

34th IASP Annual World Conference
Istanbul, Turkey

On the road to world's first self-sustainable business incubator

Plenary Session 5
"New funding schemes for AOI/STP ecosystems"

Author:
Martin Gorosko (martin@tehnopol.ee)
Tallinn Science Park Tehnopol, Estonia
www.tehnopol.ee

Executive summary

STPs and AOIs are constantly struggling to present the stakeholders the strategy of financial sustainability because it shows clearly the effect of the STP or AOI in the business supporting ecosystem and gives a statement to the stakeholders that they are not interfering the investments of the private sector and the normal market conditions. Today STPs and AOIs have worked out a good set of KPIs that are constantly monitored and presented to prove the effectiveness of their activity. Financial independence and breakeven point is still something that is hard to achieve.

In 2015 Tehnopol, together of stakeholders decided to build up the self-sustainable incubation program for up to 50 tech-companies that lasts for one year. Today, in early 2017, Startup Incubator is about to accomplish the financial self-sustainability and is taking steps to introduce new revenue models in 2018 proving that incubation programs can be sustainable after all.

Introduction of the topic

Tallinn Science Park Tehnopol is one of the leading science parks in the Baltics. Tehnopol has a long history, being established in 2003 through public partnership – the founders of Tehnopol are the Ministry of Economic Affairs of Estonia, Tallinn University of Technology (the largest technical university in the region) and Tallinn City municipality. The main goal of Tehnopol is to support and increase the technology based entrepreneurship and exports capacity in the region.

In order to fulfil the task assigned to Tehnopol the STP has derived three directions of activities combined in the portfolio. They are:

1. Business development services – consultation services, trainings and matchmaking services for high-growth companies that intend to start or increase the export potential or start new product development procedures;
2. Real estate services – after the establishment of Tallinn Science Park Tehnopol, it holds around 10 hectares of land and around 60 000 m² of office and R&D spaces for technology companies. Tehnopol rents out the spaces and is providing the real estate maintenance services. In addition, Tehnopol is eligible to co-invest in real estate developments and R&D labs together with private partners and clusters if the need occurs.
3. Business incubation services – Tehnopol helps and supports the growth of technology start-ups and provides co-working HUB, mentorship and specially design training program to become sustainable.

After the establishment in 2003 Tallinn Science Park Tehnopol is self-sustainable. Meaning that Tehnopol is managing the assets (real estate, land) given to the Foundation by the stakeholders and makes the investment decisions based on the needs of tenant companies; and based on the strategy that is needed to fulfil the task of supporting the technology based economy in Estonia. That has given Tehnopol a good set of assets to be invested in real-estate developments and also to provide different value adding services to tenant companies.

Today there are around 200 companies located in the Science Park, together with 14 000 students and 3000 researchers located in the same campus with Tallinn University of Technology and IT College. The business development services are consumed by 160 companies and there are around 35 start-up companies in the incubation program.

Due to this setup of the services and structure of income Tallinn Science Park Tehnopol in Estonia is encountering the same challenges as other STPs and AOIs globally. Tehnopol is providing business development services for grown companies, business incubation services for start-up companies and real estate services that have good quality and perspective, but the main source of income is the real estate that covers the cost of providing different other services.

Case description: Tehnopol's Startup Incubator

Tallinn Science Park Tehnopol has started to provide the business incubation services from 2003. To promote the incubation services in Estonia (and more widely in the neighbouring region) the new brand name of Startup Incubator has been created and used to develop the incubation services.

Startup Incubator is a business development program for early stage technology start-up companies, one of the strategic services provided by Tallinn Science Park Tehnopol. Startup Incubator is providing one-year development program including coaching, trainings and physical co-working location for the start-up companies in the areas of ICT, health technologies and green technologies.

Startup Incubator has worked with 185 start-up companies. 60% of these companies are sustainably operating today and have raised around 12MEUR of follow up private investments. The portfolio of Startup Incubator has 35 start-up companies in the program constantly (which is the maximum amount of companies the program can work with).

Startup Incubator is working with early stage startup companies that have scalable business model, prototype of the product or service and full scale team to launch the product in international markets (covering the start-up COMMITMENT, VALIDATION, SCALING phases according to the following start-up growth stages).



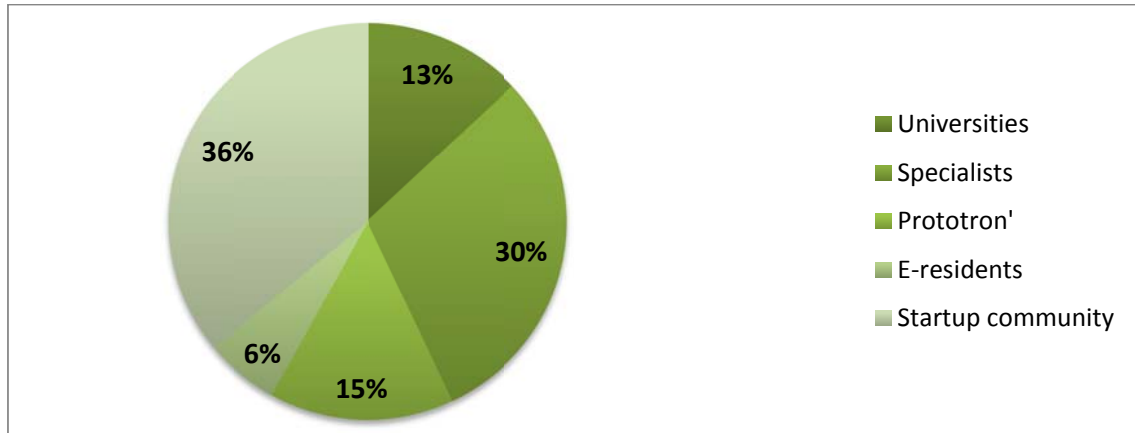
Startup Incubator invests up to 10 000 euros' worth of expertise to a start-up company in one-year program to bring the company to sustainable revenue (200 000+ euros annually) or seed round private investment (100 000+ euros).

Throughout the years of operations Startup Incubator has developed a set of services tailored for high-growth start-up companies. The main components of the service portfolio are the following:

1. Hands-on coaching – Startup Incubator has more than 65 hands-on business coaches working with the companies daily. The main areas of expertise covered by the business coaches are business model development, sales and marketing, investor readiness and raising capital, legal, product development and design, team-building etc. On average the business coaches dedicate around 1500 hours to coach the portfolio of Startup Incubator annually.
2. Training program – Startup Incubator is organizing trainings, seminars, networking events, investor panels and business missions to the start-up companies. The aim of the program is to level the skills of start-up entrepreneurs and bring the companies closer to the investment or potential client. There are around 50 different events annually with more than 2000 community members participating.
3. Co-working hub – The co-working hub at Tallinn Science Park Tehnopol has around 700 m2 of open office areas, small offices and meeting rooms for the companies. The facilities are 24/7 opened for start-up companies and most meetings take place in the HUB.
4. International partner network – Startup Incubator has developed a wide network of partners providing services for tenant start-up companies. These services include support for entering export markets, help in product development, legal services, help in finding investment opportunities (mainly in Europe, angle investments).

Startup Incubator has around 100 applications to enter the program annually. The review panels of the applications take place weekly and the final decision about approving the application is made by the business coaches of Startup Incubator. The decision of approving a start-up is made based on the 5-minute elevator pitch and Q&A session each applicant needs to attend. After the positive decision, each start-up will be assigned a key-coach who reviews the progress of the company weekly and

connects the company to additional expertise if the need occurs. The main sources of the pipeline are the following:



**Prototron is a 450 000 euros' financial fund established by Tallinn Science Park Tehnopol, Tallinn University of Technology and Swedbank. The aim of the fund is to support the development of prototypes (first working product examples).*

***E-residents are the entrepreneurs using the Estonian e-Residency solution that allows them to establish their virtual citizenship and operate in Estonian legal environment.*

Startup Incubator is the biggest incubator in the Baltics and in Estonia. Each year around 35 start-up companies complete the program. Key statistics of the Startup Incubator:

- 185 start-up companies have completed the program;
- 60% of these companies are operating today (sustainable);
- 13 MEUR of private capital has been invested to the portfolio companies.

Case study – self-sustainable Startup Incubator

During the period of 2003 till 2012 the operations of Startup Incubator purely relied on the finances of Tallinn Science Park Tehnopol. Moreover, the national (Estonian) financial grants were used to provide the services to technology start-up companies. In Estonia, the main supporters of the incubation programs were the Ministry of Economic Affairs, matching the financial means with EU structure funding. Together with local and regional money the Enterprise Estonia (roofing organisation for national support mechanisms) ran annual procurements to outsource the incubation services for the certain amount of start-up companies each year.

Naturally STPs, AIs and private accelerators were the one using the grants to establish business incubation units and cover the administrative costs of the incubation services in full scale. This brought us to the situation where in 2012 around 60 start-up companies were incubated with public finances and there were around 10 different incubation service providers in Estonia. The main weaknesses, threats and opportunities of the situation were:

1. Sustainability and the creditability of the incubation service providers – STPs and AIs that have the track-record of providing incubation services got a fierce competition from the public sector, that quickly adopted and developed new age of incubators. They very often served in the interest of private investors and built a pipeline of companies through the incubation services. These private incubators also didn't care do much about the sustainability of the program and were willing to end the program as soon the financing is over. It made the situation for the STPs and AIs more difficult but for the first time created a healthy competition with quick and agile private sector that helped to redefine a lot of processes, and models of service providing.
2. Lack of programs for the start-up companies – A lot of start-up companies started to fade away from Estonian start-up ecosystem due to the lack of places in the incubation or acceleration programs. As all the service providers were operating purely based on the public procurement, the terms and models for services were pre-defined and not very flexible. It was fixed how many companies in the areas of ICT, health-tech, green-tech, creative industry can be incubated and how long the process of incubation should last. The quality of the program and the needs of start-up companies were not considered to be as important and the results were not achieved.

Due to these developments, the STPs, AIs, private acceleration programs and other stakeholders were not satisfied with the financial model and the stated that this should be revised to stay ahead of the global competition of start-ups and talents. Eventually, in 2012 the direct public funding was ended and only! 2 out of 10 incubator service providers remained in the market to support the business development of start-up companies. One out of these two providers were also Tallinn Science Park Tehnopol and Startup Incubator program.

Although the competition was not there and Startup Incubator was free to design the program, working methods, goals and structure of the services as we wished, the financial support was no longer there, and a huge step towards self-sustainability had to be taken.

Re-defining a lot of models and learning from the experiences of other incubators the full set of services was finally launched. The annual budget to work with 30 companies in one year was around 0,5 MEUR (bootstrapping and testing) and included the personnel salaries, fees for the business coaches and mentors, limited budget for sales and marketing, very limited budget for event management and business trainings. So, in 2012-2013 started the first testing period for Startup Incubator, fully financed by Tallinn Science Park Tehnopol, and on the road to test, build and learn; eventually become self-sustainable.

Due to the lack of competition the pipeline of new ideas and promising start-up companies was granted and the focus could right away be directed to finding additional funding for the program. At first, Startup Incubator determined and tested many different options for private financing. According to the high costs of running the business incubation, it was clear that the full financial plan could not rely on one partner (public authority, Tehnopol, private partners, structure funding of the EU etc.) and the method of mixed income sources should be derived and implemented.

To understand the need for additional financing Startup Incubator designated the main cost articles that need to be covered:

1. Building the pipeline – to operate at full capacity Startup Incubator requires at least 100 high quality companies or teams applying annually. In the first phase of the operations it is not crucial but to grant the sustainability this aspect needed definitely financial means and attention.
2. Coaching – the pool of mentors that are working with the companies are payed for their contribution hourly bases. Incubator also needs to be attractive for the best of the best – the practicing professional that can be used to coach the portfolio companies. The average lifespan of a mentor or a business coach with one company is around 3 months and then the substitution is required. That dictated the pool of mentors that is required for the portfolio, which is around 70 different mentors.
3. Co-working HUB – the open office and meeting rooms for the companies is required to have the community close together and enable knowledge sharing. The facilities need to motivate the companies, fulfil their expectations and provide plenty of flexible opportunities for the companies in different growth stages.
4. Training program – the events, workshops and matchmaking taking place during the program are relevant to level the skill-set of the entrepreneurs and to bring the global opinions and practices closer to hem. Networking and business matchmaking are relevant for start-ups as well.
5. Administrative costs – the team of the incubator must be skilled and experienced in building a start-up company, raise the capital and provide full professional support for high-growth companies.

Based on the expenditures, Startup Incubator started to derive a long-term plan to cover the costs by bringing together multiple sources of income. All the different financing means needed to be tested, improved and matched to the normal work-flow of the Startup Incubator.

Today Startup Incubator has practiced and adopted the following mix of funding:

1. Success fee for the companies. As the aim of the program is to raise investment capital (angel investments in seed-round) or reach the sustainable revenue phase, Startup Incubator has introduced success fee on investments and revenue. There is a standard percentage the companies need to pay back to the Startup Incubator if they raise the capital or earn revenue during the program. It also requires the Startup Incubator to set up a sustainable and professional work-flow with global business angels networks, VC funds our other acceleration programs so the pipeline of the Incubator has a routine to reach the investments.
2. Program fee for the companies. Participation in Startup Incubator program is not free for the companies. A fixed sum of 100 euros monthly is introduced that includes the access to Startup Incubator open offices and meeting rooms, business coaching and training programs. This fee is somehow motivational and gives instant feedback for the team of Startup Incubator if their services are valued enough to pay a monthly fee for.

3. Real-estate fee for the companies. All the companies in the program will be granted the access to Startup Incubator open office facilities and meeting rooms, If the teams want to move in the more private booths there is a fixed fee based on m2 of the room. The teams that are proceeding faster and their teams grow substantially quicker are the ones who will start paying for the additional facilities they are using.
4. Sponsorship deals with private companies. In order to cover the costs Startup Incubator is looking for long term private partnerships with the companies that need the visibility in start-up community. There are around 10 different sponsorship packages in Startup Incubator (including specially designed rooms, special training or networking events, promotional material distribution etc.) that require at least one-year commitment. The cost of sponsorship deals varies from 2000 – 20 000 euros annually. It gives the opportunity to private partners to promote their brand or services directly in the target group and for the Startup Incubator it allows to provide more add-on services and cover the expenditures of the program.
5. Rental fee for external visitors. Startup Incubator premises are opened for external guests that need the rooms for their seminars or meetings. If the companies are not using the rooms (especially during the weekends) a lot of different organisations hold their meetings in the premises.
6. Programs for external partners. Startup Incubator is constantly working in order to package and develop full scale programs for external clients and that can be associated with the growth methods of a start-up companies. The latest inclusion in the portfolio is for example the innovation program for the corporates. It is an intensive 3-months program that is fully operated by the incubation team (including the pool of mentors and business coaches) and is directed for the companies that want to initiate in-house spin-offs, innovative product development procedures and new products etc. The program includes trainings and seminars, hackathons, business coaching and follow up for program for the spin-offs. Eventually a lot of these spin-offs become the full members of Startup Incubator as well.
7. In addition: fee for hosting delegations at Startup Incubator, fee for providing investment pipeline for private investors, equity holding in start-up companies.

Combined, this business model and set of services proved to grant the sustainable flow of incomes for Startup Incubator and helps the program to reach financial sustainability in these days. Moreover, Startup Incubator has developed a high professional approach when working with start-up companies that is valued by the venture capital and potential entrepreneurs in the region.

Conclusion and lessons learnt

All the efforts that Startup Incubator has taken have proved to be successful with some minor throwbacks. The financial sustainability is almost reached and additional models, including equity taking, direct investments, pipeline sales, will be introduced in 2017 - 2018.

During the process of doing that Startup Incubator has indicated five main takeaways:

1. Start-up companies are willing to pay for the services if the program is competitive and understandable for them. There needs to be money in the end of the tunnel and links to private capital are crucial. Value proposition (the promise) for the start-ups should be clear and understandable.
2. Pipeline is the biggest value that the incubators have. It can be capitalized and the buzz among the investors bring more good quality companies to the program. Investing one euro to the pipeline brings definitely two euros back. Marketing activities and costs should not be overlooked but the smartness should also be there. In the case of Startup Incubator we specially launched a financial fund called Prototron to bring in new ideas. The core of Prototron is simple – we give development grants to the start-up companies for developing a prototype. If the team is successful we take them in the program and start working with the company. Each year we have around 600 applications for the grant and the pipeline is high-quality.
3. Business incubators are competitive in comparison with private acceleration programs because of the long-term commitment. It is valuable in building long-term collaboration with start-up companies and to the community of private investors. Usually the acceleration programs last for 3 months and the commitment of the mentors and business coaches is hectic. Companies tend to value if the key advisors stick to their advice for longer and take the commitment together with the company.
4. Operating in real market conditions gives a good quality assessment discipline and motivation to the business incubator team. It helps to build a world-class service in competitive market. If the companies are willing to pay for you it means you are worth it, if not, then probably you should re-define something in your program or keep the services more focused.
5. Incubators should establish a fixed mixed portfolio of incomes to be successful. For Startup Incubator it has been tricky to have the funding only from one source. All the STPs and AIs should have multiple lines of business connections and interests that they are serving. It gives you the opportunity to grant the sustainable income flow and minimizes the risks of failure.

Martin Goroško

Manager of Startup Incubator

Tallinn Science Park Tehnopol Foundation, ESTONIA

Phone: +372 56 800 228

E-mail: martin@tehnopol.ee