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BW SMALLBIZ -- STARTUPS

Hatching For Success

Business incubators are back -- and ready to transform your startup

Here's no doubt that Arthur "Mac" Jones knows how to build a company. A former Arthur Andersen accountant, Jones was CFO and later president of drugstore chain Big B Drugs during a 19-year expansion that resulted in more than 400 locations across five southeastern states. In 1998, he signed on as CEO of International Pharmacy Management, a five-person mail-order pharmacy and prescription-benefit card company. By 2000, the company had 25 employees and \$10 million in sales. That year, Jones sold it for \$40 million.

But Jones, now 57, also has the good sense to know when to accept a helping hand. That's why his next venture -- a nutritional supplements manufacturer -- is being launched from the Entrepreneurial Center, a business incubator in Birmingham, Ala. IPM was housed there when Jones came on board and it's where he met the venture capitalists who put \$3 million into that startup. "Once you've been in an incubator, you know you want to be in one the next time around," he says.

It's easy to see why. Jones pays about two-thirds of the market rate for rent, and receives free marketing and accounting advice from local professionals who volunteer their services to resident companies. His current company, Health Care Supplements, now has five employees and revenues of \$1 million. Jones expects it to strike out on its own in about a year.

Just a few years after hundreds of them imploded in the tech bust, business incubators -- which provide office space and professional advice to startups -- are making a comeback. About 1,000 incubators now operate in the U.S., a 10% increase over 2001. Incubators typically take in young companies that have a clear business plan but need access to specialized facilities or advice. They generally offer below-market rent and the expertise of staff or outside consultants willing to work at reduced rates. Companies can "graduate" from the incubator once they reach milestones such as completing a big round of financing or winning a hefty contract -- goals incubators can help them achieve. "Incubators take companies that are missing something, and give them the resources they need to get to the stage where they can get funded," says Kala Marathi, managing director of the Houston Angel Network, which invests about 25% of its portfolio in companies that have graduated from incubators.

Incubators can afford to be picky about who they choose to host. Typically, they want local entrepreneurs with a full-fledged business plan and one to five employees. (If you need help developing a plan, most incubators offer assistance to entrepreneurs who aren't quite ready to be full-time tenants.) To get in, you'll then have to pass muster with the incubator's director, and sometimes a selection committee. Be prepared to answer hard questions about your business' growth strategy. "I'm looking for companies that can really do something unique, that can add a lot of jobs to the community," says Charlie D'Agostino, director of the Louisiana Business and Technology Center in Baton Rouge. Companies that already have an established management team, receive significant funding, or generate substantial profits usually won't be accepted.

Whether an incubator is right for your startup depends on what type of company you own and what assistance you need. Some incubators are open to all companies; others welcome only those in certain sectors. And their different sponsors -- universities, corporations, private investors, local governments, and economic development agencies -- often determine the services they offer and the types of startups they accept. If your company needs plenty of funding to grow, a for-profit incubator

that invests in tenant companies can be a good choice. But enrolling in one is no guarantee you'll get cash, because most take equity stakes in only their most promising tenants. Start by finding the incubators in your area or industry. Then ask a few important questions before you sign up.

FINDING THE RIGHT FIT

A good place to start your search is the Web site of the National Business Incubation Association, nbia.org/resource_center, which lists its member incubators by state and links to about 20 state incubation associations. Overall, incubators fall into two broad categories: mixed-use incubators, which accept companies from a variety of industries, and sector-focused incubators, which work only with companies in certain industries.

Mixed-use incubators are ideal for entrepreneurs who have an established product or knowledge of their industry but who need help with the ins and outs of growing a new business. They're often funded by state and local governments or economic development agencies, and their chief aim is to spur local job creation. While the staff at mixed-use incubators probably won't have an in-depth knowledge of your industry, they can help with the day-to-day problems and questions common to most small businesses.

That's exactly the kind of help James Prinster and Steve Kramer needed. After the manufacturing company they had worked for shut down in 2002, Prinster and Kramer decided to start a contract-electronics manufacturing outfit. They met with Thea Chase Gilman, director of the Business Incubator Center -- a nonprofit mixed-use incubator in Grand Junction, Colo. -- who asked them tough questions about potential buyers, cost structures, financing options, and equipment needs. They worked together to draft a business plan.

After securing a \$100,000 bank loan, Prinster and Kramer founded Canyon Electronics and Cables. They rented a 1,200-square-foot manufacturing facility in the incubator at about 25% below the market rate. The incubator's 11 employees helped with critical issues such as payroll and financing options. "We knew about the manufacturing side of the business. [The incubator] helped us with the stuff we didn't know," says Prinster.

Canyon Electronics quickly outgrew its facility and rented additional space in the incubator. "When I was gone on vacation they even took over my office," says Gilman. The 28-employee company had 2004 revenues of \$850,000, up from \$60,000 in 2002. And in December, 2004, Canyon moved into a 6,000-square-foot manufacturing facility of its own in Grand Junction.

NARROWING THE FOCUS

Sector-focused incubators, also called clusters, are becoming increasingly popular. They now make up more than half of all incubators and are designed for entrepreneurs who need specialized facilities or access to particular markets. But finding one that's right for your company might be difficult. Clusters are usually limited to big cities or areas where a certain industry is particularly strong, such as software in Silicon Valley or defense technology in Maryland.

While some cluster incubators are funded by state or local governments, universities and corporations are becoming players in this field as well. University-sponsored incubators, often focused on technology, provide access to a broad range of resources, such as volunteer business school students, faculty research and expertise, and state-of-the-art laboratories. Corporate incubators, such as Panasonic's Linux Collaboration Center in San Jose, Calif., or Nokia's Innovent incubator in Annapolis, Md., accept startups working on innovations that promise to expand the corporation's existing product line.

Greg Woodworth was in search of a more unusual type of sector-focused incubator -- a kitchen incubator -- for his Stony Brook Cookie Co., which now sells gourmet cookies and gift baskets through its Web site. He investigated prospects in Boston, Portland, Ore., and New York before settling on Nuestra Culinary Ventures, a Jamaica Plain (Mass.) incubator designed for small to medium-size retail food and catering businesses. For Woodworth, who'd spent 12 years in the restaurant and catering business before launching his company, the draw was mainly financial. He estimates he would have had to spend about \$30,000 to set up a commercial kitchen that met Food and Drug Administration regulations. Instead, he was able to launch Stony Brook with a meager \$3,200.

Woodworth rents NCV's 1,600-square-foot kitchen for \$27 an hour during the day and pays \$62 a month for dry and freezer storage. He shares an office equipped with fax, copier, and Internet access with NCV's 47 other tenants. The incubator holds seminars on everything from menu pricing to tips for running a catering business, and local suppliers often give NCV companies discounts. "It was the perfect place to start my business," says Woodworth. The three-employee company had 2004 revenues of \$65,000, and sales have quadrupled in 2005. Woodworth hopes to move to a permanent location next summer.

Once you've managed to find an incubator that appears to suit your needs, it's time to dig in and do some homework. Find out about the incubator's graduation requirements, and how flexible the rules are. You don't want to be kicked out before you're

ready. Many incubators increase their tenants' rent and other fees after an initial period, so ask about long-term lease arrangements and fees charged by outside consultants. And take a look at companies who've recently graduated: Are they where you want your company to be in a few years? Perhaps most important, talk with current tenants and recent graduates about their experiences. If they're anything like Arthur Jones's, you'll want to enroll right away.

By Michael Patterson

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