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Critical role and screening practices of European business incubators

Kris Aerts[a,b,*], Paul Matthyssens[c,d], Koen Vandenbempt[c]

[a] *K.U.Leuven, Department of Managerial Economics, Strategy & Innovation, Belgium*
[b] *K.U.Leuven, Steunpunt O&O Statistieken, Belgium*
[c] *University of Antwerp, Department of Applied Economics, Belgium*
[d] *Erasmus University Rotterdam, Department of Marketing Management, The Netherlands*

Abstract

Business incubators guide starting enterprises through their growth process and as such constitute a strong instrument to promote innovation and entrepreneurship. In this article we sketch the European business incubator landscape. Then we describe screening practices by European business incubators in 2003 and compare these results with the American incubators in the 1980s. In the last phase an exploratory link between screening practices and performance, measured in terms of tenant failure, is established. Most incubators do not screen potential tenants on a balanced set of factors, but concentrate either on the characteristics of the tenant's market or on the characteristics of the tenant's management team. However, we found that the tenant survival rate is positively related to a more balanced screening profile. Based on our study results, we propose some recommendations for the main stakeholders in the field: authorities, incubators and innovative entrepreneurs.

JEL classification: L84; L85; M13; O31 and O32

Keywords: Business incubator; Tenant screening; Performance; Tenant failure

1. Introduction

As the famous Austrian economist Schumpeter (1942) underlined already in the early 1930s of the previous century, an economy will only be able to survive if its entrepreneurs keep following the path of continuous innovation. Today, the belief that innovation drives competition is spread all over the world (see e.g. Debackere and Veugelers, 1999). The European Union aspires to become the most competitive economy in the world and intends to achieve this aim through innovation (Commission of the European Communities, 2000). However, it is clear that Europe still has a long way to go to rival the United States and Japan, the two world leaders in innovation (Commission of the European Communities, 2004a; European Commission, 2005).

Start-up companies constitute an important dimension in the innovation process. The encouragement of the establishment and growth of innovative companies is one of the priorities in the policy of the European Union (Commission of the European Communities, 2000). Nevertheless, the start-up failure rate is rather high according to a study[1] of the OECD (2002). On average, one on three new European enterprises fails before the second year of its existence. 50–60% does not survive the seventh year.… Moreover, the current economic situation does not add to the attractiveness of the risky business of establishing new companies. When the economy falters, potential investors are hesitant and reluctant to invest in uncertain and risky high-tech projects (Sauner-Leroy, 2004).

One instrument to promote innovation and counter this high start-up failure rate is the business incubator (see e.g.

*Corresponding author. K.U.Leuven, Steunpunt O&O Statistieken, Dekenstraat 2, BE-3000 Leuven, Belgium. Tel.: +32 16 32 63 59; fax: +32 16 32 57 99.
E-mail addresses: Kris.Aerts@econ.kuleuven.be (K. Aerts), Paul.Matthyssens@ua.ac.be (P. Matthyssens), Koen.Vandenbempt@ua.ac.be (K. Vandenbempt).

[1]These percentages are based on data about West-Germany, France, Finland, Italy and Portugal in the 1990s.

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Lalkaka, 2003). Business incubators constitute an environment, especially designed to hatch enterprises. They provide their tenant companies with several facilities, from office space and capital to management support and knowledge. This allows the start-up to concentrate on its business plan and raises the success rate. The benchmark study of the European Commission (2002) revealed that the survival rate of incubator tenants was significantly higher (80–90% still exists after 5 years!) than the business success rate amongst the wider SME community.

The success of an incubator depends on the performance of its tenants and thus an incubator benefits from limiting the tenant failure rate. One way of minimising the number of tenant failures is to subject potential 'clients' to a severe screening process. This allows the incubator to evaluate the presence of characteristics that are deemed essential to develop sound enterprises (see e.g. Merrifield, 1987; Lumpkin and Ireland, 1988; Peters et al., 2004; Hackett and Dilts, 2004). These qualities differ, according to the incubator (Lumpkin and Ireland, 1988).

In order to boost the innovation level, the European Union should understand the nature of the incubator business. Furthermore, the European Commission should encourage the growth and working of both incubators and start-ups. This paper studies the screening practices of business incubators within the European context. Hence, it tackles the following research issues:

(1) a profile of the European business incubator landscape;
(2) a description of screening practices by European business incubators;
(3) an exploratory link between screening practices and performance.

The remainder of the text is organised as follows. Section 2 guides the reader through the relevant literature. Section 3 describes the methodological framework of the empirical part of our study. In Section 4, the findings are reported and encased in the academic literature. The last section summarises our conclusions and leaves some space for recommendations to the main stakeholders in the innovation network: incubators, innovators and governments.

2. Literature study

In this section we describe the academic background of each research issue as set out in the introduction. After the clarification of the phenomenon of a business incubator we review the literature on screening practices. We conclude with an overview on how incubator performance has been measured throughout the literature.

2.1. The phenomenon of a business incubator

The first incubator was established in 1959 in Batavia, New York in the United States. Charles Mancuso rented space in his Batavia Industrial Centre to small and starting companies and guided them through their growth process (Mancuso Business Development Group, 2006). Until the 1970s, this concept was unique. The focus of incubator predecessors was either on the technological or on the management aspect; an incubator combines both. The typology represented in Fig. 1 was elaborated by the European Commission (2002). In an *Industrial Estate* (in the upper left corner of Fig. 1), the level of support is very low and limited to renting space for the entrepreneur. The European Commission (2002) adds a non-selective intake and the absence of specific criteria with regard to business activities and technology content to the characteristics of this organisation type. When we follow the vertical axe downwards, we encounter the *Managed Workshop* at the medium level and the *Multi-purpose Business Incubator* at the high level of management support. If the technological level is raised, we first arrive at the *Business Park* and then at the *Science Park*. The Enterprise Centre combines both medium levels. The *Technology Centre* applies "highly selective admission criteria, provides hands-on management support and has a highly specialised technology focus" (European Commission, 2002, p. 6). In the right-hand lower corner (shaded area), the European Commission groups the *Innovation Centre*, the *BIC* and the *Technology Centre* under the single denominator of *Business Incubator*.

From the 1970s onward, business incubators have spread out all over the world (Albert and Gaynor, 2001). Estimates indicate that today their number worldwide rises to 3000: one-third is located in North America; 30% in Western Europe and the rest is dispersed over the Far East (20%), South America (7%), Eastern Europe (5%) and Africa, the Middle East and other regions (5%) (European Commission, 2002).

The European Commission favours the further development of the business incubator sector. The European Charter for Small Enterprises was signed by EU leaders at the Santa Maria da Feira European Council in June 2000. One of its main targets is to create top-class small business support systems, which are easy to access and understand and relevant to the needs of business (European Commission, 2000). The 2004 and 2005

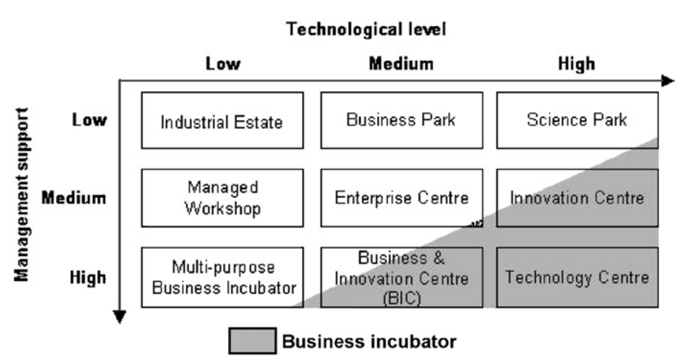

Fig. 1. Position of the business incubator. *Source*: European Commission, 2002. Benchmarking of business incubators, Brussels, p. 6.