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## Acceleration programs versus Incubation

Parallel Session 1

Organisation of STP Services

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## Acceleration programs versus Incubation

The role of technology startups in global economy has never been more important. Startups may seem insignificant compared to large multinational companies that have trillions of dollars of wealth sloshing around in public markets. Despite of that start-ups have become the main driving force of innovation and economic growth. Companies like Dropbox, Facebook, Twitter, Rovio, Soundcloud are all shaking the cornerstones of large traditional corporate businesses. 25% of international phone calls are made with Skype what had its first employee in 2003. We can notice hundreds of new applications appearing in iTunes Appstore or Android market daily what can improve our life.

Supporting entrepreneurship and helping local innovative start-ups have been one of main instrument of public sector to support creation of new jobs regionally. According to study made by Kauffman Foundation start-ups are the main origin for job creation in U.S. Incubation programs are one of most universal instruments to do that. First incubators where established already late 50-ies of past century. At the present approximately 7000 incubation programs operate worldwide. For science parks technology incubators are natural elements of services.

Incubators are combining different support elements like free or low cost premises, business training or mentorship and financial support to help start-ups in their very early period. Typical period for incubating a company have been 2-3 years. To have more spillover effect among companies incubators usually specialize on some industry like IT, biotech, creative industries etc. In technology intensive fields like biotechnology or nanotechnology many incubators also provide lab infrastructure to support start-ups in their product development phase.

Main idea of an incubator is to lower operating costs during the start-up period of the company combined with some assistance. Incubators usually do not take equity in start-ups, the only revenue they have are fees for rent and services. At the same time to keep prices attractive and affordable also for start-ups most incubators use public support to keep their business model sustainable. From the public point of view enterprise support through incubation is one of most cost effective way to support regional development.

Approximately five years ago new model of supporting start-ups have evolved called accelerator. Accelerator programs are mixing early stage seed capital investments with mentorship during intense 3-month period of the program. Most successful accelerator programs at the present are initiated and operated as privately held companies mainly financed by VC industry and business angels.

## Differences between incubators and accelerators

Accelerator programs in the new wave have a number of distinctive features that set them apart from existing incubators and other programs to support startups. There is some variation between programs, but they comprise five main features:

- Taking equity in companies
- Global and highly competitive selection process
- Focus on small teams not individuals or ideas
- Time limited program
- Startups supported in cohort batches or 'classes'.

Opposite to majority of incubators most of accelerators take equity. It builds totally different and much more bounded relationship between company and a program. Giving away even 5-10% in very early stage for 10 000- 50 000 EUR is very painful for company thus the interest to get the maximum from the program is also higher. On the other hand most of very useful advice provided by program mentors is free and the program expects to earn in the future liberating start-ups from running costs. Thus they do not charge for services when the company has a period of most limited resources.

From the perspective of the program, making an investment and not charging for services as incubators typically do, accelerators are more focused on impact of the program and on quality of selection process. Because of by investing in participants accelerators remain tied with companies even after 3-month program and they are really interested in company's future and potential. We have to consider also that money for investments is coming from private sector not public sector. That means program is focused more on short-term positive results and have additional pressure to the performance of the program and selection.

Sometimes accelerator program has been called also "American Idol" type contest for entrepreneurs because of the way the start-ups are chosen to the program. As Simon Cowell have changed the entertainment industry Brad Field (Techstars) and Paul Graham (Y-combinator) have changed the way how web and mobile technology industry works.

As the quality of projects is so important application process is one of key elements of accelerators. Incubators usually act regionally as they are supported by local public actor (local government, university etc.). This means they have to focus on companies with local origin.

Accelerators on opposite are ready to take on board any good project from any part of the world. So similarly to their companies they are from the day one on global market. Strongest programs like Y-combinator or TechStars Boston get more than 2000 applications to one call. Especially in the context of European Start-up scene this is one of most influential changes what accelerators have introduced. Accelerators have broken national borders of support programs and forced start-up scene become really pan-European in the context of business angels, mentors and companies.

Accelerators preferring teams of a size 2-4 people and do not accept start-ups with only one founder. As the program is really intensive and companies really need to make change during 3 month it is clear that it is too much for one person. Also teams are much more eager to "pivot" their business. It all rises probability of success which is really crucial for the program. Execution capability of the team has become one of key elements of success because lower costs to start have also lowered costs of changing or "pivoting" business idea. Incubators historically have not been so selective on teams as they more have looked on idea than team. Due to fact that incubation process is longer there is also more flexibility to work with the team building. Accelerators just can't afford it.

Time-limited intensive program of accelerators is 8-10 times shorter than typical incubation period. Making program so short forces both companies and mentors focus on things what are really important. It creates right behavioral culture for modern innovation environment

where everything changes quickly and you have to be able to use the right momentum quickly. As almost all accelerators are active in mobile and web industry the length of program is suitable for these sectors. In other industries probably it would be too short period to go through the whole process from idea to selling the product to first customer. Still mindset of acceleration program could have positive impact when start-up needs to make some critical spurt for moving their business to next milestone.

Having “classes” of 5 to 10 companies makes organizing acceleration program as short as 3 month much more efficient. It is easier both for mentors and for companies plan their limited time. Incubators also tend to have calls for “classes”, but they are much more flexible as mentoring is not their main value proposition of program.

### Reasoning for appearance of accelerator programs

There are three main forces what have forced the scene to change:

- Changes in VC market and the way seed investments are made
- Costs to start new venture. Especially in mobile and web business
- Costs to acquire new customers including new methods for payment

Appearance of accelerators is in one way an answer to the changes in VC markets after “dot com” crisis. VC-s used historically to be risk-taking investors who actively participated in setting up the company and hiring the management team. Often VC partners would serve alongside founders as top managers of newly formed companies

On present day VC have almost abandoned seed-phase investments and even if they invest they take on better occasion a seat in supervisory board, but they do not participate actively in management.

Business angels have at least partly fulfilled the gap of disappearance of institutional investors there has been certainly a gap to be fulfilled. Both VC-s and angels needed an efficient framework to invest in companies and also to select the best ones.

Besides the model and need from VC industry also environment for implementing innovation have changed. Existence of new infrastructure based on telecommunications solutions (internet, mobile phones) such like cloud computing, open source software have broken barriers to start technology businesses global on very early stage. This have also caused innovation cycle to became faster than we used to it decade ago. As incubators where mostly focused on lowering costs, we can say appearance of accelerators is a response to fact that costs for starting a business have lowered so significantly.

| 2001 (dot com era)  | 2011 (lean start-up era)   |
|---|--|
| <ul style="list-style-type: none"> <li>• Buy servers and drive them to the datacenter</li> <li>• Go out and buy software licences for all your employees</li> <li>• Agree and sign an office lease</li> <li>• Launch a billboard campaign</li> <li>• Take years to build software and then release</li> </ul> | <ul style="list-style-type: none"> <li>• Create a new instance in the cloud from your desk</li> <li>• Activate Google Apps for your domain</li> <li>• Book by the hour at TechHub</li> <li>• Google Adwords or Facebook adverts</li> <li>• Iterative agile software development with dailyupdates</li> </ul> |

Even more dramatic change is that customer acquisition costs (the cost of advertising to and attracting a paying customer to your service) have dramatically fallen and the sophistication of the tools available to target particular customers and measure the

effectiveness of different approaches have improved markedly.

Global market has been historically playground for big multinational companies. Today two to three person company has the same access conditions with the help of Google Adwords or Facebook what multinational companies had with multibillion-dollar advertising budgets. Small teams can easily test how much it will cost to gain new customers using different approaches and set it flexibly into action.

Along with the sheer numbers of potential customers that are available to online businesses today compared to a decade ago, there are much better routes to monetization, particularly through direct payments in the form of transactions (e-commerce), app stores and subscription models.

Until present majority of accelerators have been mostly oriented on mobile and web based solutions. In these sectors barriers and also time to market are the shortest and most suitable to the program. But there are first ventures to build accelerator programs also in mechanical engineering and biotech.

### **Is era of incubators over and there is time for accelerators now what are the risks?**

Almost half a century incubation as a process dominated without major changes in their core services until the beginning of new century. During last five years new accelerator model have quickly started to take more and more ground. Is it the end of almost half a century era or just a complementary model for incubators? To measure success of accelerators is a bit too early. Until now they have proven that in web and mobile sector they are a really useful tool for both investors and start-ups.

Due to high and global competition accelerators with most attractive program and mentor network most certainly are able to provide some return also to their investors. During past year a significant number of new accelerator programs have introduced across the world and we can call it even a “boom of accelerators” what is happening now. Will it become a “bubble” and how it will influence so hole industry is not clear yet.

New trend is formation of alliances or networks of accelerators. Techstars in U.S. running accelerator programs in 5 different cities. Start-up Bootcamp in EU are running 4 programs in for countries. These two are probably the most visible known examples. Networks are helping to pool better investors and also mentors what are so crucial for program. From that point of view in future accelerator programs which are a member of some network will have clear advantage against other programs. In 2010 Techstars founded “Techstars Network” what today is known as “Global Accelerator Network”. The aim of the network is to provide benefits via corporate partnership’s with global multinational companies like Microsoft, PayPal, Amazon etc. and share knowledge and experience.

To apply accelerator model also to all other industries besides web and mobile the necessary preconditions should be first filled. It means customer acquisition costs, time to market and flexibility to “pivot” your business model should be as easy as it is in web and mobile industry today. If to look the trend that prototyping is getting cheaper also industries dominated long time by big multinationals like machine building, biotechnology we can say that there is a future for accelerator programs also.

But most probably technology fields where development of product needs still expensive machinery or long development and testing periods stay a playground for incubator programs.

Some elements like time-limited intensive business development periods, active usage of large pool of mentors during that period and mixing it with micro investments into equity already are integrated into several incubator programs. Accelerators with that have already have wider impact on start-up and innovation processes generally introducing new more efficient methods on supporting new ventures. And have proved once more that bottom-up solutions with strong demand from market are the driving forces of market economy.

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