5. Wider Business Environment for SMEs

Ensuring an effective environment to encourage entrepreneurship and business development is a critical issue for all market economies. Governments are increasingly putting efforts into ensuring an effective environment for business growth, reducing unnecessary red tape, creating circumstances where fair competition can flourish, and addressing market failures in ensuring access to finance and services.

Business Incubation is a sub-set of this wider range of policies adopted to create a facilitative environment for business creation and growth. As such the impact achieved by business incubation policy is affected by the wider environment for business development in which it is placed. In some cases problems in the wider environment can create circumstances where incubators are unable to succeed in their central mission to help growth businesses.

Some incubators can have significant gaps in basic infrastructure. For example many incubators in Africa have unreliable electricity supply. In other developing countries there are gaps in ICT access and infrastructure.

Access to public and private R&D, market research and industry practices is an additional barrier to innovation and entrepreneurship in many incubation environments, while a key weakness is often a lack of incentives for entrepreneurial activity and innovation. In countries like Uzbekistan, the tax incentives simply do not exist in the environment. In many developing countries, the missing incentives include intellectual property laws that facilitate the commercialization of ideas. Countries where the laws themselves can be cited as particular barriers include Thailand and Iran, whereas in other countries, incubators lack of knowledge of intellectual property (IP) laws or have to deal with the cumbersome process and high cost of securing a patent.

The bureaucratic challenges of starting a business can also be cited as a key challenge. Time and costs for registering a company can be very high (i.e. up to almost 150 days). Financing gaps are then typically recurring both in developed and developing countries.

In the very early stages, financing needs may vary significantly but are often compatible with funds accessible through informal or traditional sources (e.g. micro and small and medium enterprises banks, MFI facilities, bootstrapping). Anyway, these sources do not always solve the problem in the following business development stages and cannot address the financial requirements of “high profile” innovative products and of many knowledge-based companies.

In these cases, sometimes there is a shortage due to underdeveloped supply side and/or the challenge is compounded by high collateral requirements. This is typical for example in countries with a weak “equity culture” where debt financing is regarded as the main option and there is the need to introduce financing tools that can offer guarantees replacing the collateral as well as to promote progressively a wider use of equity and quasi-equity products.

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24 According to the Monitoring and Evaluation Impact Study undertook by InfoDev on assisted incubators, more than 80% of grantees indicated that their clients are limited either because they cannot afford banking products or services or because SME-appropriate offerings do not exist in their local business environment. This gap exists in all regions.

25 In Mauritius, for example, an innovative range of mechanisms exists to fund SMEs in the ICT sector, but clients of the National Computer Board ICT Incubator Center report that the collateral requirements make these funds difficult to access.
However, often the problems lies in a mismatch between the supply and demand side and the need to improve their interaction. In most countries, financial institutions do not have enough information about the economics or financial parameters of clients and so they show a conservative attitude. On the other side, clients are often not very well prepared in approaching banks or investments funds. They are unable to analyze the financial instruments available and to understand which suites best their needs. Nevertheless, they cannot prepare a good business plan in the most effective way.

Each business environment has its own unique mix of gaps, and these differences are reflected in the activities that incubators can undertake to support local entrepreneurs.

It is the case that incubation services can, and often do, help the specific businesses supported by the incubator to overcome wider problems in the business environment, for instance:

- providing financing services (brokering loan arrangements, developing clients negotiations skills, training and advisory programs to enhance investment readiness, in-house loan schemes, seed funds, specific venture capital access, linking to business angels);
- building stronger links between entrepreneurs and universities thus promoting the development of the knowledge capital;
- accessing improved services from state owned or supported monopoly (i.e. overcoming ICT access problems),
- overcoming bureaucratic delays in obtaining licenses and permits (creating special fast track systems);
- working (formally and/or informally) to improve the regulatory environment for SMEs - not only for their own clients, but also for the broader community of SMEs (e.g. regular consultation with the government on SME and business environment issues).

Building on their reputation and network of relationships and collaborations, incubators can then positively influence the environment dynamics. Many incubators are acting as effective pioneers for change. ISST in Iran had a direct influence on the country’s strategy and now is focusing on knowledge-based development.

While this is the case business incubation is not a substitute for fixing significant problems in the wider business environment, and incubators programs need to be complemented with wider SME support initiatives addressing main constraints to enterprises development and growth. Public authorities have to intervene with other public mechanisms to create favorable conditions in the business environment, addressing financing and legal aspects relevant for new ventures.

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26 Brazil has a very well developed network of business angels
27 The Genesis Institute in Brazil, for example, was founded with a mission to "transfer knowledge from the University to Society," and it has succeeded in promoting a stronger culture and structure for entrepreneurialism for students and faculty of the Catholic University of Rio
28 Yangling and Tianjin in China, ANPROTEC and RMI in Brazil, and TREC-STEP in India, are regularly consulted by government on issues affecting the local business environment, particularly with respect to developing the SME sector.
Government leaders in countries such as Tunisia and Mauritius, for example, have made the build-out of ICT infrastructure a national priority in recent years. Policymakers in developed countries usually facilitate knowledge-sharing across sectors by creating stronger incentives for commercialization and R&D.

There are then environments where governments are providing cohesive policy, regulatory and legal frameworks that support the SME sector. For example, the investment in new technologies development and R&D activities as well as the involvement in new business sectors have raised some issues to governments in terms of intellectual property rights and the related economic and social implications. Of course, a balance must be reached between the need to encourage research and creation on the one hand and, on the other, the legitimate wish to make innovation and culture freely available to all.

In Tunisia, for example, recent legislation that protects knowledge-based SMEs includes the Telecommunications Code, the Electronic Business and Signature Law, and the Personal Data Protection Law. The Indian government has also focused on the Small Scale Industrial (SSI) sector as a driver of future growth and innovation through the National Science & Technology Entrepreneurship Development Board (NSTEDB), established under the aegis of the Department of Science & Technology to help promote knowledge driven and technology intensive enterprises. The Board has representations from socio-economic and scientific Ministries/Departments and aims to promote and develop high-end entrepreneurship for S&T Manpower, thus converting "job-seekers" into "job-generators" through Science & Technology (S&T) interventions.

Similarly, to overcome the shortage of available financial resources for new start-up companies, governments have contributed with the provision of a variety of financing tools which cover all the phases of the incubation process (loans, guarantee funds, venture capital). Initiatives are also launched to improve the legislative and institutional framework and promote sound and functioning financial markets. However, it is also recommendable that governments pay attention to the financial mismatch that can occur in their countries and that they compound incubators in promoting the investment readiness of their clients by launching adequate training and advisory programs involving both the supply and demand sides.

6. Funding Strategies for Business Incubation and Sustainability

6.1. Sponsorship

Initial funding of the incubator programs is usually provided by public authorities.

There are some examples, especially from developed countries of private enterprises²⁹ establishing incubators, especially in the ICT industry, often requiring a proportion of the initial share capital in exchange for space in the incubator.

²⁹ Private establishment of incubators is common in USA, Australia and in many EU countries. The New Zealand case study identified investments of this sort and our Ghana research identified an incubator receiving financial support from Barclay’s Bank.