

**BUSINESS INCUBATOR PROCESS:
A POLICY TOOL FOR ENTREPRENEURSHIP
AND ENTERPRISE DEVELOPMENT
IN A KNOWLEDGE – BASED ECONOMY**

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This paper has been prepared to give an overview to the Ministry of Finance about the role of the business incubators in innovation and competitiveness to boost the economic growth and job creation

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1. Background

This background paper is on business incubation as a policy tool that has been used by several governments to spur knowledge based enterprise development. It is intended to assist and supplement a number of SME development initiatives being undertaken in Pakistan, including the USAID funded PISDAC project.

2. Introduction

In a rapidly changing global economy, small and medium scale enterprises are increasingly a force for enhancing national economic growth and employment. Many government programmes contain policy instruments addressing SMEs. New structures and strategies are being explored that will help small enterprises to grow and provide a promising future in the global market.

In a number of more competitive economies, business incubation is one of the tools that have helped to create new entrepreneurial skills and new businesses. The incubation process that was developed has included services for on the spot diagnosis and treatment of business problems, dramatically lowering the usual early stage failure rate.

Business incubator programs, often called “new entrepreneur creation projects” helps develop new entrepreneurs and supports them to start up business and be better able to survive on a longer-term sustainable basis. The business incubator target group includes small entrepreneurs that want to grow, new graduates and those who would like to develop their talent and ideas and commercialize them.

The need for business incubation is one of the outcomes of USAID sponsored benchmarking exercise of the small and medium enterprise support structure in Pakistan. This exercise was aimed at the identification of gaps in SME support activities that need to be addressed for the SMEs to increase their contribution to the Pakistani economy. These gaps included: a need for increased innovative approaches to SME finance, better linkages between the academic community and industry, better and quicker commercialisation of innovation including the process for business incubation.

3. What are Business Incubators?

Business Incubators are defined as a location in which entrepreneurs can receive pro-active, value-added support, and access to critical tools, information, education, contacts, resources and capital that may otherwise be unaffordable, inaccessible or unknown.

Well structured incubators provide links to industry; business support services to enhance and develop business; upgrade skills and techniques; technological advice and assistance with intellectual property protection; financial resources for R&D; initial marketing expenses; and access to potential private investors and strategic partners.

The benchmarked SME support entities in more competitive countries were encouraged by their governments to foster the process of incubation. They successfully hosted several pilot projects at relevant companies and universities to allow entrepreneurs to develop their ideas and talents, and to commercialise them. The respective governments financed those pilot

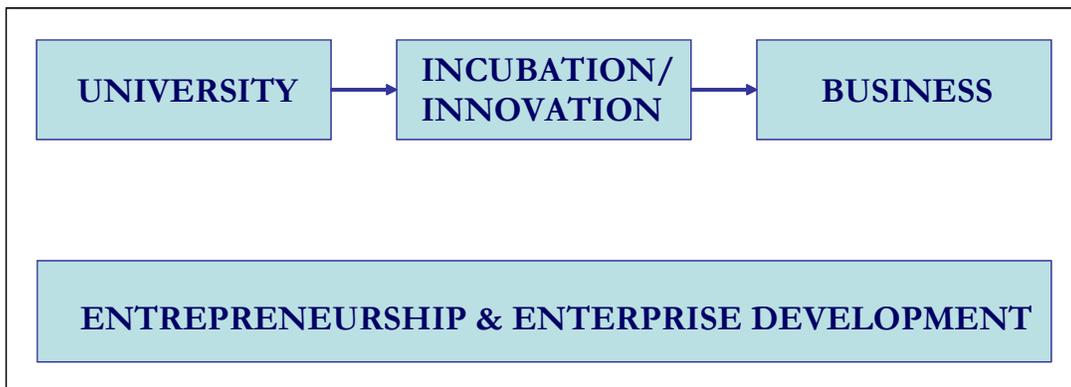
projects through an additional financial contribution to the budget of SME support agencies in the benchmarked countries. Those institutions involved recognised the value added by these initiatives, formed incubators, and financed them through public/private investment. One of these efforts is included as a possible financing facility model for the proposed Competitiveness Support Fund (see below table no. 4).

4. Types of Business Incubators

Incubators come in many formats, mostly fitting the following four types:

- Public or not-for-profit incubators: government and non-profit organisation, whose primary objective is to promote economic development, sponsor these.
- Private incubators: these are run by venture and seed capital investment groups, or by corporations and real estate development partnerships. These incubators generally seek a return on their investment.
- Academic-related incubators: these are started where which have academic objectives also focus on faculty development, and on creating business-spin-offs from faculty research
- Public/private incubators: these are joint efforts between government and non-profit agencies. This type of incubation offers the advantage that government funding can often be secured to support private sector expertise and financing.

Table 1: Academic-related incubators and public/private incubators



5. How Incubators Are Set-up

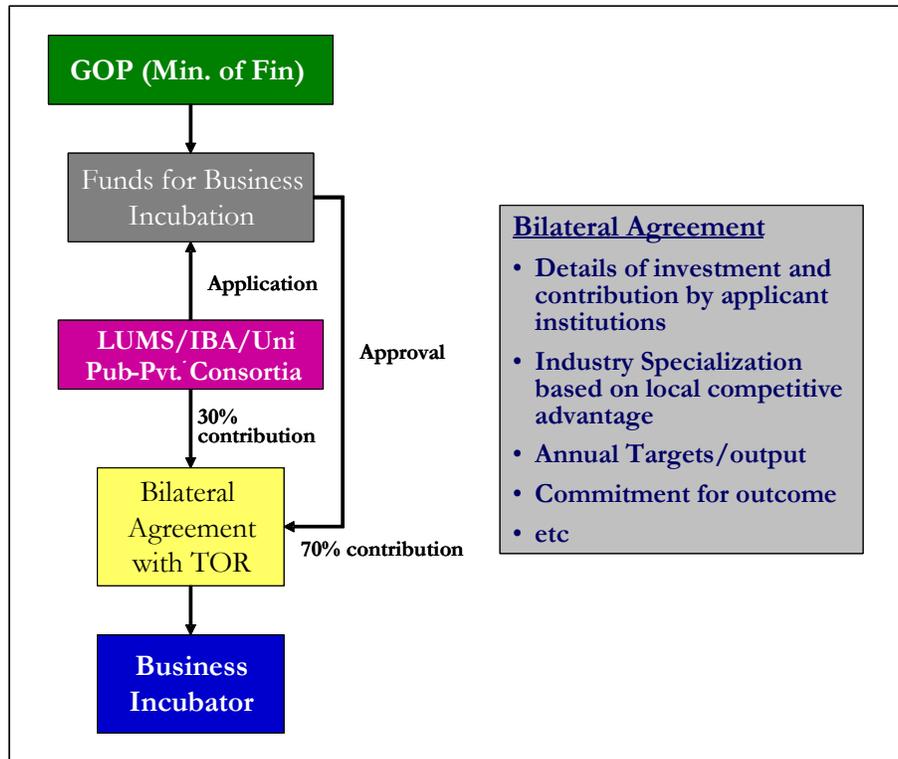
Quite often Governments initiate incubators. The Government creates a funding program for business incubation. The funding program issues general requests for proposals from relevant applicants to set up incubators. Anyone can respond with a proposal. It can be private consortia, universities, communities or mixed consortia. Incubator initiatives are then selected.

The incubators in the network receive:

- A yearly grant, just about enough to pay for the manager, one secretary and low-cost facilities for the incubator management and incubator projects (they are situated in the same location.)
- The right to apply for incubator project grants for which the turn-around time is fast, approximately a few weeks.

Incubators included in the network must follow set requirements for the overall program and grants.

Table 2: Business Incubator Set-up



6. The Operational Procedure of the Business Incubators

Entrepreneurs may apply to incubator managers to participate in incubator projects. If the incubator managers like the proposals then they take it to the screening committees at their own incubators. Once a project idea is accepted, the incubator manager and entrepreneur develop a proposal that is submitted to the incubator fund. It is screened again. If it is approved, the incubator gets funding for a project for two years. The fund provides up to 85% of the total project budget; the rest must come from the promoter and it covers all the services, use of equipment etc. There is a funding ceiling per project of approx US\$350,000 over two years¹.

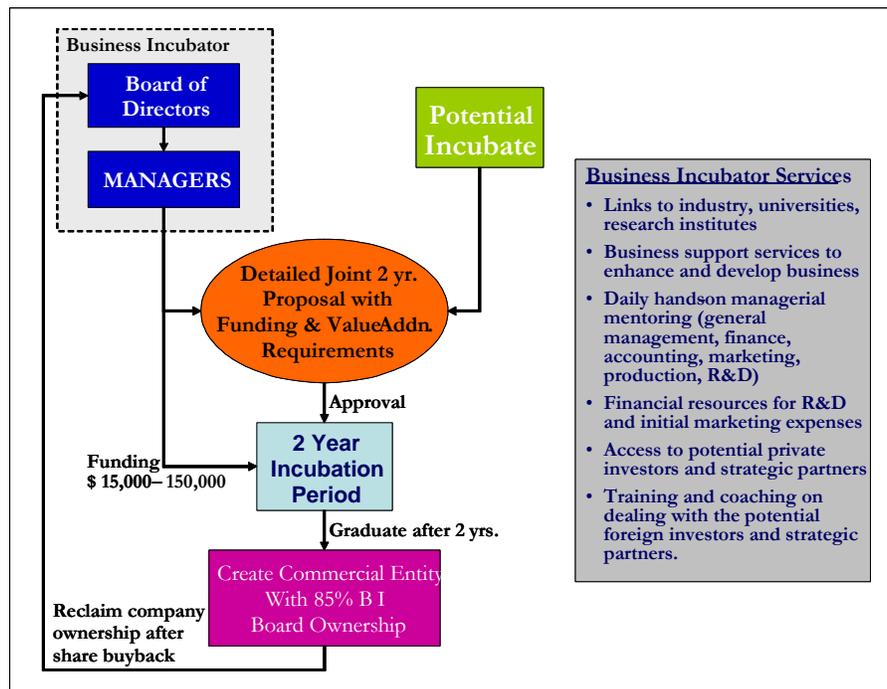
Ideally incubator companies build a prototype of their products or services in year one and find an investor and exit out of the incubator during year two. The following are important milestones for a successful business incubator operation:

- Forming a strong managing board with an advisory structure and enabling them to observe incubator operations;
- Experienced managers and personnel for the incubator;

¹ The maximum amount of the funding is different in the benchmarked countries. The average amount of the funding is between US\$150,000 to US\$350,000.

- Careful selection, training at home and abroad, and proper remuneration of the manager and team;
- Screening of the technical, business and market potential of tenants;
- Promotional campaign to mobilise community support;
- Involvement of private sector, through subcontracting and other arrangements;
- Exchange of experiences through national incubators and international network

Table 3: Business Incubator Operation



7. Upgrading through Pilot Projects and Business Incubation:

The benchmarking of the SME sector suggests that there is a great opportunity to work with SME sectors to facilitate development of a broad strategy for each sector and for this strategy to drive identification of pilot projects that in turn drive SME upgrading and innovation. In addition to such projects situated throughout Pakistan, the more successful SME development agencies in the benchmarked countries are also engaged in business incubation.

So far, a number of pilot projects have been identified in the dairy, marble & granite, and gems & jewellery sectors. The pilot projects approximate the business incubator concept: bringing together individuals from the entire value chain to not only provide support to them but also enable them to share information and improve the value chain as a whole. This might take various forms for specific investments such as a vertically integrated joint venture in which various parts of the value chain collectively invest.

CSF will assist as catalyst and facilitator in the above processes of strategy, pilot projects and incubation, in co-operation with sector strategy working groups (SWOGs) and other relevant institutions to help to facilitate the undertaking, management and financing of pilot projects and the formation of business incubators that the relevant institutions are planning to form in several locations in Pakistan.

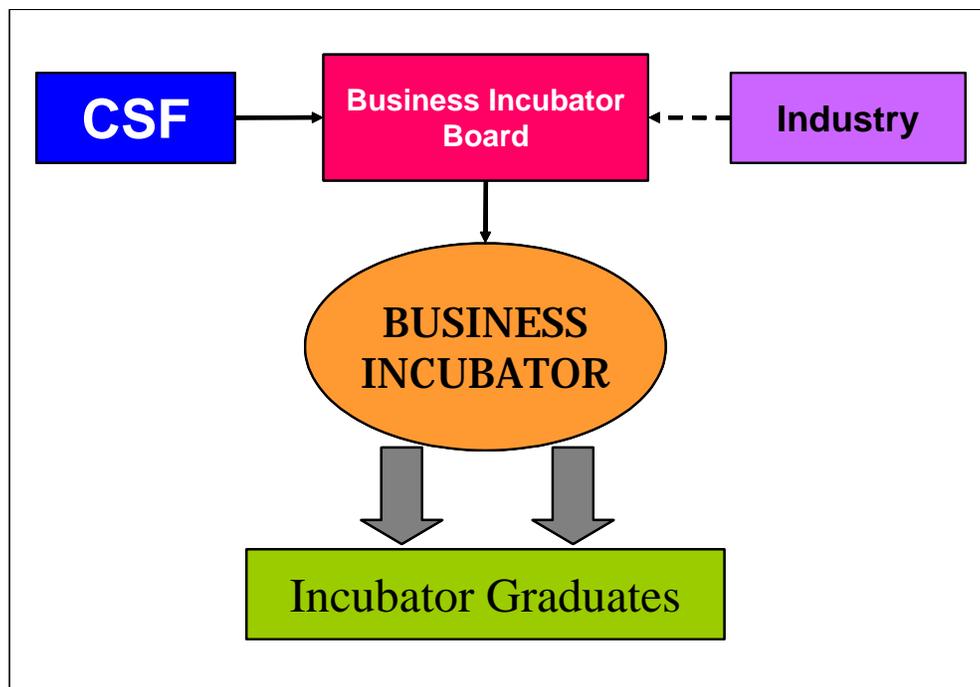
In addition to its support for sector Strategy Working Groups (SWOGs)², CSF, in close co-operation with the relevant stakeholders, could assist the supervisory and management body of planned business incubators to be formed and assist with monitoring of pilot projects.³

8. The Role of the Competitiveness Support Fund (CSF) in Supporting the Process of Business Incubation

The Government of Pakistan through the Ministry of Finance has decided to integrate the business incubation support programme into the CSF through the GOP financial contribution. In addition, CSF will also organise workshops with interested relevant institutions to invite foreign experts from benchmarked countries to give training and exchange experiences about successful business incubators.

CSF would produce and place articles in relevant newspapers and use other media to disseminate this information. Furthermore, CSF would organise workshops with interested stakeholders to encourage them to form business incubators.

Table 4: Funding for Business Incubators through the CSF



² As SWOGs function on a regular basis they adopt simple operating rules which may or may not be formalized, and designate an interim group of functionaries to record activities and conduct other operational functions. Over time they draft and refine strategic documents, plans, and pilot project descriptions. The SWOGs or members of the SWOGs form working groups as required, as well as joint stock companies or other legal entities to conduct pilot projects.

³ The planned business incubators by the relevant institutions might take the example of the well advanced countries to start the process. Business incubators should operate under a rigorous selection process. Not all firms that apply for entry are accepted. Incubators should operate under rigorous “up or out” procedure. Firms typically remain in the incubator for no more than two years.

With the support of the Ministry of Finance, the CSF is to undertake an initiative with the two universities to set-up two small **pilot projects** for business incubation. The capacity of those incubators might be 5 to 8 participants.

Based on experience with these two pilot incubator projects, other institutions would be able to observe and understand the added value of such initiatives and begin to form incubators financed through public/private investment.

The CSF would not be involved in the creation or day to day management of business incubators; it would rather encourage relevant and appropriate institutions – such as universities, industry research organizations and associations, etc. – to establish them. This work is one of the primary objectives of the CSF like entities in India, Thailand, Finland, Turkey and Israel.

9. Conclusions

Business incubators are confirmed in the literature on innovation and in practice in more successful economies as one of the important instruments to develop effective employment and sustainable new start-ups to support knowledge based enterprise development.

It is proposed that the Ministry of Finance develop a strategy based on this concept paper for an open public private sector debate on the importance of the business incubation process for enterprise creation and development of SME sector countrywide. To support this, visits could be arranged to some business incubators in the benchmarked countries to become familiarised with existing experiences. To the extent possible this should be done jointly with other relevant Pakistani public and private sector institutions such as universities and industry consortia and associations.

10. The Seven Benchmarked Countries

- Thailand
- India
- China
- Sweden
- Ireland
- Turkey
- Israel