



Georges Haour

IMD Professor of Technology
Management

Professor Haour teaches technology management at IMD. Elsewhere, he is an advisor to companies in the area of R&D/-technology and innovation management: He is Director of the Generics Group, in Cambridge, UK, where he works with new ventures. At IMD he teaches on the CEO, MBA and Orchestrating Winning Performance programs.

For further information on these and other IMD programs, please contact our Program Advisors:

Tel. +41 21618 0342
Fax +41 21618 0715
info@imd.ch
www.imd.ch

Incubating technology ventures: **a shortcut** to value creation?

Our turbulent economic environment compels technology companies to boost their value-creation process. While endeavoring to maintain the impetus of their internal innovation dynamics, they develop alternate ways of "harvesting" their technical expertise. In the first instance, firms increasingly rely on innovation mining to multiply the value of specific developments. Also, many companies establish corporate investment funds, in order to secure windows on technologies complementary to theirs and potentially important to their future business. Furthermore, they increasingly establish incubators to turbo-charge the commercialization of specific, technology-intensive activities born of their Research and Development (R&D). Setting up and managing an incubator raises a number of challenging issues.

Incubating new ventures

In the context of business creation and growth, the word incubation evokes different things to different people. In most cases, incubating a technology-intensive idea into a business is carried out "externally"; which means that the *start-up* is hosted by a third-party structure, while it grows its business. Atviso is a typical example: this Paris-based joint venture between Softbank and Vivendi, helps North American information technology companies to speed up the development of their businesses in Europe.

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Recently, there has been an inflation of such "external" incubators, which often adopt picturesque names, contrasting with the "Science Parks" vintage of previous decades. In the UK alone, the number of incubators has increased roughly tenfold during the year 2000. The recent precipitous decline of "technology" stocks indeed threatens the survival of many of them.

We are concerned here with "internal" incubators set up by corporations. Such corporate incubators are entrusted with the task of turning *homegrown*, technical projects into "spin-out" companies, in which the parent corporation retains equity. This type of incubator provides a learning life-space as a "buffer" in the transition from a controlled corporate environment to the fiercely competitive market place. It aims at lowering somewhat the high risk of failure typical of technology start-ups.

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In the recent past, several companies have announced the creation of internal incubators as an additional vehicle for exploiting their innovations. These include: British Telecom (BT), with the Brightstar initiative in the United Kingdom, EDF-Electricité de France, Ericsson, and Norsk Hydro. Many more firms are considering setting up such “hatching grounds” for start-ups.

A small number of companies, such as Generics in the UK, or Thermo Electron in the USA, and to some extent, Starlab in Belgium, have had the incubation process at the core of their business model for more than 15 years in certain cases. These companies have developed the elements for an internal incubator:

- 1) a technological laboratory acting as a source of innovations,
- 2) investment funds for seed capital, and
- 3) an incubator facility located next to the laboratory.

These particular firms constitute inspiring models for the corporate initiatives discussed here. For example, BT partners with Generics, in order to access complementary inputs: participating in the board selecting the projects, contributing particular technical capacities to joint ventures, patent audits, due diligence work and coaching the venture teams. In the 15 months of its existence, BT’s Brightstar has incorporated four companies, with an additional eleven in the incubation pipeline. To date, £15 mio of first round funding have been secured from venture capital firms.

Why set up a corporate incubator?

The rationale for a company to establish an incubator is to *create value*. In doing so, several objectives are pursued:

- Enhancing shareholder value, by generating equity in start-up companies, out of which, it is hoped, one will be a star performer with a “blockbuster” market capitalization that will handsomely compensate for other, less successful, ventures.
- Creating a more business-oriented, entrepreneurial culture in the R&D function. In turn, this will attract a rather rare breed of people, the so-called *researchers-entrepreneurs*. They will replenish the ranks thinned out by the departing spin-out teams.
- Developing an array of companies that will provide the parent company with useful “windows” on new businesses made possible by new technology.
- Promoting the positive image of an agile, exciting company, more likely to seduce investors and financial analysts, thus boosting the company’s share price.

The weight placed on each of these elements varies from firm to firm. BT’s Brightstar *raison d’être* is clearly rooted in the first two of the above objectives, while the others also apply. At one extreme, France Telecom’s Innovacom even helps launch projects that have nothing to do with the telecom industry, such as opening a bookstore-coffee shop, for example. In this case, the firm puts a premium on encouraging an entrepreneurial culture, as well as, possibly, out-placing staff. The rationale for incubating *spin-outs* indeed also evolves with time: an early and highly successful start-up, no doubt, will shift top management’s focus even more on the first point.

Putting incubation to work

The laboratory and offices of an internal incubator are typically located at one of the corporation’s major R&D sites. The incubation path is schematically illustrated in [Fig.1](#).

In order to be candidates for incubation, projects have to satisfy pre-established criteria. These include: risks for the corporation to lose a competitive edge by letting go of a piece of the company and making it available to competitors, anticipated rate of profitable growth, size of the total investment required, etc. Through a mix of top down and bottom up processes, project-teams composed of R&D professionals, come forth as candidates for incubation. An Innovation Board, which preferably includes, at least, one expert coming from outside the company, selects the projects on the basis of the quality of the team and of its project, in the light of the above criteria.

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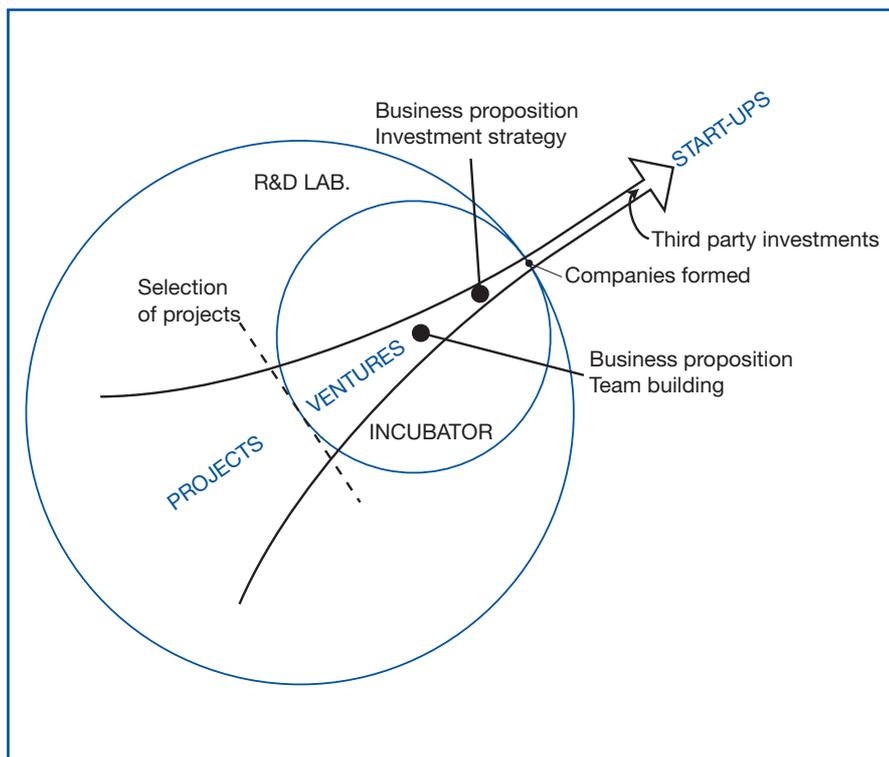


Fig. 1: Schematic steps in incubating an R&D project into a start-up.

Seed investment is provided to the selected projects, in the form of salaries for the project members for the transition period, usually a few months, as well as “out of pocket” funds to purchase necessary outside services, such as management development, patent audit, or specific market studies.

The selected project team (typically less than six people) thus becomes a venture, beginning a journey towards the creation of a new *spin-out* company. In a symbolic rite of passage, the venture team moves to the dedicated “incubator” facility, often only a few hundred meters from where they used to work in the laboratory. This proximity makes it possible for the team to maintain close contacts with colleagues on the site; they continue to belong to the same community, from which they are able to draw valuable advice, suggestions and support, mostly in an informal fashion.

The team thus embarks on a path, shifting its focus from the technical contents to the business processes. In order to effectively accompany this journey, it is crucial that the appropriate coaching is provided to the team. The coach typically is an experienced individual, from outside the firm (probably somebody who has been a scientist, a R&D professional/manager in previous activities), so as to bring the critically needed technology-literate, external perspective, as well as an additional set of contacts.

Such venture *coaching* involves raising the relevant business questions and issues, forcing the team members to get to the bottom of them in the course of continuous, intense “conversations” as a group. The coach also calls in experts when a specific contribution is required outside of her/his sphere of competence. Elements of such *just-in-time management development* include: team-building, defining the venture’s specific business proposition, sharpening the business sense of the team and raising its awareness of its need for complementary skills (typically in finance or marketing), keeping a sense of urgency and relentless focus on the customer, preparing an effective business plan and updating it regularly, as well as identifying appropriate investors and recommending a sound equity structure for the start-up.

An effective incubator is much more than just buildings and facilities! An absolutely critical component is constituted by the support, expertise and relevant contacts provided by the coach to the venture. Corporations setting up an incubator must realize that providing effective venture coaching offers a powerful contribution by enhancing the value-creation process.

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Key issues

Launching start-ups from a parent company raises a number of issues. Some of the most critical questions are the following:

- *Intellectual property*: What intellectual property (IP) rights are devolved to the spin-out company at the time of its creation? Does the parent company retain the patent ownership, granting exclusive rights to the newly formed company? What happens to the rights based on subsequent patents derived from the earlier ones? These are critical issues, as third party investors usually prefer a situation in which the start-up fully owns and controls the intellectual property rights.
- *Strategic risk*: As one outcome of this process, a portion of the company's business is made available on the stockmarket. A competitor may thus seek to acquire the start-up and effectively leverage it for its own competitive advantage, or, alternatively, in order to kill it.
- *Entrepreneurial spirit*: Are incubees on a corporate payroll motivated with the same entrepreneurial energy as in true start-ups, coming out of the sheer vision and ambition of the founding team? Or do they keep in the back of their minds the thought that, if their venture fails, they will go back to their previous, more sheltered life?
- *Management meddling*: the parent company is reluctant to really "let go" the spin-out company and wastes much of its energies by imposing bureaucratic rules.
- *Equity*: the newly incorporated company, with a large part (say, more than 50%) of its equity is owned by the parent firm, may find it problematical to secure third party investments to finance its growth. For one thing, venture capitalists do not want a situation where the parent company retains a dominant part of the shares. Industrial investors may possibly be more receptive to the argument that they are actually buying into an activity, which already has a proven track record, of often several years, in the operations of the parent firm.

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There is a paradox associated with several of these questions: they are best addressed as early as possible, but, if the corporation attempts to do so, the chances are that this will put brakes on any existing momentum to launch the adventure of the incubator: there seems to be no choice but *to go ahead and do it* before all issues are resolved, accepting the risk that certain ventures just may have to find their own way through treacherous minefields.

In this exciting time for business innovation, corporate incubators are expected to gain acceptance as effective value-creation tools. They may generate a whole new crop of technology companies, from which, who knows, might emerge tomorrow’s Oracle, Philips or SAP!

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IMD International Institute for Management Development

P. O. Box 915, CH-1001 Lausanne, Switzerland
Tel.: +41 21 618 0342
Fax: +41 21 618 0715
info@imd.ch
<http://www.imd.ch>

Editor: Roger Whittle



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