about 20 to 25% of an incubator's total revenue.<sup>38</sup> Context, however, can determine how much an incubator receives from rental fees. Russian incubators bring in an average of 83.7% of their revenue from rental fees,<sup>39</sup> while most Chinese incubators generate a negligible amount in rental fees.<sup>40</sup> In the European Business and Innovation Centre Network (EBN), which is made up of 147 incubators, rental fees account for a total of 23% of the revenue stream.<sup>41</sup> Incubators that rely

<sup>38</sup> Source: European Business and Innovation Centre Network - The BIC Network in 2008: Facts and Figures: <http://www.ebn.eu/Observatory/>

<sup>39</sup> Source: Lazarowich, Michael and M. John Wojciechowski (2002) – Russian Business Incubator Program, Institute for the Economy in Transition Report:

[http://www.aucc.ca/\\_pdf/english/programs/cepra/Russian%20Bus%20Incub-%20nd%20Report-%20Text.pdf](http://www.aucc.ca/_pdf/english/programs/cepra/Russian%20Bus%20Incub-%20nd%20Report-%20Text.pdf)

<sup>40</sup> Source: Chandra, Aruna (2007) - Approaches to Business Incubation: A Comparative Study of the United States, China and Brazil, Networks Financial Institute Working Paper, Indiana State University - <http://www.idisc.net/en/DocumentArticle.38674.html>

<sup>41</sup> Source: European Business and Innovation Centre Network - The BIC Network in 2008: Facts and Figures - <http://www.ebn.eu/Observatory/>

heavily on rental fees often employ fewer staff members in comparison to those that rely on services to their tenants, which require a larger and more qualified staff. Incubators that rely on rental fees for sustainability typically have small staff numbers, ranging from 1 to 5, depending upon the incubator's size. Typically 20 to 30 incubatees are served by one manager.<sup>42</sup>

By relying on rental fees, the incubator always has the risk of a downturn in the rental market, which may make the incubator's rent pricing not as attractive to potential incubatees. In order to limit this risk, it is important for an incubator that plans to have rental fees as revenue source to minimize its investment in real estate. In other words, the incubator should become established at a location that is subsidized or donated by the local government, or is available at a very low cost compared to the surrounding real estate.

In addition to the risk associated with downturns in the rental market, there is also a risk that the incubator will act more as a leasing company rather than an incubator. It is important that the incubator remains faithful to its mission whilst leveraging rental fees to support a portion of its budget.

#### Section 2.5.2: Consulting Services

These are another option open to incubators looking for revenue streams from their incubatees. Consulting services can include training, bookkeeping, marketing, document processing, study tours and traditional business consulting.<sup>43</sup>

The incubator may set prices for the services it provides to add to the revenue generated by the renting of space. Whenever this option is adopted, it is highly recommended that a market analysis be conducted to ensure that prices practiced by the incubator are equal to or lower than the prices practiced by external providers of the same services. This model can be applied in a progressive way, meaning that clients in their early stages of growth would not have to pay the total costs, or could pay for part of the costs, while clients in a more advanced stage of maturity would have to pay for them up front. The provision of such consulting services can also be organized, partly or fully, like a loan in which the incubator provides the services and charges the client, but the client pays later. This model is like paying a loan back, by paying royalties on turnover. The particular payment structure depends greatly on the business environment and availability of different sources of financing for the incubator and its incubatees, and needs to be decided on a case-by-case basis.

Consulting services can pose problems for incubators if, when offering these services for fees, their actions leads to more favorable treatment of some incubatees to the detriment of others for example. This is because when an incubator is being paid for additional services provided to clients outside the incubation process, it may neglect those incubatees that only require the basic services.<sup>44</sup> Incubators must ensure that they provide sufficient attention to the needs of all their incubatees and not just those which demand additional consulting services.

<sup>42</sup> Source: Webb, Julian (2006) -Sustainability: Business Models, Pricing, and Financing – 2nd Global Forum on Incubation, India, Hyderabad

<sup>43</sup> Source: *infoDev* - Revenue Models for Business Incubators - <http://www.idisc.net/en/Article.38388.html>

<sup>44</sup> Source: Webb, Julian (2006) -Sustainability: Business Models, Pricing, and Financing – 2nd Global Forum on Incubation, India, Hyderabad



### Section 2.5.3: Profit Sharing Agreements

**Royalty agreements** are another way incubators can bring in revenue from their incubatees. This refers to a fee or portion of the proceeds paid to the owner of specific rights for their use. For example, this can be intellectual property rights, such as a patent, or rights to a brand such as a trademark. Royalties can be applied as a model that generates revenue from royalty agreements on incubatees' sales.<sup>45</sup> To this end, incubator managers can sign specific agreements with incubatees, through which a proportion of the incubatees' revenue is passed to the incubator.

In this model, incubators charge royalties on the incubatees' gross sales. The fraction of those sales that should be charged by the incubator as royalties is critical in the process as it needs to be high enough to guarantee incubator sustainability and low enough to allow the incubatee to grow and prosper. Since net margins vary considerably from business to business and sector to sector, it is highly advisable that the incubator manager sit down with the incubatee manager to decide on a percentage that is fair to both parties. This is typically a percentage, agreed up front, on the turnover/ revenue of the incubatee and usually in the order of 2 to 5%. It can either be charged during the incubation phase, post-incubation, or a combination of the two.

Royalty agreements may take months or years before they provide the incubator revenue. An incubator that plans for royalty revenue should be very conservative in its expectations at the start. The royalty revenue expected during the first few years of the incubator should be very low. Once royalty revenue starts to be generated by the incubatees, the incubator manager will be in a better position to estimate royalty revenue growth over time. A typical royalty agreement last 3 years.<sup>46</sup>

A good example of the royalty revenue model is the Maxum Business Incubator<sup>47</sup> in South Africa. Maxum's 23 incubatees pay for the incubation services they receive through a royalty system. This system means that graduates pay Maxum a royalty of 2% of annual turnover for the equivalent period that they participate in the incubation program. This system enables incubatees with potential, but without significant resources, to afford Maxum's subsidized rental rates for office space, meeting rooms and "free" mentorship. Incubatees are not charged in full for these services until they graduate, where after the royalty payment contributes to recouping the expenses they incurred whilst in incubation. This is a cross-subsidization model whereby the royalty payments from the successful graduates subsidizes the "non-payment" of unsuccessful candidates.

Note: In order for this model to work, it is important that the incubator and incubatee representatives negotiate in a spirit of openness and honesty with each other. Incubatees are often not very willing to reveal financial information to the incubator and usually their major boost in sales comes after they have graduated from the incubator, when the incubator-incubatee relationship is at its weakest. It is believed that this model is very seldom applied by incubators in developed countries. This is due to the complexity of the model, uncertainty of the revenue stream and the significant period of time experienced before revenue is generated for the incubator.



<sup>45 & 46</sup> Source: Webb, Julian (2006) -Sustainability: Business Models, Pricing, and Financing – 2nd Global Forum on Incubation, India, Hyderabad

<sup>47</sup> Source: Maxum Incubator - <http://www.maxum.co.za>



Note: In similarity to royalty revenue, equity revenue requires the incubatee to be successful for the incubator to receive revenue. Therefore, equity revenue is a high risk for the incubator and cannot be considered a reliable revenue source. As with royalty revenue, it may take time for significant revenue to be generated. In addition to these issues, equity agreements require a high level of know-how due to their complexity. Therefore, incubator staff must be well qualified to pursue this type of agreement. Often the incubator's share is diluted even further when the company raises second round financing, and the effort of administrating and managing the small equity share, in most cases does not justify the commitment of the incubator's time and resources. For these reasons, equity agreements are the least common profit sharing agreements.

**Brokerage fees** - The incubator can serve as a broker, finding investors and helping to secure funding for an incubatee. Each time the incubator secures funding for an incubatee, the incubator receives a percentage of the funds that were brought in. Unlike royalty revenue, brokerage fees are entirely based on the incubator's ability to attract investors for its incubatees. The incubator manager should have a good sense of how successful the incubator can be in this regard, as they control this process. If brokerage fees are a planned source of revenue for the incubator, the incubator manager should set brokerage fee goals in order to dedicate the time and effort necessary to secure investors. The typical percentage applied for brokerage fees is 6%.

**Equity agreements** are complex, but are another form of providing incubator revenue. In this arrangement, an incubator earns revenue when the incubatee achieves a profit and pays off dividends. Equity stakes vary by incubator type and from incubate to incubatee, with most incubators not exceeding a 10% equity stake and with some going as low as 2%.<sup>48</sup> The incubator can also earn revenue by capital gains by selling its participation in the incubatees' equity. This is typically in lieu of rental payments and other cash payments that may be beyond a start-up's means.

<sup>48</sup> Source: CollegeMogul.com - Directory of Incubators & Seed Funding Venture Programs - <http://www.collegemogul.com/content/directory-incubators-seed-funding-venture-programs>

#### COMPONENT CONCLUSIONS

When exploring the various sources of funding available for incubators, one aspect is crucial to bear in mind - funding needs are both related to the establishment of the incubator **AND** the start of the incubator's activities.

Balancing the different possibilities of funding and the implications of each of these is crucial to identify which are the most relevant to the incubator's funding needs. It is to be noted that usually a combination of different financing and revenue schemes is preferable to secure the appropriate level of investments and revenues necessary to support the incubator's setting-up and starting-up of its operations.

It is only once the sources of funding have been identified that a proper fundraising strategy can be developed.



# 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.

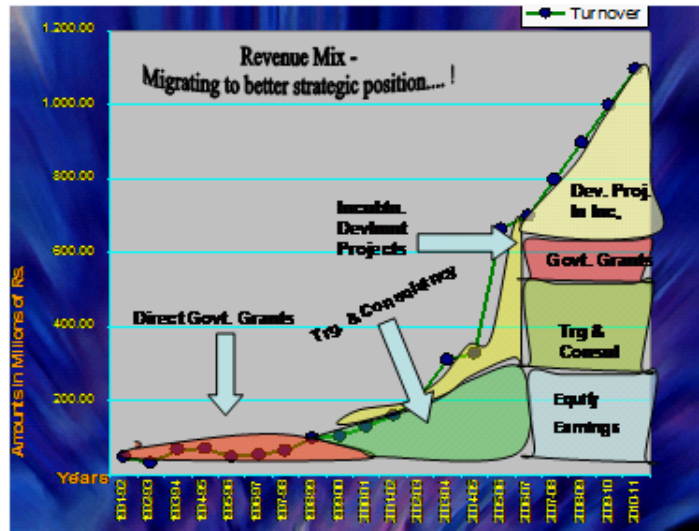
TREC-STEP's spectrum of training programs include:

- 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>

#### **REFERENCES**

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.

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

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