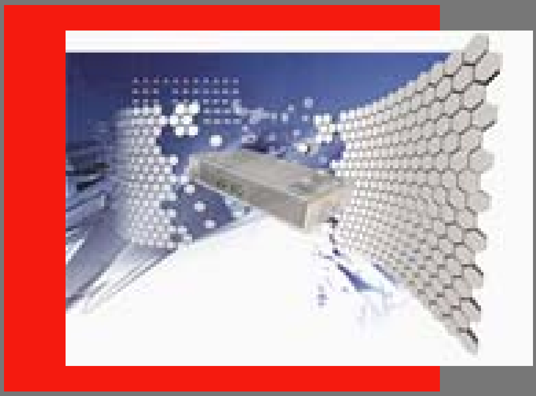
Assessment of Incubator Program

Operations, Tenant Surveys & Economic Analysis



- Software Business Custer
- U.S. Market Access Center
- San Jose BioCenter
- eCenter

San Jose Redevelopment Agency
Downtown Management / Industrial Development

June 2009

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1.0 Assessment Period

This Incubator Assessment Report was prepared for the San Jose Redevelopment Agency. Incubator tenant interviews, management and operations assessment, and economic impact and revenue impact modeling were conducted December 2008-March 2009 by Chabin Concepts, Inc., Applied Economics and F.J. McLaughlin & Associates.

2.0 Purpose of the Assessment

2.1 Background

The San Jose Redevelopment Agency (Agency) has been a leader in technology-focused economic development efforts for almost two decades. The Agency was an early adopter of industry sector focused incubation programs that began with the founding of the Software Business Cluster and the Environmental Business Cluster in early 1994. In addition to business incubation, the Agency has also supported other innovation initiatives, most notably the BioCenter, SDForum and Entrepreneur Center (eCenter). Recently, the Agency, along with the City of San Jose, has been a sponsor of the California Clean Tech Open, an industry competition that benefits and show cases start up companies involved in clean technology.

San Jose Incubator & Business Service Programs

- Software Business Cluster (SBC)
- Environmental Business Cluster (EBC)
- U.S. Market Access Center (US MAC)
- SDForum
- The Entrepreneur Center (eCenter)
- San Jose BioCenter

The Agency's investment in the incubator programs over the past fifteen years has been significant: From 1994 to November 30, 2008, the Agency has invested over $30 million; $19,385,351 in annual lease payments (incubators and business service programs), $10,474,760 in building improvements and equipment (BioCenter) and $568,511 on business outreach and studies.

While the San Jose incubator programs have been recognized on numerous occasions as "*incubation models*" by the National Business Incubation Association and have successfully spawned hundreds of start-up technology companies[1], there has never been any formal assessment of these programs in 15 year their history to measure their achievement to Agency goals. In November 2008, the Agency commissioned an assessment to measure how effective the incubators have been achieving the Agency's priority goals—job creation, stimulating business growth, innovation, and economic diversification primarily through the expansion of businesses that graduate from the incubators and are retained in the City of San Jose.[2]

The assessment reviewed current mission, goals, operations and return on investment from the incubator programs to determine the extent to which they have fostered business development, created jobs, enhanced the City's revenue base and diversified the base of the industry clusters in San Jose. With respect to the six programs that are the subject of this study, three are classified and function as incubators–the Software Business Cluster, the Environmental Business Cluster and the

[1] 2001, Best Practices in Action, NBIA Publication

[2] Source: "City Incubator Program" staff report to the Community and Economic Development Committee submitted by the San Jose Redevelopment Agency, April 6, 2007, p.1.

San Jose BioCenter. These programs work primarily with start-up companies that are developing new products for commercialization.

The U.S. Market Access Center (referred as U.S. MAC) is more of a “hybrid” incubator that supports mature foreign companies seeking a presence in the U.S. market primarily for the purpose of forging strategic alliances and partnerships primarily for the sale of company products and services as well as commercialization of technology. The SBC, EBC and US MAC incubators the two business support programs are located in office buildings in Downtown San Jose, and the BioCenter is located in an industrial park in South San Jose.

The Agency has a Sublease and Co-Sponsorship Operating Agreement with the San Jose State University Research Foundation (SJSURF) for fiscal and management oversight of the SBC, EBC, BioCenter and US MAC. The Agency maintains a master lease and pays 100% of the rent for all four incubator facilities. Through the Sublease and Co-Sponsorship Operating Agreement, SJSURF subleases to incubator tenants and recoups an administrative fee percentage from the incubators’ operational revenue, calculated against expense. Directors and staff of the SBC and US MAC are employees of SJSURF. SJSURF contracts with Prescience International a private company to manage the BioCenter and EBC.

A business incubator is an entity organized to deliver support services to businesses during the start-up phase. The goal of the incubator is to help the founder(s) grow the business to a level where it can stand alone.

A business incubator may be a not-for-profit entity or a for-profit organization. It may provide a wide range of services including management and consulting assistance, office space and shared facilities, shared equipment, shared administrative services and other business support. By sharing the resources operating expenses are reduced for all incubator tenants.

A typical scenario would be for a start-up business to get the business established in no more than three years and then move out (graduate) to make room for more start-ups.

Small Business Administration

SDForum and eCenter are not incubators, but are organizations that provide business services. SDForum provides business networking, services, programs and events primarily for software and other technology industry sectors. The eCenter is a small business/entrepreneur resource center for start-up businesses developed in partnership with the Small Business Administration.

2.1 Assessment Methodology

The process undertaken to review the incubator and business service programs included the following:

- Review of all background information available, including financial records, agreements, reports, and previous studies;
- Interviews with Agency staff, incubator directors and managers, San Jose State University Research Foundation staff, contractors and other stakeholders;
- Personal interviews and completed surveys with tenants of the three incubators – Software, Environmental and BioCenter (68% response rate); and
- An Economic Impact and Revenue Analysis based on current year data.

While the priority Agency goals for evaluating the incubators are centered on job creation and economic impact, these measures are not applicable to the SD Forum and the eCenter because they focus on business resources and services not directly growing business. Their assessment needed to focus more on intangible factors such as the recognition, and visibility for the city and perceived value of the programs held by key stakeholders and customers.

This assessment used the National Business Incubation Association (NBIA)'s "Principles & Best Practices of Successful Business Incubation" and *Measuring Your Business Incubator's Economic Impact*[3] as guiding principles for evaluating the incubator and business support programs. The principles and standards are used as the basis for findings and recommendations that can help the Agency asses the performances of the incubators in fostering job creation and local investment.

The NBIA principles are listed on the next page:

[3] www.nbia.org

NBIA Principles and Best Practices of Successful Business Incubation

NBIA research has consistently shown that incubation programs that adhere to the principles and best practices of successful business incubation generally outperform those that do not. The following industry guidelines are replicable and broadly applicable to incubation programs around the world, regardless of their focus or mission.

Two principles characterize effective business incubation:

1. The incubator aspires to have a positive impact on its community's economic health by maximizing the success of emerging companies.
2. The incubator itself is a dynamic model of a sustainable, efficient business operation.

Model business incubation programs are distinguished by a commitment to incorporate industry best practices. Management and boards of incubators should strive to:

1) Commit to the two core principles of business incubation
2) Obtain consensus on a mission that defines the incubator’s role in the community and develop a strategic plan containing quantifiable objectives to achieve the program mission
3) Structure for financial sustainability by developing and implementing a realistic business plan
4) Recruit and appropriately compensate management capable of achieving the mission of the incubator and having the ability to help companies grow
5) Build an effective board of directors committed to the incubator's mission and to maximizing management's role in developing successful companies
6) Prioritize management time to place the greatest emphasis on client assistance, including proactive advising and guidance that results in company success and wealth creation
7) Develop an incubator facility, resources, methods and tools that contribute to the effective delivery of business assistance to client firms and that address the developmental needs of each company
8) Seek to integrate the incubator program and activities into the fabric of the community and its broader economic development goals and strategies
9) Develop stakeholder support, including a resource network, that helps the incubation program's client companies and supports the incubator's mission and operations
10) Maintain a management information system and collect statistics and other information necessary for ongoing program evaluation, thus improving a program’s effectiveness and allowing it to evolve with the needs of the clients

2.3 Origins of the Incubator Programs

A brief description of the six programs assessed in this report is provided below. More detailed profiles are included in the appendices.

The Software Business Cluster (SBC)

The Software Business Cluster (SBC) was the first incubator that opened in Downtown San Jose in 1994 with financial support by the Redevelopment Agency. In addition to fostering job creation and business expansion, the Agency believed that the incubator would help fill Class B and C office space in the Downtown. The Agency entered into a Sublease and Co-Sponsorship Operating Agreement with the San Jose State University Research Foundation (SJSURF) for fiscal and management oversight of the SBC and EBC, and later for the US MAC and BioCenter. The Agency maintains a master lease and pays 100% of the rent for all four incubator facilities. Through the Sublease and Co-Sponsorship Operating Agreement, SJSURF subleases to incubator tenants and recoups an administrative fee percentage from the incubators' operational revenue, calculated against expense. Directors and staff of the SBC and US MAC are employees of SJSURF.

Currently, the SBC shares office facilities with the Environmental Business Cluster (EBC) on three floors of a Downtown office building for a total of 24,300 square feet. Total annual rent in 2008 paid by the Agency for the SBC/EBC space is $432,540. The SBC occupies 20,150 square feet of office space and has three full time staff shared with the Environmental Business Cluster, all of whom are San Jose State University Research Foundation (SJSURF) employees. The SBC has an advisory board but it does not meet on a regular basis.

Since its inception, the SBC has assisted over 67 companies. Six SBC graduates have gone public. They include Agile Software (later acquired by Oracle); Callico Commerce; eGain Communications, deCarta (formerly TelCon Tar), and Callidus Software. Only five of the 67 companies graduated are actually located in San Jose today. As shown in the following summary of incubator graduates in Table 1, Callidus accounts for 79 percent of the economic impact benefit generated by all incubator graduates. Callidus is still located in Downtown San Jose.

The peak of the SBC success in assisting software start-ups occurred in the 1990s. After that time, a global shift in the software industry occurred with the emergence of new technology centers in India and Eastern Europe. The number of software start-ups in the SBC has declined over time and, today, there are only seven companies in the SBC with 101 employees, of which a single tenant accounts for 60 of the total. The largest tenant occupies the majority of the space and pays the lion's share of the rent. This company joined the incubator in 1998 and really no longer meets the incubation criteria. The company is allowed to stay because it pays 39 percent of the rent for the SBC/EBC facility which adds to the operating revenue for both. The total rent paid by all SBC/EBC tenants is $30,173 per month[4]. Rents are $2.75 per square foot full service.

The Environmental Business Cluster (EBC)

The EBC was founded in 1994 and serves as a technology commercialization center that specializes in clean energy and clean technology. In 2003, the EBC was selected by the California Energy Commission (CEC) to provide advisory services to CEC grant recipients, with the goal of helping clean energy companies commercialize their technologies. The EBC has received $1,763,435[5] in

[4] Source: SBC-EBC Tenant Lease $2.75 sf Office Occupancy Report, 3-16-09

[5] Source: Mary Sidney, SJSURF, 3-25-09

grant revenue since 2002; the majority of the funds have been from one grant source, California Energy Commission. The EBC has graduated 71 companies since 1994 but only two graduates are currently located in San Jose with a total of two employees.

The EBC shares the 24,300 square foot facility with SBC, occupying 3,790 square feet on the third floor. The EBC currently has 15 tenant companies with 42 employees and 10 affiliates that receive services. As with the SBC, the EBC has some longer term tenants who have been at the incubator for over 10 years. Rent fees are reported as $2.75 per square foot. Affiliates, businesses not located at the incubator but receiving technical business services, pay a flat rate of $500 per month.[6]

As an award to the California Clean Tech Open (CCTO) top 12 winners for 2008, the City's Office of Economic Development offered free rent or services for one year at the EBC incubator valued at $6,000 per winner. The San Jose Office of Economic Development reportedly will reimburse the San Jose State University Research Foundation (SJSURF) for the CCTO winner's space and/or affiliate services.

After the retirement of original EBC manager in January 2009, the SJSURF contracted with Prescience International to provide on-site management.

The US Market Assistance Center (US MAC)

The US MAC was founded in 1995 as the International Business Incubator whose mission was to "incubate" small international companies that wanted to enter the U.S. market. Today the US MAC no longer functions as a true incubator but more as an executive suite space offering business development services to international companies that want to establish a foothold in Silicon Valley. The US MAC currently occupies 14,700 square feet on three floors in a downtown San Jose office building. Total annual rent paid by the Agency in 2008 for this space is $246,741. There are currently 31 tenants with 64 employees that occupy space and 29 affiliate companies. Many of the companies in residence are beyond the start-up phase and some have numerous employees and offices abroad. Their main purpose for locating in the US MAC is to find U.S. business partners either to commercialize technologies or sell products and services.[7]

In addition to these companies, there are four government commercial offices located in the US MAC that include the Japan External Trade Organization (JETRO), which is a well funded Japanese government trade agency with offices in major markets throughout the world; Enterprise Estonia; Finnode, a Finnish government resource center; and Invest Fukuoka which represent businesses in their counties as well as provide business development and economic development services in the US for their countries.

The US MAC has cubicles as well as office space so the cost of tenant space depends on the size of space occupied by the tenant. The fee is reported to be $3.50 per square foot. Total monthly tenant space revenue is $29,962.[8] Staff for the US MAC includes a full time manager, a part-time manager and an office manager; all staff are employees of SJSURF. It is reported that an advisory board is being formed, which is required by the Operating Leases, in order to involve external business experts, such as venture capitalists, investors, real estate brokers, international businesses in the

[6] Source: Doraleen Fontaine, SBC/EBC staff, 3-16-09

[7] Buying products and services from San Jose businesses is the type of investment that provides benefits to San Jose companies and the City's economic base.

[8] Source: US MAC Tenant Monthly Charges Report, Marie Tran, 3-16-09

operations and execution of the incubator program. No date has been set for the first meeting of the Advisory Board.

The San Jose BioCenter

The San Jose BioCenter opened in 2004 and occupies 36,594 square feet in an industrial building located in the Edenvale Technology Park in South San Jose. Subsequent to the Dot.com bust in 2001, seeking to diversify the City's technology sector base and support development of a redevelopment industrial area in the southern part of the City, the Agency commissioned a feasibility study to determine if there was a need for incubator services for start-up bioscience companies. The study confirmed the need, but was skeptical that the incubator could attract tenants to an area where there was no synergy with research institutions and established bioscience companies.

The BioCenter quickly filled with start-up ventures and the demand has motivated the Agency to pursue an expansion of the incubator. There are currently 19 tenants and nine affiliates. Tenants pay $111,628.26 a month for rent with only one dry lab suite currently available.[9] The annual rent for the spaces paid by the Agency in 2008 was $439,128. Of the five incubator programs, the BioCenter has the most direct involvement of the Agency and is the only one that is being expanded to accommodate additional tenants.

The BioCenter is managed by Prescience International which contracts with the San Jose State University Research Foundation to provide on-site management.

[9] Source: Melinda Ritcher, BioCenter, 3-16-09

3.0 Summary of Current Tenants and Graduates

The following chart provides an overview of the incubator performance from 1994-December 2008.

Overview of Incubator Programs, as of January 2009									
Incubator	Founded	# of Tenants, Jan 2009	FTE Employees	# of Graduate Companies	FTE Employees	Graduate Companies Located in San Jose	FTE Employees	Capital & Equity Funding Raised (millions)	Total Agency Investment 1994- Dec 2008
Software Business Cluster (SBC)	1994	7	101	67	1,677	5	476	$635 M	$8,776,505
Environmental Business Cluster (EBC)	1994	15	42	71	338	2	2	$118 M	combined in SBC
US Market Access Center (US MAC)	1995	31	64	168	322	24	52	$126 M	$4,286,304
San Jose BioCenter*	2004	19	120	19	278	1	8.5	$800 M	*$11,527,607
Total		72	327	325	2615	32	538.5	$1,679 B	$24,527,607

*BioCenter Build-Out and Additional Expansion Investment $10,476,760

The incubators were reviewed based on their track record for business incubation and job creation. This remainder of this section addresses:

1) Current business tenants and employees: near term impact, and
2) Graduate businesses: the longer term benefit that the Agency seeks with business growth and revenue generation.

3.1 Current Business Tenants and Employees

Based on records and information provided from incubator managers and tenant surveys, the following table provides a detailed overview of the incubators' current tenants and affiliates as of January 2009.[10]

[10] A weakness with the program is the lack of quantifiable annual reporting of incubation activities. The only formal reports/documents provided were monthly space utilization by tenant and quarterly financial reports which were started only a few years ago. The BioCenter is the only incubator to have an annual report (2007-08). One summary report of activities for the Software, Environmental and US MAC for Q1 – 2007 was received and used for this assessment.

Table 1 – CURRENT INCUBATOR TENANTS & AFFILIATES, as of January 2009

Incubator	Founded	Current Tenants[11]	# FTE of Employees	Affiliates[12]
Software (SBC)	1994	7	101	none
Environmental (EBC)	1994	15	42	10
US MAC	1995	31	64	29
BioCenter	2004	19	120	9
	Total	*72*	*327*	*48*

- Although the BioCenter is relatively new compared to the SBC, EBC and US MAC, all the incubators appear to consistently have a 90% occupancy rate. The number of full time employees of the tenant companies fluctuates depending on the company and their operations.
- The number of employees in this report reflects the self-reporting of incubator tenant interviews in January 2009. The information self-reported varies slightly from reports submitted by incubator managers but, overall, seem to reflect the incubators' occupancy history.[13]
- The SBC has two anchor tenants, one of which reports 60 employees and accounts for half of the SBC employment base.
- Sixty-two percent (62%) of the tenants surveyed said the incubator had a *positive effect* on the success of their business during the start up phase and 35% said it had a *strong positive effect*.
- Additional information on the incubator tenants is included in the findings and recommendations and incubator profiles (Appendix 1).

3.2 Graduate Businesses

With respect to return on investment, the **success of the "Graduate Businesses**" and their location, continued growth and ability to create jobs in the City of San Jose are priority goals of the Agency.

During the incubation stage many of the businesses have employees who are working for equity positions in the companies and do not have the purchasing power to create tax revenue that directly benefits the City. However, as the companies grow and leave the incubator it is anticipated that the "**graduates**" can create a direct revenue impact to the City over time through capital investment, payment of property tax on leased or owned facilities and job located in the Downtown or the industrial redevelopment project areas.

As shown in the table below, the incubators have assisted 325 businesses[14] from start-up through commercialization and capitalization since their inception to January 2009.

[11] Current tenants & number of employees figures were self-reported by all tenants of the incubators, January 2009

[12] Affiliates or virtual companies are businesses receiving technical services from the incubator but are not physically located at the incubator and not necessarily located in San Jose.

[13] Occupancy and number of employees reported monthly by SBC/EBC & US MAC.

[14] Graduates records may not be complete according to incubator managers. Data used was information provided by managers. The consultant team did search to validate as many businesses as possible still operating and their current location.

Table 2 – REPORTED GRADUATE BUSINESSES & EMPLOYEES

Incubator	Founded	Graduate Companies[15]	# Employees	Graduate Companies Located in San Jose[16]	# Employees
Software (SBC)	1994	67[17]	1681	5	476
Environmental (EBC)	1994	71	322	2	2
US MAC	1995	168	322	23	52
BioCenter	2004	19	278	1	8.5
	Total	*325*	*2603*	*32*	*541.5*

Summary of SBC, EBC, BioCenter and US MAC Graduates:

- Of the 325 companies that have graduated since 1994, 88 percent are reported by the Incubator Managers as still being in business or acquired by other businesses (higher than the 87 percent national average). Annual tracking of graduates has not been maintained on a consistent basis and appears the last complete survey/tracking of graduates was completed in 2004. Incubator Managers did comment they have lost track of some of the early graduates of the incubators. Efforts were made during this assessment by the Incubators Managers to contact and update graduate information.

- Although many graduate companies have thrived, most of them ***do not stay in San Jose.***[18] About nine percent of the companies were acquired by others firms not located in City of San Jose.

- Using Dunn & Bradstreet and city business licenses a search of business location was conducted to determine how many of the graduates were located in San Jose. Of the 285 graduates that were reported as still being in business:

  - 11 percent were identified as operating in San Jose.
  - 32 percent were identified as being located elsewhere in the Bay Area.
  - Seven percent were identified as being located elsewhere in California.
  - Nine percent were identified as being located out of state.
  - Nine percent were identified as being located in other countries.
  - The remaining 32 percent could not be located through business database searches. Given the graduate records of the incubators have not been maintained on an annual basis, this

[15] As reported by incubators Jan 2009, the number of graduate companies including companies that are no longer in business, employment number were current as of graduation.

[16] Graduate companies located in San Jose were identified by searching for all graduate companies through Dunn & Bradstreet, Google and City business licenses.

[17] SBC reported the 67 graduates but indicated there were more. Earlier records of graduates were not available.

[18] Over the years, there have been discussions about requiring incubator tenants to make a commit to stay in San Jose for a period of time post graduation, but incubator directors firmly believe that the companies will not agree to this condition. Companies make location decisions based on key factors that the City, for the most part, does not ultimately control—cost and availability of quality facilities, adjacency of location to key company personnel, etc which challenge retention efforts.

32 percent of "unidentified" businesses could mean the business has changed names, been sold or merged with another business, or could no longer be in business.

- The retention statistics[19] vary somewhat between the incubators. For example, the US MAC has the largest number of former tenant and client companies that have stayed in San Jose (24 companies) out of 168 companies utilizing the services of the incubator which is a local retention rate of only 14 percent. The US MAC appears to attract mainly small, foreign office operations that want to establish a presence in the Silicon Valley and U.S. These 24 current tenants have a total of 52 employees, which indicates only one to two employees per company. During the research for identifying the location of the 168 companies leaving the US MAC only five of the companies reported to have over 10 employees and none of these five companies are now located in San Jose. This does not diminish the incubator's success rate but it does not support Agency's long term goal of retaining the companies in San Jose.

- By comparison, the SBC has only five graduate companies that located in San Jose (20 percent of surviving graduates), but they represent 476 local employees due primarily because of Callidus Software which employs an estimated 400 employees.

- The survival rates of graduate companies also vary among the incubators ranging from a high of 99 percent in the US MAC to 72 percent in the SBC[20]. However, it should be noted that tenant companies in the US MAC are generally not start up companies but more established firms with a longer history of operation.

- The BioCenter, which is the newest of the incubators (founded in 2004), has already had 19 graduates, 16 of which are still in business. These 16 surviving companies represent about 269 employees including several companies with 20 or more employees. Only one of those graduates is located in San Jose which represents a lower retention rate than the other incubators except for the EBC.

- The EBC has 71 graduate companies with a survival rate of 79 percent. Of the 56 surviving companies, only two have been acquired by other firms. Two of the companies are still in San Jose and both of these are one employee companies. However the majority of other EBC graduates have remained in the Bay Area.

- Comments from graduates are very positive of the concept, the networking opportunity (particularly with the BioCenter) and the hands-on technical assistance provided by incubator senior staff.[21]

3.3 Economic Impact

- One of the ways to measure the success of the incubators is to assess the **economic and revenue impacts** of current and graduated businesses. The following is an overview of the economic impacts. Detail information on how the economic impacts are measured are

[19] Retention rate is defined as percent of total graduates that are located in San Jose, are still in business and have not been sold to another company.

[20] Survival rate measures the share of total graduates that are still in operation, including those that have been sold to other companies.

[21] Graduate company interviews were limited to those that were located in San Jose.

included in Section 5.0 Measuring Economic & Revenue Impacts, Appendix 1 – Incubator Profiles and Appendix 5 – Economic Impact Spreadsheet Model.

- **Economic impacts** measure the effects of economic stimuli or expenditures in the local economy. They trace spending through an economy and measure the cumulative benefits of that spending. These impacts can be expressed in terms of direct and indirect jobs, payroll, and economic activity or output that are generated by local companies.[22] ***Note*** *that these are three different measures of economic impacts and they cannot be added together.*
- **Indirect impacts** are the result of the multiplier effect and include supported supplier and consumer businesses and employees in the City of San Jose that will benefit from current and graduated companies in the incubators.
- **Multiplier effects** are a way of representing the comprehensive economic effects on the local economy referred as output.
- Economic and revenue impacts are measured separately.

The impacts shown in Table 3 represent a single year: 2008. For consistency of planning and measuring, the impacts shown here **represent "typical" annual impacts** that can be attributed to incubation activity.

The combined 2008 annual economic impact of the four incubators (EBC, SBC, BioCenter and US MAC) is estimated at $515,782,349 million to the local economy (this is not tax revenue generated to the City or Agency, only economic activity). This impact is attributed to both current tenants and graduates still located in San Jose, Table 3 – Annual Economic Impact & Revenue Impact.

2008 Annual Economic Impact & Revenue Impact **See Table 3 and Section 5.0**		
Incubator	**Annual Economic Impact**	**Annual Revenue Impact**
Software Business Cluster	$407,510,756	$187,584
Environmental Business Cluster	$13,554,251	$13,489
US MAC	$35,751,323	$40,241
BioCenter	$58,966,019	$39,573
Total	**$515,782,349**	**$280,887**

- About 79 percent of the total economic impact can be attributed to Callidus Software. Callidus is an SBC graduate and a stand out success story. As previously mentioned the company is still located in San Jose and now has an estimated 400 employees.

[22] Note: these are three different measures of economic impacts and they cannot be added together.

The $515.8 million annual impact corresponds to 1,900 directly and indirectly supported jobs and $196.6 million in annual payroll. These impacts include the operations of tenant and graduate businesses at the incubator as well as the multiplier effects those businesses have on the local economy through business to business purchases and employee spending. The economic impacts include output[23], payroll and jobs. This is a way to measure how much these companies contribute to the local economy. However, both graduate companies as well as current tenants may have economic impacts that extend far beyond the local area.

3.4 Revenue Impact

Revenue impacts measure the amount of local tax revenue that incubator tenants and local graduates generate. Further description of revenue impact modeling is included in Section 5 Measuring Economic & Revenue Impacts.

In the case of the incubators, the revenue impact typically includes sales, business license, franchise and utility taxes. Some of these revenues are generated by the companies directly, while some are generated by their employees. It is important to note that the analysis only includes revenue impacts to City of San Jose. Other revenues may be generated to other jurisdictions if the incubator graduates locate outside the city.

A portion of the revenues, primarily through property tax, can accrue to the Redevelopment Agency if the graduate company locates in the redevelopment project area and leases or buys a facility and capital equipment.

For planning and measuring purposes, the impacts shown here **represent "typical" annual impacts** that can be expected from incubation activity, unless there is an increased in graduate business retention and growth.

- The total amount of **annual revenue** generated by current tenants and graduates of the four incubators to the City of San Jose is approximately **$280,900**, less than one percent of all City business tax revenues.

[23]Output - The multipliers effects translate an increase in output (loosely defined for service industries as sales, less profits) into a corresponding increase in jobs and personal income. In essence, the multiplier effect represents the amplification of local spending. This process creates new business opportunities in the city's economy.

2008 ANNUAL REVENUE IMPACTS						
	Local Employees	Local Payroll	Direct Business Tax	Indirect (Employee Based)		Total Tax Revenues
				Sales Tax	Franchise & Utility Tax	
Software Business Cluster	296	$32,924,448	$10,812	$102,066	$74,706	$187,584
Environmental Business Cluster	23	$1,669,427	$2,400	$5,175	$5,914	$13,489
San Jose BioCenter	66	$6,062,952	$4,044	$18,795	$16,734	$39,573
US MAC	63	$5,255,867	$4,200	$16,293	$15,848	$40,241
Total Incubator Revenue Impacts	448	$45,912,694	$21,456	$142,329	$113,202	$280,887
City of San Jose[24] FY 2008-09 Tax Revenues			$12,000,000	$152,536,000	$125,311,000	$289,847,000
Assumptions: Local employees include the percentage of direct and indirect jobs from the economic impact for workers at incubator tenant and graduate companies that are also living in San Jose. Based on survey data, 22 percent of SBC employees live in San Jose, 33 percent of EBC employees and 27 percent of US MAC employees. The direct business taxes are based on the city's current business license tax schedule and the number of employees at current tenant and graduate companies in San Jose. Sales tax calculation assumes 31 percent of income is spent on taxable goods per the Consumer Expenditure Survey and shows the 1 percent of sales taxes retained by the City of San Jose. Franchise and utilities taxes are based on current per capita rate in the city.						

- City business license tax is the major direct revenue that can be attributed to the companies. **However, it has been determined that 58 percent of the incubator companies currently do not have City of San Jose business licenses.** The incubator tenants interviewed/surveyed reported no taxable product sales and limited supply purchases. Indirect sales tax revenue is attributable to employees of these companies who also live in San Jose. They generate other revenues such as local sales tax as well as franchise and utility taxes. While there are no doubt other sources of revenue that may be generated by local employees and residents, these are the major sources of local tax revenues to the City other than property tax.

  Note: The *annual revenue impact* of $280,900 differs significantly from the $12 million in sales tax revenues (for a 10 year period) published in the Agency's 2004 incubator program brochure. Twelve million dollars in sales tax revenue generated over 10 years is highly unlikely. That is not to say there wasn't a high economic impact but it is less than what was cited in the brochure for the following reasons:

  - In reviewing the previous ROI analysis (2004), it estimated for 2003 an annual impact of $1.9 million, which did not include the new BioCenter. Although there are a number of differences in methodology, the primary difference is that the previous ROI assumed taxable product sales by incubator tenants and graduates of $181.7 million per year from 1994 to 2003. It is not clear what the basis was for this level of sales or why all sales are assumed to be taxable.[25]

[24] City of San Jose Proposed RY 2009-10 Budget, except as noted

[25] 2004 ROI analysis, taxable sales note. Many of the incubator tenants are service providers, intermediate product manufacturers (original equipment manufacturers) or are engaged in R&D which are not taxable sales contributors. It is highly

- The 2008 revenue impact ($280,900 annually) when compared to the Agency's annual rent investment of $1.2 million to the incubators only yields a return on investment (ROI) of 24 percent. When compared to the average total investment per year (total investment $24,527,607 including build-out and expansion investments) of $1.6 million per year the ROI is 17 percent. This measure of ROI yields a very different result than an ROI based on the annual economic impact and it measures different objectives. As a result:
  - In general it is not expected that incubator tenants would create a break even ROI as they are primarily small start up companies and the primary goal for the investment in the incubators is not to generate tax revenue.
  - However, once these companies graduate and, hopefully, expand in San Jose, it is possible that comparing revenues generated by graduate companies to the investment in the incubators could come closer to a break even outcome, i.e., 79% of 2008's economic impact is attributed to one company Callidus Software.

unlikely that incubator tenants and graduates created taxable sales in San Jose of $4.5 million per firm per year 1994-2003 (as confirmed in surveys with tenant companies during this assessment).

Table 3 – Annual Economic Impact & Revenue Impact[26]

SUMMARY OF ECONOMIC AND REVENUE IMPACTS

Environmental Business Cluster	
Current Tenant Companies	15
Local Graduate Companies	2
Total Employees	44
Total Annual Economic Impact[1]	$13,554,251
Total Annual Revenue Impact[2]	$13,489
Software Business Cluster	
Current Tenant Companies	7
Local Graduate Companies	5
Total Employees	577
Total Annual Economic Impact[1]	$407,510,756
Total Annual Revenue Impact[2]	$187,584
Biocenter	
Current Tenant Companies	19
Local Graduate Companies	1
Total Employees	129
Total Annual Economic Impact[1]	$58,966,019
Total Annual Revenue Impact[2]	$39,573
USMac	
Current Tenant Companies	31
Local Graduate Companies	24
Total Employees	116
Total Annual Economic Impact[1]	$35,751,323
Total Annual Revenue Impact[2]	$40,241
Total Incubator Impacts	
Total Annual Economic Impact[1]	$515,782,349
Total Annual Revenue Impact[2]	$280,887
Total RDA Annual Investment[3]	$1,188,816

[1]Includes current tenants and graduate currently operating in San Jose.

[2] Includes business license taxes from tenants and local gradutes as well as sales, franchise and utility taxes generated by employees living in San Jose.
[3] Total investment includes lease payment only and does not include one time investment of $9.1 million in build out and equipment for the biocenter.

[26] The multipliers used in this analysis are from IMPLAN, a national vendor of economic impact software, and are specific to the City of San Jose. Industry specific multipliers were used for each type of industry represented here.

3.5 Incubator Operations

As noted in the overview of the incubators later in this report, the SBC, EDC and BioCenter incubators have produced a high success rate with incubation of tenant companies, and the US MAC has assisted foreign companies in establishing a U.S. presence. The companies are generally complimentary of the service and support they receive in the incubators and the incubators are recognized across the nation as leaders in the field.

However, in the area of management, operations, sustainability and retention of companies, weaknesses are evident. Also, the incubators need to be evaluated base don the relevancy of the program to current economy and Agency's goals. The ability of the programs to achieve the Agency's long term goals of job creation and business investment will require resolution of the following issues:

- Consensus on goals and objectives
- Tracking and reporting on performance
- Tenant criteria / mix
- Financial stability and sustainability
- Incubator business plans
- Graduate retention

Using the National Business Incubation Association's (NBIA) *"Principles and 10 Best Practices"* as a guide for reviewing the incubators, Section 4.0, "Incubator Key Findings and Recommendations," presents key findings from the research, interviews and surveys.

4.0 Incubator Program Key Findings & Recommendations

To put the key findings in context, the National Business Incubation Association's (NBIA) "*Principles and 10 Best Practices*" were used as a framework. The ten key principles of model business incubation programs are distinguished by a commitment to incorporate industry best practices. Management and boards of incubators are encouraged to:

1) Commit to the two core principles of business incubation
2) Obtain consensus on a mission that defines the incubator's role in the community and develop a strategic plan containing quantifiable objectives to achieve the program mission
3) Structure for financial sustainability by developing and implementing a realistic business plan
4) Recruit and appropriately compensate management capable of achieving the mission of the incubator and having the ability to help companies grow
5) Build an effective board of directors committed to the incubator's mission and to maximizing management's role in developing successful companies
6) Prioritize management time to place the greatest emphasis on client assistance, including proactive advising and guidance that results in company success and wealth creation
7) Develop an incubator facility, resources, methods and tools that contribute to the effective delivery of business assistance to client firms and that address the developmental needs of each company
8) Seek to integrate the incubator program and activities into the fabric of the community and its broader economic development goals and strategies
9) Develop stakeholder support, including a resource network, that helps the incubation program's client companies and supports the incubator's mission and operations
10) Maintain a management information system and collect statistics and other information necessary for ongoing program evaluation, thus improving a program's effectiveness and allowing it to evolve with the needs of the clients

Red Flags 🏳 in the key findings denote an area of concern that requires immediate attention. Comments and recommendations received from interviews with tenants and graduates are also included in the key findings and recommendations.

NBIA Best Practice 1: Commit to the two core principles of business incubation.

As noted in the NBIA's Best Practices, there are two core principles that characterize effective business incubation:

***Core Principle 1*: The incubator aspires to have a positive impact on its community's economic health by maximizing the success of emerging companies.**

Key Findings: All of the incubators meet the test of maximizing the success of emerging companies. The incubators have assisted hundreds of companies during start-up, product commercialization, and equity funding and merger/acquisition stages. There are examples of company successes such as Callidus and Agile, however, retaining these companies in San Jose to achieve the economic impact is very low.

The Agency's timing in starting these incubators was fortuitous. San Jose was optimally located in the center of innovation for these industry sectors and the early years of the incubators afforded the City an opportunity to capture start-ups from Silicon Valley's growing technology sectors. While innovation in these industries will undoubtedly continue, during the current economic downturn it may not continue at the rate it has in the past in terms of generating a similar number of start-up companies.

The incubators as employment centers do provide an **economic impact** on the community. However, for many of these start-ups, employees are working for equity in the company and do not receive pay. There is little **revenue impact** generated for the City and the Agency until more incubator graduates grow and locate in San Jose. *See Section 3.3 & 3.4 Economic Impact & Revenue Impact and Appendix.*

Weakness: Because the incubators are located in the heart of Silicon Valley, they are serving the region as many of the graduate businesses have located outside of the redevelopment project areas and outside of the City of San Jose.

Recommendations:

- Require operators and managers of the incubators to provide better and **consistent** tracking and reporting of company incubation that includes data on job creation (define jobs to be counted) and operations and submit formal reports at least annually using the same reporting methods.
- Conduct an annual survey of tenants and graduates (continuing with graduates for at least five years after they leave the incubator).
- Update economic and revenue impacts of the incubators every two to three years.
- Require incubator managers to identify tenants that are about to graduate as part of their monthly reporting. An Agency staff person should be assigned as an account manager for each company to monitor its growth and help them secure space in San Jose prior to graduating from the incubators.

***Core Principle 2*: The incubator itself is a dynamic model of a sustainable, efficient business operation.**

Key Findings: Three of the four incubators have been in existence since the mid-1990s. Except for the BioCenter, which is currently working on a formal business plan and sustainability strategy, none of the incubators or San Jose State University Research Foundation currently has business or financial sustainability plans.[27]

Recommendations:

- As part of agreement with SJSURF, business, sustainability and exit plans should be provided to the Agency and updated annually. All incubators should use the same business, sustainability and exit plan report format.
- A financial feasibility plan should be immediately developed for the US MAC, **given its current record of five quarters of losses** (update as of May 2009, six quarters of losses have occurred).
- If not a current practice, financial audits should be conducted and submitted by the operating entity at least every two years.

[27] Business plans were requested from Incubator Managers and SJSRF, none received and none on file with Agency, except BioCenter Fundraising plan.

NBIA Best Practice 2: Obtain consensus on a mission that defines the incubator's role in the community and develop a strategic plan containing quantifiable objectives to achieve the program mission.

Key Findings: This is an area that has not been clearly articulated or updated over the years. The goals and objectives of any organization change with economic trends and conditions. The programs have also not been measured at regular intervals or based on specific objectives.

Agency staff researched and identified the following original goals for the incubators.[28]

- Provide a location for the growth of software, environmental and international businesses in San Jose
- Help new businesses
- Bring jobs to Downtown
- Enhance the job and revenue base
- Diversify the base of industry clusters

More recently, due to the economic downturn, the goals are more focused on job creation, capital investment, revenue generation and industry diversification.

The Agency's investment in incubation has been focused on long term benefits, based on the assumption that the graduate businesses will locate and grow in San Jose and create jobs, thus improving the local economy and generating a higher return on the Agency's investment. However, most incubators are focused on the near term, specifically assisting the businesses through start-up to graduation.

Recommendations:

- As part of an annual review of the incubators, the mission and goals of each incubator should be reviewed and clearly identified in the context of both *tangible objectives*, such as companies to be served, job creation, graduates, location of graduate companies, equity capital, IPO's, etc. and the *intangible objectives*, such as marketing, public relations, and the value and recognition these programs bring to San Jose as a leader in emerging technology clusters.

Example: The objectives of the US MAC, which is a hybrid incubator, should be reviewed. *Invest Fukuoka*, a Japanese prefectural commercial office located in the US MAC, states on the US MAC website that its mission is to **attract** U.S. investment to Fukuoka, which is the reverse of what the Agency's goals are for the incubators. That goal is most likely shared to some degree by the other three foreign trade offices located in the US MAC along with helping their companies commercialize technology and sell products and services to U.S. companies.

[28] Ryan O'Sullivan, fellow intern with the Agency conducted research of records/reports

- This highlights the question: How does this program achieve the Agency’s priority goals, such as, facilitating supplier relationships (purchasing from San Jose companies) and establishing production facilities in the U.S. (which appears not to be the primary purpose for tenants of the US MAC)? It appears the US MAC is more closely aligned with the Office of Economic Development’s international program which includes a focus on strengthening the City’s visibility and ties with foreign governments and companies.

- All of the incubators should use the same annual review reporting format, including consistent metrics.

- An Agency staff person should be assigned as an account manager for each US MAC company to monitor its growth and expansion and assist the firm with finding space in the City when the opportunity arises.

NBIA Best Practice 3: Structure for financial sustainability by developing and implementing a realistic business plan.

Key Findings: As noted, there were no formal business plans for the incubators (although specified in *Sublease and Co-Sponsorship Operating Agreement* between SJSURF and the Agency). The BioCenter is in the process of preparing plans. Another missing component is an exit plan that addresses the question: when has an incubator reached the end of its lifecycle?

The following summarizes the key elements of the financial structure of the incubators:

- An Annual Master Lease is paid by the Agency to landlords for five facilities (four incubators (SBC & EBC collocated), SDForum and eCenter), at an estimated cost of $1.5 million per year. Given the length of time the incubators have been in existence and the investment made in lease payments, owning the facility versus leasing may be a better option if the Agency continues to support these programs. SDForum is a 501(c)(3) entity and has a separate sub-lease agreement with the Agency.

- The San Jose State University Research Foundation (SJSURF), as a 501(c)(3), holds the *Sublease and Co-Sponsorship Operating Agreement* and is responsible for managing the incubators (SBC, EBC, US MAC and BioCenter) and providing fiscal and management oversight.

  Fiscal Structure:

  - SJSURF collects an administrative fee of eight to ten percent to offset the cost of staffing and other incubator operations. Affiliate companies pay a separate fee for services;
  - SJSURF solicits sponsorships and grants to support incubator programs and operation; and
  - SJSURF charges ten percent administrative fee on **expenses**.

  Staffing:

  - SJSURF employees and staff for SBC and the US MAC; and
  - SJSURF contracts with Prescience International, a consulting firm, to manage the BioCenter and the EBC.

- The established fee to incubator tenants is to cover their service costs and any facility, maintenance; supply costs (note: the total amount for these expenses is almost double the cost of space paid by Agency). The value to the tenant is the month-to-month lease, hands-on technical assistance and, in the case of the BioCenter, access to lab facilities.

  - *Exception:* Last year's eleven winners of the California Clean Tech Open (CCTO) received a $500/month allowance for one year's rent or services in the EBC or an affiliate membership in the BioCenter. The Office of Economic Development (OED) agreed to pay the EBC the cost of the $500/month allowance for each winner's rent or services for one year. *Note: An agreement between OED and the SJSURF referencing these arrangements was not provided.*

- To support operating expenditures and the SJSURF management fee, the incubators must generate additional revenue through sponsorships, grants, events, equipment/lab rental, and affiliate services.

Key Findings: *Incubator Financials*

Environmental & Software Business Cluster (EBC & SBC): the Agency investment in 2008 was $432,540 for lease of 24,300 square feet of office space.

- The EBC and SBC financial reporting is combined. The fee established for incubator companies is $2.75/sq. ft except for the CCTO winners who receive a $500/month for one year discount. The SBC has an anchor tenant that has been in the incubator since 1998 occupying the entire fourth floor of the incubator and some space on the third floor. Rent from this one tenant is 39% of the total revenue for both incubators.

- **Year End FY 2007-08 Financial Report ending June 30, 2008**[29]

  - The EBC and the SBC operated with a net operating balance for the year of $62,146, but there is still a negative balance from inception of <$25,110>. *This does not account for the Agency's investment, only operations.*
  - EBC and SBC received $252,046 in outside grant revenue and $20,000 in sponsorships and gifts, but there is no information in the financial report that explains the source of these revenues.
  - SJSURF charged an administrative fee of which percent on expenses. It is unclear which expenses are used as a basis for the fee. For FY 2007-08 a fee of $41,832 was charged.
  - In addition, SJSURF charges a grant fiscal and administration fee (26 percent) which was $34,232.
  - During the Q4 Fiscal Year 2007-08, there was a significant increase in expenses, specifically a *$30,000 increase in Salary & Fringe*. Revenue increases in rent and leases totaled only $10,000, resulting in expenses exceeding revenue.

- **FY 2008-09 Quarter 1 & Quarter 2 Financial Reports** (as of December 31, 2009): some of the items in the reports are potential Red Flags (note: financial paperwork that was provided did not contain corresponding explanatory notes.)

  - Grant revenue is significantly behind FY 2007-08 levels. *Note: What is the projection for remainder of year and next year*? Without the grant revenue the incubators cannot operate in the black.
  - To date, the client fees revenue line item (fees charged affiliates) has reached the total year "client fee" revenue for FY 2007-08, indicating a major increase in this revenue source. *Note: This may mean more time is spent with affiliates who may or may not be located in San Jose (this is a source of revenue for the incubator but may not help*

[29] Financial report prepared by SJSU Research Foundation. Reports do not show details or explanations of significant changes in revenue or expenses.

achieve the Agency's priority goals of local job creation and retention of expanding companies).

- Tenant rent revenue has increased to Q2 2007-08's highest level which indicates that the SBC and EBC are near full occupancy.
- Salary and fringe expenses, increased in Q2 FY 2008-09 but decreased in Q1 FY 2008-09. It is unclear whey the salary and fringe expenses fluctuate from quarter to quarter. The expenditures for independent contractors also fluctuate and appear to be a variable cost.
- Expenses reported for the first two quarters FY 2008-09 for independent contractors and professional services are currently equal to FY 2007-08 full year expenditures. *Note: This could be a result of the increased revenue from client fees but this is not clear in the financial report. It is a significant expenditure and although the revenue may be up, the total expenses are exceeding revenue (providing more consulting services with less corresponding revenue).*
- Q2 2008-09 had a negative operating balance of <$35,229>, increasing the deficit from inception to <$32,229>.

US Market Access Center: the Agency investment in 2008 was $246,741 for lease of 14,700 square feet of office space.

- **Year End FY 2007-08 Financial Report (ending June 30, 2008):**
  - For the last three quarters of 2007-08, the US MAC ended with a negative operating balance of <$161,657> and a cumulative deficit of <$71,253> since July 1, 2006 when there was a change in management. This does not include a reported deficit of $600,000 accrued from the period 1995-2006 when the US MAC operated as the International Business Incubator.
  - There are two expense line items for personnel, Salaries and Independent Contractors and Professionals (the latter being contractors that are brought in to provide technical assistance to the tenant companies). At year end salaries accounted for $247,705 in expenses, however, $308,803 was expended on independent contractors and professional, significantly more than what was spent on salaries that should be the primary points of contact and service providers to the tenant companies. There are no explanatory notes for this difference in the financial report.
- **FY 2008-09 Quarter 1 & Quarter 2 Financial Reports (ending December 30, 2008):**
  - Rent and lease revenue from tenants are tracking closely to revenue generated in 2007-08. Client service fees are substantially down as compared to 2007-08.
  - There are no reported sponsorships or gifts.
  - There is a significant increase in other business expenses from Q1 to Q2 2007-08.
  - Costs for independent contractors and professional services at $176,489 are currently higher than FY 2007-08 and significantly higher than salaries to date. The difference is

almost double. *There are no notes of explanation as to why is there is an increase in costs for independent contractors if revenue from client fees has decreased.*

- For the first two quarters of FY 2008-09 the US MAC shows a negative operating balance of <$90,146>. **There are now a total of five quarters operating with a deficit**[30], with a total negative operating balance of <$161,399> since July 1, 2006. This does not include the previous deficit of approximately $600,000. *No plan for addressing the current deficit was found.*

***San Jose BioCenter*:** the Agency investment in 2008 was $439,128 for lease of 36,594 sq ft.

- For FY 2007-08, BioCenter has increased revenue by 43% while increasing expenses by only 8%.

- The SJSURF fee is eight percent of expenses for a total of $103,729 for FY 2007-08. The administrative fee is assigned to all expenses including leasehold expenditures for which the Agency is noted to have provided a $25,000 grant. There were no notes or explanation of this $25,000 grant on the financial report.[31] Notes in other documents reference the Agency assisting with equipment replacement.

- Due to an unanticipated expense, the FY 2007-08 net operating balance was <$3,156>.

- The BioCenter is relatively new compared to the other incubators. Revenue is increasing while expenses are being maintained and there are projections for a positive net income for FY 2008-09.

The current **cumulative deficit**[32]**, as 2nd Quarter 2008-09, December 2008, for the four incubators is <$494,344>** (SBC/EBC <$32,229>, US MAC <$161,399> and Biocenter[33] <$300,716>). The previous deficit at the US MAC is approximately $600,000 and there is a $700,000[34] deficit reported for the BioCenter not shown on the quarterly reports. Total deficit as of end of 2nd Quarter FY 2008-09 is more than **<$1.7 million dollars>**.[35]

[30] 3rdQ FY 2008-09 reported dated April 2009, shows a sixth quarter loss of <$56,288> for a total negative operating balance of <$217,688>.

[31] Prepared by SJSU Research Foundation, reports do not show details or explanations of significant changes in revenue or expenses.

[32] Deficit as reported on FY 2007-08 and 2nd Qtr FY 2008-09 report. Deficit noted on previous US MAC financials but not a specific dollar amount. Dollar amount was noted in interview with Mary Sidney, SJSURF.

[33] BioCenter Deficit as of Q4 2007-08 July 2008

[34] There were no physical records provided to the consultants documenting the US MAC or BioCenter deficit, the deficits were reported during interview by the Foundation and reported to consultant as noted in a letter from the Foundation to the Agency.

[35] Note: the operating agreement between the SJSURF and the Redevelopment Agency stipulates that any operating deficit is the responsibility of the Foundation.

Operating Deficit, 2nd Quarter FY 2008-09, December 2008				
Incubator	Founded	Agency Annual Investment	Agency Total Investment since inception to Nov 2008	Financial Operating Profitability since inception as of Dec 2008
Software Business Cluster (SBC)	1994	$437,400	$8,776,505	<$32,229>
Environmental Business Cluster (EBC)	1994	combined in SBC	combined in SBC	combined in SBC
US Market Access Center (US MAC)	1995	$246,742	$4,286,304	<$161,399> <$600,000>**
San Jose BioCenter	2004	$439,128	$11,464,798	<$300,716> <$700,000>**
Total Incubators		$1,123,270	$24,527,607	<$1,794,344>

Recommendations:

- The financial questions and inconsistencies of the incubators are at the heart of the *sustainability* principle of the NBIA guidelines. With the Agency's commitment to paying rent for the incubator facilities (and additional investments for the BioCenter), the incubators should be able to operate near or at break-even. ***If they cannot, what impact does this have on the Agency's continued investment in these programs?***
- As noted previously each incubator should have a business, marketing, funding and exit plan. There should be an accompanying annual operating budget and projected sources of income for each program.
- The financial stability of the **US MAC is of major concern.** Key questions include: 1) Can the situation be remedied? 2) If so, how? 3) How long will it take for the US MAC to break even? 4) Are there other operating and funding sources to support the facility/operations? The tougher question needs to be asked: ***Is this program financially viable?***
- SJSURF staff needs to better monitor financial reporting to anticipate any potential problems.
- The SBC should also be reviewed from the standpoint of financial feasibility. Given the few tenants in the SBC, is there still demand for this program? Are the services needed by this industry being provided by SDForum? SDForum seems to have better connections with and integration in the software industry than the SBC and offers some of the same services.
- The EBC has probably one of the highest opportunities for growth because its mission is focused on the clean tech industries. However, the EBC should be taken to a higher level in order to be state-of-art with the clean technology industry by enhancing its relationship with the National Renewable Energy Laboratories and California Energy Commission. The EBC has the potential to add more grants and sponsorships, provide stronger technical assistance and industry specific resources to support the growth of its operations, especially if the advisory board is well connected to the clean tech industry.
- The incubators should be operated as a business.
- The contract administrative fees assessed by the foundation and specific expense line item charges in financial reports need to be clearly defined.
- The SBC and the EBC should produce separate financial reports versus a combined report.
- Reviews of financial reports, with back-up documentation, should be conducted at least every six months, in person between the SJSURF and the incubator managers and between the SJSURF and the Agency.
- Financial reporting should be standardized with all of the incubators using accepted business financial reporting formats with clear explanations and descriptions of entries.

NBIA Best Practice 4: Recruit and appropriately compensate management capable of achieving the mission of the incubator and having the ability to help companies grow.

Key Findings: The SJSURF is the operating umbrella for the four incubators and is responsible for hiring incubator management. SJSURF provides staff for the SBC, EBC and US MAC as Foundation employees. For management of the BioCenter, SJSURF contracts with Prescience International.

- This report did not review the compensation for incubator management.
- All are experienced business counselors. Prescience International, contracted with the SJSURF, has staff experienced in incubator and facility management.
- During tenant and graduate survey and interviews, the incubator managers were highly rated as being key to helping the businesses.
- The service provided by the SBC manager was credited as being the "proposition value" of the incubator and graduates continue to call him for assistance.
- The BioCenter tenants interviewed said they would like to have professional expertise more aligned with their technical needs and commensurate with the biotechnology field.

Recommendations:

- Management of the incubators should be evaluated for their ability to provide the level of service desired by the tenants. The recommendation is to have a follow-up meeting with tenants to determine the technical assistance they need and the feasibility of delivering that service.
- Based on the survey of SBC tenants, the value of the incubators was the service and expertise provided by the manager and not the facility. This information, plus the type and number of companies currently in the SBC, raises the question of whether the facility is still necessary to support software companies. *Can this service be provided in another way either virtually or through another organization like SDForum?*

NBIA Best Practice 5: Build an effective board of directors committed to the incubator's mission and to maximizing management's role in developing successful companies.

Key Findings: The EBC and SBC have advisory boards with board members serving on both boards. The SBC board only meets as needed, and has not met in several years. The boards represent consulting firms, Agency staff, SJSURF, other partner organizations and some industry representatives. By agreement, the Agency's Executive Director, or his designee, is a member of the EBC board. The US MAC reported it is in the process of forming an advisory board. *It should be noted the establishment and functioning of this board is a requirement of the Sublease and Co-Sponsorship Operating Agreement with SJSURF and was a requirement that was given special emphasis when the agreement was amended in spring 2007.*

The BioCenter has a six member industry-based Advisory Group that provides recommendations on the business model and marketing of the shared equipment labs. The SJSURF, as per Operating Agreement[36] was required to establish and convene an Advisory Board by September 30, 2007. The Board's responsibility is to review and approve the Center's Budgets, policies, goals, fundraising strategy, subtenant selection and staffing.

In interview with BioCenter staff, the Agency and SJSURF serve as the Board of Directors; however, joint meetings are few. SJSURF has been "hands off" on the management or operations of the incubator just handling the fiscal responsibilities, i.e., bank account, receivables, payables, contract signing and insurance. However, the BioCenter also maintains full accounting accrual records to double check the SJSURF (a needed checks and balance duplication as SJSURF has a complex accounting process). Because of this hands-off approach, the incubator manager established their own relationships with other University departments, such as, Master of BioTechnology Program. There is new interest from the University in the BioCenter because of a Stem Cell grant award to the University and its relationship to business at the BioCenter.

On the other hand, the BioCenter staff works closely with Agency staff on incubator operations, management, financing and expansion.

[36] Source: Second Amendment to Sublease and Co-Sponsorship Operating Agreement, dated June 15, 2007, Section 6 Advisory Board

Recommendations:

- The Agency staff person who is assigned oversight of the Sublease and Co-Sponsorship Operating Agreement should attend all incubator board meetings.

- The advisory boards should be comprised of industry professionals with relevant experience in the industry sector and/or businesses support services for that industry as well as venture capitalists, other investors and real estate brokers. Example: *The current make-up of the SBC/EBC advisory boards are primarily independent consultants, City and Agency Staff and other representatives of incubator or partner programs vs. experienced industry professionals.*

- The BioCenter industry advisory board for the shared labs is an excellent model.

- Review with SJSURF the Operating Agreements to ensure agreements are being met by both parties.

NBIA Best Practice 6: Prioritize management time to place the greatest emphasis on client assistance, including proactive advising and guidance that results in company success and wealth creation.

Key Findings: For the most part, SBC, EBC and US MAC incubator staff and independent contractors are focused on assisting clients. Incubator staff has been very helpful in working with tenants on intellectual property, product commercialization and venture funding. During personal interviews with the SBC and EBC tenants, they indicated the best value of the incubators was not the facilities, but the individual technical assistance and counseling they received from the Incubator Managers and independent consultants brought in to assist and counsel the business.

The BioCenter model is focused more on the facility, providing a unique space for emerging biotech firms to locate in small spaces having access to specialized equipment and labs. This was a critical gap in the San Jose market for this industry sector. The BioCenter has partners to work with tenants on specific, specialized technical assistance and commercialization. The BioCenter sponsors workshops on technical issues and venture forums as well as connects tenants with providers. Personal interviews with BioCenter tenants confirmed they highly valued the facility, ability to locate in smaller space on a month-to-month basis while having access to equipment and labs. However, they did mention they would also like to have more hands-on business coaching with experts in their field.

Recommendations:

- The focus of the SBC, EDC and US MAC incubator managers has been on providing technical assistance. There appears to be less attention paid to financial management and record keeping. There needs to be a balance.
- As part of their work with tenant companies, the incubator managers need to ensure that all tenants comply with business regulations such as obtaining a city business license. This requirement should be part of the initial application/lease package. Currently 42 of 72 incubator tenants do not have a City of San Jose business license.
- For San Jose to receive the economic benefit of companies graduating from the incubator, incubator managers should work closely with Agency staff when tenants are preparing to leave the incubator for their next growth stage. Agency staff should be assigned as account manager for these businesses to find new space in San Jose and potentially providing other assistance and resources that will help grow their companies.

NBIA Best Practice 7: Develop an incubator facility, resources, methods and tools that contribute to the effective delivery of business assistance to client firms and that address the developmental needs of each company.

Key Findings: Following are verbatim key comments/highlights from personal tenant interviews during on-site visits to the incubators (SBC/EBC, BioCenter) by the consultant team.

The purpose of including these comments is for Incubator Managers, SJSURF and the Agency to have further discussion and communications with the tenants regarding their input.

The comments and recommendations from the tenant perspective have value, but could also have fiscal impact from the incubator facility stand point or there may be a lack of communication on how an issue has been addressed. An example is comment on downtown parking, Agency and incubator staff worked with Downtown Parking Board to incorporate a 50% discount on monthly parking at public parking garages and lots approved by City Council (tenants may not be aware of this action).

SBC and EBC

Value:

- Manager and the conference rooms.
- Month-to-month lease is very, very attractive to companies just starting up that can't make a longer commitment.
- Image/credibility (not physical location) makes the start up look bigger and more "together" than it really is which is important to investors and employee recruitment.

Areas for improvement:

- Image from the parking lot – seedy and treacherous – this is a reflection on the business. "We've lost investors (who are image conscious) between Victory Parking and here" [the incubator].
- Cost of parking for workers and guests.
- The whole package is not provided. "We don't get enough access to funders (public and private)."
- No room right now to grow (in office space). This was a major attraction; the ability to expand and contract that has now disappeared.
- Very low churning of companies: there used to be a mandatory up and out in two years policy which was harsh but effective. What happened? Now we have one company occupying the entire fourth floor for years and years. Seems to be losing a "critical mass" of companies. There are limited opportunities to share ideas, etc.

- Internet is so slow – we need a secure server room with AC.
- How is the ideal tenant defined? What characteristics? Revenue producing to support the facility or an IP generator? Need to decide, because their needs are different (questions from tenant regarding the mission of the incubator).
- From a graduate: “It was very inconvenient and expensive (cost of parking), congestion/traffic downtown, etc. Anticipated a lot more synergy/energy with the other entrepreneurs. Instead there are a lot of non-start up companies, and therefore a lot of closed doors. We left the incubator because we did a cost/benefit analysis and the cost was more than the benefit (because of location, cost of parking, etc) and we still have access to the incubator director outside the incubator.”

Potential Weaknesses:

- The question has been raised: Why does one long-term tenant, 11 years, occupy the entire fourth floor and part of the third floor? (This tenant does not consider itself part of the incubator as evidenced by the disregard for the repeated and persistent attempts to schedule an appointment for the incubator questionnaire.) *From a financial standpoint this company covers 39% of the rent revenue; however, it is way past incubation phase. A policy should be in place to move graduates along and planning should be done to have a pipeline for new incubating companies to take the space.*
- On site SBC staff is located on the fourth floor with the major tenant and not on the floor where the other tenant companies are located.
- Tenant mix doesn’t seem to be appropriate. The goal should be to incubate innovative growth companies. The EBC currently has a tenant mix that includes a ‘solar panel installation’ company and a consulting firm that has been in the incubator since 1998 with four employees.
- Office layout doesn’t seem to be conducive to interaction. It is a maze of small cubicles and limited open areas.
- The building is a bit rough on the outside with lots of smokers and people hanging about in front of the transit agency next door.

Recommendations:

- Each incubator should have a business plan that is updated annually. If one exists, it needs to be reviewed and updated. Additional questions that should be answered include: Who is responsible for monitoring tenant longevity and mix? How is success defined? Who is tracking graduates, etc? How are contracts and performance of the incubator measured? How do you calculate the loss of "critical tenant mass" due to the long term use of the fourth floor by a large non-incubator type tenant?
- Move the SBC staff to where the "action" is on one of the floors that actually have incubator tenants.
- Many tenants are not satisfied with the location due to diverse mix of patrons hanging around the entrance to the building. There is not much that can be done about this, other than find to another location which may be a good decision, especially given the current real estate market.
- The tenants feel access to funders is lacking. Are there creative ways to increase the interface between tenants and potential public and private funders either through informal introductions or formal networking events? There should be a more formal working partnership with SDForum which provides the access to and networking opportunities with funders.

BioCenter

Value:

- Equipment, especially the very expensive lab equipment that most tenants could not afford.
- The economic efficiencies provided by access to expensive capital equipment/facilities enable the company to focus on product development without other distractions.
- Lab size is very small and thus very desirable. "It's difficult to find small labs."
- Flexibility to rent month-to-month
- "Tony –he's all over the place helping us" (*Tony Gonzalez, Operations & Facilities Manager at the San Jose BioCenter)*
- Legal shipping address
- San Jose address in Silicon Valley – facility lends credibility to start-ups in terms of attracting talent and investors.
- Plug and play operations
- Graduate comment: "It's a dream come true."

Areas for Improvement:

- Need an on site tech expert – someone that knows our industry and the equipment we have here.
- Different management is needed. The university is very bureaucratic, a poor choice. It took six months to get new water filters.
- More training on the specialized equipment. "We're only given the basics so we only learn a tiny fraction of its capabilities."
- More formalized networking events and venues are needed.
- Need larger hoods and more durable working surfaces.
- "BioCenter should get its own insurance, not through state system. A claim forces the tenant to deal with a third party adjustor."
- "Don't charge for use of equipment – goes against purpose/value proposition of the center."
- "Restrooms inside, not just in the foyer."
- "Four digit code is avenue to black hole when calling out four digit and then press #."

Areas of Strength:

- Tenants seem appropriate for the space. Most of them use the shared lab and equipment facilities.
- Most don't generate revenues/sales because they are still in R&D.
- Filling a critical gap/niche – but I'd be interested in knowing how much the company is assisted when graduating to ensure a site in San Jose.

Potential Areas of Weaknesses:

- Don't seem to get a high level industry specific technical assistance.
- Graduate comments: "Management and staff need to be entrepreneurial. Start with the front desk which is only open from nine to four o'clock or so (government hours). This caused a lot of problems for us. We got lots of complaints from vendors, clients, etc., in terms of its inaccessibility. Also, same attitude with Internet, phone systems which are not what start-ups need in terms of bandwidth and speed/ease of use. It became more of a burden and it was more cost efficient to move out. It's expensive, and with the obstacles, small companies can't afford. And, it's very difficult to grow there. It became more of a hassle. The location is great, the facilities are great, right concept but needs to have the same entrepreneurial mindset as the tenants. Management must think/act like a startup company. This is needed."

Recommendations:

- Based on tenant interviews, there seems to be a need to more fully define/clarify the purpose/goal of the incubators.
- Develop a business plan for the incubator that addresses and includes very specific language about the goals and objectives of the center and the type of tenants desired based on relevance to the goals and objectives. For example, if this is an early stage R&D facility, then services, management, facilities and advisory should be targeted to this type of tenant. Also, the business plan should include performance measures that match the objectives. For example, if early stage R&D companies are desired, then tracking of patents obtained would be an appropriate performance measurement versus revenue generated. Performance measures appropriate to the type of incubator should be developed and used.
- Many of the tenants expressed the lack of onsite professional/technical support. With tenants, create a duty statement for skills and expertise for this technical support.
- The comments about the phone, insurance, equipment training and the cost/charging for use of equipment and networking events were stated by current tenants and graduates. This may be an old issue that is difficult to solve but, if possible it should be addressed as quickly as possible because there is concern that the new expansion will divert management attention and resources.

Overall Recommendations:

- Incubator Managers, SJSURF and Agency should follow up with tenants to further discuss their needs, solutions and new opportunities. Some of these comments, particularly “areas of improvements” and “potential weaknesses” may be old issues but seem to still need resolution in the mind of the tenant. These comments provide the perfect opportunity to have an incubator management meeting with tenants.

NBIA Best Practice 8: Seek to integrate the incubator program and activities into the fabric of the community and its broader economic development goals and strategies.

Key Findings:

- Currently, the incubators do not have business plans.
- As noted in NBIA Best Practice 2, there does not seem to be a consensus on mission and goals between the Agency, SJSURF and incubator management. SJSURF and incubator management appear to not clearly understand the Agency's priority goals and objectives for long term economic and revenue impact, specifically, retention of graduates, which is where the benefit pays off for the Agency and city.

  In the incubators' effort to obtain operating funds, all have initiated "Affiliate Programs", where services are offered to businesses not located in the incubator and who are mainly outside of the City of San Jose and the U.S. These businesses do not "benefit" the Agency or the City of San Jose, unless those businesses were to ultimately locate and grow in San Jose which has not been the case.

  The retention of graduates is critical to achieving the Agency's goals for long term economic growth. As noted in Section 3.3, Economic Impact, 79 percent of the total economic impact, $515.8 million is attributable to one graduate, Callidus Software. The retention rate for keeping graduates in San Jose is only 12%, however, many locate in the Silicon Valley/Bay Area so the incubators' benefit is more regional in impact.

Recommendations:

- Define specific goals and objectives in each incubator business plan that address how the incubators align with Agency, City and other programs. Do the incubators align with the Agency's own priority goals and objectives or with the City's economic development goals and objectives? Does management of the incubators clearly understand what those goals and objectives are?
- Increase graduate retention rate or restructure programs to focus on accelerating early stage growth that are ready for market versus start-ups.
- Although the Agency has worked to find space for companies referred by the incubator programs, there is currently no formalized retention program in place for graduating incubator companies. Agency staff should be assigned as account managers to incubator tenants to monitor their growth and assist with their expansion needs.
- Given the benefit to the region, possibly other regional organizations and communities should be supporting the efforts of the incubators.

NBIA Best Practice 9: Develop stakeholder support, including a resource network, that helps the incubation program's client companies and supports the incubator's mission and operations.

Key Findings: Each incubator appears to have created excellent resource networks as noted in the marketing materials and websites.

NBIA Best Practice 10: Maintain a management information system and collect statistics and other information necessary for ongoing program evaluation, thus improving a program's effectiveness and allowing it to evolve with the needs of the clients.

Key Findings: Although incubator managers provide monthly reports on current tenants, there is a significant amount of inconsistent data on the tenants, their employment, and the space they occupy. It is not clear that all of the data in the monthly reports is actually verified on a consistent, reliable basis. Also, the level of reporting varies from incubator to incubator.

Recommendations:

- There should be a consistent report format for all incubators. All information on that form should be verified and updated for each monthly report. This will facilitate monitoring and updating the performance of the incubators on a regular basis.
- The key information in the reports should include company names; FTE employment (at incubator/San Jose or location out of area); square footage occupied; industry type and date of occupancy. Information needs to be maintained in a master database. All of this information should be provided for tenants and affiliates.
- On an annual basis (use the NBIA ToolKit Model) collect data such as payroll, taxable product sales, local supplier purchases, capital investment in equipment, debt incurred, capital raised, IP, commercialization status. Providing this information should be a requirement for locating at the incubator.
- A similar standard report structure should be set up for tracking graduates. Since the graduates are a key component of the economic impact in terms of creating a direct revenue impact back to the Agency over time through capital investment, taxable sales, property tax and job creation it is important to keep in contact with companies and track their progress, employment growth and current location.
- To promote the incubators, a formal annual report highlighting tenants, graduates, sponsors and events should be produced, sent to the media and posted on the incubator and Agency websites. ***Note:*** *The BioCenter produced a 2007-08 Annual Report which could be used as a model.*

5.0 Measuring Economic & Revenue Impact

The NBIA Tool Kit National Business Incubation Association, "*Measuring Your Business Incubator's Economic Impact: A Toolkit,"* is a guide for measuring the impact of incubators. This methodology was used for the economic and revenue impact analysis for the report and consists of a two-step process:

1) Collecting the correct data from the tenants, and

2) Using a proven economic impact model for measuring economic impact to ensure the right application of formulas.

The multipliers used for this analysis are from IMPLAN, as recommended by NBIA, a national vendor of economic impact software and are specific to the City of San Jose. Industry specific multipliers were used for each type of industry represented here.

Section 3.3, "Economic Impact" and Section 3.4, "Revenue Impact" provided an overview of the total amount of both impacts for all four incubators, $515.8 million annual economic impact and $280,900 annual revenue impact for 2008 respectively. This section furthers describes the impact model and assumptions. Appendix 1 - Incubator Profiles also has detailed explanation of the economic and revenue impacts for each incubator and Appendix 5 includes the economic model spreadsheet.

The economic impacts include output, payroll and jobs. In other words, this is a way to measure how much these companies contribute to the local economy. Revenue impacts measure the amount of local tax revenue that these companies are generating. In this case local taxes include sales, business license, franchise and utility taxes. Some of these revenues are generated by the companies directly, while some are generated by their employees. *In this analysis, only impacts in the City of San Jose were reviewd*. However, both graduate companies as well as current tenants may have economic impacts far beyond the local area. It is also important to note that this analysis only represents a single year. The impacts shown here are intended to represent "typical" annual impacts.

A. Economic Impact

Economic impacts measure the effects of economic stimuli or expenditures in the local economy. They trace spending through an economy and measure the cumulative benefits of that spending. These impacts can be expressed in terms of direct and indirect jobs, payroll, and economic activity or output that are generated by local companies. Note that these are three different measures of economic impacts and they cannot be added together. Indirect impacts are the result of the multiplier effect and include supported supplier and consumer businesses and employees in the City of San Jose that will benefit from current and graduated companies at the incubators.

Direct impacts include payroll and jobs as well as the value of goods and services produced by companies located in the incubator and by graduates that are operating in San Jose. These companies generate additional impacts through the increases in demand for goods and services they create in the local economy. As part of their operations, these businesses will make local supplier purchases that are captured in the total impacts. Their employees may also make local purchases that are also captured in the total impact estimates. The total impact includes both the direct impacts and the secondary or induced impacts created by other supported local businesses and their employees.

Note that these figures are only reflective of the impacts in San Jose. These companies also purchase goods and services outside the local area and create additional impacts not captured here. It is also important to note that impacts may vary from year to year and these numbers represent annual impacts based on information about current tenants and graduates.

2008 Annual Economic Impact				
Incubator	Current Tenant Companies	Local Graduate Companies in San Jose	Total Employees	Annual Economic Impact
Software Business Cluster	7	5	577	$407,510,756
Environmental Business Cluster	15	2	44	$13,554,251
US MAC	31	24	116	$35,751,323
BioCenter	19	1	128.5	$58,966,019
Total	72	32	866.5	$515,782,349

The secondary impacts of supplier expenditures and employee expenditures are called multiplier effects. Economic impact analysis is not a matter of applying a multiplier factor to make the benefits of a project look bigger. Rather, economic impact analysis is a means for identifying the nature of changes in jobs, personal income and business activity that can occur in a given area as a result of some project, program or policy. Multiplier effects are a way of representing the comprehensive economic effects on the local economy. The multipliers effects translate into an increase in output (loosely defined for service industries as sales, less profits) into a corresponding increase in jobs and personal income. In essence, the multiplier effect represents the amplification of local spending. This process creates new business opportunities in the city's economy.

The multipliers used in this analysis are from IMPLAN, a national vendor of economic impact software, and are specific to the City of San Jose. Industry specific multipliers were used for each type of industry represented here. As an example, in the case of the SBC that included software development, custom programming and internet based services. The overall output multiplier for the SBC companies is 1.49. This means that for every $1 million in economic activity or sales in San Jose, there would be $490,000 in additional demand created at other local businesses along with about five direct and indirect jobs. This is a relatively high output multiplier due to the fact that San Jose has a well developed software industry and complimentary supplier base.

B. Revenue Impacts

Revenue impacts measure the amount of local tax revenue that incubator tenants and local graduates are generating. In this case the revenue impact includes sales, business license, franchise and utility taxes. Some of these revenues are generated by the companies directly, while some are generated by their employees. It is also important to note that the analysis only includes revenue impacts to City of San Jose. Other revenues may be generated to other jurisdictions.

2008 ANNUAL REVENUE IMPACTS

				Indirect (Employee Based)		
	Local Employees	Local Payroll	Direct Business Tax	Sales Tax	Franchise & Utility Tax	Total Tax Revenues
Software Business Cluster	296	$32,924,448	$10,812	$102,066	$74,706	$187,584
Environmental Business Cluster	23	$1,669,427	$2,400	$5,175	$5,914	$13,489
San Jose BioCenter	66	$6,062,952	$4,044	$18,795	$16,734	$39,573
US MAC	63	$5,255,867	$4,200	$16,293	$15,848	$40,241
Total Incubator Revenue Impacts	448	$45,912,694	$21,456	$142,329	$113,202	$280,887
City of San Jose[37] 2008-09 Fiscal Year Tax Revenues			$12,000,000	$152,536,000	$125,311,000	$289,847,000

Assumptions: Local employees include the percentage of direct and indirect jobs from the economic impact for workers at incubator tenant and graduate companies that are also living in San Jose. Based on survey data, 22 percent of SBC employees live in San Jose, 33 percent of EBC employees and 27 percent of US MAC employees. The direct business taxes are based on the city's current business license tax schedule and the number of employees at current tenant and graduate companies in San Jose. Sales tax calculation assumes 31 percent of income is spent on taxable goods per the Consumer Expenditure Survey and shows the 1 percent of sales taxes retained by the City of San Jose. Franchise and utilities taxes are based on current per capita rate in the city.

Note: the results of this ROI analysis, Sections 3.3 & 3.4 and Table 3, are quite different from the results of the previous analysis conducted in 2004. There are a number of significant methodological differences described below. Because of the numerous differences in methodology it is not possible to directly compare this analysis to the previous ROI analysis.

This analysis includes only local economic impacts to San Jose. It does not consider the economic impacts generated by suppliers made outside the City because the economic multipliers used here are specific to the City of San Jose. This analysis is also limited to economic and revenue impacts of incubator graduates that are still located in San Jose. Likewise, in terms of employee-based revenue impacts, only impacts for employees living in San Jose are reflected in the revenue impact.

This analysis accounts for the fact that about one third of graduates overall are no longer in businesses (88% of the graduates were reported by Incubator Managers as still in business, only 68% could be verified as being in business in 2008). Thus the number of jobs and other impacts created by graduates over time is reduced. It does not appear that graduate survival rates over time were taken into account in the previous analysis.

[37] City of San Jose Proposed RY 2009-10 Budget, except as noted

The multipliers used here are both industry specific and geographically specific and are intended to measure only the impact in San Jose. The multipliers also vary measurably from industry to industry. In the previous analysis, a single employment multiplier was used for all incubator companies which was not an appropriate way to utilize multipliers.

The approach to looking at employee-based revenue impacts is significantly different than in the previous analysis. While both methodologies are valid, it is important to understand that they are different. The previous analysis looks at restaurant and food sales of staff and employees as well as transportation and retail sales. It is not clear how the rate of employees living and working in the city was incorporated into the previous analysis. In the current analysis, employee spending is tied to payroll and includes only expenditures made by employees living in the city. While employees may eat out at lunch or make other retail purchases on their way home from work, the majority of local spending will be from employees that also live in the city.

The previous analysis also includes sales taxes generated by business purchases based on a rate of $3,400 per company per month. The tenants and graduates interviewed in January 2009 for this analysis reported they make a very small percentage of local business expenditures, with BioCenter tenants accounting for the largest expenditures. Not all expenditures are in the City of San Jose. Only three of the companies interviewed directly sell to other businesses.

6.0 Business Services Programs Key Findings & Recommendations

In addition to the incubator assessment, *SDForum* and *eCenter* were also reviewed for the indirect benefits these programs provide. The SD Forum and the eCenter are considered to be *business service* programs. They do not provide physical facilities like the other incubators but provide business services directly to businesses.

The Agency similarly invests in these two programs by paying the annual leases for the facilities. The SD Forum's rent is $163,133 and eCenter rent $281,818.

6.1 SDForum

111 West Saint John Street, Ste 200
San Jose, CA 95113
408-414-5950
http://www.sdforum.org/
7,524 sq ft
Agency 2008 Investment: $163,133

SDForum is a private not-for-profit 501(c)(3) organization funded through a combination of sponsorships, user fees and membership (1,800). SDForum's mission is to provide a venue for engineers, executives, researchers, technology leaders, and venture capitalists to exchange information on emerging technologies and best practices. The organization has eight staff (full and part time and interns) focused on "Education, Advocacy, Business Development and Networking."

SDForum has over 47 sponsors in six different categories:

1. Strategic Alliances
2. Partners
3. Catalysts
4. Leaders
5. In-Kind
6. Media

Most notably are the *Strategic Alliances*, which are sponsorships of $50,000+, provided by companies such as Hewlett Packard, Microsoft, Nokia, SAP, Sun and the San Jose Redevelopment Agency which is the only public agency sponsor.

SDForum holds over 300 events per year including 100 full day and half industry workshops and four investor showcases. Two-thirds of the events are Special Interest Group (SIG) events which are the core of SDForum's success. These SIG events are topical and help drive education in changing technology. Most of these events and programs are "hosted" at member facilities throughout the Silicon Valley which adds visibility and recognition for the business members of SDForum.

An “Annual Visionary Award” event is held annually that is attended by 250 key business people. The event honors four to six industry leaders who have significantly contributed to the Silicon Valley economy and industry. The honorees recognized are received into a “Tech Hall of Fame.”

There is a close linkage between SDForum and the City’s Tech Museum through mutual goals and “cross-over membership.”

SDForum is broadening its mission from software development (SD) to include other emerging technologies such as clean technology. It is also one of the few organizations providing mentorship to young emerging companies, but there is no formal tracking of the companies. Mentoring provides monthly services such as a legal clinic; a venture capital coaching event (provided by VC firms); coaching for “crafting a fundable roadmap” (offered two to thee times a year); and a dinner series with guest speakers from Silicon Valley’s top venture capital firms. These coaching services are beneficial to other incubator companies and may duplicate services they provide.

SDForum also has “companies in residency” program which is intended for young entrepreneurs. Services includes month-to-month, short term office space, providing mentoring service and partnering them with SDForum members. There are typically two to four companies in residence each year. Note: this not a formal program.

The City has a representative on SDForum’s Board of Directors.

Facility:

SDForum occupies 7,524 square feet in a Downtown office building with offices, two conference rooms (one can hold approximately 40 people), a kitchen and storage. Conference rooms can be used by member companies and are equipped with wireless Internet, flip charts, supplies, and projector available. Space is not optimal for holding SDForum events (and members prefer to host them at their facilities).

At $1.82 per square foot, the rent is the highest cost per square foot of all the facilities the Agency leases, but is also the smallest facility (total annual investment $163,133). As a comparison, rent for the SBC/EBC is $1.50 per square foot and the eCenter rent is $1.44 square foot.

Value to the Agency:

- Established, recognized technology companies, including some of the largest and well known, are actively involved in SDForum and highly value the networking, education and SIG events

- Provides high visibility for the Agency through the promotion of events and a bi-monthly news publications distributed to over 4,000 individuals

- Functions as an international “ambassador” per se because its “SIG International Technology” focuses on global technology issues. SDForum hosts a number of international delegations that visit San Jose, but the composition of the delegations is not known. (Are they primarily governed or business delegations?)

- Provides business referrals (this is not done formally. In past some referrals have been international companies seeking to enter the market and were referred to US MAC)

- Offers a young entrepreneur mentoring program

- The value is the visibility for the City and the Agency because of the regional audience for programs and events

Recommendations:

- SDForum provides value to the Agency's efforts to support emerging technology companies because of the services they provide to this industry sector. In interviews with industry board members it was clear t*he industry highly values SDForum, particularly the SIG venues.* There is considerable visibility for the City and the Agency through SDForum's publications and events which recognize its "Strategic Alliances". The San Jose Redevelopment Agency is listed with the top tech industry companies in Silicon Valley as a major sponsor. However, because the audience for SDForum events and programs is regional, it is not unreasonable to expect that the organization should seek sponsorship from other public entities and public/private organizations such as Joint Venture Silicon Valley. According to SDForum CEO is, the organization does not currently solicit sponsorships from other cities in the region even though a significant number of events are held in these communities.

- SDForum recognizes San Jose Redevelopment Agency in its publications *SDForum news.* However, the City of San Jose is recognized not the San Jose Redevelopment Agency on its website. Clarification and consistency is needed in terms of how recognition is listed for events, SDForum website, its publications and acknowledgements displayed in the office.

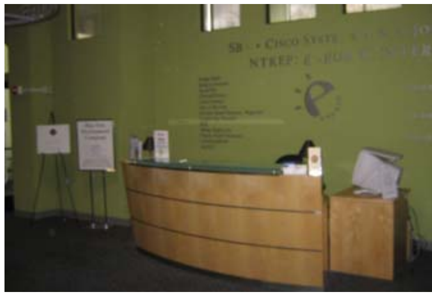
- Given the current economy and its impact on budgets, many businesses are looking at consolidation as a way to reduce costs. A co-location of SDForum with other programs and incubators could create a strong center of innovation and entrepreneurship. Also there might be ways administratively to better utilize and cover costs of common area, conference and training rooms. A co-location may provide the opportunity to upgrade and reposition the eCenter so that it can better address the needs of current businesses.

- There appears to be duplicative services offered by SDForum and the SBC. SDForum is not a "real estate" incubator (although has some 'companies in residence') but provides similar services to young entrepreneurial companies in the form of mentorship as well as extensive workshops and venture coaching (services that were rated "limited" by the SBC incubator tenants). The similarity of these programs raises the question: "Is a physical software incubator needed?" Could the valued services provided by of the SBC incubator staff provide another service component to SDForum portfolio of services and support an incubator without walls?

- SDForum is also an excellent channel for Agency staff to connect with businesses, ***venture capitalist and other top Silicon Valley business services providers.*** To build relationships and promote other Agency resources and services that assist businesses the Agency should increase collaboration and attendance at events that provide access to technology companies. The Agency currently does not have a representative on the Board.

6.2 eCenter

84 W. Santa Clara St.
Suite 100
San Jose, CA 95113
www.ecenteronline.org
16,350 sq ft
Agency 2008 Investment:
$281,818



Whereas SDForum is very industry focused, the eCenter is focused entrepreneurs and small businesses, (providing a full range of support services in one convenient location). The Silicon Valley SBDC services approximately 450 businesses a year. Also the SCORE Chapter located at the eCenter is very active working with 400-500 start-up business per year. The new eCenter management, Humboldt State University, has plans to work with the other organizations on tracking performance.

The eCenter, which originally had financial sponsorship from Cisco, is a partnership between the Small Business Administration (SBA) and the Redevelopment Agency, but the SBA does not provide any financial assistance to the Center. The eCenter houses 11 organizations providing business services.

They include:

1. SBA – Small business Administration
2. SCORE – Service Corps of Retired Executives
3. SV-SBDC – Silicon Valley Small Business Development Center
4. SBDC-TAP – Small Business Development Center – Technology Advisory Program
5. AnewAmerica Community Corporation
6. BADC – Bay Area Development Company
7. TMC Development – Largest micro-lender of SBA products
8. LCD – Lenders for Community Development
9. GSJHCC – Greater San Jose Hispanic Chamber of Commerce
10. HCC – Hispanic Chamber of Commerce
11. PCC – Portuguese Chamber of Commerce

An extensive study of the eCenter was conducted in 2006. At that time, the eCenter, like the incubators, was managed by the San Jose State University Research Foundation. In 2007, the administration of the eCenter was transferred to Humboldt State University (HSU) which had assumed the management of the Northern California Small Business Development Center (SBDC) programs and is an SBA partner located in the eCenter. The SBDC now acts as administrator and fiscal agent. The Director of SBDC is on-site.

During HSU’s short tenure, they have made significant improvements to the operations. The eCenter is guide by a Steering Committee comprised of representatives of the SBA, HSU, the San Jose

Redevelopment Agency and City of San Jose’s Office of Economic Development. The committee meets monthly to discuss the operations of the center and any potential new directions it might take. The committee’s initial focus has been on improving the operations of the center. HSU and the Steering Committee are working on a long-term strategy, which includes:

- Joint marketing (already occurring with joint calendar, online)
- Sustainability, revitalizing sponsorships
- Tenant mix, businesses and non-profit and tenant fees
- Increasing the use of the training room – more venues for businesses
- Upgrading technology
- Increasing foot traffic
- Redesigning common space areas for more efficient use
- Surveying clients that have been served by the eCenter

The strategy is to position and promote the eCenter as a regional destination for business services.

Recommendations:

- In the current economic downturn, businesses need more assistance than ever to survive. Thus the services provided by the eCenter can help small businesses better sustain the impacts of a slow economy. If possible, more one-on-one business coaching should be provided to local businesses. The new stimulus funds recently allocated to the federal workforce development program, Work2Future, may be a source of funds to help reposition the center and increase services to business.
- HSU and the Steering Committee are on the right path in developing a strategy for repositioning and sustainability. Even though the HSU has been responsible for operating the eCenter for only a short period, at least the Steering Committee is meeting regularly and exploring opportunities for strengthening the program.
- As noted in the section on SDForum, the Agency should consider the synergy from a co-location of SDForum, the eCenter and incubator programs either at it's currently location or a new one. The co-location would strengthen the eCenter as a regional destination for business services.
- SDForum's business accelerator program, monthly business workshops, would be valuable component to the services offered at the eCenter and could leverage business services provided by the incubators and other programs.
- HSU and the Steering Committee should investigate the concept of ***co-working***, a web driven, membership-based space and services for home-based and entrepreneurial businesses. Co-working office facilities combine the structure and social environment of corporate office space with the flexibility of working from home. They have desks to rent, conference rooms, Internet access, and office equipment. Most of the facilities rent space by the day, week, month, or year. They appeal to freelancers, entrepreneurs, telecommuters, and other laptop nomads who are tired of working at home alone or in crowded and noisy coffee shops. And unlike traditional office suites, *co-working facilities* provide a community of like-minded people to collaborate and socialize with. There is also a growing trend of corporations reducing their office space and experimenting with telecommuting, hoteling, and other forms of remote work. This is leading to an increase in the number of corporate employees using ***co-working facilities***. Examples of co-working facilities are: CubeSpace in Portland, Oregon http://cubespacepdx.com/ and Conjunctured in Austin, Texas http://conjunctured.com/.

7.0 Summary of Key Findings & Recommendations

As noted in the "Incubator Program Key Findings," over the years, the incubators have successfully performed in assisting start-up companies. The critical challenges for the incubators continued operations have to do with:

1) Management and sustainability, and

2) Retention of incubator graduates.

If the Agency's goal is creating jobs for local residents, long-term economic benefits and revenue generation for the city, then retention and growth of the graduates is critical to achieving that goal. Currently the region as a whole is a major benefactor of San Jose's Incubator graduates. For continued Agency sponsorship of these programs it is recommended there be clear understanding with SJSURF and incubator managers regarding the Agency's goals and objectives; more monitoring of SJSURF's fiscal responsibilities; a requirement for a sustainability plan (finding other sources of revenue for operations); and an annual business plan of each incubator. According to Incubator Managers, SJSURF has not been actively involved in the programs, and according to tenants, they see no value provided by SJSURF and sometimes feel they are a hindrance.

There are also a number of issues that should be addressed that were raised in tenant interviews. Of particular interest is the fact the tenants of the BioCenter were most complimentary of the facility but not the technical expertise of the staff, who are charged with running the facility. On the other hand, the tenants of the SBC/EBC were most complimentary of the technical assistance provided but not the facility.

SDForum and eCenter are not incubators, but business service delivery programs. The critical question is whether these entities achieve the goals and objectives of the Agency with respect to job creation, local investment and supporting the expansion and retention of growing companies in San Jose. They do play a critical role in the infrastructure that is key to the growth of small business and entrepreneurial companies.

Lastly, Applied Economics conducted an **Economic Impact and Revenue Impact** modeling for this report using IMPLAN. The Economic Impact conducted in 2004[38] used assumptions that resulted in a reporting that "*tax revenues generated from the incubators from 1994-2004 were $12 million dollars.*" For 2008 the four incubators created a total combined economic impact of $515.8 million ***but only $283,000 in tax revenue***. The 2004 quoted "$12 million tax revenues generated" is overstated. Comments to these difference are noted here in the conclusion and in Section 4.0 Measuring Impact.

The following pages summarize the report's key findings.

[38] Source: SJSURF and reportedly prepared by the Incubator Managers in 2004 (BioCenter was not included).

7.1 Incubator Operations: Management, Fiscal Oversight & Sustainability

The priority management issues that should be addressed in moving forward with the incubator program are grouped in four categories:

1) Consensus on Goals & Objectives

- The Agency should define clear measurable goals and objectives to be achieved. These should be the foundation for tracking and measuring the program.

- *Examples:*

  1) What is the appropriate role of the Agency in supporting business incubation, and can or should this role change moving forward?

  2) Should the Agency remain the primary stakeholder in the incubators, or should it attempt to bring in additional, significant financial sponsors?

  3) Does the Agency want the incubators to operate as "traditional" incubators, with an emphasis on technical assistance, or as small, specialized space for young technology companies, with an emphasis on facilities?

  4) US MAC: does the US MAC achieve the Agency's goals and objectives? What are the goals of the Agency as it relates to an international business incubator or international program? Is this better aligned, from a global perspective and agenda, with the Office of Economic Development's International Program?

  5) SBC: has the SBC reached its prime? The market has changed for the software industry. These shifts, along with the few tenants that currently occupy the SBC raise a question about the viability of the physical incubator? While support services may still be critical to these companies, the question is can they receive the "valued" one-one-one coaching without being located in the incubator? Can the services be provided to the tenants as affiliate businesses through a program in conjunction with S.D. Forum and the eCenter? Also since the SDForum continues to offer new services and programs, is it filling this industry need?

  6) EBC: the CleanTech industry sector is a growth sector particularly for San Jose. Significant research and development is occurring in this sector. The current space is office space, inappropriate to grow commercialization in new technologies where equipment and labs, similar to the BioCenter, is needed and could be shared.

  7) Could there be cost savings and efficiencies in consolidating locations and programs, or acquiring a building versus leasing?

The answers to questions such as these will have a large influence on the future facilities and operating model.

2) Tenant Criteria & Mix

- There should be clear criteria and vetting of companies entering and accepted to incubators. Focus should be on emerging and growth companies – not consulting companies or companies filling space. Potential tenants should be well screened. See Appendix 10, sample business selection criteria.

- Graduate terms – although graduation terms should be somewhat flexible, a company at some point outgrows the incubator in it physical size or its need for one-on-one coaching services. A graduation policy should be developed to provide parameters. See Appendix 11, sample graduate policies.

- *Example of tenant companies that appear not to be compatible with incubator criteria:*

  - SBC – One company has been in the incubator for 11 years, occupies the entire fourth floor of the incubator and some space on the third floor. The company is termed an "anchor tenant" as its lease fee covers a significant portion of the incubator's operating cost, but the company is clearly beyond incubation.

  - EBC – A consulting firm, similar to the one above, has been in the incubator since 1998, a total of 11 years. The company has four employees and has not grown. There is also another single person consulting firm located in the EBC.

  - EBC – There is a solar panel installation company occupying space which appears not to meet the criteria of innovative growth companies.

  - US MAC – Several tenants are government entities and economic development agencies whose goals are to promote two-way trade and investment between their nation and the U.S as well as perform other economic development services, such as recruiting businesses and investment to their countries. The question is should the Agency be financially supporting foreign economic development organizations that otherwise would pay rent for office space in the City as do other foreign commercial and economic development offices? In fact, other countries such as Scotland and Korea currently operate incubators in San Jose to assist their businesses in commercializing technologies and establishing partnerships. If the goal of these foreign non-profits is truly trade based, those organizations could be collocated and rent space at the eCenter, thus helping the eCenter to build their visibility as a destination center for business services.

    Also due to the unique hybrid nature of this incubator which is focused on helping mature foreign businesses get a foothold in the U.S. market, the key factor in screening potential tenants is understanding each tenant's purpose for having a San Jose office. Establishing a local production facility or supplier relationships with other local companies is beneficial to the City in terms of both economic and revenue impacts. If however, these companies are just small sales offices, there is little or no direct local economic benefit to this activity.

3) Financial Stability and Sustainability

The major red flag issue for the incubators concerns financial stability and sustainability (*see Key Findings for NBIA Best Practice 3, Structure for financial sustainability by developing and implementing a realistic business plan*). Given the Agency holds the Master Lease and pays 100% of the lease payments for all incubator facilities, the expectation is SJSURF would establish a rent fee that would equal cost recovery, i.e., cover the costs of staffing, facility maintenance and administrative fees. The current situation, which is the end of 2nd Quarter FY 2008-09, is that all incubators are operating in a deficit.

- An operating deficit exceeding $1.7 million which appears to be growing each quarter without resolution by SJSURF.
- As part of the Agency's agreement with SJSURF, all incubators should have a business plan, sustainability strategy and exit plan.
- US MAC: in addition to the question of whether the US MAC meets the goals of the Agency, there are numerous financial red flags for this program. Notwithstanding a previous estimated $600,000 deficit, this program has been running a deficit for the past five quarters with a current year total of $90,146 and a $161,399 deficit since July 2006 *without a plan for how this trend will change*.
- This incubator has produced the largest number of graduates and has the strongest retention rate in San Jose but the fiscal management has been weak. As far as this assessment could determine, based on documentation from all parties involved (who were all very responsive), there is no written plan for reversing the downward trend for the future. Specific questions that need to be addressed include:
    - How is the US MAC going to reverse their negative operations by end of the fiscal year?
    - Can expenses be reduced, i.e., specifically for independent contractors?
    - Why does SJSURF charge an administrative fee on expenses versus income? There would be no motivation to increase the incubator's income if fees are based on expenses.
    - What will happen if the incubator does not reverse this trend?
    - What is the Agency's own plan for addressing the issues concerning the sustainability of this program?
- Given comments from tenants regarding SJSURF's management as another layer of bureaucracy, the administrative fee, and the need for stronger industry specific technical assistance (BioCenter), the Agency should evaluate the option of contracting with another entity that has more expertise to directly manage innovative life sciences incubators. According to Incubator Managers, SJSURF's primary role in the operations of the incubators has been as the 501(c)(3) fiscal agent.

4) Reporting

Another major weakness with the incubator program is inconsistent and incomplete reporting and records of performance. A significant amount of time was spent trying to obtain records and many of the records had conflicting information. Lists of graduates were not complete because of management changes and records that were not current.

- Tracking: incubators should have a master database of tenants and graduates, based on reporting criteria and aligned with fiscal year operations.

- Quarterly reports should contain records on:

  1) Tenants: company names, FTE employment (at incubator/San Jose/out of area), square footage, industry type/product, entry data, significant occurrence at company (i.e., major contract, IPO, etc).

  2) Affiliates: company profile, location, and services provided.

  3) Incubator milestones: other services provided at the incubator, i.e., events, grants received, etc.

  4) Financial performance with notes regarding changes in revenue or expenses.

- Annual tracking report: to measure performance it is recommended that the NBIA ToolKit Model be used for collecting more in-depth information for economic and revenue impact reports:

  1) An annual survey tenants for additional information should be conducted that includes information on payroll, taxable sales, local supplier purchases, capital investment in equipment, debt incurred, capital raised, intellectual property, IPO, commercialization status. Provision of this information should be a condition of location at the incubator (some information may not be obtainable because of confidentiality).

  2) Graduates should be surveyed for five years after graduation for information similar to that requested of tenants. Location of the company is very important along with the company’s current business status (sold, merged, or closed). Attempting to track companies longer than five years is difficult. However, those companies locating in San Jose should be on an annual retention follow-up list monitored by the Agency. Any changes in status should be recorded.

  3) Economic and revenue impact reports – if records are maintained, it will not be difficult to update the economic and revenue impact report provided in this report.

- The Agency should evaluate the intangible value the incubators provide, such as, visibility and recognition by key stakeholders involved in the technology sector. The BioCenter is an example of addressing a very nationally recognized niche in the bioscience sector and has received significant international, national and regional recognition from industry.

- Annual Reports: for promotion purposes the incubators should develop formal annual reports that highlight incubator achievements, facilities, events and companies located in the incubator. The BioCenter has prepared an annual report.

7.2 Graduate Retention

- Efforts to retain graduate companies need to be strengthened. Currently the overall retention rate for keeping businesses in San Jose is 12%. As noted in the economic impact, 79% of the economic impact is attributable to one SBC graduate company, Callidus Software, which has remained in San Jose with over 400 employees.

- It is not likely that tenant companies would agree to stay in San Jose for a period of time post graduation in return for assistance and benefits received during their stay in the incubators. Agency staff should be assigned as account managers for incubator tenants and should monitor their growth and need for space once they graduate from the incubators. Incubator managers should be required to provide regular tenant monitoring reports to staff.

7.3 Tenant Perspective/Survey

Personal interviews with tenants at the **BioCenter** revealed some issues (raised by a number of the tenants) that should be addressed immediately while the expansion is currently in the planning stages:

- Too many bureaucratic layers: may BioCenter tenants see no "value" in the San Jose State University Research Foundation as the operator of the incubator. In fact, many respondents felt that SJSURF's presence was a negative factor and one more layer of bureaucracy. If the university is involved, it should bring expertise and value that is currently not provided and that reflects its strengths.

- Although Prescience staff might be excellent managers of the facility, the tenants do not feel they are entrepreneurial and that they do not receive the type of technical assistance (from experienced, industry specialists) expected in an incubator that supports cutting edge technology. *There should be an internal meeting with the tenants to review their specific needs, to identify ways to continually improve the services at the BioCenter and the technical assistance required.*

- Given the high interest of tenants at the BioCenter to have industry specific technical assistance (which are core principles of incubation) and the impending expansion of the BioCenter, serious consideration should be given to investing in technical expertise to help tenants accelerate and navigate the complex issues associated with their industry, or making it available through an industry advisory board.

- Other issues mentioned by tenants (see NBIA Best Practice 7 for more specific comments):

    - Hours of BioCenter operation are not conducive to industry's hours. The center needs to operate 24/7.
    - Need fast, responsive services.
    - Want technical assistance aligned with industry with a comprehensive understanding of the industry and phases they go through.

- Not enough oversight and service for cleaning the equipment. Some tenants don't use the equipment for fear it has not been cleaned properly.
- Advanced training on equipment.
- Physical facility issues that include slow internet and inadequate phone system.

Tenants at the **SBC/EBC** also had specific concerns about the physical facilities:

- Location: Downtown is okay; just this specific location of the incubator was problematic.
- No interaction among the tenants because the physical layout is not conducive to networking.
- Staff (they are the face of the incubator) are on the fourth floor with the "anchor" tenant and not where the companies are located. This does not facilitate networking.

7.4 SDForum and eCenter

As noted in Section 5.0, **SDForum** provides unique value to the tech industry and to the Agency by providing technical assistance to driving industry sectors that are important to the future growth of jobs and investment in San Jose. SDForum provides exposure through its events, corporate partnership and recognition and publications. There could be some synergy and opportunities to leverage its sponsorship when the Agency considers lease renewals by consolidating locations of SDForum, with the eCenter, and other downtown incubators in a single building to create a stronger "Destination" location for both.

The **eCenter,** with its recent change in management, has focused on operational improvements. The new management, Humboldt State University and SBDC, working with a Steering Committee, comprised of stakeholders and sponsors, has developed, in concept, a strategic plan for future sustainability. One of the goals is to strengthen the eCenter as a **Destination** – the place for entrepreneurs to go for business services.

The time may be opportune for repositioning the eCenter to be something more dynamic and visible. Substantial new funds will be allocated to the City's workforce development program through federal stimulus funds. These funds can be used for business services and it may be possible for funding to be allocated from this source to help reposition and repurpose the eCenter.

Key recommendations to consider:

- Co-location of SDForum, the eCenter and downtown incubators.
- Improve and upgrade facilities to meet today's business needs by adding state-of-the-art conference and meeting facility equipment and services.
- Evaluate opportunity for implementing a business accelerator program.
- Evaluate "co-working concept", newest trend for entrepreneurs and corporations.

The timing is right to consider new opportunities, sunset/retire or reposition programs that have been successful but have served their purpose, as well as, streamline and improve the management and reporting of program success.

8.0 Alternative Innovative, Emerging Growth Programs and Models

One of the original intents for the formation of the incubators was to provide a supportive environment for start-up companies to mature and expand in San Jose thereby increasing local jobs and investment for the City's economic base. The incubators would help create a pipeline for developing new emerging technology companies that could grow and expand in the City.

Overall, these programs have had a generally successful run for fifteen years, albeit some very significant issues regarding their management and sustainability. The retention rate of incubator graduates which provide the greatest return on investment to the Agency and the City has been challenging. Agency staff and the incubator directors need to work more proactively to retain graduates from the EBC and the BioCenter which are the two incubators with the strongest potential for producing the emerging technology companies that are the Agency's driving industies and prime candidates for retention. Yet, even with a stronger, more consistent effort there are many critical factors that affect a company's location decision that are not within the City's control. For this reason, it is difficult to require incubator tenants to stay in San Jose for a period of time post graduation as a condition of their tenancy in the incubators.

The intent of this assessment was to provide the Agency with data and information to further evaluate how these incubators and business services align with the Agency's goals and objectives and, if necessary, make modifications given changing economic and internal demands for resources. If fostering innovation is one of the Agency's priority strategic goals, it is important to recognize that innovation is not only about learning and implementing new ideas and programs but also modifying or letting go of old ones to make room for new initiatives that can better accomplish key goals and objectives. For example, new management of the Environmental Business Cluster presents an opportunity to take this incubator to the next level by strengthening the advisory board and the tenant mix and possibly new or more appropriate facilities in order to focus on companies involved in commercialization of cutting edge clean and environmental technologies and expand the technical assistance they require to grow successfully.

The Agency should also strengthen the pipeline for job creation by expanding its access to a niche of emerging technology companies in the region that are ready to commercialize new technologies. There are now a number of new business accelerator opportunities and programs that provide access to companies ready to expand ideally in the City's industrial areas. These programs focus on technology sectors such as bioscience and clean technology. In fact, the Agency already has a working partnership with three of the programs—the Clean Tech Open, TiE, and SDForum. A description of the programs that provide access to these emerging technology companies include the following:

The Agency's recent sponsorship of the California Clean Tech Open is an example of a new opportunity to support the growth of young clean tech companies. At the opening of this competition, hosted by the City at City Hall on March 19, 2009, Agency and City staff was able to obtain numerous leads for clean tech companies looking to expand operations. (See http://www.cleantechopen.com/).

TiE (The Indus Entrepreneurs) is an organization founded in 1992 and based in Santa Clara that provides access to entrepreneurs and new businesses interested in mentoring, networking and education through special interest groups (SIGs) and targeted industry sector events and meetings. TiE has strong SIGs and programming for emerging technologies such as biotech and clean technology. (See www.tie.org).

The Agency needs to have stronger involvement in the SDForum, which provides high level access to emerging growth companies, venture capital and angel investors, special interest groups, and companies that provide legal, accounting, financial, and marketing services for technology companies. SDForum hosts numerous conferences and meetings focused on many of the technology industry sectors identified by the Agency and the City of San Jose as key targets for business attraction and expansion efforts. Recently, the Mayor of San Jose spoke at a major industry conference, the "State of the Clean Green Industry" which was attended by over 300 individuals interested and involved in clean tech initiatives and programs. These industry events provide an opportunity for the Agency to target their industry attraction efforts. (See www.sdforum.com).

California Business Ascent, a program of Golden Capital Network, is a series of grassroots business contests within multiple regions of the state that identify, assist and connect companies and entrepreneurs with the greatest potential to expand into locally headquartered high-growth, high-impact entrepreneurial ventures. In return, these expanding companies will generate local jobs, local technology clusters and local tax revenue. In addition to the new Business Ascent program, Golden Capital Network has developed a series of programs such as Venture Communities and Venture Forums which are designed to assist emerging growth companies and entrepreneurs access financial capital and other technical assistance. (See http://www.goldencapital.net/contact).

The Churchill Club is Silicon Valley's premier business and technology forum. The 6,000-member, nonprofit organization has built a reputation for dynamic, in-the-news programs featuring Silicon Valley CEOs, up-and-coming executives and national business leaders. The events regularly draw more than 400 attendees and give members the opportunity to network with the best of Silicon Valley which includes CEOs and executives from many of Silicon Valley's top established and fast growth tech firms as well as venture capitalists and providers of critical industry intelligence. Agency staff has attended these events in the past. Potential opportunities include sponsorship/hosting of events in San Jose to target access to entrepreneurs and companies. (See www.churchillclub.org).

Dow Jones VentureWire Alert is a daily email service providing top headline news, a summary of each day's developments, a briefing of private company deal activity and coverage of general trends in the technology industry. This service monitors company activity, venture deals, mergers and acquisitions, and executive management changes. In addition there is a Clean-Tech division. Supporting the Alert is the VentureWire Professional which provides details of a business' activity. This is a great resource to "alert" agency staff of specific companies who have received capital, consolidated, or had a change in management, all indicators of growth and expansion opportunity. San Jose companies that are featured should be targeted for retention. In addition to this service, there are numerous VentureWire events for meeting and networking with growth companies.

These are only a few of the opportunities available to the Agency for access to emerging technology companies. Others include SVASE, Keiretsu Forum, Angels Forum and Band of Angels. Most of the Venture Capital firms also profile their portfolio companies on their websites, an excellent source for "mining" growth companies. There are also new Venture Fund programs being formed with established Silicon Valley Venture Capitalist firms which the Agency could participate more directly with companies.

Proactive, consistent involvement in these types of initiatives can allow staff to better leverage resources and utilize their time, contacts and networking more effectively.

Appendix

1. Incubator Profiles
    a. Matrix Incubator Activity, 1994-2008
2. Financial Reports
    a. Summary of Lease Payment, Agency, Feb 2007
    b. 0809 2 Q Report, EBC?SBC
    c. 0809 2 Q Report, USMAC
    d. 0809 1 Q Report, BioCenter
    e. FY0708 SBC/EBC
    f. FY0708 US MAC
    g. FY 0708 BioCenter
3. Space Reports
    a. Monthly Space Report Mar 09
    b. SBC/EBC Tenant Lease
    c. US MAC Monthly Fees Report 3-16-09
    d. BioCenter Tenant Leases 3-16-09
    e. EBC Incubator Grant Awards
4. Tenants, Affiliates & Graduates
    a. Master List of Tenants, Affiliates & Graduates – submitted by Incubator Managers Jan 2009, updated by Managers Feb & March
    b. Incubator Clients with Business Licenses 2-24-09
5. Economic Impact Model
6. Tenant Survey
    a. Tenant Survey – Incubator Business Profile
    b. Survey Responses
    c. Survey Charts
7. San Jose Emerging Technology Innovation Accelerator Program
8. NBIA Impact Toolkit
9. Background Documents – List Source
10. Sample Incubator Business Selection Criteria
11. Sample Graduation Policies

About the Consulting Team

Chabin Concepts' core competency is in realistic, achievable and measurable actions.

We are more than a consulting group – we are a solutions **network**. We use our network to bring our clients the best practices of renowned experts in urban and rural economic development, site location analysis and hands-on experience in implementing and managing competitive and results-oriented economic development programs.

We value every client and project, respecting the characteristics, heritage and goals of each community, their stakeholders and their economic development team. We commit to integrating our values, integrity and philosophy to create success through:

- Involvement of the community and all partner organizations.
- Research that is tailored to specific areas of interest, program implementation or industry focus.
- A team of experienced and diverse professionals to bring specialized techniques, knowledge, and expertise.
- Innovative strategies and creative economic development tools.
- Tactical plans designed for implementation.
- Effective and successful economic development roadmaps – integrating resources, innovative tools and creative marketing – for communities to accomplish their goals consistent with their values.

The **consulting team for San Jose Redevelopment Agency Incubator Assessment Project** included Audrey Taylor, President, Chabin Concepts, Project Team Lead, with Fawn McLaughlin, FJMcLaughlin & Associates, incubator tenant interviews and surveys and Sarah Murley, Applied Economics, economic impact modeling for the four incubators, SBC, EBC, US MAC and BioCenter.

The consulting team would like to thank the Incubator Managers, San Jose State University Research Foundation, eCenter, SDForum and Agency staff, particularly, Leslie Parks, Julie Amato and Ryan O'Sullivan, for their assistance in providing the background and extensive data needed to complete this project.

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