

**State of Washington  
Joint Legislative Audit and Review Committee (JLARC)**



**Small Business Incubators: Review  
of State Policy, Funding,  
and Incubator Performance**

**Report 07-10**

**August 23, 2007**

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in alternative formats for persons with disabilities.*

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## JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE

506 16<sup>th</sup> Avenue SE

PO Box 40910

Olympia, WA 98501-2323

(360) 786-5171

(360) 786-5180 Fax

[www.leg.wa.gov/jlarc](http://www.leg.wa.gov/jlarc)

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The statutory authority for JLARC, established in Chapter 44.28 RCW, requires the Legislative Auditor to ensure that JLARC studies are conducted in accordance with Generally Accepted Government Auditing Standards, as applicable to the scope of the audit. This study was conducted in accordance with those applicable standards. Those standards require auditors to plan and perform audits to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on the audit objectives. The evidence obtained for this JLARC report provides a reasonable basis for the enclosed findings and conclusions, and any exceptions to the application of audit standards have been explicitly disclosed in the body of this report.

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### **Committee Approval**

On August 23, 2007, this report was approved for distribution by the Joint Legislative Audit and Review Committee.

**SMALL BUSINESS  
INCUBATORS:  
REVIEW OF  
STATE POLICY,  
FUNDING, AND  
INCUBATOR  
PERFORMANCE  
REPORT 07-10**

AUGUST 23, 2007



STATE OF WASHINGTON

JOINT LEGISLATIVE  
AUDIT AND REVIEW  
COMMITTEE

**STUDY TEAM**  
John Woolley

**PROJECT SUPERVISOR**  
Keenan Konopaski

**LEGISLATIVE AUDITOR**  
Ruta Fanning

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or contact

Joint Legislative Audit &  
Review Committee  
506 16<sup>th</sup> Avenue SE  
Olympia, WA 98501-2323

(360) 786-5171  
(360) 786-5180 FAX

# REPORT SUMMARY

Small business incubators provide services to firms in an attempt to help the firms succeed and thus lower the rate of small business failures. Such services might be one or all of the following: floor space, shared equipment, clerical support services, assistance in how to run a business, access to capital, and technical assistance.

To better understand small business incubators, the Legislature directed JLARC to answer a number of questions, summarized in three topic areas:

- How many and where are they in the state?
- What is the state's role in supporting incubators and what are their costs to the state?
- How are incubators performing?

At their core, these questions focus on the fundamental policy concern of whether incubators assist in the creation and expansion of firms and keep businesses from failing.

After conducting an extensive review of the literature and visiting incubators in Washington State, we found no analysis that answers the key question: "if not for the incubator, what would have happened to the firms using its services?" **Thus it was not possible for JLARC to determine the true impact of incubators in Washington.**

We did, however, learn much about incubators in Washington State, in other states, and in other nations. We provide insights about incubators and offer suggestions for information that can be systematically collected to help policymakers better evaluate incubators in the future. Like many other economic development efforts, incubators might best be characterized as ongoing experiments. Improved information will help policymakers understand whether these experiments are producing the desired results.

## **Identifying Business Incubators: How Many and What Types of Incubators Exist in Washington State?**

There are no licensing or certification requirements for business incubators, nor any tax identification code or other common coding convention that identifies an entity as an incubator. Therefore, determining the exact number of incubators is difficult. JLARC found two estimates of the number of incubators in Washington.

The Department of Community, Trade and Economic Development (DCTED) is charged with administering the small business incubator grant program. DCTED's 2005 survey found 53 current or potential "self-proclaimed" incubators.

More recently, the Washington Association of Small Business Incubators (WASBI is part of a national organization, the National Business Incubation Association) estimated that there are 24 incubators (16 in existence and 8 in the planning stage) in Washington State. WASBI uses a more stringent definition of what constitutes an incubator and also defines "types" of incubators. WASBI attempts to determine if an incubator follows national (NBIA) best practices, such as providing business assistance or having a graduation policy. WASBI's approach moves beyond the definition of an incubator providing only floor space.

## What is the State's Role in Supporting Business Incubators and What Are Their Costs to the State?

In 2004, the Legislature created a statutory definition for incubators, established policy, and created a competitive small business incubator grant program in the Department of Community, Trade and Economic Development (Chapter 43.176, Revised Code of Washington). Statute states: "It is hereby declared the policy of the state of Washington to assist in the creation and expansion of innovative small commercial enterprises that produce marketable goods and services through the employment of Washington residents...through the use of small business incubators."

Business incubators are defined in statute as a *facility* that offers:

- Space for start-up and expanding firms;
- The shared use of equipment and work areas;
- Daily management support services essential to high-quality commercial operations; and
- Technical assistance.

To qualify for program grants, incubators must meet the definitions above, be nonprofit, and focus on developing small businesses in an economically distressed area. In each of the three years that grant money has been available (fiscal years 2005, 2006, and 2007), four organizations received one-year grants averaging \$48,000 per year. No grant funding was included for the program in the recently passed 2007-09 Operating Budget.

Outside of the grant program, select incubators have received specific state funding in the operating or capital budgets. **Each of these selected appropriations has exceeded the total yearly amount available for the competitive grants.** Finally, since incubators frequently bring funding from a variety of sources together, there are instances where other funding has been provided by the state but not identified as incubator funding.

Determining the total amount of this funding is not possible.

Washington State does not provide any tax incentives to business incubators.

## How Are Business Incubators Performing?

Since there is no analysis that answers the key question "if not for the incubator, what would have happened to a firm and the jobs it created?" it is not possible to answer the most important performance question. This report's focus on performance reporting shifts to the collection of more basic performance indicators and measures. These indicators might include: the number of firms assisted by an incubator, how long the firms stay in business, the number of employees of those firms, and the revenues of those firms.

For instance, one of the current requirements for receiving a grant from DCTED is that each incubator must report the number of firms assisted and the number of employees working for those firms. Over the three-year history of the grants, five different incubators have received awards. DCTED does not collect information on business incubators not receiving grants. Thus, systematic collection of performance information is limited.

The National Business Incubation Association (NBIA) is in the process of publishing a "toolkit" for incubators to use to help gauge incubator economic impact. This toolkit recognizes two key issues about incubators: there is too little information on the performance of incubators, and some incubators use inaccurate "apples to oranges" comparisons when talking about performance. If incubators begin consistently collecting performance information over a suitable time period (NBIA suggests five years), policymakers will be in a better position to understand the performance of specific incubators. This information might help with the important but difficult job of answering the *key question* "if not for the incubator, what would have happened to the firm?"

# REPORT DETAIL

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## What is a Business Incubator?

The simple definition of a small business is a firm with fewer than 500 employees. The federal Small Business Administration reports such firms as important to the economy as they:

- Represent 99.7 percent of all employer firms;
- Employ half of all private sector employees; and
- Have generated 60 to 80 percent of net new jobs over the past decade.

There is concern, however, with their survival rate. One-third of new small businesses don't exist after two years, and 56 percent don't exist after four years.<sup>1</sup> Small business incubators are a strategy intended to assist small businesses to be successful.

The first incubator began as a real estate venture, essentially an attempt to utilize unused manufacturing building space in the late 1950s in upstate New York.

From that first real estate venture, some incubators have evolved to provide a range of services to help businesses succeed. Such services are incorporated into Washington State law (Chapter 43.176, Revised Code of Washington) as not just building space but also shared equipment, management support services, and technical assistance.

The National Business Incubation Association (NBIA) defines business incubators as: “a comprehensive business-assistance program targeted to help start-up and early-state firms, with the goal of improving their chances to grow into healthy, sustainable companies.”<sup>2</sup>

This JLARC report provides information on 11 questions about incubators posed by the Legislature, grouped into three topic areas:

### ***Topic One: How many incubators?***

1. How many are there and where are they?
2. What types of incubators exist in Washington?
3. What are their stated purposes?

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<sup>1</sup> Small Business Administration, Office of Advocacy: Frequently Asked Question. Updated June 2006.

<sup>2</sup> Adkins, Dinah, A Brief History of Business Incubation in the United States. National Business Incubation Association, Athens, Ohio. 2002.

**Topic Two: What is the state's role in supporting incubators and what are their costs to the state?**

4. What are the criteria for state support?
5. What state financial and tax support exists for incubators?
6. What are their costs to the state?
7. What policies exist for reducing or terminating state support?

**Topic Three: How are incubators performing?**

8. What are their performance outcomes?
9. What are the private and public impacts and benefits?
10. How many businesses and jobs have incubators created?
11. What is the survival rate of the businesses?

**Topic One: How Many Incubators?**

**Question 1: How many are there and where are they?**

Finding an exact answer to this seemingly simple question proved difficult. There is no certification of incubators, and there is no coding used by federal or Washington State governments that identify an entity as an incubator.

The National Business Incubation Association (NBIA) estimates that there are 1,400 incubators in North America, with 1,115 incubators in the United States. For Washington, JLARC identified two estimates of the number of incubators.

The Department of Community, Trade and Economic Development's (DCTED) 2005 estimate identifies **53 current or potential 'self proclaimed' incubators** in Washington. This estimate was developed for DCTED by the Washington Association of Small Business Incubators (WASBI) through a survey of economic development stakeholders.<sup>3</sup>

More recently, WASBI used a different method and counted **24** incubators in Washington (16 existing with 8 in the planning stage). Exhibit 1 on the following page illustrates where these incubators are located.

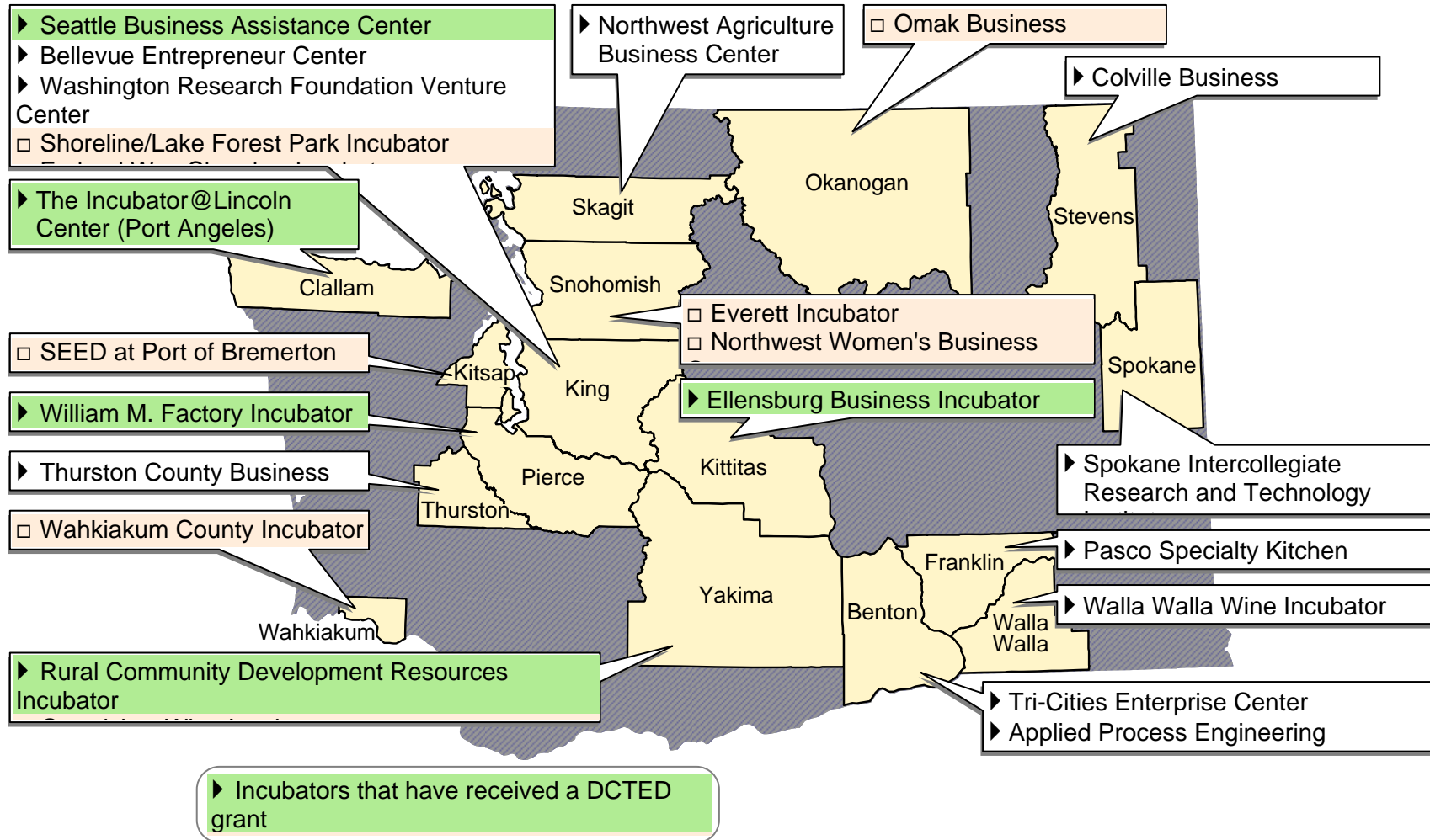
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<sup>3</sup> Washington State Department of Community, Trade and Economic Development: "Legislative Discussion Paper on the Washington State Incubator Study." Not dated, however the study is dated January 1, 2005.



## How Many Incubators?

Exhibit 1 – 2007 Estimate of Business Incubators in Washington



Source: JLARC analysis of DCTED and Washington Association of Small Business Incubators (WASBI) data.

The difference between the two numbers is explained by looking at the more recent WASBI number as a refining process. The Association applies a test as to whether incubators meet some of the industry “best practices” as suggested by WASBI and NBIA. However, because there are no certification requirements or standard industry codes, the number is an estimate.

### **Case Study: What’s in a Name?**

Identifying the number of incubators may start with the most basic of questions: is “incubator” in the name? But sometimes names change. Indeed, sometimes “incubators” become “virtual incubators” or stop calling themselves “incubator” altogether.

“Virtual” incubators are essentially organizations that might supply similar business consultation and support services as a “regular” incubator, but do so without supplying floor space.

In Washington, the Northwest Agricultural Business Center provides a good example. When it received its first state funding (\$300,000 in the 2005-07 Biennial Operating Budget), the funding went to the “Northwest Agricultural Incubator Project.” Its second increment of funding (\$50,000 in the 2006 Supplemental Operating Budget) also went to the “Northwest Agricultural Incubator Project.” However, its most recent funding increment (\$990,000 in the 2007-09 Biennial Operating Budget) went to the “Northwest Agricultural Business Center.” The term incubator is no longer referenced in the funding.

The Center could be a “virtual incubator” as it provides or organizes the provision of business and technical assistance to farmers. But farmers do not require the facility that partially defines an incubator. Thus, the Northwest Agricultural Business Center might be viewed as a different entity entirely that focuses on the specific needs of farmers, does not attempt to provide floor space, and is not an incubator.

### **Question 2: What types of incubators exist in Washington State?**

There are a number of ways of grouping incubators. One of the ways NBIA groups the 1,400 North American incubators is by addressing the following questions: Are they for profit? What sorts of companies do they assist? Where are they located? Where do they get their primary financial support, known as “sponsors”?

Table 1 on the following page presents NBIA’s answers to these questions for North America. While incubators in Washington State have not been split into the exact same groupings, similar information is available and is presented in Table 2 on the same page.

## How Many Incubators?

Table 1: Incubator Types in North America

<b>Profit Orientation</b>	
Profit	10%
Nonprofit	90%
<b>Types of Companies They Assist</b>	
Mixed use	47%
Technology	37%
Manufacturing	7%
Service	6%
Community Revitalization	3%
<b>Location of Incubator Clients</b>	
Urban	44%
Rural	31%
Suburban	16%
Outside of Area	9%
<b>Sponsorship</b>	
Academic Institutions	25%
Government Entities	16%
Economic Development Organizations	15%
For-profit entities	10%
Other types	10%
Hybrids: more than one sponsor	5%
No sponsor	19%

Source: National Business Incubation Association, "Business Incubation FAQ". Downloaded April 2007.

Table 2: Incubator Types in Washington State

	<b>2005 Survey</b>	<b>2007 WASBI Analysis</b>
<b>Profit Orientation</b>		
	Information not readily available; however, most appear to be nonprofit	One for-profit, with the remainder nonprofit.
<b>Types of Companies They Assist</b>		
Mixed	46%	62%
Technology	13%	17%
Agricultural	5%	13%
All others	36%	8%
<b>Incubator Setting</b>		
Metropolitan	41%	33%
Smaller City	32%	50%
Rural	27%	17%

Source: JLARC analysis of information supplied by the Department of Community, Trade & Economic Development and the Washington Association of Small Business Incubators.

Sponsorship for incubators in Washington State appears to be mixed between economic development organizations, ports, cities, utilities, and academic institutions, with some having multiple sponsors.

### Case Study in Mixed Sponsorship: Who's the Sponsor?

The William M. Factory Small Business Incubator can be seen from Interstate 5, not far from the Tacoma Dome. This nonprofit has a mixed client base but has a focus on the building and construction trades.

Looking at its \$3.2 million construction budget provides insights into how incubators obtain funding from a variety of sources, making "sponsorship" sometimes difficult to peg. The Factory Incubator reports the following sources:

State Capital Budget	\$	1,110,000
Bank Construction Loan	\$	850,000
US Office of Community Services	\$	349,000
Pierce County	\$	250,000
Tacoma Community Development Fund Loan	\$	250,000
City of Tacoma Community Development Block Grant	\$	155,807
Community Capital Campaign	\$	77,693
Puyallup Tribe	\$	50,000
Foundations and Others	\$	<u>107,500</u>
	\$	3,200,000

### Question 3: What are incubators' stated purposes?

Incubator literature points to an evolution in purpose. The first incubator was simple: utilize unused factory floor space.

Now, broadly speaking, the purpose of incubators is claimed to be "To increase the chances of [an incubate] firm surviving its formative years"<sup>4</sup> and to "nurture the development of entrepreneurial companies, helping them survive and grow during the start-up period, when they are most vulnerable . . . . Incubator graduates create jobs, revitalizing neighborhoods and commercialize new technologies, thus strengthening local, regional and even national economies."<sup>5</sup>

Incubators in Washington focus on assisting new firms but reflect a variety of specific purposes, missions, and goals. Six examples are presented in Table 3 on the following page to illustrate this diversity in purpose.

<sup>4</sup> Hackett, Sean M. with David M. Dilts. "A Systematic Review of Business Incubation Research," Journal of Technology Transfer, Vol. 29, 2004, page 60.

<sup>5</sup> National Business Incubation Association, "Business Incubation FAQ." Downloaded April 2007.

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## How Many Incubators?

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Table 3: Examples of Incubators and Diversity of Purpose

<b>Incubator</b>	<b>Purpose</b>
Seattle Business Assistance Center	Provide access to capital and business assistance to low-income, women and minority entrepreneurs.
Applied Process Engineering Laboratory (APEL)	Serve as a technology business startup center with engineering and manufacturing scale space, as well as wet labs, bio labs, and electronic laboratories.
Tri-Cities Enterprise Center	Function as an economic development program for the city of Richland in response to the area's concern for diversifying the local economy in preparation for the post-Hanford era.
Spokane Intercollegiate Research and Technology Institute (SIRTI)	Accelerate the development and growth of technology companies in the Inland Northwest, especially in eastern Washington.
Rural Community Development Resources Incubator	Focus on the recruitment of limited English speaking specialty construction trade contractors and trucking business owners.
Walla Walla Wine Incubator	Support the wine industry in Walla Walla by making it easier for start-up wineries to find suitable facilities.
Source: JLARC analysis of DCTED incubator program grant applications and WASBI data.	

## Topic Two: What is the State's Role in Supporting Incubators and What are Their Costs to the State?

### Question 4: What are the criteria for state support?

There are two primary means of state support for incubators: grants from the small business incubator grant program, and specific capital or operating budget appropriations to specific incubators. The criteria for support vary for each of these.

#### **Grants from the Small Business Incubator Program**

In 2004, the Legislature established a state policy regarding incubators, a definition of an incubator, a small business incubator grant program, and very specific criteria for eligibility for grants (Chapter 43.176, Revised Code of Washington). Table 4, below, presents the relevant parts of statute related to incubator subject areas. The Legislature provided funding for the grant program in fiscal years 2005, 2006, and 2007 (*detail on grant distribution follows on page 11*). No grant funding was included in the recently passed 2007-09 Biennial Operating Budget.

Table 4: Chapter 43.176 RCW—Small Business Incubator Program

Subject	Statute
Policy	It is hereby declared the policy of the state of Washington to assist in the creation and expansion of innovative small commercial enterprises that produce marketable goods and services through the employment of Washington residents, the use of technology, and the application of best management practices. This policy is to be implemented through the use of small business incubators.
Definition	Business incubator means a facility that offers: <ul style="list-style-type: none"> <li>• Space for start-up and expanding firms;</li> <li>• The shared use of equipment and work areas;</li> <li>• Daily management support services essential to high-quality commercial operations; and</li> <li>• Technical assistance.</li> </ul>
Grants	The small business incubator program is created in the Department of Community, Trade and Economic Development to provide start-up and operating assistance to qualified small business incubators. Grants are awarded for: <ul style="list-style-type: none"> <li>• Construction and equipment costs, up to \$3 million per recipient.</li> <li>• The provision of technical assistance to small businesses, up to a maximum of \$125,000 per year per recipient.</li> </ul>
Criteria for Receiving Grants	Incubator must: <ul style="list-style-type: none"> <li>• Be a nonprofit, 501(c)(3) organization or a partnership between a nonprofit and a government or quasi-government organization.</li> <li>• Focus on developing small businesses in an economically distressed or disadvantaged area.</li> <li>• Be structured around a sound business plan.</li> <li>• Have the resources to complete project in a timely manner.</li> <li>• Have additional fund sources so that the state grant is not the sole source of funds.</li> </ul>

What is the State's Role in Supporting Incubators and What are Their Costs to the State?

**Specific Capital or Operating Budget Appropriations to Specific Incubators**

Analysis of budget documents from the 2001-03 through the 2007-09 Biennia show specific appropriations to five different incubators (*detail of these appropriations follows on page 12*). These appropriations are separate from the small business incubator grant program and have no specific statutory criteria for the appropriations.

**Questions 5 and 6: What state financial and tax support exists for incubators? What are their costs to the state?**

There are no tax incentives specific to incubators. While the Legislature has recently considered specific property tax exemptions to nonprofit incubators, none have passed.

Incubators do however receive funding from the state, through Small Business Incubator Program grants and specific budget appropriations. Table 5, below, presents detail on the distribution of the Small Business Incubator Program grants. Table 6, on the following page, presents a summary of the grants as well as specific budget appropriation funding made available to incubators over the past four biennia. During this four biennium period, appropriations to the grant program totals \$620,000, specific operating budget appropriations total \$1,340,000, and capital budget appropriations total \$3,610,000.

Table 5: Small Business Incubator Program Grants

Fiscal Year	Grant Recipient	Grant Total
2005	Seattle Business Assistance Center	\$ 50,000
	Washington Association of Small Business Incubators	\$ 48,254
	African-American, Hispanic, Asian, and Native American Business and Professional Association Business Education and Training Program	\$ 25,000
	William M. Factory Business Incubator	\$ 25,000
	<b>Fiscal Year Total (\$150,00 available)</b>	<b>\$ 148,254</b>
2006	Rural Community Development Resources	\$ 75,000
	Seattle Business Assistance Center	\$ 72,500
	William M. Factory Business Incubator	\$ 67,500
	Ellensburg Business Development Authority	\$ 10,000
	Other expenditures	\$ 6,181
	<b>Fiscal Year Total (\$235, 000 available)</b>	<b>\$ 231,181</b>
2007	Shorebank Enterprise Pacific (Port Angeles)	\$ 65,000
	Rural Community Development Resources	\$ 50,000
	William M. Factory Business Incubator	\$ 50,000
	Seattle Business Assistance Center	\$ 42,500
	<b>Fiscal Year Total (\$235,000 available)</b>	<b>\$ 207,500</b>
<b>TOTAL OF GRANT AWARDS</b>		<b>\$ 586,935*</b>

*\*The total amount of grants awarded, \$586,935 is slightly lower than the available funding of \$620,000. For fiscal year 2005, the appropriation for grants went directly to the Small Business Incubator Account. Amounts not awarded in that year would remain as an Account balance. For fiscal years 2006 and 2007, appropriations did not go to the Account but were directed in budget provisos to be used for Small Business Incubator grants. Unexpended amounts in those years become part of the State General Fund year ending fund balance.*

What is the State's Role in Supporting Incubators and What are Their Costs to the State?

Table 6: Summary of Incubator Funding

Budget	Name	Operating Budget	Capital Budget
2001-03 Biennial	Factory Small Business Incubator, Tacoma <i>(Included in DCTED: Community Services Facilities Program)</i>		\$ 300,000
2002 Supplemental	William H. Factory small business incubator <i>(Included in DCTED: Job Creation and Infrastructure Program)</i>		\$ 250,000
2003-2005 Biennial	William Factory Business Incubator <i>(Included in DCTED: separate section)</i>		\$ 560,000
2004 Supplemental	Small Business Incubator Account: DCTED <i>(Detail in Table 5)</i>	\$ 150,000	
2005-2007 Biennial	Small Business Incubator Account: DCTED <i>(Detail in Table 5)</i>	\$ 470,000	
	Northwest Agriculture Incubator Project <i>(Included in DCTED operating appropriations)</i>	\$ 300,000	
	Port of Walla Walla Wine Incubator <i>(Found in DCTED Jobs In Community)</i>		\$1,000,000
2006 Supplemental	Northwest Agriculture Incubator Project <i>(Included in DCTED operating appropriations)</i>	\$ 50,000	
2007-2009 Biennial	Northwest Agricultural Business Center <i>Included in DCTED operating appropriations: Note: no longer called "incubator" in budget documents.</i>	\$ 990,000	
	Technical and scientific services incubator (Factory Incubator, Tacoma): <i>Included in DCTED Job Development Fund Grants</i>		\$ 250,000
	Port of Walla Walla wine incubator: <i>Included in DCTED Local and Community Projects</i>		\$ 500,000
	Thurston County Small Business Incubator: <i>Included in DCTED Local and Community Projects</i>		\$ 750,000
<b>Multi-Biennium Total</b>		<b>\$1,960,000</b>	<b>\$3,610,000</b>



In addition to the appropriations included in Table 6, the Spokane Intercollegiate Research and Technology Institute (SIRTI) gets a biennial appropriation. SIRTI's appropriation is included in the Higher Education portion of the budget. Detailed, back-up budget documents indicate that \$1 million of SIRTI's 2007-09 Operating Budget appropriation of \$4.9 million is for incubator activities.

Sometimes it is difficult to identify state funding as incubator funding. Since incubators may piece together funding from a variety of sources, funding may not be identified as going specifically to an incubator. Thus, with no certification process, no code identifying an organization as an incubator, and funding brought together from a variety of sources, a comprehensive inventory of all sources of state support for incubators is difficult to develop.

### **Case Study: The Difficulty in Identifying Incubator Funding**

The "Incubator@Lincoln Center" occupies about one-fourth of the space of a new building in Port Angeles. Like many other incubators, it has multiple "sponsors" including Peninsula College, the Clallam County Economic Development Council, and the Port Angeles School district. Also, as with other incubators, its capital funding was brought together from a variety of sources.

One such source was the State Capital Budget. According to incubator staff, components of the \$9 million in total funding needed to build the Lincoln Center include three separate capital budget appropriations of \$3 million, \$2 million and \$500,000.

The \$3 million 2002 Supplemental Capital Budget appropriation was included in DCTED's budget, under the Community Services Facilities Program area. The project included in the Budget Act is titled "Port Angeles Skills Center/Skills Consortium."

In order to track this project to an incubator, it is necessary to review the project description in back-up budget documentation maintained by legislative staff. Here, the project is described in more detail, identifying it as including an incubator: "Funds are provided for the construction of a building in Port Angeles to co-locate the programs of the North Olympic Peninsula Skills Consortium with a new business incubation program. The North Olympic Peninsula Skills Consortium delivers job skills training programs to students and workers in rural Clallam County."

The \$2 million 2003-05 Capital Budget appropriation was included in the State Board of Education's budget, under the project: Port Angeles School District North Olympic Skill Center. Budget documentation simply states: "Funds are provided to complete the construction of the North Olympic Skills Center" with no reference to an incubator.

Another \$500,000 was included in the Community and Technical Colleges 2003-05 Capital Budget, specifically for "Peninsula College: Community Resource Center." Here again budget detail is required to understand the link to an incubator. In the "Agency Request" version of the budget, the project was described as follows: "This center includes a Skill Center, a Small Business Development Center, a Business Incubator, and instructional space for the college."

**Question 7: What policies exist for reducing or terminating state support?**

With the exception of the Spokane Intercollegiate Research and Technology Institute, state funding for incubators has been considered “one-time” in nature. Specific funding amounts are reconsidered each fiscal year. DCTED’s awarding of grants has reflected this yearly funding; grants are awarded only for one year. The capital appropriations are by their nature project-specific and “terminate” at the project’s conclusion.

## **Topic Three: How are Incubators Performing?**

**Question 8: What are their performance outcomes?**

**Question 9: What are the private and public impacts and benefits?**

**Question 10: How many businesses and jobs have incubators created?**

**Question 11: What is the survival rate of the businesses?**

Underlying the 11 questions of this report is the fundamental policy concern with incubator performance: do business incubators work? Do they help firms start, grow, create jobs, and stay in business?

There are no explicit incubator performance goals in statute. There is, however, a great deal of literature regarding business incubators, analyzing and discussing their history and hoped-for performance as well as articulating what are often called “best practices.”

After extensive analysis of this literature, **JLARC is not able to determine the impact of incubators.** No research answers the key question, often characterized as the “but for” question: what would have happened to an “incubated” firm if it had not been in the incubator? Stated simply, claims of saving businesses and saving jobs may be misleading when they are not backed by rigorous analysis that compares incubated to comparable non-incubated firms. One extensive analysis states: “*Data on the success and failure of comparable non-incubated companies is rarely kept and has proven quite difficult, if not impossible, to obtain.*”<sup>6</sup> The four review questions above all relate to understanding the performance of incubators. Because of this lack of credible comparative analysis, none can be answered completely.

A draft document from the National Business Incubation Association (NBIA) recognizes this problem with comparable data. This draft “toolkit” to improve business incubator information, which was shared with JLARC staff, states: “Unfortunately, statistics comparing business success for incubated vs. non-incubated firms do not exist.” This draft toolkit makes suggestions for the systematic gathering of information to better understand incubator impacts and performance.<sup>7</sup> While individual incubators might be collecting information, this document encourages a more systematic approach to the collection of performance outcome data.

### **NBIA’s Suggested Data Collection**

The National Business Incubation Association’s (NBIA) draft toolkit suggests that a set of ten basic measures be tracked by incubators and that these are tracked for at least five years after firms leave an incubator. Table 7 on the following page presents these measures as contained in the draft toolkit and some explanation of each measure and the measure’s value.

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<sup>6</sup> Hackett, Sean M. with David M. Dilts. “A Systematic Review of Business Incubation Research,” *Journal of Technology Transfer*, Vol. 29, 2004, page 73.

<sup>7</sup> National Business Incubation Association, “Measuring Your Business Incubator’s Economic Impact: A Toolkit.” Draft shared with JLARC, March 2007.

Table 7: NBIA’s Suggested Performance Metrics for Small Business incubators

<b>Metric</b>	<b>Explanation</b>
Number of current clients	The number of companies the incubator currently serves.
Total number of graduates since program inception	Demonstrating number of graduates is essential to demonstrate success.
Number of graduate firms still in business or that have been merged or acquired	Graduate firms that remain in operation demonstrate a program’s ability to produce successful companies that survive.
Number of people currently employed full-time by client and graduate firms	Collection of current employment figures from both clients and graduates shows growth over time.
Number of people currently employed part-time by client and graduate firms	Part-time employment may be significant.
Current monthly salaries and wages paid by client and graduate firms	Allows calculation of current average wages and is easier for clients and graduates to collect than annual figures.
Gross revenues for the most recent full year for clients and graduate firms	Total gross revenue amount shown on income statement measures firm size.
Dollar amount of debt capital raised in most recent full year by client and graduate firms	Indicator of amount of money borrowed in last full year.
Dollar amount of equity capital raised in most recent full year by client and graduate firms	Indicator of ability to attract investors.
Dollar amount of grant funds raised in most recent full year by client and graduate firms	Indicator of ability to attract grant funds.
Source: National Business Incubation Association, “Measuring Your Business Incubator’s Economic Impact: A Toolkit”. Draft shared with JLARC, March 2007.	

## How are Incubators Performing?

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At the local level, many of the incubators JLARC visited collect data on their client firms. They may do this to follow “best practices,” or they may do so because one of their funding sources may require it. For example, DCTED began requiring quarterly reports and a yearly report for incubators receiving grants through the small business incubator grant program. For incubator client firms, incubators are to report:

- Number of businesses
- Type of businesses
- Number of full-time/number of part-time employees
- New jobs created in last year
- Percent of jobs above county minimum wage
- Number of graduates during the grant year
- Percent of graduates still in business
- Number of graduates in the last three years
- Income of incubator clients
- Taxes of incubator clients

These reports are not required once the annual grant period is complete. Also, such information, while an important start, still must be compared to data from comparable firms not assisted by an incubator. This is essential to answer the question, “but for the incubator, what would have happened?”

### **Case Study: What is an Appropriate Performance Target for “Graduating” From an Incubator?**

Business incubator literature contains suggestions for “best practices.” These practices cover a variety of areas, from incubator staff qualifications to the assistance to be provided to incubator clients. Such practices can be another metric for understanding incubator performance.

One practice relates to incubator client “graduation” criteria. Such criteria are time limits placed on a client’s use of the incubator. The National Business Incubation Association suggests that time limits be included in all leases with incubator tenants. Policies should: “reflect the period in which the client should realistically progress to accelerated growth or be supported by private sector providers.” No specific period is suggested; rather, the period should be based on the specifics of the industry type being assisted. An easy performance indicator for this topic is the simple question: “does the incubator have a graduation policy?”

Things get much more complex when trying to determine if the graduation requirement is appropriate and how strictly it should be enforced. Is two or three years too long, the correct length, or too short?

The Walla Walla wine incubator has a six-year graduation period. With three buildings, each housing one winery, it is possible that in the course of six years a maximum of three firms will be assisted. However, according to the incubator sponsor (the Port of Walla Walla), this graduation policy is based on an analysis that determined it takes about six years to become a viable winery. A “viable” production capacity was calculated at year six, equivalent to 2,000 cases. Therefore, these incubators were designed so that they could house a winery with a capacity up to 2,000 cases per year. After six years, a successful winery would likely want to expand capacity above 2,000 cases and would want to leave. Thus, a graduation period that at first seems long—six years—is based on what is considered to be appropriate for the industry.

## Report Conclusion

Small business incubators have existed for almost 50 years. During this time, some have evolved from a simple real estate venture to organizations that provide a menu of assistance to businesses, from access to capital to access to specialized technical assistance. At their core they strive to help new businesses immerge, survive, and become viable.

We were unable to conclude that any given business would not have succeeded “but for the incubator.” Similar to other economic development strategies, incubators may best be considered as ongoing experiments.

Policymakers may wish to improve the information available to them to judge the success of these experiments. This report illustrates some of the data which the industry itself suggests should be collected on a routine, systematic basis. This information will not fully answer the “but for question.” More generally, the comparative impacts of economic development efforts are regarded in research as very hard to measure. The systematic collection of business incubator data might, however, establish basic information that at a minimum will assist in comparing incubators to each other and to “best practices,” a necessary and first step towards understanding incubator performance and success.

# APPENDIX 1 – SCOPE AND OBJECTIVES

## BUSINESS INCUBATORS: REVIEW OF STATE POLICY, FUNDING, AND TAX PREFERENCES

### SCOPE AND OBJECTIVES

FEBRUARY 21, 2007



STATE OF WASHINGTON  
JOINT LEGISLATIVE AUDIT AND  
REVIEW COMMITTEE

#### STUDY TEAM

JOHN WOOLLEY  
ANALYST

#### PROJECT SUPERVISOR

KEENAN KONOPASKI  
AUDIT COORDINATOR

#### LEGISLATIVE AUDITOR

RUTA FANNING

Copies of Final reports and Digests are  
available on the JLARC website at:

[www.jlarc.leg.wa.gov](http://www.jlarc.leg.wa.gov)

Joint Legislative Audit & Review  
Committee  
506 16<sup>th</sup> Avenue SE  
Olympia, WA 98501-2323  
(360) 786-5171  
(360) 786-5180 Fax

## WHY A REVIEW OF BUSINESS INCUBATORS?

The 2006 Supplemental Operating Budget directs JLARC to review the state's policy on state funding and tax preferences for business incubators.

## WHAT IS A BUSINESS INCUBATOR?

State statute (Revised Code of Washington, 43.176.020) defines a business incubator as a facility that offers:

- Space for start-up and expanding firms;
- Shared use of equipment and work areas;
- Daily management support services essential to high-quality commercial operations; and
- Technical assistance.

Additionally, the National Business Incubator Association (NBIA) notes that a business incubator is a **comprehensive business-assistance** program, targeted to help start-up and early-stage firms, with the goal of improving their chances to grow into healthy, sustainable companies.

NBIA estimates that there are approximately 950 incubators in the U.S. The Washington State Association of Small Business Incubators estimates there are 19 incubators or developing incubators in Washington State. Nationally, most business incubators (84 percent) are nonprofit.

## STATE FUNDING FOR BUSINESS INCUBATORS

The review will include an analysis of how incubators are funded. Some state funding is easily identified. In 2004, the Legislature created the Small Business Incubator Program, to provide start-up and operating assistance grants to qualified small business incubators. The program is administered by the Department of Community, Trade and Economic Development. The 2005-2007 Operating Budget includes \$470,000 General Fund-State for the program. Also included is a \$350,000 General Fund-State appropriation for the Northwest Agricultural Incubator project. The 2005-2007 Capital Budget includes \$1,000,000 for the Port of Walla Walla wine incubator.

## STUDY SCOPE

The study will review the state’s policy on funding and tax preferences of business incubators. It will include an examination of the types, costs, and performance outcomes of business incubators.

## OBJECTIVES AND QUESTIONS TO BE ANSWERED BY THE REVIEW

As directed by statute, the review will focus on the following questions:

1. What types of incubators exist in Washington?
2. What are their costs?
3. What are their performance outcomes?
4. How many are there? Where are they?
5. What are their stated purposes?
6. What state financial and tax support exists for incubators?
7. How many businesses and jobs have incubators created?
8. What is the survival rate of the businesses?
9. What are the criteria for state support?
10. What policies exist for reducing or terminating state support?
11. What are the private and public impacts and benefits?

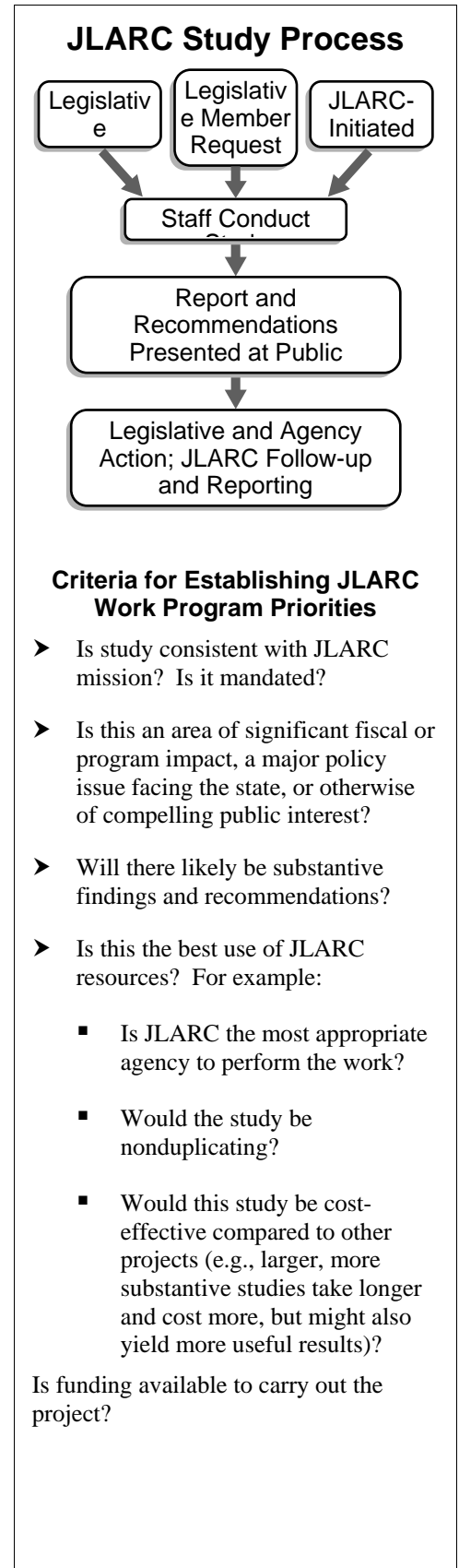
JLARC will review the Department of Community, Trade and Economic Development’s administration of the business incubator grant program, with an emphasis on the outcomes achieved by grant recipients. JLARC will consult with those running business incubators, the Department of Revenue, and other state, federal, and local agencies involved with business incubators.

## Timeframe for the Study

A preliminary report will be presented at the June 2007 JLARC meeting, with a final report presented at the August 2007 meeting.

## JLARC Staff Contact for the Study

John Woolley (360) 786-5184 woolley.john@leg.wa.gov





# APPENDIX 2 – AGENCY RESPONSES

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- Department of Community, Trade and Economic Development
- Office of Financial Management





STATE OF WASHINGTON

DEPARTMENT OF COMMUNITY, TRADE AND ECONOMIC DEVELOPMENT  
128 - 10<sup>th</sup> Avenue SW • PO Box 42525 • Olympia, Washington 98504-2525 • (360) 725-4000

DATE: August 9, 2007

TO: Ruta Fanning, Legislative Auditor  
Joint Legislative Review Committee

From:  Juli Wilkerson, Director

SUBJECT: CTED's comments concerning the JLARC Draft Report, "Small Business Incubators: Review of State Policy, Funding, and Incubator Performance"

Thank you for the opportunity to include the Department of Community, Trade and Economic Development's (CTED) comments reflecting our views on small business incubators. We have noted the confidential nature of this draft report and have shared it with only key department staff.

Our comments will touch on each of the three topics in the Report Detail section.

Topic One: How many incubators?

CTED agrees with the JLARC staff that there is much work to do and decisions to make as to the nature of self proclaimed incubators and whether or not they meet the criteria outlined by the National Business Incubation Association (NBIA).

As the economy of Washington struggled in the late 1980's incubators provided another tool for potential business development. In a similar manner, the downturn of Washington's economy five years ago spurred a renewed interest in incubators. In both instances, incubators received some assistance from CTED, and in both instances there was no long-term funding provided for staffing a long-term program capable of identifying the locations, defining the types and reporting on the purposes of local incubators beyond a few grant recipients.

Topic Two: What is the state's role in supporting incubators and what are their costs to the state?

The Report notes that criteria varied between the dollars granted through the CTED small business incubator program and the specific operational and capital budgets and they were not consistent. Additionally, as noted, the grant program housed in CTED represented the smaller amount of those three funds. And, as mentioned before, there was no funding for staffing an incubator program in CTED's budget.



Ruta Fanning  
August 9, 2007  
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As a result, our view was that while interest in incubators was piqued, CTED had no real ability to coordinate a standard, sustainable response to the local economic development community interested in the potential of an incubator, or the ability to help sustain any existing incubator efforts. CTED's response was limited to offering a grant program efficiently and quickly by using staff capacity from existing programs. The opportunity to expand the program simply did not exist.

Topic Three: How are Incubators performing?

CTED is interested, also, in having research into the nature of the true and measurable successes of Washington's incubators. And, while CTED was mandated to gather information from the handful of incubators that were grant recipients, the grant recipients only represent a small percentage of the either self-identified incubators or those identified in Washington by the Washington Association of Small Business Incubators. Additionally, there is no requirement of those grantees to provide any additional information past the annual grant period.

If, in the future adequate staffing and funding are provided to begin a systematic collection of data and information about the comparative performance and long term value of incubators in Washington State, CTED is willing and able to provide assistance.

We have appreciated the professionalism of your staff and the courtesy you have provided us for our comments during the course of this study.

cc: John Woolley, JLARC  
John Thomas, CTED  
Larry Williams, CTED




STATE OF WASHINGTON  
OFFICE OF FINANCIAL MANAGEMENT

Insurance Building, PO Box 43113 • Olympia, Washington 98504-3113 • (360) 902-0555

June 29, 2007

**TO:** Ruta Fanning, Legislative Auditor  
Joint Legislative Audit and Review Committee

**FROM:** Victor A. Moore, Director 

**SUBJECT: PRELIMINARY REPORT – SMALL BUSINESS INCUBATORS:  
REVIEW OF STATE POLICY, FUNDING AND INCUBATOR  
PERFORMANCE**

Thank you for giving the Office of Financial Management the opportunity to review JLARC's preliminary report on "Small Business Incubators: Review of State Policy, Funding and Incubator Performance."

Your preliminary report contains useful information about business incubators and concludes that more research is being done on how to measure their success. The report also is consistent with Governor Gregoire's focus on measuring performance to hold agencies accountable for delivering results and to show Washingtonians how their tax dollars are being spent.

We look forward to your final report. If you have any questions, please contact Mike Woods at (360) 902-0548.





