

# P L A N N I N G P R A C T I C E

## Hatching Small Businesses

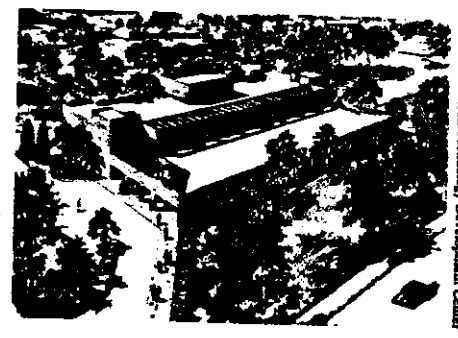
Business incubators are a hot topic in local economic development circles. Here are some of the conclusions from a recent survey of some 50 incubators.

By Candace Campbell

**S**mall, homegrown businesses are becoming the focus of local economic development efforts. Whether the nurturing party is a city agency, a chamber of commerce, a private corporation, or a community group, the recipient is often an indigenous, fledgling business rather than an established business recruited from elsewhere.

What a start-up business often receives is space in a "business incubator," a building that offers low rent, centralized services, flexible leases, and management advice—thereby acting as a hatchery for new businesses and new jobs.

In the past year we have studied several dozen of these business incubators around the country. Most of them are publicly owned or operated, and half of the total have been in operation less than a year. Most incubators arose from a collaboration between local government, universities, and private corporations.



Advanced Technology Development Center

*Georgia Tech's Advanced Technology Development Center occupies a new building (right). More typical is the Fulton-Carroll Center for Industry in Chicago, in three old warehouses.*



People Building

### Financing

Almost all of the incubators began in existing, often vacant, buildings—including office buildings, warehouses, schools, post offices, shopping centers, and storefronts. The Akron, Ohio, office of economic development found its incubator building, an old warehouse, after surveying 26 vacant and underused buildings. In several other cities, abandoned factories have been donated as incubator sites.

The purchase and rehabilitation of these structures have been funded by a variety of government loans and grants, including such sources as: the federal Economic Development Administration, the Appalachian Regional Commission, Urban Development Action Grants, and Community Development Block Grants. Some have been paid for by state or locally issued industrial revenue bonds. A few resulted from the donation or bargain sale of buildings and property by private corporations.

In several of the incubator projects we surveyed, Emergency Jobs Bill and Job Training Partnership Act funds were used to provide labor to rehabilitate the buildings. In other cities, low-interest renovation loans are available to tenants.

We have found that business incubators are like mother hens. They want their chicks to hatch, grow, and leave the nest. After a few years, successful new businesses are asked to pay market-rate rent or to leave the incubator building to make room for others. These incubators are set up so that it is easier to leave the nest than enter it. Business plans are screened, and potential tenants often must be interviewed by seasoned business people before being accepted.

The industrial incubator developed by the city of Akron, Summit County, and the University of Akron works this way. Akron's economic development office manages the facility but prospective tenants' applications are reviewed by a board with representatives from the city, the county, and the Private Industry Council's job training program. Applicants also are interviewed by representatives of the Small Business Institute of the university's business school, the Service Corps of Retired Executives, and the Regional Development Board.

"Each company is evaluated based on its business plan, financing, and job potential," explains Greg Balbierz, the project manager. "The aspiring new businesses are then given

# P L A N N I N G P R A C T I C E

a punch list of things to do before admittance." Balbierz views the business plan as the start-up firm's "sweat equity—the blueprint, backbone, and foundation of the business."

Flexibility in the leasing and management of space is typical of most incubator buildings. At the Bennington County Industrial Corporation's incubator in North Bennington, Vermont, bigger operations are offered longer leases while smaller ones are often rented on a month-to-month basis. This arrangement allows the smaller firms to be relocated within the incubator as larger firms expand. "The larger the number of jobs at stake, the longer the lease," says BCIC's former executive director John Williamson (now head of the Springfield, Massachusetts, Economic Development Corporation).

Flexibility also means that when a business falls on hard times but the future looks promising, leases are renegotiated downward and the rent is spread out over time or deferred until cash flow picks up again. June Lavelle, director of Chicago's Fulton-Carroll Center for Industry, says, "We're out to encourage people to go into business without slaughtering them; therefore, we are very flexible."

But Lavelle and other managers of business incubators also speak of running the incubator itself in a businesslike fashion. Jerry Mahone, director of the Rensselaer Polytechnic Institute's incubator program in Troy, New York, says of the fledging entrepreneurs, "You must be able to hold their hands when needed and give them a push when they need pushing." Balancing flexibility and skill in business management appears crucial to the success of an incubator.

## Centralized services

The centralized services available in the incubators help to reduce the overhead costs of the new businesses located there. These services may include telephone answering, typing, copying, data processing, bookkeeping, and legal assistance. Some incubators provide computers and software specially designed for small businesses, bulk mailing equipment, WATS lines, TELEX, satellite communications, laboratories, classrooms, furniture, office equipment, libraries, conference rooms, and lunchrooms.

Some of these services and facilities are included in the rent while others are offered for a fee. For example, tenants in the Control Data Corporation's Business and Technology Centers may use the centers' conference rooms without charge eight hours a month. Most of the other services available in Control Data's centers are offered at market rate.

*In all, 432 people work for 25 companies in the Fulton-Carroll incubator. The center is owned by the Industrial Council of Northwest Chicago, which is trying to get the area designated as an enterprise zone.*



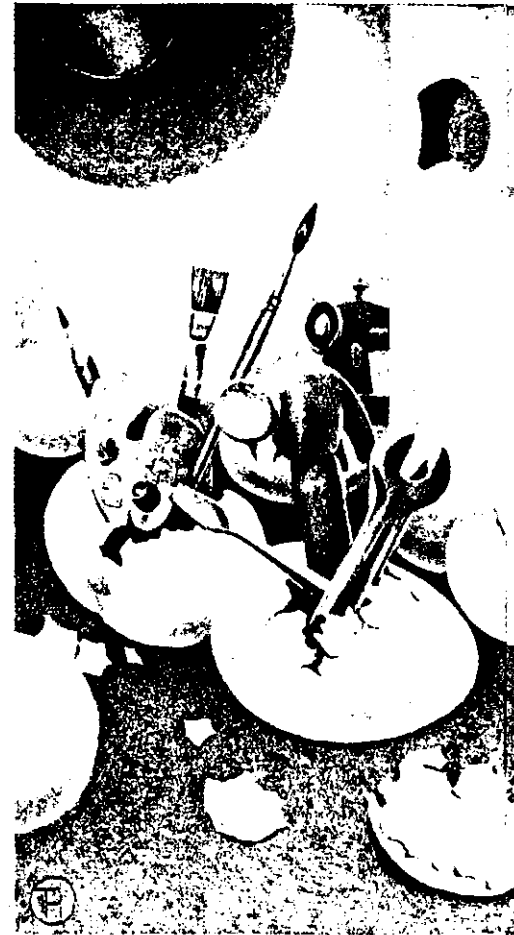
There is some disagreement among incubator managers on the need for centralized services. June Lavelle says the Fulton-Carroll Center in Chicago developed centralized services only after tenants expressed a strong demand for them. "Only the basic type of service is important," she adds, noting particularly phone answering and limited secretarial assistance.

Overall, the most common comment from those involved in business incubation is that "the people are more important than the building." Thus a close rapport between the building's managers and its tenants is vital.

The incubator's unique social atmosphere encourages trading relationships. In Buffalo's industrial incubator, one firm makes parts for another's assembly operation. Similarly, Chicago's Fulton-Carroll Center has five or six tenants that buy and sell from each other.

Resident managers or management teams help with business plans, product development, marketing, personnel, and the technical aspects of the incubator's businesses. Many incubators strive to maintain a mix of new and established businesses, since the best source of advice for new businesses often is other established firms. Another advantage is purely financial; the higher rents from established businesses help subsidize the start-ups.

As with a mother hen, an incubator's organizers must have the ability to meet the diverse needs of its fledglings. Says John Toon of Georgia Tech's incubator: "It takes more than a building with low rents. It takes business development people, it takes financing people, and it takes a close relationship with the companies."



# P L A N N I N G P R A C T I C E



Drawings by Tom Herdman

With the exception of those that have established venture capital funds, most business incubators act as brokers between new businesses and investors. Sometimes this means simply providing introductions to lenders and venture capitalists; other times it means developing proposals and packaging loans to suit particular needs. The Georgia Tech center sponsors an annual two-day venture capital conference at which incubator tenants and others can meet Georgia investors.

## Baby-sitting

In most locations, small businesses can take advantage of the Small Business Administration's low-interest loans through a business development center. The SBA-backed Small Business Investment Corporations (SBICs) and Minority Enterprise Small Business Investment Corporations (MESBICs) also provide equity capital in some areas. In addition, several states and local governments have developed small business revolving loan funds for new businesses. These local sources of financial assistance, if not offered directly by the organization that manages the incubator, are often located within the incubator building itself.

In Chester, Pennsylvania, the city's development office can provide incubator tenants and other small businesses with up to \$15,000 in low-interest loans from a revolving loan fund. The development office controls disbursement of the loan by endorsing the checks to the business owner and each of its suppliers during the life of the loan. John Fitzgerald, the director of the development office, explains, "You have to baby-sit them. These entrepreneurs have no concept of accounting. If they are in the red for nine months and you find out on the tenth, it's too late. To help new businesses you have to intrude into their business for the first few months."

This intrusion sometimes takes the form of periodic reviews, which are required in the lease agreements. During these reviews, the progress of each firm is weighed against its business plan and job targets. If a firm fails to meet the targets, its lease can be terminated for cause.

The Innovation Center at Ohio University in Athens negotiates an equity position in each firm along with the tenancy agreement. The center can maintain its part-ownership forever but offers the right of first refusal to the business should the center want to sell its shares.

## Public efforts

Creating jobs by creating employers is the main objective of publicly sponsored business incubators. Their organization and management are centered in city economic development departments, urban renewal authorities, and regional planning and development commissions. With some exceptions, public incubators tend to shy away from high-technology tenants and toward light assembly, manufacturing, and sometimes retail and service businesses.

One of the oldest publicly sponsored incubators is Buffalo's Incubator Industries Building, which was constructed by the city's urban renewal agency in 1978 with the aid of a \$2.3 million Economic Development Administration grant. It offers no centralized services, but the tenants do have access to city loans and assistance programs.

More common than new construction is the conversion of existing vacant buildings. The East End Manufacturing Center in Chester, Pennsylvania, for example, is in an old knitting yarn factory, converted with the aid of \$1.3 million in EDA and Community Development Block Grant funds.

St. Paul, home of two Control Data business and technology centers, has just opened its first public incubator as part of its "Homegrown Economy Project." The idea is to diversify the local economy by encouraging the growth of light industry, thus reducing the amount of goods and services imported from outside the city. This public incubator is unusual, by the way, because the city does not own the building. Instead, it has worked out a deal with the owner-developer of a recently renovated, 60,000-square-foot building in the Midway industrial area. In return for a city-financed low-interest mortgage, the

*Tenants in the North Bennington, Vermont, incubator range from a furniture design school (below) to a company that makes cookware out of laboratory beakers.*



Bennington County Industrial Corp.

# P L A N N I N G

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# P R A C T I C E

developer has agreed to provide incubator space and also to use his profit to renovate other property in the same area. "From the city's perspective, it's a good deal," says Richard Mahony, who directs the Homegrown Economy Project. "We get a building rent-free, although not cost-free, and we get our money back in 10 years."

## Nonprofit agencies

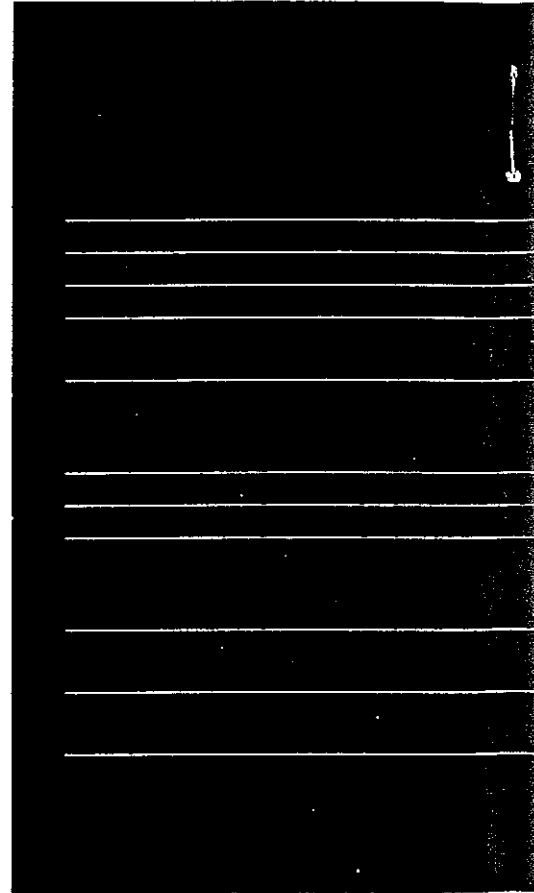
Many of the nonprofit incubators target development to a particular industrial area or neighborhood. The organizers are industrial development associations, chambers of commerce, and community organizations with broad local support and a good real estate development track record.

The Bennington County (Vermont) Industrial Corporation, for example, has been developing real estate since 1957. In 1978, the group bought an old mill complex, renovated it in two years at a cost of \$1.2 million (paid for by an EDA grant and state loans), and offered space to small businesses. The building presently houses 22 firms, ranging from a company that refashions laboratory beakers into gourmet cookware to a firm that manufactures Teflon-coated fabric (some of which was used to cover the Humphrey Metrodome in Minneapolis). Another tenant is a sheltered workshop for the mentally retarded, which provides lunch service for the building's tenants. The industrial corporation's former director, John Williamson, estimates that 250 jobs have been created at the center since 1978.

Another example, also mentioned above, is the Fulton-Carroll Center for Industry, which was started by the Industrial Council of Northwest Chicago in late 1980. Presently leasing its 340,000 square feet to 25 businesses, the center has created a net increase of 249 jobs and graduated seven firms in three years. Its director, June Lavelle, estimates that 50 percent of the jobs created are low-skilled and the rest semi-skilled.

## The universities

While universities have long owned science and technology parks, business incubators are a newer technique for retaining prominent professors and attracting quality graduate students. The goal of most university-related incubators is to transfer basic research findings to the development of new products and technologies, and many university incubator businesses are, in fact, spin-offs of academic research projects. New firms are



## Begin at Home

Community-based, nonprofit development organizations—experienced in creating local housing, business, and job opportunities—also may have the ideal background for creating business incubators.

Incubators are usually small enough to be handled by an experienced community development organization. Moreover, developing incubators calls for precisely the same skills that most community groups already have: developing property in a depressed market, obtaining subsidies to keep rents low, generating community support, providing ongoing assistance to small businesses, financing, and arranging for support services.

Two examples of community-initiated incubator projects illustrate this capacity:

**Wayne Avenue, Philadelphia.** The Southwest Germantown Community Development Corporation of Philadelphia (SGCDC) began as a housing development organization, buying and renovating abandoned buildings, and selling them to local residents. In 1981, increasingly concerned about the neighborhood's poor business climate and lack of jobs, the group began buying up empty storefronts along four blocks of Wayne Avenue, where two-thirds of the property was empty or underused.

With the aid of a \$100,000 Columbia Broadcasting System grant, SGDC bought and rehabilitated 12 storefronts over a period of two years. The average purchase price was \$7,500. The properties then were made available to commercial firms at low rents. Whenever possible, SGDC tried to sign up businesses that either added a missing service to the area

or generated jobs and street traffic. Several of the apartments above the stores were rented to the business owners or tenants.

In return for the low rent and free business assistance, the businesses must agree to hire local residents "whenever commercially feasible." This means that SGDC can terminate a lease if a business hires a nonresident when an equally qualified resident has been referred. The firms also are required to join the merchants association and to maintain their building's facade and abutting sidewalk.

Ten entrepreneurs have opened businesses as a result of this project, half of them from the neighborhood. Of the 20 people they have hired, 15 are from the neighborhood, and all are Philadelphia residents. All but one of the 30 people who now have work are black, as is most of the neighborhood.

# P L A N N I N G P R A C T I C E

often specifically attracted to university incubators because they are the source of innovations in the biomedical fields, computers, and robotics.

Perhaps the oldest of the university incubators is the University City Science Center in Philadelphia. Adjacent to the campuses of the University of Pennsylvania and Drexel University, this 1.2-million-square-foot complex is owned by a consortium of 28 universities, colleges, and medical schools in the Delaware Valley. Developed in a burned-out West Philadelphia neighborhood in 1963, the center now employs 6,000 people. A recent study showed that a third of the jobs required a college degree and a third an advanced degree; another third were reserved for those with a high school education or less. About a quarter of the employees are residents of the neighborhood.

## The corporations

Private corporations establish business incubators for two reasons: the chance to make a profit and the chance to contribute to the community. For example, Control Data, which has developed its business and technology centers in some 20 cities, both in the U.S. and abroad, sells computer, library, and secretarial services. "Control Data has made the development of new businesses part of its product line," says company representative Sharon O'Flannigan.

Another private-sector developer of incubators is Loren Schultz, president of Technology Centers International, Inc., who has five "technology enterprise centers" in operation and six in the development stage. Like other incubators described in this article, TCI offers below-market rents, centralized services, and equipment rental in its incubator buildings. An unusual feature is TCI's "champion"—a subcontractor with extensive business experience who helps incubator firms with business planning and financing. Initial consultation is free, but follow-up assistance is on a retainer or fee basis. Each of Schultz's centers has a locally developed venture capital fund of \$3 to \$5 million and the possibility of financing through TCI's larger master venture fund.

One of Schultz's newest centers is in a former high school in Minneapolis two blocks from the University of Minnesota campus. This incubator is unusual in that the building will be operated as a cooperative and the mix of enterprises will include two dance companies, a sculpture school, and 30 to 40 high-tech firms.

In Rockford, Illinois, where unemployment has hovered around 20 percent the last

Source: National Council for Urban Economic Development

The SGDC effort has not been without problems. Sales have been slow, and arson, vandalism, and burglary on the strip have made the marketing job more difficult. There also have been two business failures in the SGDC-owned properties, which has led the staff to be more hard-nosed about prospective tenants. Finally, there is the general problem that most retail businesses do not, as a rule, create a large number of jobs, especially in poor areas. This situation stimulated the SGDC to begin its second incubator project—this one an industrial incubator.

The new incubator will be in a five-building complex that is being bought by a for-profit subsidiary of SGDC in partnership with a local businessman. Because the property was abandoned, the bank that held it was willing to offer a generous mortgage on the \$214,000 purchase price: two

percent interest in the first year, increasing to seven percent after most of the space has been leased. An additional \$110,000 for renovation will be sought from foundations. Two of the buildings will be sold to provide capital for operating expenses.

**East New York (Brooklyn).** For over a year, the Local Development Corporation of East New York has been working closely with the Public Development Corporation of New York City (PDC) and with Interface, a nonprofit research and training organization, to convert a four-floor, 20,000-square-foot industrial building in a badly deteriorated part of Brooklyn into a business incubator. They hope to have the building operating by mid-1985.

The building is city-owned and will remain so under current plans. Specific leasing terms have yet to be negotiated between the LDC and the city. Both groups

are applying to the city and state and federal sources for nearly \$700,000 in renovation funds.

Five to seven businesses at a time will be accommodated in the incubator. A three-year rental and occupancy cycle will be followed. In the first year, rents will be set at \$1.80 per square foot—about 10 percent below the market rate in the area. In the second and third years, the rents will increase 10 percent annually.

After the third year, the businesses will be expected to move out, although it is hoped that they will stay in the neighborhood. A new set of tenants will move in, and the cycle will continue.

*Mihailo Temali*

Temali is a community development specialist in the Cooperative Community Development Program of the Humphrey Institute. He directed the institute's incubator study.

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# P R A C T I C E

Another North Bennington company manufactures fuel and oil lines for jet airplane engines.



Bennington County Industrial Corp.

two years, the Barber-Coleman Corporation started the Business Center for New Technology in 1982 in an idle textile machinery plant. The company does not offer any financial assistance itself, but it has donated space in the incubator to the local business development agency.

Barber-Coleman's approach may signal a trend if other corporations pick up on the idea and offer surplus manufacturing space for use as business incubators. John Dixon, the incubator coordinator, already has met with corporate representatives from two other states considering similar centers.

### Advice

While it's clear that most incubators are still in the fledging stages, their early experiences offer some suggestions to potential developers:

- Evaluate the potential entrepreneurs. Is there a market for their ideas and products?
- Compare the cost of renovating an old structure with the price of building new.
- Enlist qualified people with business experience to manage the incubator.
- Select a mix of new and established businesses.
- Don't waste money on unnecessary services.
- Avoid conflicts by developing explicit lease agreements, but be flexible.

Candace Campbell, a graduate student at the University of Minnesota's Hubert H. Humphrey Institute of Public Affairs in Minneapolis, is a former planner for the Neighborhood Development and Conservation Center in Oklahoma City. She surveyed 50 business incubators as part of a research study for the institute's Cooperative Community Development Program. The study, *Business Incubator Profiles*, is available from the institute, 267 19th Ave., So., Minneapolis, MN 55455 (\$15; \$5 for community groups).

## Contacts

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### Corporations

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