

# XXV IASP World Conference on Science & Technology Parks

The role of science parks in accelerating knowledge economy growth – contrasts between emerging and more developed economies



## IASP

International Association  
of Science Parks



14 - 17 September 2008, Sandton Convention Centre, Gauteng, South Africa

## XXV IASP World Conference 2008

### *Specific problems of the Incubator Industry: A Case of Uganda*

*Parallel Session 7:*

*Incubators: what are the new developments in the incubation industry?*

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## Specific problems of the Incubator Industry: A Case of Uganda

### Executive Summary

*Start up companies play an important role in bringing innovation and much needed new economic growth for developing countries like Uganda. It is therefore imperative that more conducive business environments are created to support them. Business incubation fosters innovation and entrepreneurship by addressing weaknesses in the business environment. These include provisions of business services, infrastructure and finance.*

*The Incubation industry is still very young in Uganda with approximately less than 10 incubators faced by the critical challenge of scarce overall financial resources to help start-up businesses expand to the point where they can attract risk capital; Very few resources exist for entrepreneurial funding especially during the early stages. This paper aims to examine the specific challenges to the Incubation industry in Uganda and highlights what remains to be done is to overcome the many challenges to the process .It is critical that Incubation is widely promoted in Uganda as one of the ways in which the economy will be able to grow.*

**Key words: Small and Medium Enterprises, Business Incubation.**

### Introduction.

In today's world, true competitiveness requires entrepreneurial businesses that can establish strong positions in niche markets through innovative products and services. Such businesses in their start up stages are good candidates for incubation systems<sup>1</sup>. In most emerging economies, most businesses are very small with few large ones. Similarly in Uganda, there is an increasingly dominant role being played by small enterprises. The advantage of these small players is that they make use of local resources and have lower capital intensity. Incubation can therefore play a very important role to ensure that these small enterprises start up, expand and stay strong.

Business Incubation is a public/and /or private entrepreneurial economic and social development process designed to nurture business ideas and start up enterprises through a comprehensive business support programme in order to help enterprises accelerate their growth and success.<sup>2</sup> The business incubator is a physical space or facility that accommodates a business incubation process. The incubator is beneficial to all stakeholders as indicated in the following sentences:<sup>3</sup>

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<sup>1</sup> UNIDO (1997): Lessons from International experience for the promotion of Business Incubation Systems in emerging countries, Small Medium Enterprises Programme.

<sup>2</sup> Regional Incubation Manager Training, 8-12<sup>th</sup> October 2007, Mauritius

<sup>3</sup> Lalkaka, Rustam (2001), Best Practices in Business Incubation, Lessons yet to be Learned, International Conference on business Centre, Actors for Economic and Social Development Brussels 14-15 November 2001.

For the entrepreneur or business, it enhances the chances of success, helps improve skills, raises credibility and facilitates access to mentoring, information and seed capital. For the Government, it generates jobs, incomes and taxes and demonstrates political goodwill for small businesses. For the research institutions/universities, it promotes research commercialization and gives opportunities for graduate students to better utilize their capabilities.

Therefore it is critical that the following ingredients are in place for the successful development of the business incubation concept in emerging economies; public policy that stimulates entrepreneurial businesses and provides the business infrastructure; private sector partnerships for mentoring and marketing; knowledge base of learning and research; professional networking, national and global; and community involvement to promote entrepreneurship and cultural change.

In Uganda, there are an estimated 800,000 MSMEs in urban and rural areas. These enterprises provide employment to approximately 1.5 million people - 90% of total non-farm private sector workers.<sup>4</sup> Employment growth is 20% per annum in the MSME sector and it contributes to 20 % to GDP. The potential advantages of the SMEs are many. Firstly, they tend to use less capital per worker than large firms do, not only because of differences in the types of products made but also because of differences in the technology used to make the same products. Secondly, they use resources that otherwise might not be drawn into the development process, e.g. workers with little formal training who learn skills on the job, or the small savings of the entrepreneurs who may not use the banking system but who may invest in their own firms, etc. Thirdly, in addition to serving as a seedbed of entrepreneurship, small enterprises occupy a highly useful niche in industrial structure, sub-contracting with large firms and engaging in small batch production, made -to-order work, or finishing operations complimentary to large scale industry. Vendors selling merchandise on the roadside, craftsmen repairing electronic and mechanical gadgets in small shops and artisans equipped with simple tools producing basis consumer goods are familiar sights in Uganda.

The relevance of informal sector needs to be viewed in relation to poverty and unemployment. Poor people cannot afford to be unemployed. Nor can the young be unemployed over long periods without being a burden on their families. Jobs become not only necessity, but a matter of survival. Small Enterprises, in informal sector, in handicrafts, manufacturing, construction, trade and service industries are increasing

There is therefore a high formation rate of new enterprises. Similarly there is a high collapse rate of these newly formed enterprises. Key SME challenges include:

1. Lack of entrepreneurial skills.
2. Lack of technical capability;
3. Inadequate infrastructure;
4. Access to finance;
5. Access to market;
6. Access to technology.

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<sup>4</sup> Draft MSME Policy, (2007) Government of Uganda.

Incubation is therefore seen as one of the means through which MSMEs will be able to grow and become more competitive for private sector development in the country but developing Incubation still remains a challenge. Incubators add value to enterprises by reducing costs and generally giving them a better chance of survival.

### **Importance of Incubation to Enterprises and Challenges.**

The bulk of small enterprises operate at low technological levels. They generally lack the skills to identify and address their technical problems as well as the finances to pay for information, consulting, research or training services. Starting a new business in Uganda can be a hazardous task compounded by large capital requirements, limited appropriate work spaces and little or no linkages to sources of knowledge. Further growth of the modern small business sector in Uganda requires renewed efforts to improve production methods, raise quality and shift to value added products. This is a role incubation can play in Uganda by providing special support systems which provide integrated services on production, management, access to finances and marketing.

However, the Incubation industry is still very young in Uganda with approximately less than 10 incubators. Specific challenges facing the industry are expounded on in the next paragraphs.

#### ***Incubation is still a new experience***

The concept of business incubation is still new in Uganda with very little experience on how best it should be run and managed. Business incubation is not yet widely seen as an agent of innovation as well as a gate for development. There are difficulties in raising public and private sector awareness of the importance of business incubation. This is so because the concept has not been widely promoted in Government policies. Uganda is yet to develop a business incubator that in its own right is an example of innovation and entrepreneurship. Uganda needs to develop Business incubators that will identify and test solutions for increasing business survival and success. Marketing of the business incubator concept needs to be done at the level of strategic entities and institutions as well as the local community. There are still insufficient national, regional and international networking opportunities to exchange best practices and lessons from experience. Due to incubation being a relatively new experience, there is also inadequate access to expert advice on urgent issues facing business incubator managers. Uganda lacks professional expertise for successfully starting and managing incubators. Technical Assistance in this regard would be helpful from start up of the incubators till it attains sustainability<sup>5</sup>.

#### ***Limited incentives for new businesses***

Uganda lacks policies that offer strong incentives for research and development and new businesses. The Government of Uganda is yet to produce a National MSME policy that will be responsible for SME friendly regulations including those that can persuade Government on their responsibility to provide initial financing for incubators. Incubators would play a role of are

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<sup>5</sup> Private Sector Foundation Uganda (2005), Private Sector Competitiveness Project II, Project Implementation Manual.

helping clients navigating some of these challenges, and also act as effective advocates for change in the local business environment.

### ***Limited Public-Private Partnerships***

Business incubation relies upon linkages with many organizations and service providers; other public and private business service providers; universities and technical colleges, as service providers and a source of emerging entrepreneurs (clients); governments for support of the business incubation activity and for improvement to the enabling environment; finance providers, from banks and venture capital companies to informal lenders and individual equity investors (angel investors); and the private sector including local entrepreneurs and large multinational firms, to help as mentors, trainers and as channels to markets.

Running an incubator is a very expensive proposal seldom undertaken by the private sector. It has to be Government to make the initiative as incubation is paramount in its efforts towards employment creation, poverty reduction and increasing the overall tax base. The Public Private Partnerships (PPP) are an important success factor for the incubation industry and the Business Incubator will thrive when the public and private sectors work together and build local capacity. However this remains a challenge for emerging economies like Uganda where both entities the Public and Private sectors at times view each other with a lot of suspicion and yet business incubators require broad based support.

The Private Sector in Uganda is visibly absent from the incubation scene and yet its involvement is critical for mentoring new entrepreneurs as well as for the provision of financial support for emerging start ups. Since incubators provide significant reduction in the risk of entrepreneur early stage failure, it is critical that the private sector gets more involved in the incubation process. The private sector focus should be on direct participation through service providers and mentors for individual entrepreneurs. Indirectly, private enterprises form a vital role in financing. As private enterprises realize that incubators provide significant reduction in the risk of early stage failure, the participation of the private sector is expected to increase<sup>6</sup>.

The donor community needs to join the partnership to support the incubation process business in, particularly in environments like Uganda where SME growth, innovation and entrepreneurship is at a nascent stage. The donors provide critical funding to start up the incubation process which could further leverage funding from others. This association with donors will also increase opportunities for the newly formed incubators to network for continued development and dissemination of good practices and lessons learned.

The following are critical roles that the Government should play in supporting the Incubator<sup>7</sup> concept in the country but unfortunately very limited progress in being made in this direction

1. Improving the enabling environment and ICT infrastructure
2. Providing strategic direction for business incubation
3. Financial resources for establishment of incubation operations

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<sup>6</sup> UNIDO (1997): Lessons from International experience for the promotion of Business Incubation Systems in emerging countries, Small Medium Enterprises Programme.

<sup>7</sup> Regional Incubation Manager Training, 8-12<sup>th</sup> October 2007, Mauritius

4. In kind support e.g. buildings for the incubator.

Universities provide the critical research linkage for Business growth and new ideas. In Uganda linkages do exist between the private sector and universities although the linkages are still very weak and yet Research and development institutions are the source of emerging entrepreneurs and have infrastructure that can be used for business incubation e.g. pre-business incubation facilities, access to ICT infrastructure, laboratories, libraries etc. There is the need to establish incubators to will support universities and research centers in the design of new business undertaking as means if advancing technological innovation.

#### ***Limited Technology uptake.***

##### ***Limited ICT network:***

Information and Communication Technologies (ICT) can be powerful tools of private sector innovation and competitiveness. Incubators around the world are helping their clients address the gaps in ICT infrastructure by providing ICT access at subsidized rates or for free as well as ICT capacity building. However developing countries including Uganda face considerable challenges in promoting and sustaining ICT enabled innovation for new business creation.<sup>8</sup> Internet and communications are an essential item for the success of any incubation program. Uganda still faces a number of ICT related challenges which include limited and costly access to telecom services, particularly the internet.

##### ***Innovations for new start ups:***

The technology innovation process is not Research and Development alone but a larger constellation of interrelated issues including policies for investment, education and trade and also involving strong public private partnerships<sup>9</sup>. This will encourage new start ups that can be targeted by the incubation industry. The technology uptake process however is still lagging behind. The increasing complexity of technology makes it difficult for the individual enterprises, especially small and medium enterprises, to engage themselves in competitive R&D and technological development efforts due to high financial risks. The technological needs of MSMEs are extremely diverse, reflecting the wide range of products and services that are provided and the comparative level of sophistication of the business operation. At one end, there are micro and small enterprises which are labor-intensive whereas on the other end there are manufacturing enterprises which need sophisticated technologies to keep them competitive in markets<sup>10</sup>. However, MSMEs access to such technological needs is very limited, firstly, due to lack of information, even about existing technologies and, secondly, due to the inadequate availability of suitable technologies including appropriate technologies suitable for local

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<sup>8</sup> Innovation, Entrepreneurship and Growth: Scaling up ICT Enabled Private Sector Development, [www.infodev.org](http://www.infodev.org)

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UNIDO (1997): Lessons from International experience for the promotion of Business Incubation Systems in emerging countries, Small Medium Enterprises Programme.

<sup>10</sup> Draft MSME Policy, (2007) Government of Uganda.

environment. The linkages between MSMEs and large companies including MNCs for technology transfer are weak.

In Uganda , there is therefore an urgent need to actively promote the adoption, transfer and mastery of process and product technologies that will improve the productivity and competitiveness of MSMEs by strengthening the institutional framework for Technology Development, including Appropriate Technology, Technology Up-gradation & Technology Transfer, and the linkages between public and private sector stakeholders.

### ***Financial Constraints***

Incubation in Uganda faces a challenge of attracting clients and thus growing because many of their would be clients, the MSMEs. There is a feeling that entrepreneurs were “stuck in the middle” between the types of small enterprises that microfinance institutions serve and the deals that banks and private investors find attractive. Financing for MSMEs, which represent the bulk of enterprises in Uganda, is an even greater challenge because their needs and capabilities do not fit well with prevailing methodologies of either commercial banks or microfinance institutions (MFIs).

On the overall, Uganda’s financial markets are shallow, with a limited range of instruments available for financing even for the most favored clients. This implies that there scarce financial resources to help start-up businesses expand to the point where they can attract risk capital. Very few resources exist for entrepreneurial funding especially during the early stages. This means that incubators have limited start up companies that survive with which they can work. There are limited knowledge resources for business incubator managers, their clients and financial organizations on the appropriate financial mechanisms, exit strategies and risks mitigation tools, which could facilitate investment in new small enterprises in developing countries like Uganda.

It is clear that the financial resources which are available in the economy will not be harnessed for private sector development without innovative interventions aimed at encouraging the development of appropriate financing instruments. Banks perceive MSMEs as relatively higher credit risks with high cost of lending due to higher administrative and servicing costs of small loans.

MSMEs are normally required to assign immovable property as collateral to secure their obligation, a condition that most MSMEs find difficult to comply with<sup>11</sup>. Moreover, lack of suitable lending modalities, and limited capability of MSME credit staff to appraise MSMEs cash-flow-generating capacity is another reason for the predominance of collateral-based lending. Lack of ownership of land or immovable property as collateral for bank financing poses additional problem especially to the women entrepreneurs.<sup>12</sup>

If the incubator industry was supported, it could work to solve this financial crisis of MSMEs. This could be through working to increase their clients’ access to capital by offering financial

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<sup>11</sup> Draft MSME Policy, (2007) Government of Uganda.

<sup>12</sup> Stevenson L, St Onger A (2005), support for Growth Oriented Women Entrepreneurs in Uganda, ILO

products themselves including seed funding and credit guarantees or brokering access to the financial institutions. Funding to sustain the incubation program is also critical as incubators are expensive to establish and manage. Uganda does not have the resources to set up one in every town let alone reach all the people needing support in more rural and remote areas.

### ***The challenge of Informality among SMEs.***

In Uganda, there are limited Business Development Service providers who would support the SMEs to develop an entrepreneurial attitude so that more and more start ups can be formed. This is further combined with a large section of informality among the existing SMEs. Formalization is an issue for developing countries is an issue because:

1. Informality limits enterprise growth: at some point in their development entrepreneurs need to interact with formal structures. Either they comply or are locked out.
2. Informality undermines governments: states support private sector development by providing public goods and selective interventions. Tax evasion deprives them of resources to do so.
3. Informality carries large environmental and social costs. In the long run these can undermine the whole economic sector

This informality becomes a challenge to the incubation industry as there is limited demand for the services of incubation which could support their clients develop an entrepreneurial attitude, followed by developing a business plan, improving the business model and developing an idea or concept for growth

### ***Limited Infrastructural Support***

An absence of basic business support services related to transportation (roads, railways), power generation, transmission and distribution, water supply, telecommunication is a challenge to incubator development in the country. Further still facilities like industrial parks, export zones business villages and incubators were found to be extremely rare<sup>13</sup>. The shortage of serviced industrial land is a major constraint for the expansion of the manufacturing sector in general and exports in particular. Established locations within Kampala are fully occupied and have little space for expansion. If serviced industrial area mushroomed in Uganda, they would create room for the incubation industry to support the emerging industries in the industrial parks. The Government has rightly acknowledged the need for well-planned, environmentally friendly serviced land for industry outside Kampala and has planned the Kampala Industrial and Business Park (KIBP), located 11 kilometers east of Kampala<sup>14</sup>. There have been recommendations made to the effect that specific women focused incubators are developed to support the growth and development of women enterprises in urban and rural areas.

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<sup>13</sup> Stevenson L, St Onger A (2005), support for Growth Oriented Women Entrepreneurs in Uganda, ILO pg 56

<sup>14</sup> Private Sector Foundation Uganda (2005), Private Sector Competitiveness Project II, Project Implementation Manual.



## **Conclusion**

In conclusion, Uganda still has a long way to develop its Incubation industry but at least the ball has been set rolling. What remains to be done is to overcome the many challenges to the process. There is need for a high powered drive to create awareness of incubation on a national level and to engage the donor community and other relevant stakeholders to support its growth in the country. Access to expertise in the incubation business will be critical to the development of the industry on Uganda.