



South Africa Siyasebenza

## **Evaluation Insights: Evidence and lessons from South Africa's Jobs Fund on the role and potential of business incubators in creating jobs in South Africa**

*A meta-evaluation of three business incubators carried out by Impact Economix, on behalf of the South African Jobs Fund, has shed new light on the potential of business incubators to support entrepreneurs and create jobs in South Africa. Business incubators are unique in their operations, however, a wide range of business incubation good practices have been identified as generally applicable to successful business incubators. Recommendations to further enhance the potential future economic development impacts of business incubators in South Africa have also been identified.*

### **CREATING JOBS FOR THE YOUTH IN SOUTH AFRICA IS ONE OF THE COUNTRY'S CRITICAL CHALLENGES**

It is well known that South Africa has one of the highest levels of unemployment in the world. The level of youth unemployment is more than double the overall unemployment level and therefore implementing solutions which address the specific labour market challenges of the youth is of paramount importance. Business incubators have a long history in more developed countries, but are they a good approach to addressing unemployment challenges in South Africa?

The Jobs Fund has been funding innovative approaches to addressing unemployment in South Africa. This has included funding three quite different business incubators: A2Pay, Awethu Project, and Shanduka Black Umbrellas (SBU). A meta-evaluation of these three incubators has resulted in useful insights into their role and effectiveness in addressing unemployment.

### **WHAT ARE BUSINESS INCUBATORS AND WHAT IS ENTREPRENEURSHIP?**

No two business incubators are the same. Each incubator responds to the needs, opportunities and challenges of their local contexts and differ in terms

of their objectives, target clients and sectors, funding sources, and services offered. Generally, business incubators help to reduce the failure rate of early stage companies and speed up the growth of companies which have the potential to become generators of employment. They do this by providing a supportive environment to entrepreneurs at start-up and during the early stages of businesses. Most incubators provide some form of mentorship and some provide a structured business development process and programme (which can include training), business premises, shared services, access to finance, and/or networking opportunities.

Various definitions of entrepreneurship exist, with two widely quoted definitions as follows:

1. The pursuit of opportunity without regard to resources currently controlled where "opportunity" implies an offering that is novel in one or more of four ways. The opportunity may entail: 1) pioneering a truly innovative product; 2) devising a new business model; 3) creating a better or cheaper version of an existing product; or 4) targeting an existing product to new sets of customers (Stevenson, 1983); and

2. “Undertaking the creation of an enterprise or business that has the chance of profit or success” (Dorf, Byers, & Norman, 2010).

There are a range of differing types of entrepreneurs. Arguably the most important distinction deals with the main motivation entrepreneurs have for starting a business in terms of opportunity-driven entrepreneurs (an entrepreneur who starts a business in order to pursue a market opportunity) and necessity-driven entrepreneurs (an entrepreneur who starts a business because it is the best option available and is needs-based and often has much lower growth potential than an opportunity entrepreneur). Necessity entrepreneurs are by far the most common type of entrepreneur in South Africa.

### A FEW GENERAL BUSINESS INCUBATION GOOD PRACTICES

There are a range of universal principles which have been shown by extensive research over the past 3-4 decades that lead to incubators successfully impacting on the growth and survival of incubatees:

1. **Incubators should be integrated into a wider entrepreneurship development strategy** which aims to enhance the overall entrepreneurship ecosystem. This requires both a combination of national and regional strategy.
2. **Incubator pre-establishment planning Processes (e.g. feasibility, business plan etc.):** Incubators should carry out a rigorous feasibility analysis and business planning process.
3. **Objectives and operations:** Ideally incubators should have the goal of becoming self-sustainable where the incubator generates enough revenue to cover operational expenses within two to four years of operation (or should aim to receive not more than 25-35% of total revenue from public subsidies). Incubators should be run in a business-like manner with the aim of maximum value for money and should charge incubatees for their services (which can be slightly, but not significantly below, market rates- so as not to crowd out private sector providers).
4. **Overall Incubator Service Delivery Approach:** The mix of services provided must reflect the

needs of the target group (which may also be tailored to the needs of the specific sector(s)).

5. **Recruitment, Application and Selection Processes:** Strict recruitment criteria and selection processes should be applied to assess and recruit high potential incubatees.
6. **Graduation and Scaling-Up Processes:** Incubators must apply strict graduation criteria for when incubatees are ready to leave the incubator. Setting clear exit criteria linked to business targets can provide an incentive to incubatees and focuses their goals. This also potentially contributes towards improving their development, level of independence and ability to successfully graduate from the incubator and achieve business sustainability. Experience suggests that many firms are at their most vulnerable stage when they leave an incubator. The provision of after-care services to ‘graduates’ is therefore critical to ensuring sustainable incubator impacts. Incubators must help graduates with the transition from the incubator. After care and networking with firms that have left an incubator should be regarded as just as important as providing services to incubator tenants. Graduates must be monitored for at least 3 years after exiting an incubator if possible so as to allow for sufficient time to assess business growth and performance.

### WHAT DID THE THREE BUSINESS INCUBATORS SEEK TO ACHIEVE AND WHAT DID THEY ACTUALLY ACHIEVE?

The intended outcomes for the three incubators were reasonably similar and included short term outcomes (e.g. improved business knowledge and skills in the areas of business plan development, financial planning and management), medium term outcomes (e.g. including access to business opportunities and finance and growth in business turnover) and longer term outcomes (e.g. incubatee’s achieving sustainable business employment growth and profitability).

Over the three year Jobs Fund funding period, each incubator had a jobs target for growth in incubatee employment. A2Pay came close to achieving its jobs targets of 3128 new jobs created (creating 2868

jobs), Awethu fell short of its 1000 jobs target (achieving 239 jobs), and SBU exceeded its jobs target of 157 jobs by 137 jobs.

One of the evaluation lessons learned is that job creation can often be a long process and does not necessarily occur at scale in many new enterprises within the first three years (Wolpe. 2016).

There were numerous shorter term impacts and benefits reported by over 300 incubatees who were surveyed, including the following:

- Between 75%-88% of incubatees reported increases in business turnover as a direct result of the incubation process.
- More than 70% of incubatees indicated that the incubators had a high impact on the development of a range of personal qualities and attitudes which included the incubatees' motivation to do business, self-discipline, determination to succeed in business, confidence and self-belief, creativity, ability to keep trying when dealing with obstacles, willingness to take risks, and ability to deal with failure.
- Between 33%-70% of respondents indicated that the incubators had increased their business knowledge and skills.
- Between 50-60% of respondents generally found the impact of the incubator to be either 'good' or 'excellent' on a range of dimensions, including finding information on business opportunities and identifying market trends, selecting market entry strategies (e.g. finding new products for existing customers, taking

At the same time, the following weaknesses have undermined the optimal achievement of objectives include:

- Poor support with networking.
- Inconsistencies in the mentoring approach.
- Challenges in assisting with access to finance (such as very stringent business formalisation requirements as well as excessively lengthy 6-12 month funding application processing time-frames with some financial institutions).

existing local products to new markets, imitating a successful product or service, buying a business, testing a business idea), planning and coordinating activities and completion of tasks, mobilising, acquiring and allocating resources (financial, physical, human etc.), problem solving, and innovation.

Other types of outcomes achieved by the incubators include the following:

- A2Pay has enhanced cheaper and more convenient access to a wide range of services to peri-urban and rural communities. This includes loans, air time, electricity, money transfers, bus tickets etc. The potential indirect impacts of this improved access are vast;
- All three incubators have increased their funding and revenue streams from other sources and moved strongly towards achieving financial self-sustainability. For Awethu and A2Pay this is linked to growing supplier development partnerships with corporates and government role-players.

### **WHAT WERE SOME OF THE MAJOR FACTORS INFLUENCING THE EFFECTIVENESS OF BUSINESS INCUBATORS?**

The following incubator good practices have been implemented by the three incubators and have contributed towards their effectiveness:

- Good screening of business ideas and entrepreneurs.
- Joint setting and monitoring (with mentors) of business targets and action plans.

The following steps in the incubation process appear to be powerful enablers of a successful enterprise:

- Incubatee selection.
- Mentorship.
- Access to finance.
- Post-incubation support.

Incubators should therefore be clear on the specific good practices to be followed in at least these four areas.

Specific inter-relationships and synergies between at least the following 3 components are critical:

- i. Personal qualities (which include competencies and behavioural habits) of the incubatee as well as of their business team).
- ii. Broader growth prospects related to industry dynamics and competitiveness of the business model and idea/ product/ service (including innovation).
- iii. Synergies between the needs of the incubatee, their business, and the support provided by the incubator.

### **IS INCUBATION AN APPROPRIATE MEANS OF ADDRESSING UNEMPLOYMENT IN THE SOUTH AFRICAN LABOUR MARKET CONTEXT?**

Incubators face significant challenges in trying to directly assist the unemployed to create and run sustainable businesses. These include a weak culture of entrepreneurship, and a relative lack of opportunity-driven entrepreneurial thinking or skills. In addition, entrepreneurs from lower income backgrounds often face cultural constraints related to poverty and a lack of deeply embedded entrepreneurial culture or history. There has been mixed success with addressing employment creation where incubators have provided business ideas/ products to potential entrepreneurs with relatively lower levels of education (e.g. A2Pay and Awethu). Many Awethu incubatees appeared to sustain informal employment for one or two people. In contrast, SBU has focused on entrepreneurs with relatively higher levels of education (post-matric) than the majority of unemployed in South Africa. These entrepreneurs (being black and with post matric qualifications) are more likely to be opportunity-driven entrepreneurs (in that they could probably find formal employment if they so wished) and, as a result, have a strong motivation for their business to succeed.

Overall, we believe that incubation (including public sector funding for incubation) is one effective approach to addressing unemployment in the South African labour context for the following reasons:

- a) Many matriculants (as well as school leavers without a matriculation pass) face challenges in obtaining jobs in other formal sector

businesses. As a result, starting a business remains an important avenue that many school leavers need to explore in South Africa.

- b) Incubation minimises a wide range of obstacles which many start-up businesses face (e.g. access to premises, support for business registration, access to mentorship) and thus reduces the disincentive for starting a business.
- c) Incubation assists entrepreneurs to develop and strengthen an entrepreneurial opportunity-driven mind-set and to conduct market research and test their business idea. This speeds up the start-up process (which includes clarifying whether the business idea is worth pursuing or not) and enhances the prospects for business survival, growth and sustainability.
- d) Incubation training and mentorship is highly experiential and practical and helps new entrepreneurs to obtain important business knowledge and to develop a wide range of personal and business skills (for example: setting goals and targets and developing action plans to achieve these; financial management) which are vital to success as both an entrepreneur as well as a participant in the labour market.
- e) Public sector funding of operational costs is required to support most business incubators and is justified due to the many positive economic and social externalities or benefits which incubators can contribute towards.
- f) Incubators can be valuable corporate partners in supporting supplier development and Broad Based Black Economic Empowerment.

### **ARE SOME INCUBATION MODELS MORE EFFECTIVE/APPROPRIATE IN ADDRESSING UNEMPLOYMENT?**

The following business incubator model components appear to have been more effective in assisting businesses to grow their employment:

- a) Focusing on entrepreneurs working in (or wanting to work in) sectors with growth potential (the specific sectors with growth potential will depend, to a certain extent, on the local economic context, but could include (and is not necessarily limited to) at least the following: construction, engineering, ICT

including software development, renewable energy, natural products, agriculture, business and personal services.;

- b) Ensuring entrepreneurs have properly market tested and refined their business ideas through interacting with potential customers.
- c) Providing entrepreneurs with office space, facilities and services for a three year period.
- d) Assisting entrepreneurs to access corporate procurement opportunities.

### **WHAT KINDS OF ENTERPRISES ARE MOST LIKELY TO GENERATE ADDITIONAL JOBS AND SHOULD JOB CREATION INITIATIVES FOCUS ON THESE ENTERPRISES?**

The majority of the literature talks to four key success predictors in the entrepreneurial realm: personality and intelligence; experience and skills (and relevant networks/ contacts); quality of business idea; motivation for starting business.

Incubators should focus on identifying and supporting opportunity-driven entrepreneurs (ideally with some prior work experience in the same business sector) and who possess a high motivation to make money for themselves and who exhibit a strong work ethic. In addition, incubators should focus on entrepreneurs who have conducted proper market research for their business idea/ model and where the results indicate meaningful market potential and opportunity.

### **WHAT IS THE EFFECT OF DIFFERENT LENGTHS OF INCUBATOR PROGRAMMES?**

Some business types (e.g. depending on the sector and stage of business development) take longer than others to become self-sustaining and therefore it is difficult to make generalisations regarding the effect of different lengths of incubator programmes. A 2002 European incubator benchmarking study found incubator tenancy time-frames ranged from 6 months to no limit and were on average 35 months and recommended a benchmark of 3 years (European Commission, 2002).

It is clear that longer periods of incubation spanning more than one year (and probably not exceeding three years) are likely to produce better outcomes

in many instances. The main cost implications of this relate to the need to provide ongoing mentorship support and possibly office facility support if that is required by incubatees.

### **WHAT NEEDS TO BE DONE TO IMPROVE THE IMPACTS THAT BUSINESS INCUBATORS COULD HAVE ON ADDRESSING UNEMPLOYMENT IN SOUTH AFRICA?**

One key constraint to scaling up the impacts of business incubators is the supply of potential entrepreneurs (e.g. many potential incubatees are unemployed and do not have work experience) as well as the shortage of opportunity-driven entrepreneurs in South Africa. The main implications are that at a national level, a concerted strategy is needed to enhance the basic and higher education systems role in providing a foundation for opportunity-driven entrepreneurship. Achieving this increase will require a range of interventions and support at different stages of the entrepreneurship pipeline (i.e. integrating entrepreneurship into the curriculum of the general schooling system as well as the higher education system by implementing the recommendations of the South African Human Resource Development Council as contained in the South African Human Resource Development Strategy and its 2014 Entrepreneurship Task Team report).

More effective entrepreneurship education and partnership initiative is required at both high school and tertiary levels. This will increase the pool of potential incubatees with growth potential and reduce the incubatee recruitment and screening costs currently being experienced by incubators. A key lesson from a World Bank study on incubators found that the achievement of incubator objectives is only likely to occur if business incubation is part of a wider transformation program [ecosystem] (The World Bank, 2010).

At the level of the business incubator, incubators will need to ensure that their support approach includes a pro-active networking component to help incubatees establish and develop relevant business networks, and that the business idea market research process is well structured so as to ensure that business ideas with a low prospect of

success are identified and alternative options explored wherever possible.

With respect scaling up and replicating business incubators, all government funding programmes should be reviewed and strengthened to ensure that incubator good practices are being followed and aligned, where necessary, with the 105 incubator good practices identified in the Jobs Fund's detailed evaluation report.

In terms of replicating incubators, a generally recognised incubation good practice is that

incubators should generally be run as businesses and along business lines in all aspects of their operations. This is critical to incubator sustainability. Good practices generally recommend conducting feasibility studies and market research into the size and requirements of target markets so as to ensure a substantial supply of suitably qualified and interested entrepreneurs (The World Bank, 2010).

### **About the Author**

Rae Wolpe is a development economist at Impact Economix ([www.impacteconomix.com](http://www.impacteconomix.com)) and specialises in evaluating economic development interventions including business incubators.

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