CHAPTER 1

ONCE UPON A STARTUP . . .

Research is the mother of industry, and thus a necessity for any thriving country. Technology, for the most part, does not occur by accident, nor is it nurtured by ignorance. It is created by brilliance, fed by visionaries, and only succeeds well when nothing is left to blind faith. So many brilliant ideas have died in the garage because technologists didn't have the know-how to find resources to assure their survival in a competitive landscape. Time after time investors have found these same types of brilliant technologists who had ventured out of their garages, provided them with what they lacked, and became extremely wealthy in the process.

If you're reading this book, you're either contemplating starting up a corporate venture arm, an incubator, or an accelerator. This book looks at the many different models of each separately and the combinations, as well as the infinite number of methodologies about running them. All of the models are dependent on the success of the companies they have within their portfolios. And, in many cases, the success of both is tied in to how well the companies do after they graduate from the programs.

> *You can certainly make a reasonable argument that incubators are more important in bad economic times than good. I think that in times when people are just giving away money and anyone can get it, an incubator's value is reduced.*
>
> —Jim Robbins, Executive Director,
> Panasonic Concepts Center,
> CEO, Business Cluster Development &
> Executive Director of the Software
> Business Cluster

It's very important that startups are able to depend on money and resources from entities for value-add services that they would not be able to get elsewhere. After all, if a company was able to obtain these resources on their own, chances are they wouldn't be knocking on your door. In my research I've noted that both corporate venture arms, incubators and accelerators, have similar goals and the entrepreneurs involved with them have similar needs. Corporate venture groups are expanding their services to include in-house incubators, and reaching out to the established incubators to discover how they can add value to their portfolio companies.

By reading this book, you'll see the elements of success in the types of organizations and hopefully pull them together in your own offering. The people in this book have gone through years of trial and error to reach the point where they are now. Some have also failed in the field. If you are serious about the endeavor of building a solid infrastructure for your incubator, accelerator, or corporate venture group—listen and learn before you try building a program or fund on your own.

THE GLITZ OF A BYGONE ERA

Incubation, although it can be tracked to the 1800s, basically started around 20 years ago when it was used to spearhead economic development in depressed areas. It has gone in and out of style, and only a small percentage of those incubators were dedicated to technology. Many companies like Xerox PARC and Bell Labs had research labs inside the companies where technologists could research new ideas. Universities have always been a source for early innovations because of the freedom to choose research projects and the resources available to them. Now, more than ever, universities and corporations are leveraging technology developed into licenses to distribute to startups in hope that the licenses can sustain a company. In some cases they are doing this by working hand-in-hand with incubators and accelerators.

For a relatively brief period of time, everyone thought they could be an incubator. People and companies were coming out of the woodwork with a building, a T-1 line, and some desks to help push entrepreneurs forward, whether they knew how to do it themselves or not. The reason why everyone wanted a piece of the incubator action? One only needs to take a glimpse at companies such as idealabs! and CMGI to see why people of wealth, or with a source of investment, thought they could take advantage of the dot-com boom. In retrospect, we've seen that something in those models was terribly flawed.

Sometimes people, both entrepreneurs and investors, rely too heavily on the glitz surrounding startups as magazines tell the story of a startup like a fairy tale. *Once upon a startup there were two guys in a garage who went to lunch one day and started talking about their company . . . an eavesdropping venture capitalist immediately wrote them a check when he saw their business model drawn out on a napkin and everyone made stacks of money.* That is exactly the kind of mind-set that caused people to come to The Valley en masse, driving up housing prices, clogging freeways, and setting us up for this huge correction in the market. Okay, perhaps there are one or two stories that actually did occur that way, but for the most part, especially now, entrepreneurs are like deer stuck in the headlights. Get them out of their garage and they don't have a clue.

I sit on the advisory boards of several startups in the early stage of development; brilliance they have, but business people they are not. And technologists usually know other geeks, not people who will help them launch, but others who will help them code, qualify, and quantify. Resources are the missing link between the companies that make it and those that crash and burn. Building a bridge that connects genius to commerce is how a savvy investor, and that can be a corporate venture arm, an incubator, an accelerator, or an early-stage investor of cash, will make money.

Recently I heard about the first entrepreneur casualty, literally. A young guy living in Woodside whose company valuations took a dive shot himself in the head. Woodside, where Larry Ellison is currently building his billion (yes, I do mean billion) dollar home, is an idyllic mountainous, redwood covered city that made its money in the 1840s by being the first to market with the timber used to build San Francisco and the surrounding areas. I call it the wood infrastructure. A guy named Tripp figured out how to efficiently find a workforce, and built a road and water gully trail that carried the wood all the way down the hill to the Peninsula to be processed and shipped. He was able to get wood to market first when there was a great need, collect premium prices for it, and sustain a business.

Now Woodside, sans many of its original trees, is a city characterized by its main restaurant, Buck's—a place where deals are made in booths and a backdrop to more than 250 media stories (articles, TV, and documentaries worldwide) about the Valley's culture. Companies such as Netscape and hotmail were founded at Buck's, and it's the place where you can catch John Doerr and any other number of Silicon Valley elite having breakfast. At any time during the day, you can find high-powered VCs meeting with entrepreneurs over PowerPoint presentations and pancakes.

This is a city where a good deal of Silicon Valley's population aspire to live, and who, when they got their chance and signed on with a dot-com for big bucks and a huge options package, bought $2.3M houses with big driveways to park their Hummers. Now, caught in the dot-com aftermath, they can't pay their mortgages, real estate signs crowd every corner on Sunday mornings touting "reduced," and the number of luxury vehicles for sale in the classifieds has gone up exponentially.

For a brief time a good deal of the investors in "the new economy" forgot what it was like to grow a company and make it profitable. Twenty-three-year-old kids started e-commerce companies with no idea about how they would make money. Companies that had no solid business models were forced into early IPOs and crashed. And while the shareholders of these companies cried out for blood and fired the executive teams, they forgot that they were the ones who initially invested in companies with no solid revenue model. Duh. When those companies failed, the bubble burst, the market crashed, and incubators, accelerators, and venture groups of all kinds died.

What happened before the crash was that IPOs were gracing investors with returns in excess of 300 percent and people of wealth—with no investing or business experience—decided to call themselves angels and VCs for a short period of time as they made foolish investments during "The Boom." So, of course, there will be less overall early-stage investing in the upcoming years—those investors, for the most part, have been thinned from the herd. Without that early-stage money, the deal flow—however good or bad it was—and early stage development will also slow, but not for long.

HYBRIDS

During the "Boom" companies like CMGI@ventures and idealab! saw a lot of great returns on their early investments. These accelerators are a hybrid combination of entrepreneurial resources and cash; if they liked your idea, they wrapped a company around you and accelerated your growth with their resources—and took a huge stake for their services. I don't call them an incubator or an accelerator; I call them Private Clubs. These groups were owned by high-profile companies with high-profile people at the helms, who believed whatever company they touched would turn to gold. They had everyone drinking the Kool-Aid; the startups believed it, the investors they were connected to believed it—and more importantly, they believed it. It was something about the timing and the money flying around that made all of us a bit too heady. It turned out that most of the people caught in this euphoria were all a bit too high to invest, or invest correctly—or even to take money correctly from these euphoric investors.

Some of CMGI's investments are Alta Vista, MyWay.com, NaviSite, and some of the companies idealab! took on were CarsDirect.com, Cooking.com, FirstLook.com, iExchange.com, e-toys, etc. You get the gist of it. They both went a little Internet crazy with their portfolio companies. Don't get me wrong; both companies did make some good investments, and it is probably because of those good investments they've managed to survive.

According to Aberdeen Group's white paper on early stage investing, *Early Stage Investing: Outlook 2001–2002, An Industry in Transition*, CMGI was facing a $70M per month burn-rate between July 31, 2000 and October 31, 2000. idealab! hit hard times when it closed its Silicon Valley office and CEO Bill Gross was trashed in the press. I could get neither Bill Gross nor CMGI to comment on how they saw the future of their companies. Both of these companies had billions invested in the heat of the market and when they fell, the rest of the world watched closely. They'll pick themselves up, scale back, and take a close look at the way they do business. They're not going away anytime soon, but they did leave a negative feel in the market for anyone calling themselves an incubator or accelerator.

"The public incubator is the one that I think is particularly challenged," says Jim Robbins, Executive Director, Panasonic

Concepts Center, CEO, Business Cluster Development, and Executive Director of the Software Business Cluster. "Those are the incubators that are failing. They probably by and large are designed for a market we will never see again in our lifetimes. I don't want to do a blanket indictment, but if you look at one of the things happening in the popular press, incubators have gone from the best idea that ever existed with this sell-stock-to-the-public image, to the worst ideas that ever existed. When in fact, 75 percent of incubation has nothing to do with taking 30, 40, 50 percent equity in startup companies."

> *Unfortunately I think that idealab! left a bitter taste in some people's mouths as well as created what I would say are unrealistic expectations for for-profit incubators. I think for-profits are a real tough sell, but who knows? Maybe it's one of those cyclical things, but they are right now very much out of favor. I think the non-profits will survive, especially if they're smart enough to get some equity. If they run lean, I think they'll make it through this.*
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> —Mark Radcliffe, Author and Partner,
> Gray Cary Ware and Freidenrich, LLP

One of the problems the commercial incubators face is that the equity they took in exchange to pay for their high overhead was killing many of their startups. When you take that much equity in a startup, what is left over to negotiate? Granted, these companies heydays were when a company could have an IPO in a very accelerated amount of time and sell for billions. Will the companies' that gave that much equity have much of a chance to survive now?

"The commercial incubator is very much out of favor right now," says Mark Radcliffe, Author and Partner, Gray Cary Ware and Freidenrich, LLP, a Palo Alto, California, firm that works with corporations, startups, and incubators. "I mean it's so bad that I hear idealab! is changing its name. That speaks volumes. I think the people who believed that there was easy money to be made by setting up an organization like idealab! are disappearing. Look what happened to Devine InterVentures. . . . idealab! was so enormously expensive from an equity point of view, who wants to do that?"

BACK TO THE BASICS

The years 1998 through 2000 were all about leveraging investment in high-risk, early-stage startups for huge returns. Now we've come back to reality. Everyone who drank the Kool-Aid is either dead or on resuscitation. On the other hand, I believe we've learned a lot and a more engineered approach is in order for the new breed of corporate venture arms, incubators, and accelerators.

These future organizations must be tailored to the needs of entrepreneurs and their right to make a profit by keeping ownership of their company for future negotiations. However, startups need to offer enough of an incentive for the incubator or corporate venture arm to find the venture a worthwhile proposition. A new model for non-profit and commercial incubators, as well as corporate venture groups, will bring in special interests such as other corporations that want to leverage their own resources in exchange for reasonable equity, cities and governments that have their own special interests at heart, and private and institutional investors. An entity such as this will also be well networked with professionals and firms that will train and support entrepreneurs by offering mentoring and services, some in exchange for equity if their value is superior. It has been proven time and time again that corporate incubators, corporate venture groups, and other types of incubators structured like this offer superior value for startups, and viable technology companies are brought forth from these kinds of environments.

This will be the year that the more than 100 for-profit incubators and accelerators formed in the United States during the Boom will either succeed or die, although some may be put on life support to live long enough to suck more investments into their black holes. Recently I spoke with Scient, a company that had an accelerator in place during the Boom, and no longer does. Many corporate venture funds were spawned during this time and have now dissolved. Okay, so that's not the kind of talk you want to hear if you're thinking about starting a corporate venture group, an incubator, or an accelerator. But there are many facets about investing you must learn before you begin formulating your plan. The days of grabbing a bunch of cash and throwing it at a concept for quick growth are over. We're back to making money the old-fashioned way—with hard work and perseverance.

THE RELATIONSHIP

The reason I chose to use the combination of corporate venture, accelerators, and incubators in this book is because their relationships are close and most seem to have a common methodology of mentorship and resources they use to help their portfolio companies. They also seem to have similar weaknesses that contribute to the failures of their companies, and eventually their entire structure. They could also benefit from taking on traits from one another, and learn a great deal about how each other works so they can better partner to use each other's strengths.

> *One of the biggest reasons incubators fail is because people don't develop a business plan and a budget for their incubator. Something they're going to require every single one of their companies to do.*

So they wind up with problems that are predictable had they taken the time in the beginning to make a business plan and a budget; somehow people starting incubators don't think they have to do that.

—Jim Robbins, Executive Director,
Panasonic Concepts Center,
CEO, Business Cluster Development &
Executive Director of the Software
Business Cluster

Darwinian. You hear that term a lot these days and no matter how smart you think you are, people may one day be using it to describe your organizational model. There are certain lessons we've learned in the history of corporate venture capital and incubation and there is no reason why you cannot learn from them *before* you make them. And no matter how you change the names as trends come and go—whether you insist on being called an accelerator instead of an incubator, or a concept center or a corporate R&D fund instead of a corporate venture arm or group, you are what you are. If it looks like a duck and walks like a duck. . . . By nature of the beast, your company, organization, or division will be expected to perform certain tasks, make specific milestones, and be better than the competition.

Metaphorically speaking, you are practicing the ancient art of turning raw materials into gold. Even when you think you have all of the right elements in place, you have to keep in mind that it's a touch of alchemy and a bit of chemistry that will see you through. You have to take the right money, have reasonable and obtainable goals, align yourself with the right partners, take on the right companies, and have the right people in your organization to support both you and your startups through the milestones you will have to make.

Whether you are a corporate venture fund, an accelerator, or an incubator—you all have similar goals—you must build companies, and if you do your job well, they will be sustainable startups you can be proud to have in your portfolios. And that equity you took in the beginning? Well, it'll be worth a whole lot.

WHAT'S THE MOTIVE?

All over the world technology entrepreneurs are facing similar issues. How does one find resources if you have no connections? How can you possibly get funding for a company if you have absolutely no idea about who to receive mentoring and resources from? It is the catch-22 phrase—whether she's a gal in her garage in Palo Alto, California, or a guy in a kibbutz in Israel—it is always the same problem: How do they get the help they need?

Whether you are an entrepreneur, the director of an incubator, or corporate venture arm, it's easy to take money or help from anyone. The hard part is deciding whether it has the potential of being a detrimental decision. Focus is the key here—is it the entrepreneur's success that counts? Is it the corporate venture arm's success of aligning itself with a winning technology that counts? Is it the incubator's one or fifty percent equity success that counts? Or how that equity churns itself back into the organization to crank out more success that counts? Is it the special interests of investors or supporting organizations that count?

"There are lots of different reasons why people want to get involved in business incubation and the concept has proven to be a very effective tool," says Dinah Adkins, President and CEO of the National Business Incubation Association (NBIA). "You can use incubators successfully for many goals. The commonality has to do with the business incubator—what is it that you're using entrepreneurs for to achieve these goals. For example if you're a distressed inner city neighborhood you may try and create an entrepreneurial base and train entrepreneurs and provide access for people to develop their own companies who haven't necessarily had the role models in the past to bring more businesses into that area. You could also work with technologists who are developing new technologies in universities and build an incubator that builds companies around licensed technology instead of doing it the old way of simply licensing it out."

Corporate venture arms and incubators have many different motives for being. So, the first thing you need to do is design a mission statement—what is it that you want to accomplish? That said, by concentrating on your focus you may eliminate those who want to join with you but do not share your vision. That's okay, you will find others (unless, that is, it is too much of a niche) to support you in your quest. Sometimes, as in the case with *The Wizard of Oz*, all the characters had one mission—to get to Oz, but they all had different reasons for going there. But, by pulling together they were able to complete their journey and get what they needed. So, the best way to align yourself with others is to see if you can share your resources to make the journey, even though your end goals may be fulfilled in different ways. As long as you can share the ride you'll be fine.

In this sector, more than any other, I've seen that what counts is the focus of the organizations and people you align yourself with. How do you know if your goals are going to align with theirs? And, as in any deal you sign, you have to say to yourself, *What is the motive?* Then, and maybe not even then, you will know what to expect and what will be the other person's or organization's focus. Motives are important motivators, and you should know all about them before you proceed with any deal or partnership.

WILL THE DOWNTURN PINCH?

Country, state, and city governments, as well as companies and organizations, are building the skills and resources they need to help technologists via technology incubators, accelerators, and corporate venture arms. We may have hit a recession, but one thing is certain, technology never sleeps and invention is born from chaos. Incubation has not slowed down and, in fact, in some countries, has substantially increased. Korea, for instance, has upward of 300 technology incubators; most are connected with the Korean government and in cooperation with the universities and schools throughout the country. You can bet with this much of a push to nurture entrepreneurs that we will see huge strides in technology coming from Korea over the next decade. You can bet that U.S. companies will lag behind unless they follow suit.

We may have hit a glitch in the market, but that will not slow the growth we are heading toward in technology innovation. I've been invited to interview some of the leading corporations to hear of their quests to nurture technology and by the pioneers of incubation to understand the intricacies of what makes a great environment to grow companies. Although trillions of dollars have been literally pulled out of the public markets for investment in safer times, billions of dollars are being pumped into private startups. And only those savvy enough to invest in this early stage of investment opportunities will later be called visionaries. This wave of startups is being cultivated with the smart mentoring and money of investors who know the importance of relationships and growing strong companies.

Mentoring has taken more formal roles as of late, especially within incubators and corporate venture arms. Basically, the assets that both good incubators and corporate venture arms offer: giving entrepreneurs mentoring, helping them cultivate resources, and, in some cases, giving them funding. And sometimes, corporate venture arms and incubators work beautifully together as part of the same company or entity as in Panasonic's Digital Concepts Center.

It's a temporary lull based on all this stuff that came down last year. Many of these for-profit incubators were not well constituted and were based around dot-com startups because of the high *valuations of Internet companies. I believe there are some very substantial incubators out there, both corporate and venture models, that are going to be very successful and have real staying power.*

—Dinah Adkins, President and CEO of the National Business Incubation Association (NBIA)

Of course people need help clawing their way to the top when they're new to the game. And developing technology is not easy, and its costs are quite substantial. You can't compete in a garage anymore. People recognize this, corporations recognize this, and for those reasons technology incubators and corporate venture arms are being built throughout the world. Whether you are an investor of money or resources, understand one thing, if you get in early and the technology hits, the rewards will be great. If you choose the wrong technology or team, the hit you take will be less if you spread the risk. Well-established incubators, accelerators, and corporate venture arms understand that relationships are important. Relationships affirm that you have made the right choice. If you cannot find others who will believe in the dreams you do, perhaps there is no market, or the margins for the company are not great enough. Today, under scrutiny, Amazon.com with its burn rate, margins, and long-term goals for positive cash flow, would not have made the hurdles to get into any high-quality incubator, nor would it have received the cash from a corporate venture arm (unless there was a vital strategic partnership). Hindsight is 20/20. Validation from others seasoned in the technology markets is the prescription for corrective vision *now*, not more than $100M or even a billion, in the case of WebVan, down the line.

With the crash of April 2000, more and more people learned hard lessons about spreading the risk, and about doing due diligence before signing a $2M check over to a team of 23-year-old Harvard MBAs with goatees, peeper glasses, and a business plan on a napkin. Yeah, we learned some hard lessons this past year. The investment community saw a lot of people who moved into the investment space with fat wallets and no experience calling themselves angels and venture capitalists—they made the worst deals and the rest of the investment community paid the price when these companies that never should have seen the dance floor came crashing (albeit most silently because they were never able to come up with a product) down at the rate of two and three a day as we are well into 2001.

I think there's a lot more interest in corporations starting incubators. Some of our very experienced incubator managers have been hired away to become involved in corporate incubation. We have more corporations among our members who are looking to get into that sort of thing. That interest has certainly grown significantly since the 1980s when there was a corporate incubator at Kodak and Control Data. Those were very early experiences, and I think it was difficult for them to get involved in corporate incubation because most of them didn't have the experience of working with entrepreneurial companies, doing spinouts, providing assistance to grow an entrepreneurial company. I think that is changing, because what I'm seeing is corporations draw in experienced

> *people because it's not a skill that they had internally.*
>
> —Dinah Adkins, President and CEO, National Business Incubation Association

Here in Silicon Valley there are people who have gone through the technology cycles such as Autodesk's CEO, Carol Bartz and Adobe Systems' cofounder and CTO John Warnock and others who have made it, who saw the value in helping companies on their way up, and started corporate venture funds within their companies. Unlike private venture groups that need to go hustle to close each fund, corporate venture arms are primarily evergreen and one corporation can have more than $1B invested.

Technology incubators, accelerators, and corporate venture arms have become an intricate part of investing in technologies and leveraging their assets and resources to build empires of the two guys and a gal that come to them via their garages. This is a very lucrative field if you have a mission that allows you to be both strategic and profitable. Now more than ever, companies need a leg up to get to market quickly. Aligning themselves with a corporate venture arm that also gives them technology, resources, and licensing opportunities and incubators or accelerators that arm them with the common sense of staff mentors, resources, and introductions to funding, are key elements of success.

When I looked around at the different models of technology incubators, accelerators, and corporate venture arms, one thing is apparent; there are a lot of models, environments, and elements that make companies happen. There are no magic incantations or assurances; it is all chemistry—even alchemy—and the ability to be agile.

Silicon Valley is one of those rare places where everything seems to be balanced and resources to support fledgling technology companies are just a step out of the garage. Although many technology incubators and corporate venture arms may be centered here in the San Francisco Bay Area, this is by no means the only place they can thrive. Actually, I was very surprised to see how well a cluster of technology incubators in Ohio is doing. *Technology in Ohio?* I thought before I called and found out more. Honestly, I had called more out of morbid curiosity than the thought of including them in this book. So, yes, technology can happen in Ohio, too. Technology is an anytime, anywhere phenomena that can be leveraged from just about anywhere in the world granted you have the right supporting resources.

THE MATURING MARKET

There will always be eternal optimists around us, and Jim Robbins, Executive Director of the Panasonic Digital Concepts Center and principal in the group's venture fund, is one of them. Visionaries are often perceived as optimists because they see a better, more efficient future where all of our resources are leveraged to create a dream. The Panasonic Digital Concepts Center, an incubator in the heart of Silicon Valley, is one such dream that Robbins created. Robbins, also a private incubation consultant who owns Business Cluster Development (www.clusterdevelopment.com), has designed such incubators as The Software Business Cluster (www.SJSBC.org)—where Robbins is Executive Director, the Women's Technology Cluster (www.womenstechcluster.org), The Environmental Business Cluster, and many others.

Robbins is himself a hybrid of directors coming out of the maturing market. The first incubator he developed was one for DEC in Palo Alto, and others have been more community based. The Panasonic Digital Concepts Center serves its mother company, Matsushita.

"What I think is happening with incubators is that it's a maturing industry and we're seeing things happen in this maturing industry as we do in a lot of others," says Robbins of the current environment. "Five years ago there were a lot fewer incubators and there were a lot fewer models of incubation. You can liken what is happening in the incubator industry to the cell phone industry. First, people tried cell phones; it was a new idea and it took quite a while for them to catch on. They'd been around for a while before it became clear what their value was and then the industry took off and everyone started to build cell phones; you started to see a consolidation in that industry and the big companies buying small ones and sometimes small companies buying big ones. I think that's what's happening in the incubation world. It's taken a while for the model of incubators to prove itself. I think it did prove itself and companies saw that it was an effective way to accelerate their growth and increase their chances for success.

"Then a very strong market came along in which lots of people were starting companies and lots of people were getting funded and it created an incentive for people to start more incubators," says Robbins. "In that process a lot of new models of incubation came out in the last two years and now you're seeing the economy soften and a weakening economy will help us figure out which models are sustainable and which ones aren't. So you will see some incubators fail; you're going to see some struggle, others consolidate, and you're going to see some that will do fine in a down market. Right now people are trying to figure out, do you consolidate? Do you build them vertically, or horizontally? Do you do them in chains all across the world at the same time? Do you do it inside a corporation? There's a lot of creativity and an unstable market and that's the greatest time to test out different models."

WHAT MODEL WILL SURVIVE?

There are a lot of researchers in the trenches trying to figure out what the magic synergy is to keeping an incubator up and running profitably as well as creating profitable startups. "It has been notoriously difficult for researchers to gauge the financial returns due to incubators, although the data that does exist is promising," says Victor Seidel, researcher at Stanford University in the Center for Work, Technology, and Organization, who has been physically living in tech incubators to study the day-to-day operations for a study he is completing.

"That said, from my research I would expect the best returns from those incubators that provide a highly-networked but lean management team—a lean management team that has a demonstrated level of expertise in the space of the incubated companies. For incubators to best add value they must occupy what researchers term 'structural holes' in the network of relationships among entrepreneurs and investors. Those incubators that provide valuable network connections for their startups, while providing the opportunity for incubated CEOs to develop expertise in how to grow a company, should be best positioned for sustainability and growth."

Many incubators have only started taking equity in the last year—imagine to have been one of those incubators that started up a multimillion dollar, or even billion dollar companies, and not been able to have benefited from your participation, sans the rent you charged. Now incubators are realizing they don't have to rely on cheap rent and making operating in the red status quo. Those were the incubators of yesteryear; there is a new model in the works that will make the word *incubator* an accepted moniker once again.

"I think a number of incubators have gotten themselves confused about what it is they're providing; is it space? Is it space plus advisors? Plus Internet access?" asks Mark Radcliffe, author and partner, Gray Cary Ware and Freidenrich, LLP, who works closely with several tech incubators. "What

I've always found peculiar is that a number of the incubators I've been involved with have felt that they should provide space at a discount, whereas they're actually providing services from the location and should charge a premium for."

This is the dilemma of many tech incubators, and often the deciding factor in an incubator that survives and an incubator that goes down in flames.

"I think it's real important to understand what your long-term plan is because you don't want to get in a situation where you have to rely on the government or grants; you want to become self-sufficient and that should happen more sooner than later," warns Radcliffe. "In my experience, the success rates of the startups that have been through the incubators—especially startups new to the venture game—have seen a much higher degree of success because they are less likely to make a fatal mistake when they're at the most fragile part of their growth. When you're a small company it's really easy for you to make mistakes because you don't have enough resources to fall back on."

TAKING A LESSON FROM ANGELS

Angel investors are still primarily the first to invest in any deal. Many of today's angel investors were yesterday's entrepreneurs who made it and know enough about the industry to feel they can safely, with a certain amount of accepted risk, bet on the right horse and the right jockey. Of the heads of corporate venture arms and incubators, accelerators, one thing is certain; rarely do institutional investors like to be the first investors (otherwise known as leading the deal) in a startup.

The seed (first round meant primarily to cover the costs of basic development and filing patents) funding is for whatever reason traditionally taken on by angels. So, it is the angels and sometimes their groups who take on the greatest risk (this is the stage where most startups do not make it), and they are often the first to get paid in an act of liquidity (IPO, acquisition, merger, bankruptcy) because of the amount of risk. The most successful corporate venture arms, incubators, and accelerators will have tight connections in the angel communities around them.

There have been legendary entrepreneurs who have gone on to be angel investors, most CEOs who have made a good living often find it in their blood to have some skin in the game. One such entrepreneur who became a successful investor is Eugene Kleiner, who also understood the necessity of nurturing entrepreneurs' talent and monitoring their success.

When Eugene Kleiner, cofounder of Kleiner, Perkins, Caufield & Byers, founded his venture capital firm, he had a sound business sense built from starting his own company. He was one of the eight engineers to leave William Shockley's company, Shockley Semiconductors, and start Fairchild Semiconductor (several of the original group of engineers went on to found Intel). He and his cofounders set out to find the cash to start up their company with little acumen on how to do so. Years later, Kleiner would recognize this and the firm set up an incubator within its venture firm.

"Most venture funds at that time were funded by the very wealthy families like the Rockefellers and the Whitneys—there was money available from industries like steel and such," says Kleiner of the venture climate in 1971 when the firm was founded. "They had venture funds and basically they invested money but they didn't work closely with the companies. They were really risk-taking bankers. When Tom (Perkins) and I started Kleiner Perkins our feeling was that, sure companies need money, but they needed more than that—they needed help in getting started in how to staff the company and plan the business, et cetera.

"So we started a fund where we really participated with the companies—to create companies and grow them," says Kleiner. "That was different at the time, but since that time others have done the same thing. Some people have ideas and not a business, so some may use angel money to do some experiments and to write a good business plan, and then they go to a venture capitalist. At Kleiner Perkins we used to incubate some companies; there were people who had good ideas, but didn't have a business. We'd give them an office and we'd give them a salary and we told them to write a business plan. We would do this for three or four months or so, and this gave us a chance to observe people and to see whether we could work with them. Some succeeded and others left us in three months. In general the whole idea was very successful."

There will always be icons in this industry, and Eugene Kleiner is one of them. He grew his firm into one of the worldwide successes in tech venture capital. And he understood early on how important mentoring was to startups, as do many venture capital firms today.

THE FUTURE

With the market hitting a weak point, it is obvious that the investment segment is going to take a hit. According to Aberdeen Group's white paper, *Early Stage Investing Outlook 2001–2002: An Industry in Transition*, early-stage investors, including angels, incubators, corporate venture arms, and VCs, will reduce their overall investments by 40 percent. According to Aberdeen $103B was raised in early-stage funding in the United States during 2000 (this figure did not include corporate funding), and they project that only $63B will be raised in 2001.

Corporate ventures are also taking a hit. Currently the country's technology companies and the stock market are plummeting, and some companies are finding it difficult to go to the boards of their own corporations and ask that money be appropriated elsewhere to develop another company's technology. But this is what survival is all about. If you don't invest in new technology, it will be difficult to stay ahead of the game when your competition invests its money and resources into cutting edge technologies.

Nurturing creative technologists is what corporate venture arms, incubators, and accelerators are all about. With the many people interviewed for this book, no one has said an incubator does better in fruitful times; instead they say recession is when there is the greatest need for large companies and incubators to nurture fledgling startups.

"Incubators have the potential to house some of the most dynamic and exciting companies of the future," says Victor Seidel, researcher at Stanford University in the Center for Work, Technology, and Organization. "The first phase of incubation was traditionally focused on economic development initiatives; just as with real incubators, a focus on survival. The second phase of incubation, which is still underway, has focused on speeding returns on investment, a focus on acceleration. A range of approaches have been experimented with as part of this second phase—which we organizational behavior researchers find very exciting—and the experiments are still proceeding. I have found that leading incubators have the potential to continue to attract and develop top-level talent. I am very optimistic about the future of incubators, as during my research I have seen a great deal of thought by the heads of incubators regarding the critical question of how incubators can best add value to the process of entrepreneurship.

"I expect to continue to see great experimentation with the organizational forms that define incubators," says Seidel of the future. "We should not expect to see any one form emerge as dominant, as there will be room for a range of approaches, reflecting the variation in the pool of entrepreneurs, the unforeseen technologies they will be developing, and changing environments that define the context of entrepreneurship."