

**Building Success:  
An Empowerment Incubator for Champaign-Urbana**

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Cities in the United States have used many different methods over the past decades to encourage economic growth and combat poverty. Many of these attempts have cost tens or even hundreds of millions of dollars—consider the expense associated with urban renewal, sports stadiums, convention centers, and the like—but too often, the programs have little effect on low-income residents. Today, strategies that work with the existing strengths of the community are seen as much more beneficial since they build up capacity and social capital and can have an ongoing impact on the communities they serve.

One of the most popular economic development strategies of the last twenty years has been business incubation. A business incubator is a facility designed to nurture start-up businesses in their formative years. Incubators provide building space, management advice, financial counseling, and shared office services to their tenants. Most incubators today focus on general economic development or on fostering technology-based businesses. Very few concentrate on the empowerment of low-income and minority communities, though these groups arguably have the most to gain from a successful business incubation program.

Champaign-Urbana has a need for an empowerment incubator. Other programs—from private incubator-type facilities to the new University of Illinois research parks—focus on high-technology ventures and more established entrepreneurs. Nothing exists for minority or low-income innovators who are interested in starting a business or expanding an existing informal home-based business. Establishing an empowerment incubator in Champaign-Urbana would fill this need.

This paper seeks to describe some of the issues surrounding incubator development and begin to describe how an empowerment incubator in Champaign-Urbana might look and function. Part I reviews some basic information about incubators, examines some academic research, and looks at some fundamental topics, including planning, financing, staffing, and facilities. Part II will lay out some recommendations for an empowerment incubator in Champaign-Urbana.

## **Part I: Background, Research, and Issues**

There is a significant amount of literature devoted to business incubation. Although this literature is primarily practical in nature, relating to development, operations, and management issues, there is some academic research as well. Almost all of the literature is aimed at “average” incubators—those with 30,000 square feet or more, targeting middle-class entrepreneurs, often focused on high tech industries, and so on—and very little has been written about empowerment incubators, particularly the challenges of development. As a result, much of the information that follows is based on the assumptions of the “average” incubator, with added discussion of the relevance to empowerment incubators.

### **Incubator Basics**

According to incubator researchers Mark Rice and Jana Matthews, incubators are distinguished by three characteristics: “(1) a person (or staff) who provides advice/mentoring and access to a resource network; (2) shared services, which means a company located in the incubator does not have to outlay funds for a secretary, phone, fax machine, and photocopying machine; and (3) flexible space, rented on a monthly basis, that can be expanded or contracted as needed.”<sup>1</sup>

Rice and Matthews also point out that “the process of business incubation [is] much more important than the incubator facility.”<sup>2</sup> In fact, in some cases, “incubators without walls” have been established. In these programs, no central facility exists, but the business advising and mentoring programs—and possibly some shared business services—are still provided to client companies.

### **History of Incubators**

The first business incubator in the United States was the Batavia Industrial Center, opened in 1959 in Batavia, New York. When a factory there closed in 1957, a family prominent in local business bought the facility and began renting to small and start-up businesses.<sup>3</sup> The National Business Incubation Association estimates that today there are more than 800 incubators in North America.

### **Types of Incubators**

There are three basic types of incubators, according to Lawrence Molnar, an incubator expert at the University of Michigan. There are mixed-use incubators, technology incubators, and micro-enterprise/empowerment incubators. Mixed-use incubators are most often created by local governments to foster job creation and economic growth. Technology incubators, on the other hand, focus on developing high-tech enterprises and jobs. Finally, micro-enterprise or

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<sup>1</sup> Rice and Matthews xx.

<sup>2</sup> Rice and Matthews xx.

<sup>3</sup> Burger, Frederick. “Business Incubators: How Successful Are They?” *Area Development Online*, January 1999. <<<http://www.area-development.com/past/jan99/features/incuba.html>>>

empowerment incubators concentrate on economically depressed, low-income areas, particularly on assisting local low-income or minority residents in starting or expanding businesses.<sup>4</sup>

Statistics from the National Business Incubation Association (NBIA) identify seven types of incubators, though they conform to the general three-category structure used by Molnar. The NBIA categorizes incubators as mixed use, technology, manufacturing, targeted (these focus on start-ups in a specific industry), service, empowerment, or other. The breakdown of these types, according to figures from the 1998 State of the Business Incubation Industry study, are:

- Mixed use, 43 percent
- Technology, 25 percent
- Manufacturing, 10 percent
- Targeted, 9 percent
- Service, 6 percent
- Empowerment, 5 percent
- Other, 2 percent<sup>5</sup>

Given the NBIA's estimate of 800 incubators in North America, there ought to be approximately 40 incubators dedicated to empowerment. The information specialist at the NBIA was only able to identify five member incubators who are focused on empowerment, however. A 1995 article in *Black Enterprise* magazine listed 10 incubators that focused on minorities and women.<sup>6</sup> In any case, empowerment incubators represent only a small portion of the total number of incubators in the country, and there is very little information that specifically deals with them.

### **Incubator Sponsors**

According to the non-profit National Business Incubation Association, public or private non-profit entities are responsible for creating 51 percent of all incubators in North America. Academic-related incubators account for a further 27 percent. Incubators created through public-private partnerships, classified as "hybrid" incubators, account for 16 percent of the total. Eight percent of incubators are private for-profit ventures, and five percent do not fit any of the other categories. The main difference among these different sponsors is the non-profit or for-profit status. Whereas business incubators with public or private non-profit sponsors have economic development as their core mission, private for-profit incubators concentrate on investment gains. Generally started by investment groups or real estate developers, these incubators produce "economic reward for investment in tenant firms, new technology applications and other technological transfers, and added value through development of commercial and industrial real estate."<sup>7</sup>

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<sup>4</sup> Burger.

<sup>5</sup> "Incubation Industry Information." National Business Incubation Association.  
<<<http://www.nbia.org/info/facts.html>>>

<sup>6</sup> "Business Incubators." *Black Enterprise* Nov. 1995. 88.

<sup>7</sup> "Incubation Industry Information."

Business incubation is not an exclusively urban phenomenon. In fact, incubators in urban areas account for less than half of the total. Forty-five percent of incubators were located in urban areas in 1998, followed by 36 percent in rural areas, and 19 percent in suburban locations.<sup>8</sup>

### Academic Research

Although incubators have been a popular economic development strategy for the last 15 or 20 years, relatively little academic research has been done regarding business incubation. Deborah M. Markley and Kevin T. McNamara, in reviewing prior research for their 1995 article, "Economic and Fiscal Impacts of a Business Incubator," state that prior research suggested that firms located in incubators had a higher success rate than other start-up companies and that most incubator firms remained in their communities after leaving the incubator, but that each incubator firm tended to create ten or fewer jobs, with further increases over time.<sup>9</sup>

Markley and McNamara studied one incubator in depth, and it reflected the trends just discussed. For the study period 1987-1993, the number of jobs associated with the incubator rose from 17 in 1987 to 319 in 1993. Gross sales jumped from \$626,000 in 1987 to \$38,144,000 in 1993.<sup>10</sup>

A 1998 study undertaken by Hugh Sherman and David S. Chappell of Ohio University also found that business incubators are a successful economic development strategy. Their study used three different methodologies to examine incubators. The first method, a survey of 126 current and past incubator tenants, found that "firms that participated in the business incubation program showed large gains in financial performance in terms of capital investment, gross sales revenue, and total annual payroll...."<sup>11</sup> In addition, each firm on average added 2.7 full-time and 1.0 part-time employees per year. The survey also found that almost 25 percent of firms had done business with another incubator firm, and 16 percent had collaborated with a fellow firm in some way.<sup>12</sup> Their second method was a macroeconomic approach, analyzing the impacts of 23 firms randomly selected from the list of all firms entering the four incubator programs Sherman and Chappell investigated. According to their analysis, in 1996 these 23 firms directly employed 278 people and were responsible, through spin-off effects, for creating an additional 189 jobs in their communities. These employment figures translated into approximately \$10.1 million in personal income. Furthermore, the sampled firms were estimated to have produced \$402,000 in local tax revenue in 1996. The four incubators received an average of \$445,016 in subsidies per year, not much more than the 23 firms generated in local tax revenue alone. Considering that an additional 157 incubator firms were located in the four incubators studied, the authors conclude that "these incubators appear to have provided a good return on the public investment."<sup>13</sup> Sherman and Chappell's third measure of effectiveness, a survey of incubator managers and stakeholders, also found a high level of satisfaction with business incubators.

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<sup>8</sup> "Incubation Industry Information."

<sup>9</sup> Markley, Deborah M., and Kevin T. McNamara. "Economic and Fiscal Impacts of a Business Incubator." *Economic Development Quarterly* 9:3 (Aug. 1995), 274.

<sup>10</sup> Markley and McNamara, 275-76.

<sup>11</sup> Sherman, Hugh, and David S. Chappell. "Methodological Challenges in Evaluating Business Incubator Outcomes." *Economic Development Quarterly* 12:4 (Nov. 1998), 319.

<sup>12</sup> Sherman and Chappell, 319.

<sup>13</sup> Sherman and Chappell, 320.

When it comes to empowerment incubators, the research is even spottier. Sherman and Chappell's survey of incubator participants saw 11 percent of responses come from empowerment incubators. "The relatively low number of firms from empowerment incubators makes it difficult to draw firm conclusions about this type of incubator program," they write.<sup>14</sup> Managers and stakeholders of empowerment incubators, according to Sherman and Chappell's survey, "gave [the incubators] high marks for assisting minorities and women, creating new firms, creating jobs, and enhancing the business climate."<sup>15</sup>

Not all researchers have found incubators to be successful, however. Candace Campbell, principal of CDC Associates, a Minneapolis consulting firm, and a former chair of the National Business Incubation Association, conducted a study of incubators in 1987. For 18 months, she studied firms which had graduated from 60 incubators. She eventually tracked down three-quarters of all the firms. After an average of five years of independent operation, the firms had average revenues of \$1 million or less, and a median number of nine employees. "These were not high-growth firms," Campbell told *Business Week*.<sup>16</sup>

Another researcher, Peter Bearse, strongly criticized the 1997 report on the impact of business incubators published by the National Business Incubation Association, which was based on a study funded by the Economic Development Administration of the US Department of Commerce. The 1997 study found:

- "Business incubation programs help companies create many new jobs. In 1996 incubators reported, on average, that their firms had created 468 direct and 702 total jobs.'
- "Business incubation programs create new jobs for a low subsidy cost and a substantial return on investment'—at an 'estimated public subsidy cost per job' of \$1,109.
- "Incubator companies experience very healthy growth'; for example, 'the average annual growth in sales per firm was \$239,535.'
- "Business incubation programs produce graduate firms with high survival rates.'
- "Most firms that graduate from business incubators remain in their local communities.'
- "Incubation programs contribute to their companies' success and expand community entrepreneurial resources.'
- "EDA-funded incubators perform better than or equal to non-EDA funded counterparts."<sup>17</sup>

Bearse criticized the NBIA/EDA study on a number of grounds. He said that the 50 incubators studied were a self-selected group of the best-run facilities, that the fact that 80 percent of the incubators in the study had not yet achieved financial self-sufficiency despite operating for five years or more was downplayed, and that too much of the study focused on anecdotal information.<sup>18</sup>

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<sup>14</sup> Sherman and Chappell, 319.

<sup>15</sup> Sherman and Chappell, 320.

<sup>16</sup> Quittner, Jeremy. "Can Business Incubators Justify Their Existence?" *Business Week* 25 Oct. 1999.

<sup>17</sup> qtd. in Bearse, Peter. "A Question of Evaluation: NBIA's Impact Assessment of Business Incubators." *Economic Development Quarterly* 12:4 (Nov. 1998), 324 .

<sup>18</sup> Bearse, 327-329.

Criticism hasn't dampened enthusiasm for incubators, which are still widely seen as an important economic development tool. Miracles should not be expected from incubators, but they should also be seen as providing good value for the money. Empowerment incubators have a social service dimension in addition to the economic development purpose, and this may be a positive factor when local governments are considering funding such incubators.

### **Incubator Feasibility Studies**

Robert Meeder, the president of SPEDD Business Incubator Network in southwestern Pennsylvania and the author of *Forging the Incubator: How to Design and Implement a Feasibility Study for Business Incubation Programs*, likens an incubator feasibility study to a business plan. He lists a number of reasons for conducting a feasibility study: to help forge a consensus among civic leaders regarding the type of incubator desired, catalyze participation by a wider group of local actors, devise creative solutions to problems encountered, avoid common errors, identify best practices, and educate the community. A feasibility study will also identify facility and business assistance needs. Furthermore, in many cases, a study is required before applying for federal and state funds.<sup>19</sup>

Meeder cautions against hiring a consultant who does not have direct experience in developing or managing other incubators. In some cases, the local incubator development team can gather the necessary information and plan their own project.<sup>20</sup> [Meeder's book, *Forging the Incubator*, could serve as a guide for a community-led feasibility study.]

Robert Meeder also identifies funding sources for incubator studies at the local, state, and federal levels. Most feasibility studies, he says, are funded locally. While local companies, foundations, and Chambers of Commerce may provide funds, most often the local government itself provides funding, often from Community Development Block Grants, Enterprise Zone funds, or other HUD funds. At the state level, state departments of commerce sometimes provide funds for feasibility studies, though most states do not have established programs for funding such studies.<sup>21</sup> In Illinois, enabling legislation has established the Department of Commerce and Community Affairs as the outlet for state funds to support incubators. Finally, at the federal level, Meeder says the two main federal agencies providing business incubation funding are the Economic Development Administration of the U.S. Department of Commerce and the Office of Community Support of the U.S. Department of Health and Human Services.<sup>22</sup> A recent Internet search was able to confirm that the EDA continues to provide funds for feasibility studies; however, a search of the HHS website did not find any mention of funds available for business incubators.

Given the likely size and community-based scale of a potential incubator in Champaign-Urbana, the expense of a full-scale feasibility study conducted by a consultant is probably unjustifiable.

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<sup>19</sup> Meeder, Robert. *Forging the Incubator: How to Design and Implement a Feasibility Study for Business Incubation Programs*. Athens, Ohio: National Business Incubation Association, 1993. 3-4.

<sup>20</sup> Meeder, 3-4.

<sup>21</sup> Meeder, 9.

<sup>22</sup> Meeder, 9.

A dedicated group of civic and business leaders—like those already active in the Community Collaboration for Economic Development (CCED)—operating under the guidance of a guide like *Forging the Incubator* could not only perform a feasibility study, but in the process nurture relationships across the community which would benefit the incubator in the long run.

## **Financial Issues**

Mark Rice and Jana Matthews, in their book *Growing New Ventures, Creating New Jobs*, list four sources of revenue for incubators. They are rental income from tenant firms, fees for business services, fees for management assistance, and financial support or “investments” from sponsors.<sup>23</sup> Rice and Matthews also identify five major operation costs for incubators: costs related to real estate (either rent to a landlord or amortization costs), costs related to providing shared services, staff salaries, capital expenditures, and other general and administrative costs (office supplies, professional fees, etc.).<sup>24</sup>

Most incubator experts caution against the practice of providing below-market rents. As Rice and Matthews point out, if “subsidies are discontinued, the incubators have to raise the rates and often lose tenants in the process.” They go on to say, “Rather than being known as ‘low rent space,’ incubators need to be positioned as ‘success environments.’ Entrepreneurs should be expected to pay market rent rate for space—and even a small premium for flexible leasing terms and for access to all elements of this ‘success environment.’”<sup>25</sup> Again, it is probably unrealistic to assume that this principle can be fully employed in an empowerment incubator, which by its very nature focuses on businesses with fewer financial resources less able to pay full market rents.

No two incubators are financed in exactly the same way. Rice and Matthews identify three models that enable incubators to be financially self-sustaining:

- The Real Estate Model, in which the incubator is sustained mainly by tenant rents and service payments (though financial sponsors may be necessary to establish the incubator).
- The Real Estate Plus Sponsor Investment Model, in which tenant rents are supplemented by a long-term financial commitment from sponsors (local government, Chamber of Commerce, etc.). This allows the incubator to be smaller than the 30,000 square feet generally recommended for self-sustainability.
- The Venture Capital Model, in which the incubator earns royalties from the sales of current/former tenants or owns equity stakes in the companies. This model assumes that over time, a few companies will enjoy spectacular success, and enrich the incubator as well. The stake in the company could be reinvested in an investment account, providing the incubator with a stable source of income.<sup>26</sup>

An empowerment incubator like that considered for Champaign-Urbana would almost certainly have to operate under the Real Estate Plus Sponsor Investment model. Rice and Matthews

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<sup>23</sup> Rice and Matthews, 23.

<sup>24</sup> Rice and Matthews, 23.

<sup>25</sup> Rice and Matthews, 24.

<sup>26</sup> Rice and Matthews, 35-44.

provide a 1993-94 budget for an incubator following this model, but the situation of the particular incubator needs further explanation. It had a 16,000 square foot facility, about 75 percent leased, but was about to expand to a new, 30,000 square foot building. The incubator had four employees: president, operations manager, office manager, and part-time receptionist. Also note that the incubator bore no costs related to the acquisition or construction/renovation of its facility.<sup>27</sup> The budget is as follows:

Income	
Rent	\$79,000
Reimbursable Services	40,000
Contract with Sponsor(s)	157,000
Sponsor Investment	52,000
Deferred Revenues	0
<b>Total Income</b>	<b>\$328,000</b>
Expenses	
Salaries and Benefits	\$160,000
Renovation Debt Service	0
Utilities	34,000
Facilities Maintenance	19,000
Property Taxes	0
Equipment and Supplies	9,000
Telephone	26,000
Travel	4,000
Miscellaneous	76,000
Reimbursable Services	0
<b>Total Expenses</b>	<b>\$328,000</b>

### Facility Issues

The facility needed by an incubator depends in part on the type of incubator to be developed. Clearly, an incubator designed to support light manufacturing would need to be different than an incubator designed only to support office-based businesses. However, some general rules do exist. First, the cost of acquiring and renovating an appropriate facility must be affordable. Often a building is donated or loaned to an incubator program, but it may require substantial renovation before it is made habitable. Furthermore, maintenance and utility costs need to be considered from the beginning—antiquated heating, ventilating, and air conditioning (HVAC) systems can be a particular, and expensive, headache, according to Rice and Matthews.<sup>28</sup>

Naturally the size of the incubator varies with the community in which it is located, the type of incubator space to be provided, the local real estate market, and other factors. However, there is a simple rule regarding the size of a facility: it should be large enough to contribute to the financial self-sufficiency of the incubator program.

<sup>27</sup> Rice and Matthews, 38-40

<sup>28</sup> Rice and Matthews, 88-89.

Rice and Matthews offer a simple formula for calculating the size of an incubator based on financial information:

$$\frac{\text{Revenue from Rents Projected by the Model}}{\text{divided by}} \\ \text{Average Rental Rate} \times \text{Average Occupancy Rate} \times \text{Average Collection Rate} \\ \text{equals} \\ \text{Total Amount of Rental Space Required for the Model}^{29}$$

Statistics from the National Business Incubation Association indicate that most incubators have an occupancy rate of 75 percent after three years of operation. Rice and Matthews also suggest using a average rent collection rate of 90 to 95 percent.<sup>30</sup>

For most business incubators, the formula translates into a minimum size of 30,000-40,000 square feet. A facility of this size is far too large for an empowerment incubator located in Champaign-Urbana, at least initially. (Should it be wildly successful, expansion is always an option.) A more appropriately sized facility would be about half the size, approximately 15,000 square feet. Interestingly, this is only slightly smaller than the median incubator size of 16,000 square feet, as reported by the National Business Incubation Association.<sup>31</sup>

An incubator facility can be built in stages, of course. This concept might be more appropriate for a fledgling empowerment incubator, but it entails some problems. For example, assume a small "Stage 1" facility can be accommodated in an existing building. What would happen, however, if that building fills up. Will there be space nearby for expansion? If not, the existing businesses will have to be relocated to the new, larger facility, or the expansion space will not be adjacent to the Stage 1 space, possibly resulting in additional expenses (i.e. maintenance and utilities for two buildings rather than one) and likely limiting the benefits to incubator tenants of being located in the same facility, such as firms doing business with each other.

Total size is not the only space-related issue. The division of space within the incubator facility is also important, as different tenants will have different needs. As a means of illustration, here is a table with a sample space allotment for a 35,000 square foot incubator from Rice and Matthews's book.<sup>32</sup>

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<sup>29</sup> Rice and Matthews, 25.

<sup>30</sup> Rice and Matthews, 24.

<sup>31</sup> "Incubation Industry Information."

<sup>32</sup> Rice and Matthews, 91.

Type of Company	No. of Spaces	Size of Spaces	Total Square Footage
Small Start-Up Service or Software Firms	5	300 ft <sup>2</sup>	1,500
Micro-Manufacturing Start-Up Firms (and Established Small Software Firms)	15	500 ft <sup>2</sup>	7,500
Early (Stage) Growth Firms	4	1,000 ft <sup>2</sup>	4,000
Growth Firms Nearing Graduation and Small Anchor Firms	5	2,000 ft <sup>2</sup>	10,000
Anchor Tenants	4	3,000 ft <sup>2</sup>	12,000
<b>Total Leasable Space</b>			<b>35,000</b>

The smaller spaces would be suitable for start-up service firms, while the larger configurations would house established firms nearing “graduation” from the incubator and so-called “anchor tenants.”<sup>33</sup> Movable walls or partitions have the advantage of being more flexible and inexpensive than permanent partitions, though there may be need for some permanently configured spaces.

Usable common spaces are an important feature of incubator facilities as well. Provision of a lunch room, conference room, or library can encourage informal interaction between entrepreneurs. Hallways and staircases, while also common spaces, do not promote the same kind of interaction. Parking requirements should also be considered; “one rule of thumb suggests that there should be one parking space for every 300 square feet of leasable space,” according to Rice and Matthews.<sup>34</sup> Loading docks and freight elevators may also be necessary in incubators with firms engaged in manufacturing.

Rice and Matthews note that smaller incubators may be possible if there is a long-term commitment from a sponsor to subsidize the operations of the incubator.<sup>35</sup> This is likely to be necessary in Champaign-Urbana.

### **Leadership and Staffing Issues**

Rice and Matthews suggest that a board of directors ideally consist of members from each of the following groups:

- Leaders/Champions Committed to the Principles of Successful Business Incubation
- Networkers
- Real Estate and Business Operations Professionals
- Investment Professionals
- Entrepreneurs
- Product/Service Assessment Professionals<sup>36</sup>

<sup>33</sup> Rice and Matthews, 90.

<sup>34</sup> Rice and Matthews, 90-92.

<sup>35</sup> Rice and Matthews, 24.

<sup>36</sup> Rice and Matthews, 57.

The above list holds true for empowerment incubators, as well, though board members should be aware and supportive of its special mission. It may also be more difficult to assemble a high-powered board of directors for an empowerment incubator until it is up and running. Prior to this, members of a local economic development organization like CCED could double as the incubator's board.

The initial staff of an incubator should consist of three positions, according to Rice and Matthews. The president of the incubator should be responsible for counseling client companies, providing networking opportunities to clients, and managing relations with the board of directors and sponsors. An operations or business manager would be responsible for the day-to-day operations of the incubator, including facility management, leasing, accounting and finance, purchasing, marketing, and other tasks. Finally, a secretary or receptionist would be responsible for supporting the president and business manager, as well as serving as a shared resource for client companies.<sup>37</sup>

Again, this three-person staff would be beyond the means of an empowerment incubator in Champaign-Urbana. Not only does the above model assume an average-sized incubator (i.e. 30,000 square feet or larger), but it fails to deal with the reality that an empowerment incubator focused on low-income entrepreneurs probably cannot charge full market rents across the board.

### **Tenant Issues**

Most incubators have admission criteria for firms wishing to take part in their programs. Submission of a preliminary business plan is perhaps the most important part of the application process. In fact, one of the incubator's programs may be assisting applicants in developing and revising their business plans. Once submitted for review, it should be examined by the president of the incubator, members of the board, and possibly other outside reviewers. They should assess the strengths and weaknesses of the plan, and in the case of weaknesses, determine how the incubator's services might address them. The reviewers must also consider what kind and how much assistance potential clients will need and judge how committed, capable of performing agreed tasks, and willing to accept assistance the applicants are.<sup>38</sup>

Other factors may also be considered. Considering that the mission of an incubator is to create jobs and encourage the growth of companies, how likely is it that an applicant is capable of rapid growth? Not all companies located in the incubator need to grow at a high rate, but a significant portion should. In addition, how should the incubator deal with an applicant firm that would be a direct competitor of an already existing client? According to Rice and Matthews, some incubators refuse to admit direct competitors, though others consider it an opportunity—"if the conflicts can be managed."<sup>39</sup>

Different types of businesses will apply for admission to incubators, and there are benefits to each type described by Rice and Matthews.

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<sup>37</sup> Rice and Matthews, 78-79.

<sup>38</sup> Rice and Matthews, 100-101.

<sup>39</sup> Rice and Matthews, 102-103.

- Superstars. According to Rice and Matthews, “Their products or services will be nearly developed and ready for an established market in which there are already many potential customers.” Such companies will not need extensive business assistance or mentoring.
- Up-and-Comers. These firms have some sort of weakness that prevents them from being superstars; assistance from the incubator president and business network associated with the incubator can help them overcome their difficulties.
- Long Shots. These firms still have a lot of learning to do when it comes to entrepreneurship and business practices. In addition to taking advantage of the services provided by the incubator, long shot firms often benefit from being around other entrepreneurs.
- Anchor Tenants. Rice and Matthews write that firms in this category are admitted to incubators for two reasons: “(1) they help provide a stable cash flow to the incubator, and (2) they have one or more business reasons for being in close proximity to other companies in the incubator.” Examples of anchor tenants include legal and accounting firms (which can offer their services to other incubator tenants) or a state agency involved in small business development. Anchor tenants will receive little or no assistance from the incubator president.<sup>40</sup>

A list of potential services could run several pages, but they can be grouped into three general categories: shared office services, management/technical services, and financing services. Shared office services include such things as receptionist/secretarial support, word processing, photocopying, fax machine, computer, conference room, office furniture, audiovisual equipment, and security. Management/technical services encompass help with business plans, marketing, accounting, legal services, government grants and loans, and computer training. Finally, financing services can extend to assistance in gaining outside investment as well as incubator-based revolving loan or seed capital programs.<sup>41</sup>

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<sup>40</sup> Rice and Matthews, 106-109.

<sup>41</sup> Greene, Patricia Gene, and John Sibley Butler. “The Minority Community as a Natural Business Incubator.” *Journal of Business Research* 36 (1996), 52.

## **Part II:**

### **Recommendations for an Empowerment Incubator in Champaign-Urbana**

The following development plan for an empowerment incubator in Champaign-Urbana comes from the research sources presented in Part I of the report as well as discussions with Mable Thomas and Craig Rost from the City of Champaign; Mark Michaels of Merrill Lynch in Champaign; Prof. Thomas Moore, Director of the Psychological Services Center at the University of Illinois and President of CCED; and Prof. Leonard Heumann of the Department of Urban and Regional Planning at the University of Illinois.

#### **Development Team Membership**

It is recommended that an incubator development team be assembled from members of the Community Collaboration for Economic Development, along with other interested individuals. CCED has been very active for several years in efforts to increase the number of minority and low-income businesses in Champaign County. Its experience in providing training programs and its established membership of civic and business officials make it the natural choice for leading the incubator development process.

If at all possible, the incubator development team should include several widely known and well-respected minority business leaders, which would give it visibility and credibility, as well as representatives from local government (particularly from the economic development and neighborhood services departments) and banks. It should be chaired by one of the local government representatives and another prominent figure from business or education.

#### **NBIA Affiliation**

The team should immediately seek membership in the National Business Incubation Association. The NBIA offers a variety of services to its members, including a yearly national conference, and it publishes a wide array of books on the incubation industry. Organizations may join the association for dues of \$320/year. Their website is <http://www.nbia.org>.

#### **Background Information**

The team would begin to collect information immediately, beginning with some of the literature available on business incubation from the NBIA. *Growing New Ventures, Creating New Jobs: Principles and Practices of Successful Business Incubation*, by Mark P. Rice and Jana B. Matthews (also available from the NBIA), provides a comprehensive look at the incubator development process and touches on a number of important issues. *Forging the Incubator: How to Design and Implement a Feasibility Study for Business Incubation Programs*, by Robert A. Meeder, lays out a detailed process for an in-depth feasibility study, if it is decided such a study is needed. Finally, *A Comprehensive Guide to Business Incubation*, edited by Sally Hayhow and available from the NBIA, contains a host of articles from numerous incubator professionals covering topics relating to incubator development, management, client services, and more.

## **Partnerships**

The incubator development team would also enter into discussions with the cities of Champaign and Urbana, Champaign County, state and federal agencies, area banks, educational institutions, business leaders, and others in order to locate and acquire a site for the incubator, assemble funding for a building, construct the facility, identify initial tenants, hire a manager and administrative assistant, find individuals and businesses to volunteer time and services, and develop training, loan, and mentoring programs. Once the building is completed, the development team can transition to become the incubator's board of directors, focusing now on management and programming issues.

Support for the incubator is likely to snowball: as individuals and organizations offer their support, more will come forward, and so on. City government and local corporations will likely look very favorably on a well-designed incubator project with support from local civic and business leaders, educational institutions, and other non-profits.

## **Proposed Timeline**

August/Sept. 2001:	Development team forms, joins NBIA, begins gathering information
September 2001:	Begin search for funding sources
November 2001:	Funding sources identified
January 2002:	Site acquired, construction plans finalized, begin identifying tenants, advertise for manager
April 2002:	Construction begins; list of tenants finalized, manager hired
August 2002:	Incubator facility completed; tenants move in

## **Tenant Issues**

An empowerment incubator in Champaign-Urbana should provide space both for office-based and light manufacturing tenants. As a result, at least part of the building should be equipped to handle the needs of light manufacturers (e.g. space for large machines, loading docks, storage, appropriate electric and water hook-ups, etc.).

If at all possible, a secretarial service company and accounting firm should be encouraged to locate in the incubator. This would provide the other tenants easy access to these services, and relieve the pressure on the incubator management to arrange for or directly provide such services.

Graduated rents and residency limits should also be considered. Firms would be allowed to stay in the incubator only for three to five years, in order to encourage them to establish themselves and become capable of independent operation. Rents would rise with each year of residency, with low rental rates the first year; by the final year, rents could be set high enough to cover all the building-related expenses caused by the firm, including long-term capital improvements related to their use of the facility.

## **Staffing**

Obviously a small new empowerment incubator cannot afford to retain three full-time employees. At a minimum, however, a manager should be hired to oversee the day-to-day operations of the incubator, maintain financial records, pay bills, collect rents, and so on. The role of the president described in Part I—which in large part is to counsel tenant companies and help them network—could be handled by members of the incubator's board of directors. Alternatively, should a strong mentoring program be set up, the mentors could serve these functions.

Office support will also be needed, but it may be difficult for the incubator to afford a full-time administrative assistant at the beginning of its operation. A part-time assistant with daily office hours (or even just certain days of the week) that are known to the tenant firms and the public would be an appropriate and affordable first step.

## **Financing**

What follows is a hypothetical scenario, based in large part on educated guesses and discussions with City staff. Even if the estimates are wildly inaccurate, this model should give the incubator development team an idea of the types of issues that must be considered.

Assume that a 15,000 square foot incubator facility with space for 15 tenant firms will be built. With 25 percent of the floor space devoted to common areas (conference room, computer room, copy room, management office, hallways, bathrooms, etc.), each of the 15 tenants would still occupy on average 750 square feet. The smallest office-based firms might require only 200-300 square feet of office and storage space, whereas the largest spaces might be rented by small manufacturers needing 2,500-3,000 square feet and daily access to a loading dock. The building will be built of simple materials, like concrete block, and be fully outfitted with heating, air conditioning, and ventilation systems, plumbing, electricity, telephone and data lines, etc. A building like this would probably cost no less than \$50 per square foot to construct, which puts the cost of construction at \$750,000.

The building will also need furniture and equipment. By the time office furnishings (for individual offices, the incubator management offices, and common spaces), computers (if they aren't going to be provided to each tenant, there should at least be a common computer room with 8-10 computers), a photocopier, fax machines, and telephones are included, the cost could be close to \$150,000.

A fully outfitted 15,000 square foot incubator, therefore, might cost \$900,000. Using the very conservative interest rate of 7 percent, a 30-year mortgage on \$900,000 will cost \$2,155,579.20; interest totals \$1,255,580.08. More importantly, this translates to a monthly payment of \$5,987.72. Even if the incubator is only two-thirds full, those 10 tenants would each have to pay an average of \$600 per month—not an outrageous figure. Of course, maintenance, utilities, and savings for capital expenditures would also have to be included, but this would probably not raise the rents dramatically. With grants to reduce the amount of money borrowed for

construction and/or subsidies for the building-related expenses, the rent that needs to be charged could be reduced.

Staff and business expenses are also difficult to estimate, but \$100,000 a year seems reasonable. This would cover the salary and benefits for one full-time staff member (the incubator manager), some part-time secretarial staff, telephone charges, office supplies, and so on. Since all rent income goes towards building-related expenses in this model, staffing and supplies would have to be paid through subsidies. There are signs that the Champaign and Urbana city councils may be willing to pay much or all of this amount; some part of the subsidy could also come from corporate donations or state and federal funds, should they be available.

Incubator		15,000 square feet
Cost per square foot	x	\$50
		<u>\$ 750,000</u>
Furnishings and equipment	+	\$ 150,000
Total building cost		<u>\$ 900,000</u>
Construction loan		\$ 900,000
Interest over life of mortgage	+	\$ 1,255,580
Total cost of mortgage		<u>\$ 2,155,580</u>
Length of mortgage	÷	360 months
Monthly payment		<u>\$ 5,988</u>
Total area		15,000 square feet
25 percent common space	-	3,750 square feet
Rentable area		<u>11,250 square feet</u>
Capacity of building	÷	15 firms
Average area per firm		<u>750 square feet</u>
Capacity of building		15 firms
Average occupancy	x	66 percent
Average number of tenants		<u>10 firms</u>
Monthly mortgage		\$ 5,988
Average number of tenants	÷	10
Average rent per tenant		<u>\$ 599</u>

## Programs

An empowerment incubator in Champaign-Urbana would already have a distinct advantage over many other beginning incubators, in that there are business training, advising, and loan programs already in place, thanks to the efforts of the Community Collaboration for Economic Development. These programs should continue and expand. The incubator development team should investigate the possibility of partnering with Parkland College or the University (or both) to provide additional training programs.

The incubator development team should also work to establish a formal mentoring program for tenants. Start-up firms could benefit greatly from the advice and encouragement of established entrepreneurs, particularly those from the minority community.

### **Location**

Two potential incubator sites in Champaign stand out: North First Street and the city-owned parcel on the south side of Bradley Avenue, between the Seaboat Restaurant and the railroad tracks. Both have advantages and disadvantages. A North First Street incubator could help in the City of Champaign's efforts to revitalize the neighborhood; however, space is limited there. Barring the demolition of additional commercial buildings and/or housing, it would be difficult to construct a modern incubator facility in the area. The existing older commercial structures are simply not large enough or correctly equipped to serve as an incubator, and expansion and adaptation of the buildings for use as an incubator would be difficult and expensive. Parking is also tight in the neighborhood. The only large parking lot currently sited there belongs to the Champaign Police Department, and it is unclear whether the police would be willing to share the lot for much of the day with up to 50 cars associated with the incubator.

Clearly, a careful study would need to be conducted to find the most affordable and beneficial site that meets the initial building and parking requirements and provides space for future growth. But between the two potential sites previously mentioned, the Bradley Avenue site is the clear choice. It is large enough to accommodate both a 15,000 square foot building, the necessary 50 parking spaces, and future expansion. In addition, it is located near two major streets (Bradley Avenue and Market Street), near important transportation links: the railroad line and Interstate 74, and on several bus lines. The adjacent Bristol Place and Beardsley Park neighborhoods could also benefit from the incubator being located on this site.

### **Conclusion**

Many incubators fail because they are seen as buildings, rather than a combination of facility and programming. Champaign-Urbana is fortunate to have a number of training and advising programs already in place, thanks to the CCED and other groups, and this bodes well for future success. Champaign-Urbana needs an incubator dedicated to the empowerment of low-income and minority residents—and with careful planning, it can have it, soon.

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