

Some wags have called the recent Internet boom “the largest legal creation of wealth in history.” Though it may seem that the party has been closed to all but software developers in San Jose, that isn’t the case. As entrepreneurs look for new applications for advanced technology, training has become an “investment sweet spot,” in the words of Quad Ventures co-founder Lincoln Frank.

Incubators

EduVentures.com, a Website that tracks investments in the education business, reports that \$6 billion was invested in cradle-to-grave education and training business ventures from 1990 to 1999, with \$2.6 billion in 1999 alone. The firm projects that \$4 billion will be invested in 2000, as the market expands and draws more attention from the investment community. Because venture capitalists generally expect to see a tenfold return-on-investment in a three-year period, says Peter Stokes, executive vice president of Eduventures.com, \$4 billion invested in 2000 means that these companies should be worth \$40 billion by 2003.

Some startups will never be born; others will be big, bouncing babies. By Ann C. Logue

Main Points

- ❑ An incubator can provide office space, money, staff, and other tools to help grow an entrepreneur’s business.
- ❑ There are different types of incubators, depending on what they offer and what they want in return.
- ❑ You need to know exactly what you’re seeking—and what you’re willing to give up—before you approach an incubator or a venture capitalist.

How to Approach an Incubator

George Sutton of Dain Rauscher Wessels says, “If you take an e-learning idea to Silicon Valley, you won’t get the reception you’d expect given the potential market.” But what happens if you take your idea somewhere else? Investors are always looking for new ideas and enthusiastic entrepreneurs. However, they’re busy people who see hundreds of business ideas each year. Some basic words of advice: Do your research. Find out what kind of businesses the incubator or venture capitalist deals with, what kinds of services are provided, and how they want entrepreneurs to approach them. “Use a rifle, not a shotgun,” says Peter Stokes of EduVentures.com.

Know what you want and what you will give up. How much ownership in the company will you give up for how much money? How many people are you willing to show your business plan to in order to get introductions to potential customers?

You want to be partners with an investor, which means that both of you need to benefit. What tradeoffs are you willing to make?

Have a business plan, or at least an executive summary, to present. “Make sure you have a clear sense of the business model, of what the market needs, how you will sell the idea, and of what people will pay for it,” advises Lincoln Frank of Quad Ventures.

Ask the investor to sign a nondisclosure agreement. That’s standard; if you don’t ask for one, you will, at minimum, appear naïve. Worst case, an unscrupulous person can take your idea and leave you with no recourse. Some venture capitalists won’t sign NDAs, says Stokes, because they see many similar ideas. In that case, he advises that entrepreneurs at least leave an unsigned agreement so that the investor knows the level of confidentiality that the entrepreneur expects. It’s also advised to start a paper trail in case of a future dispute. Be professional and polite. Ask about the appropriate way to follow up. You don’t want to be a pest, but you don’t want your idea lost in the pile, either.

Many entrepreneurs need cash and assistance to get their companies to the next level as soon as possible. Where there’s a need, other entrepreneurs rush in to fill it.

Despite that market potential, the Silicon Valley VCs aren’t playing in this space yet. “That creates enormous incubation, venture capital, and late-stage investment opportunities,” says George Sutton, managing director and e-learning analyst at Dain Rauscher Wessels in Minneapolis. He adds, “Our research backs that up.” The big venture capital firms aren’t yet active in the training business, but many of the players involved—including Sylvan Learning, Kaplan, and Michael Milken—are hardly unknowns. The players who aren’t household names can still offer new companies capital, connections, and command of the industry’s fundamentals.

If you have an idea for a business, where can you go? One great place is an incubator—an organization that can provide you with networking opportunities, business contacts, strategic planning, and possibly capital and office space. Besides traditional business incubators, there are new hybrids such as incubators without walls, corporate *keiretsus*, and focused venture capital.

We’ll help you sort out the players and alternatives.

The incubators

Many communities and universities sponsor traditional incubators that charge entrepreneurs below-market rent and offer advice, assistance, networking, and training. However, few traditional incubators provide funding.

Unfortunately, a traditional incubator’s strengths don’t always mesh with the needs of high-tech service companies. Who needs discounted rent on physical space when the home office has a DSL line? Instead, many entrepreneurs need cash and assistance to get their companies to the next level as soon as possible. Where there’s a need, other entrepreneurs rush in to fill it. As a result, organizations labeled as incubators may do very different things. There’s an increasingly large number of incubators looking at Internet-related businesses. Only a few focus on training exclusively, but we found some. Miratech. All incubators are about training people to run a business. But only one specializes in training *as* a business: Miratech (miratech.com), based in Miramichi, New Brunswick, Canada. Founded in 1997 on a former Canadian Armed Forces base and associated with New Brunswick Community College, Mi-

ratech is devoted to advanced training and technologies. It has been a key component of New Brunswick’s efforts to promote the training industry. Marc-Alain Mallet, project executive for the province’s Office of Investments and Exports, says that when New Brunswick Community College upgraded its programs to include advanced learning technologies, it attracted older students who wanted to use their knowledge to start new businesses. Miratech let them do just that.

Johannes Larsen, Miratech’s CEO, enjoys his incubator’s unique position. “We want to exploit the whole area.” Miratech doesn’t take an investment position in companies or provide startup capital, but it does offer excellent physical space, high-speed data lines, and a broad menu of training and networking services. It has 14 companies in residence; one company left because it outgrew the facility.

Knowledge Universe. One new-style incubator is Knowledge Universe (knowlledgeu.com). Wall Street legends Michael and Lowell Milken and Oracle CEO Larry Ellison founded the company in 1996. Their involvement has given Knowledge Universe a high profile with professional investors. The Milken brothers, who

Types of Incubators

Organizations that invest in and assist entrepreneurs fall into different categories. Note that some of the players in the training and development business, such as Knowledge Universe, embody aspects of each of these:

□ *Angel*. An angel is a wealthy individual investor who puts money into a small company. Most businesses raise money first from angels, which may include friends and family of the entrepreneur. Many angels are people who made a lot of money in their own businesses and want to put some of that profit to work helping other entrepreneurs. Angels, like venture capitalists, may also have contacts or expertise that can be helpful to a young company. Or they can be busybodies who agonize about what's happening to their hard-earned cash.

□ *Holding company*. Buys all or most of a company, then lets it operate more or less as an autonomous entity as long as certain financial and operational goals are met. The holding company provides back-office support, group purchasing, and executive management expertise.

□ *Incubator*. An organization, often with the backing of a university or community development agency, that provides entrepreneurs with office and manufacturing space; technical, legal, and clerical help; and networking and training opportunities. Traditional incubators rarely take ownership positions, but they usually charge their tenants rent. Information is available from the National Business Incubation Association, nbia.org.

□ *Incubator without walls*. Unlike a traditional incubator, which operates out of a building and rents space to its tenant companies, an incubator without walls provides many of the same support and networking services but doesn't offer physical space. Sometimes called a virtual incubator.

□ *Keiretsu*. This Japanese term, for companies with interlocking historical and ownership ties that work together for the benefit of all, has become jargon among startup companies with interlocking ties. Some venture capitalists, for example, like to refer to their portfolio as a *keiretsu*. An in-

vestor or networking group that uses this term is likely to offer its affiliates a great deal of support and contacts, and will expect affiliates to work with other members in return.

□ *Venture capitalist*. An investor who gives money to a small company in exchange for an ownership position. Venture capitalists do that to make a profit and don't have the altruistic goals of many incubators. As a result, they may take a large role in the management and operation of the new company. Venture capitalists may specialize in certain industries or invest broadly. Many have excellent contacts within an industry and can help an entrepreneur find employees, customers, and partners. Most VCs look closely at the exit strategy—the sale or public offering of the company, which allows them to attain profit on their initial investment.

You can learn more about venture capitalists at the Venture One Website, ventureone.com, and see a directory of venture capitalists at vfinance.com. Information specific to the education industry can be found at eduventures.com.

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worked together at Drexel Burnham Lambert running the firm's junk bond business during the heady 1980s, have become generous and active philanthropists, particularly in education and health care. As a result of researching and monitoring their charitable donations, Lowell became an expert on education (Milken Family Foundation, mff.org), and Michael became an expert on prostate cancer (CapCURE, capcure.org). Although Knowledge Universe is completely separate from the charitable organizations, that background has informed many of its investments.

The Knowledge Universe corporate mission is to enhance the development of human capital in all its forms. The portfolio includes 40 companies organized along three vertical markets: 1) business (corporate training and information ser-

vices); 2) consumer (health care, news, entertainment); and 3) learning (primarily, but not exclusively, K-12 education). Those markets are subdivided into Internet-based companies and all others. The result is an eclectic portfolio that includes an educational toy company (Leapfrog Toys), a technology training company (Productivity Point International), and Michael Milken's *Taste for Living* cookbook series, an offshoot of his efforts to find better treatments and a cure for prostate cancer.

Although it calls itself an incubator, Knowledge Universe is more like a holding company. It usually buys all or at least a controlling position of its companies, and most of its portfolio companies have their own office space. It has the high profile to grow a business rapidly,

though the entrepreneur may no longer be part of the picture when that happens. Kaplan Ventures. Kaplan Ventures (kaplanventures.com), the new business development arm of Kaplan, is another organization funding new training businesses. Robert Greenberg, president of Kaplan Ventures, isn't sure whether his efforts should be described as incubating, investing, or organizing a *keiretsu*. Nevertheless, he's clear on his goal: to find companies that strengthen Kaplan's operating businesses.

Historically, Kaplan has preferred to buy companies outright, but it's now willing to take minority equity positions to gain exposure to a market or in cases in which an outright investment isn't economically feasible.

"We're looking for a strategic benefit

to us from a company,” says Greenberg, “if we establish an equity relationship with them and want to establish an opportunity where we can accelerate [the entrepreneur’s] success while participating in the value creation.”

Kaplan has invested in eight businesses since 1998, most notably Blackboard.com (blackboard.com), which lets teachers, university professors, and corporate trainers put course material online easily. Sylvan Education Incubator. Sylvan Learning (sylvanlearning.com) launched a venture capital subsidiary in early 2000 with \$300 million in cash and assets from the company (including investments in Caliber Learning Network, Online Learning.net, ZapMe!, and eSylvan) and \$100 million from venture capital firm Apollo Management. Sylvan plans to combine capital, management, and its strategic relationships within the incubator to generate a return-on-investment.

Despite the word *incubator* in the name, this isn’t an organization like

force mergers, and change operating strategies to protect their investment.

There are few venture capital firms that specialize in education and training, but industry observers think that the number will grow as the opportunities in the market expand and as other technology-related businesses become relatively more mature.

One firm that does specialize in education and training is Quad Ventures in New York. Named for the heart of a typical university campus, Quad was founded in 2000 to focus on education over a person’s lifetime, with a particular interest in corporate training and higher education. Quad’s five founders have backgrounds in investment banking, new media, and education.

“This is, at heart, a new media business,” says cofounder Lincoln Frank “The issue is how do you take knowledge and impart it through new technologies? That is a new art. It’s not taking existing content and just putting it up.”

One of the firm’s larger investments is

try groups that you already belong to can help you find the investors, employees, and clients you need to get your company started. Try them first, especially to find people with training and development expertise. When you need to look further, there are a lot of places to go. Many communities offer entrepreneurs networking organizations that can provide information on investors, incubators, and services. A good first place to check is the local chamber of commerce, which should be listed in the phone book. The U.S. Chamber of Commerce Website, chamberbiz.org, lists chambers across the United States.

Angel investors are wealthy individuals with money to invest in startup businesses and an interest in working with entrepreneurs. Many angels are successful entrepreneurs who can make introductions to big investors, business partners, and potential clients to help grow a startup. You may find angel investors among your friends, relatives, and business colleagues, or you can turn to several organizations

Networking organizations and industry groups that you already belong to can help you find the investors, employees, and clients you need to get your company started.

Miratech. Instead, Sylvan is more interested in providing capital and strategic support than in providing real estate.

Venture capital firms

Traditional venture capital firms give entrepreneurs money in exchange for an ownership stake in the business. They monitor operations until the company is big enough to go public or be sold to another company, at which time the venture capitalist exits the investment at a profit. It often takes more than just cash to get a business to that point, so many venture firms are evolving into incubators without walls by specializing in specific industries, providing contacts and networking opportunities, and encouraging their portfolio companies to form appropriate business partnerships. Some even provide office space. But note that unlike traditional incubators with community development or educational goals, venture capitalists are in it to make money. They’ve been known to fire entrepreneurs,

in DigitalThink (digitlathink.com), which designs and develops corporate training.

Jack Tumminello of North Point Services, who advises venture capitalists and startup companies on the training and development market, says that venture capitalists are grading the market, the product, and the people. He believes that the people behind the idea are the most important component.

“You can take a B product into a B market with an A management team and get money. Management teams create success,” says Tumminello.

Angel investors, networking organizations, other resources

Entrepreneurs have more options than incubators and venture capital firms. In fact, there may be better places to start raising money, says Tumminello, as most large investors want to see evidence that you’ve found support for your idea among people close to you.

Networking organizations and indus-

try groups that you already belong to can help you find the investors with entrepreneurs. A few: Garage.com, the NVST (pronounced *invest*) Private Equity Network, and Offroad Capital.

First Tuesday (firsttuesday.com) is an international networking organization for people in Internet-related businesses. It holds events in 60 cities (11 in North America), on the first Tuesday of each month. Entrepreneurs, investors, and professional services people can get together to learn more about technology, market issues, and each other.

Despite all of those resources, the ultimate responsibility for growing a business falls squarely on the shoulders of the entrepreneur.

“Starting your own business is very serious,” says Tumminello. “It’s not fascination with a technology, not fascination with an idea, but a business. Sometimes, you just have to bootstrap it yourself.” □

Ann C. Logue is a freelance writer based in Chicago.