

# **BENCHMARKING OF BUSINESS INCUBATORS**

**in Hungary**

by

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### 1. Does a business incubator need to have a business plan prior its establishment?

Yes, business incubators need to prepare a preliminary business plan for at least the following 3 main reasons:

- Business incubators are, without exception, established by such entities (e.g. local governments, organisations managed from public funds, enterprise development organisations, etc.) who require applications for funding the establishment of business incubators. The preliminary business plan is an important element of such applications.
- The business plan is also necessary for setting up the staff of the business incubator, since this is the document that describes what functions the incubator would have to fulfil (and what functions there are sources for), and then the appropriate human resources need to be assigned to these functions.
- The preliminary business plan is also indispensable in order to ensure the subsequent evaluation of the business incubator established: it is on the basis of the business plan that we can later answer the question whether the work of the incubator was successful or not. The question whether the organisation achieved the objectives set at the time of its launch, as documented in the business plan, can be asked on the basis of the preliminary business plan.

### 2. What are the criteria of success of a business incubation process?

The success of the business incubation process can be evaluated on the basis of meeting two concurrent conditions:

- the achievement of the objectives set forth in the preliminary feasibility study and/or business plan; and
- the number of successful enterprises that have left the business incubator. The fact by itself that a business incubator has tenants is not a proof of success; the latter can only be decided if we are able to examine the incubated clients and their survival rates in a perspective of 3-5-7 years. The majority of Hungarian business incubators still have a relatively short history to examine whether their former clients have gained strength and become successful companies.

### 3. What kind of services should a business incubator provide?

The answer to this question is dependent on the place, time and profile. Business incubators generally provide office space and services to their clients, but even this is not a general criterion, since there are also virtual incubators providing incubation services for a network without providing premises or office services. In Budapest, the “ambulanter” incubator, maintained by the Életpálya (LiveWire) Foundation, has also commenced its activities, which is an organisation engaged in providing complex incubation consultancy services with no premises where these clients can settle. Classic business incubators, however, usually also provide premises in a suitable facility. Business premises (office, etc.) are usually available at the business incubator at a discounted rate, and they normally encourage tenants to leave the given incubator after the incubation period by way of gradually raising the lease rates to the market level. In the interest of this objective, the lease may, after a time, not only reach, but even increase its usual levels on the market.

Business incubators may be facilities established by way of green-field investments (there are several examples for this also in Hungary). It is more frequent, however, that facilities that have lost their earlier function are transformed for the purposes of the business incubator. A typical example in Hungary is the transformation of military facilities (mainly former Soviet army barracks) for this purpose. Also typical around the world is the utilisation of deteriorated, no longer used industrial plants (these have the additional advantage that water, gas, electricity, sewage, etc. lines are installed in a way suitable for industrial activities and with the necessary permits also in place). Both in Hungary and abroad, the buildings of several major steel works have been turned into business incubators after the international crisis of the steel industry.

In addition to providing **leasable premises**, incubation centres usually also provide **office services** (mailing, telephone exchange, sometimes also computer server centre and the related communication connections, IT, internet, etc.).

The **business services** of incubation centres are also frequent, since it is important to ensure that entrepreneurs can work on the implementation of their innovative ideas, and to have access to business functions in which they are less competent (e.g. marketing, packaging, accountancy, etc.) in the form of services provided by the business incubator. This is especially frequent and important in case of services such as accounting, where it would be pointless for a small business to set up its own apparatus (on the other hand, an accounting firm can provide services for all the tenants of the business incubator in a highly cost-efficient manner).

#### **Technical services**

Some business incubators do not provide this type of services at all, due to their specific profile, but in some other cases, e.g. biotechnology incubators, **laboratory services, instruments, or even research services**, which are also frequently outsourced, can be provided by the business incubator. In these organisations an important incentive for the establishment of the business incubator is that the instrument needs of the activity are significant and also very expensive, with indispensable instruments only used by the given company in a fraction of the total time invested. In such cases, time-shared operation is the most cost-efficient solution, whereby several clients of the business incubator may have access to the instruments on the basis of a previously established schedule.

#### **Management services**

These are available in practically all business incubators, since the management of the business incubator, even if to different degrees, provides a **management organisational background** to the incubated companies. This may appear in the form of common elements of image, in the by-laws, the regulations related to the use of the various services, in the requirements related to contacts with the environment, the business incubator or with other incubated companies, etc.

#### 4. How long incubation period to chose for a tenant?

Generally speaking, the incubation period is at least one year and may, according to the plans, last as long as three or four years. In practice, however, many companies even stay longer than that, and it is not easy to detach a company from the incubator's favourable system of services.

#### 5. How many incubator places do you need and what kind of facilities?

It is obvious that business incubators are a rather costly element of the means available for enterprise development. In some cases, such as biotechnology incubators, such support to the

foundation and launching of businesses is inescapable and also more efficient than any other method; however, from the perspective of an average enterprise, on the level of the entire society, it is only worth spending 1-2-4 years in a business incubator if the business incubator's own costs can be reduced to a minimal level, e.g. the facility requires no expensive investment but can be solved by way of utilising an otherwise unused property. Even though the number of business incubators in Hungary is not very high, yet we can already find some facilities, such as Talent Management Park in Szeged, or the business incubator in Székesfehérvár, where for a long time they were not, or still are not able to find tenants. This risk is especially present when the founders of the business incubator set up preliminary criteria (in addition to the obvious expectations, such as start-up companies, micro or small enterprises), and require, for example, innovative services or products, or insist on a specific profile.

The level of equipment provided primarily depends on the profile: founders usually like business incubators where the needs of tenants can be satisfied with simple office services, and only an office (and common facilities on the corridor) need to be provided for them.

In case of enterprises building upon intellectual work, factors that need to be taken into consideration also include ensuring that the workers in the same room do not disturb each other, or make each other's work altogether impossible, because of overcrowding. This means that experiences proved that 6 to 12 sq. metres need to be calculated for one person, including the desk and its accessories. Attention must also be paid to appropriate traffic routes even in case of these enterprises.

In case of enterprises where machinery with moving, rotating or cutting parts are used, a labour safety specialist must also be consulted in order to ensure optimum sizes. In case of such equipment, there are specific regulations in terms of what distances must be kept between these machines and routes of traffic or approach (which must be also indicated with painted floor signs of different colours); also, in case parts, tools or materials need to be delivered to the machines, the safety of these delivery routes must also be ensured.

The observance of labour protection rules is one of the most important issues for a business incubator, and it is also a service itself, since liability is divided between the entrepreneur using the area and the incubator centre consciously renting it out for this purpose. This is why abandoned parts of plants are frequently converted into incubator facilities.

## 6. Who are the stakeholders/local alliances of the business incubators?

The founders of business incubators in the majority of cases are local governments, since they are in possession of the properties (or the right of use) where the business incubators can be founded. Among founders of business incubators we also frequently find the local enterprise development centres, the MVA, enterprises, interest-representing or professional organisations, as well as organisations whose objectives include or relate to either business incubation or the profile of the planned incubator.

Contrary to the American and Western European experiences, we rarely find institutes of higher education among the founders of business incubators. The reason for this is that provisions of law had, for a long time, prohibited universities to participate in enterprising activities.

## 7. How to finance business incubators?

In fortunate cases, a business incubator is supported by a stable financing background. The tendencies of donor policies generally determine whether they prefer to finance projects or successful organisations. In Hungary, project financing has come to the foreground in recent

years, which is unfavourable for business incubators, since it renders their business operation less certain.

Even in case of the most suitable and adequate project it may happen that the sponsor runs out of sources, or reduces the financing of the project for reason.

The revenues received from their clients usually covers only a fraction of the total budget of business incubators, which are, therefore, in constant need of financing from external sources.

#### 8. How to create clusters and networks of enterprises?

Business incubators and clusters differ in many respects. It is very rarely important for a cluster to appear in a shared property or to use a common business model. Clusters are usually alliances of already operating, independent companies, while in case of business incubators companies first settle in and the process of cluster formation begins subsequently. This process, as well as the relationship between clusters and business incubators are analysed in detail, relying on significant empirical findings, in the research project titled "Business Incubators in Hungary" (coordinated by the Association of Business Incubators and SEED Enterprise Development Foundation; the closing study written by Judit Dobák, Péter Futó, Kutor Susan and Pál Lányi; supervised by Anikó Soltész), as follows:

In the 1990s, clustering and networking became more and more important for small enterprises. Clusters and networks are alliances of enterprises operating close to each other, in the same sector, and their objective is to enable the individual companies, by way of purchasing their inputs and/or selling their outputs together, to specialise, to develop technological capabilities, to adapt to the market demands, to build upon their innovative activities, and to improve their competitiveness. The basic idea behind both clusters and networks is that enterprises that are otherwise competing with each other are able to find a form of mutual cooperation, a dynamic balance between competing and working with each other, placing mutual interests into the foreground. Business incubators have some things in common with clusters and networks inasmuch that they require external assistance, but: in case of business incubators, it is the supported inputs that are shared, while in case of clusters, the outputs (products or services) are apparently similar.

Yet another important difference is that incubation is usually fixed to a location, and presupposes enterprises located in a larger complex of buildings or conterminous premises, while businesses in the same cluster may be geographically more dispersed, although they are usually from the same, well-definable region.

*Entrepreneurial clusters* are sets of enterprises in a loose, casual relationship with one another that enter into case-by-case alliances in their purchasing, value-production and sales strategies. A cluster has members, which are typically companies and institutions, while the cluster organisation is usually a non-profit organisation consisting of a few persons only, for example an association, which operates partly from members' fees and partly from state subsidies. Members of clusters may be not only small enterprises but also administrative, research and non-profit organisations, as well as big companies interested in organised forms of cooperation. Enterprises vertically related to the participating companies also often become associated members of clusters: on the input side these may be suppliers, while on the output side they are marketing or purchasing companies. The majority of clusters are defined by either a profession/field or by a region, in some cases by both.

*From the incubator to the cluster.* Active participation between the incubated and associated enterprises often emerges around business incubators. The level of cooperation over a certain level already justifies calling these enterprising networks. A business incubator actively supporting cooperation between its tenants and with external companies/institutions, therefore, can be considered an institutionalising form an enterprising network.

9. How to select the best possible incubator manager?

The manager (project manager) of a business incubator is usually selected from applicants. It is not easy to find a good manager; however the whole success of the business incubator largely depends on the fitness of the given person for the job. In addition to the usual criteria, there is one additional requirement that makes finding the best applicants a more difficult task, which is proficiency in foreign languages, as a basic requirement. It is less and less acceptable for the manager of a business incubator not to speak, apart from Hungarian, also English, and in some cases also another foreign language.

The management of a business incubator, even though it does not generally require a big staff, is a team effort, and the manager has to be able to unite and supervise the work of the team. The manager is also “the face of the incubator”, which means that he or she has to have good PR capabilities and skills, as well as contacts. One of the most important expectations within is excellent ability to establish personal rapport and contact, since the entrepreneurs are often “difficult” people, with whom it is not easy in any case to establish a trouble free working relationship.

Managers of business incubators must have a fair level of economic knowledge, since they she would lose their credibility in the eyes of the tenants, if they were unable to answer basic questions, or would know less about the market and thinking in terms of the market than those whom they wish to help. For the same reason, over-the-average emphatic skills, wanting and being able to understand the ideas and positions of partners is also important. In addition, since the enterprise is in need of supplemental sources, the business incubator manager must be good at writing grant applications.

10. How to select the business incubator supervisory board?

The supervisory board of the business incubator is usually appointed by the founders, and its task and aim is to safeguard the implementation of the founders’ intentions. This also means that in these supervisory boards professional participation is less frequent, and the commitment of the members of the supervisory board toward their delegating organisations is more important. Experiences show that the delegating organisations often appoint such persons for the supervisory boards who, whose professional or scientific reputation guarantees that they would be able to oversee the activity of the business incubator, and whose evaluation would be clear and reliable.

The supervisory board, however, also serves the role of providing a link between the external world, society, the broadly interpreted stakeholders and the business incubator. It is often expected of members of the supervisory board that they provide assistance in finding supplementary sources, perhaps also in the PR activities of the given business incubator, and that they act less in a “supervising” than in a “contributing” function. If these intentions on the side of the management are too strong, this could cause conflicts between the supervisory board attempting to defend the concepts of the founders and the management attempting to implement those concepts.

11. How to evaluate the activities of the business incubators, science and technoparks?

Business incubators, science and technoparks should never be evaluated outside the context of the enterprise development policy. On the one hand, we can find many business incubators, which are essentially market- and profit-oriented enterprises, and their main activities are real estate development, utilisation and renting. Other organisations, however, are supported, non-profit organisations themselves, whose most important task is to forward the support they receive, with the best possible efficiency, to the incubated enterprises. A common element in different business incubators is that they try to resolve some pressing bottleneck in the region, whether it be the expansion of employment, scientific and technological development, sometimes research, innovation, or the most efficient utilisation of the human and other resources of the region.

In the course of the evaluation, therefore, the objectives and tasks for which the organisation must be taken into consideration, just as the issue of what expenditures are necessary to achieve these (or not to achieve them); on the other hand, an important starting point for the evaluation may be the initial business plan of the incubator, since the comparison of the fact numbers with the plans is an important method of evaluation.

A special difficulty is posed by the evaluation of the activities, success and efficiency of the ever more frequent virtual incubators. This is because the clients of such virtual incubators are exposed to several other influences, and the package of services, the consultancy or other inputs are only a part of these influences. In such situations it is extremely difficult to determine what results are owing to the business incubator and what can be attributed to other influences.

12. What are the criteria of the sustainability of business incubators, science and technoparks?

Several Hungarian research projects have unanimously found (cf., for example, the study of SEED Foundation and the Association of Business Incubators) that the business incubators themselves are also of the opinion that they need continuous support, especially because they can only carry out their developments (such as investments in real estate, purchase of instruments, infrastructural developments or other investments) from supplementary external sources. It is not only the opinion of the parties concerned (who clearly find it more attractive if they are continuously sponsored than having to compete for resources on the market), but our own research findings also indicate that self-sustaining cannot be a basic criterion in case of business incubators. On the other hand, business incubators have to pursue a business policy whereby they can survive temporary reductions of external sources, gradually decrease their dependence on external funds, and ensure that some of their activities operate at least at the break-even point. To expect them to provide efficient incubation services and at the same time sustain themselves from its revenues on the market seems unrealistic, however. (In theory, it is possible for a business incubator to have appropriate revenues from the rent and other fees, since many of them are able to solve this problem, while also operating quite profitably from real estate developments.) However, if the profits are generated at the developing organisation, this is only possible if these profits are withdrawn from the incubated enterprises. This, however, cannot be the interest of a developing organisation.

We consider it a good model, and especially a good financing model, where the profits are generated not at the business incubator providing the services, but at the incubated enterprises in the form of cost-price or subsidised service fees.