

Memorandum

TO: RULES AND OPEN
GOVERNMENT

FROM: COUNCILMEMBER
ROSE HERRERA

SUBJECT: INCUBATOR PROGRAM

DATE: August 24, 2011

Approved

Date

8/24/11

RECOMMENDATION

I recommend that the Committee direct staff to do the following:

1. Implement the recommendations contained in the Mayor's August 19, 2011 Incubator program memo.
2. Direct City Manager to evaluate the recommendations contained in the 2009 Assessment of Incubator Program for lessons learned that might be relevant for the Environmental Innovation center or other city programs. Implications to be shared with the CED committee in the second update on the Clean Tech Demonstration Center (a key element of the Environmental Innovation center planned for early 2012). Note: no new business incubator is included in the Environmental Innovation Center under construction.
3. Direct staff to focus efforts on preparation of the transition plan for the Incubator program with an emphasis on taking advantage of opportunities to optimize San Jose's return on investment.
4. Direct staff to work with the Bio Center Incubator operator and board to develop a vision statement that will attract regional participation in a next step Public/Private partnership for the Incubator programs with emphasis on the opportunities that will create jobs, maximize revenue to the City of San José and position San José as an innovation leader.
5. Implement a policy that all consultant reports evaluating program performance with recommendations should be circulated to Council regardless of the size of the contract.

Analysis

As we approach the coming transition of the Incubator program our focus needs to be forward looking. How can we leverage the \$30M investment San José has made in the incubators to create a second phase that is not dependent on further City or Agency investment? San José showed leadership when it created the Incubator program back in the 90's to launch companies with the goal of creating jobs and diversification of San José's economic base. The 2009

Incubator Assessment report acknowledges in the first key finding “All of the incubators meet the test of maximizing the success of emerging companies”.

Starting up companies is entrepreneurial and brings with it risk. It should come as no surprise that some Incubators have performed better than others and some are no longer in existence. The question of whether we should have gotten into the Incubator business at all 17 years ago can be debated and the 2009 Assessment points out many problems, that should have been avoided, and lessons learned that should be applied to current and future city programs. Certainly any report that has been commissioned to assess a city program should be circulated to the Council regardless of the size of the project, and I am recommending that we adopt such a policy. I do not think that the report in question was deliberately kept from the council to hide its findings. This report while pointing out some important flaws in the Incubator programs has its own flaws in methodology. That said we must focus our scarce resources on making a successful transition while taking advantage of the opportunities to maximize return on the City’s investment.

The Agency Director and City Manager have already been directed by Council to transition the Incubators and Entrepreneur center toward a model independent of Agency support for lease expenses, working with SJSU Research Foundation. The Agency has two lease obligations the Bio center expires in August 2012 while the Innovation Center continues through September 2014. Opportunities to mitigate the leasing costs might be possible in the longer term lease but this does not seem to be a realistic goal on the shorter one.

Back in 2009, sitting on the Economic Development Committee, I asked the question “how many of the Incubator companies graduate and stay in San José?” The answer was very few. The 2009 Assessment did not break new ground in coming to this conclusion. The next question should be “why aren’t these companies staying and growing in San José?” The answer is different, depending on which incubator program we are talking about. I have been focused on one of the programs which I believe has the best chance to grow and create jobs, the BioCenter.

The BioCenter is one of the newer Incubators, launched in 2004 to diversify San José’s economic job base from IT to Life Sciences, and in the process reinvigorate an industrial area in South San José which was decimated by the dot com bust. The prevailing opinion at the time was doubt and skepticism as to the chances of its success. The 2009 assessment mentions that the BioCenter has been successful, in spite of a feasibility study commissioned by the Agency, which confirmed the need was there but expressed “skepticism that the incubator could attract tenants to an area where there was no synergy with research institutions and established bioscience companies.”

The report goes on to say that the Bio Center quickly filled with start-up ventures and the demand has motivated the Agency to pursue an expansion of the incubator. The Agency had a difficult time finding operators willing to step in and launch the BioCenter. As it turned out the two key people who were will to step forward and are responsible for the successful launch of this center are Mary Sidney COO of the San José State University Research Foundation (SJSURF), incubator operator and Melinda Richter, CEO of Prescience, a private company and Bio Center Executive Director. There have been suggestions that a conflict exists regarding Prescience’s work outside of San José. Prescience’s contract with SJSRF was not exclusive, meaning Prescience has always had the right to do business outside of its contract with SJSRF. I would argue that San José has benefited from Melinda’s preeminent reputation in the Bio Incubator sector, partly gained from her experience outside of San Jose. The Bio Center has attracted 42 life science/Hi Tech companies, most VC backed, with \$1.4B in investment. Four of

those 42 have graduated from the Incubator and remain in San José. The employees of these companies are well compensated, something not acknowledged by the 2009 assessment, which makes general comments about low pay or sweat equity for Incubator employees, despite this not being true for the Bio Center. These kinds of findings point out one of the weaknesses of this report. General statements are made about the Incubators which do not necessarily apply to all of them.

In spite of the initial doubt and belief that it could not succeed, we have created a Bio Tech engine in Edenvale/South San José that has the potential of growing into a significant Life Science and Technology area, with the right partners and focus. There is a potential of creating thousands of jobs if we bring in the right partners. This won't happen if we allow ourselves to descend into analysis paralysis or demand that our Incubator leaders spend all of their time defending their programs. I received a letter from Mary Sidney, COO of SJSURF on August 19, 2011 expressing her concern about the possible adverse effects on the Incubator businesses at the BioCenter. As Mary points out "these businesses operate in a competitive business environment". Economic development professionals in other states are probably gearing up to recruit our BioCenter clients to see if they are "interested in relocating to a more politically stable business environment". We should not drive companies out of San José. Mary Sidney's letter is included as an attachment to this memo.

The 2009 Assessment does not ask why there are not more companies graduating from the Bio Center staying in San José, nor does it suggest how to change this outcome. The BioCenter is fully occupied and has a waiting list of companies seeking tenancy. The main reason why these companies do not stay in San José is because there is a shortage of developed lab space for companies at the BioCenter to graduate into and grow. We need to court specialized lab developers to come to this area, who will see the opportunity and take advantage of it.

Here are just a few of the conclusions about the BioCenter mentioned in the 2009 Assessment which are worthy of note:

- The BioCenter is the only incubator that has a financial plan, sustainability plan and produces an annual report. This Incubator was recognized by NBIA (National Business Incubator Association) as the Global 2009 Incubator of the year.
- The BioCenter's industry board for the shared labs is cited as an excellent model by the 2009 Assessment.
- The report also claims that the Incubator management did not ensure that companies complied with city regulations such as acquiring business licenses. In fact, the BioCenter and EBC both require companies to have those licenses before coming on site. The BioCenter management helped institute this policy across all incubators.

If the committee adopts the recommendations in this memo, which includes the Mayor's recommendations, the CED committee and the council will have an opportunity to consider the 2009 Assessment report findings as we move forward, and approve a transition plan for the Incubator program. The question of whether we add Incubators to the Auditors work plan can be answered better after the CED committee and council have had the chance to review the report.

Background

Since joining the Council in 2009 I have been focused on job creation. San José has a 10.5% unemployment rate which means there are at least 90,000 people unemployed in this city. These numbers do not include people who have given up looking or are underemployed. I have been working on a plan to create jobs while leveraging our existing assets. This kind of an undertaking begins with a vision. Last year I conceptualized the Evergreen Innovation corridor to describe and promote Southeast San José as an area where there is an opportunity to create jobs. During this process it became clear to me that there were great opportunities to leverage the BioCenter, Evergreen Valley College, our high percentage of skilled hi tech workers and silicon valley location to create a new Science and Technology area that could produce thousands of jobs, provide work force training, internship and collaborative opportunities for the Evergreen valley college and San José State University and potentially become a game changer for East and South east San José. We have established a BioSciences industry beachhead in Edenvale that should be nurtured and developed to realize its full potential for economic development and job creation.

August 19, 2011

Councilmember Rose Herrera
Chair, Economic Development Committee, City of San Jose
200 East Santa Clara Street
San Jose, California 95112

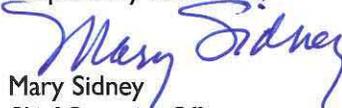
Dear Councilmember Herrera,

I am writing to you concerning the memorandum submitted by Councilmember Sam Liccardo recommending an audit of the RDA's participation in the incubator program. In view of statements in the memorandum, related information appearing in the press and other recent events, I am compelled to make the following crucial points and to once again provide summary information about the success of the San Jose Incubator Program.

1. Although not mentioned in any recent references to the 2009 incubator assessment, *the report's first key finding concluded that all of the incubators met the test of maximizing the success of emerging companies.* Now, having incubated the incubator program, the imperative before us is to focus with all due diligence and available resources to *protect—not question—the considerable public investment* that has been made by the RDA and other partners by working to ensure the future of the incubators. Public challenges to the effectiveness of the incubator program after 17 years of investment, just as the incubators are transitioning to a new model, are not only counter-productive, but seriously jeopardize a successful transition; such challenges create uncertainty in the very marketplace upon which we are depending to replace the RDA funding for our leases. Further, these public challenges are damaging to the incubator program, which operates in a competitive business environment. Yesterday we learned from an economic development professional in another state that his organization is monitoring our situation and considering contacting BioCenter clients to see if they are interested in relocating to a more politically stable business environment. Further, we fear that the BioCenter's pipeline is already being adversely affected by the continued public challenges involving the incubator program. As of this morning, one company in negotiations for space at the BioCenter quietly withdrew its request without explanation.
2. Regarding an audit of the incubator program, management has always invited and engaged City Council and staff in constructive dialogue about ways to continuously improve the program, and this absolutely remains the case. However, at this critical juncture, the focus of the incubator management team over the coming months **MUST BE** to execute the plans to transition from the lease subsidy model to a financially strong, self-sufficient model. *Any new administrative demands put upon the management team necessarily detract from their efforts to effect a smooth transition to the new model.*
3. It is also essential to any discussion about incubator performance or return on the City's investment to recognize the perspective of the client companies as well as the sophisticated and diversified group of angel and venture investors, industry experts, private sector partners and sponsors and other collaborators, *all of whom find significant value in the program.* Along with the RDA, these critical stakeholders in our local, regional and global marketplace have also invested in or have done comparative assessments and have publicly recognized the achievements of the San Jose Incubator Program and its management. (See Exhibit A)

It is critical at this time to support the incubator program in its transition to self-sufficiency without threat of disruption or the creation of new uncertainties. With a collective focus on a successful transition, we can work to *optimize the City of San Jose's ultimate return on the taxpayer's investment* as we position the incubators to continue to create companies, jobs and attract private capital to San Jose and beyond, long after the Agency's lease funding has been discontinued.

Respectfully submitted,



Mary Sidney
Chief Operating Officer
San Jose State University Research Foundation
210 North Fourth Street, 4th Floor
San Jose, California 95112

Exhibit A

Success of the San Jose Incubator Program

Today 64 resident companies and 76 affiliate companies of the incubators are finding value in the program. These companies bring 412 jobs in well-funded companies that hire for highly-skilled, highly paid positions, all contributing to the economic prosperity of San Jose. Since inception, the incubators have graduated 412 companies out into the marketplace, and those graduates created 4,005 direct jobs. Exactly how the return on investment should be calculated might be debated, but key economic outcomes are indisputable.

- **Successes of the San Jose Incubator program include national and international recognition by industry experts.**
 - BioCenter: National Incubator Business Association (NBIA) Global Incubator of the Year 2009; Best Science Based Incubator 2010; 2010 Harvard Bright Ideas program.
 - EBC: NBIA Incubator of the Year 2008; Listed as one of “Top 10 Technology Incubators Changing the World” by Forbes.com; Ranked in *Inc. Magazine*’s list of “10 Start-up Incubators to Watch” – July 2011; Ranked #8 in Cleantech Forum’s list of “Top 10 Cleantech Cluster Organizations for 2010;” Contributed to San Jose #2 ranking by Reuters in the “Top 10 Cities for Cleantech” – March 2011
 - US MAC: Designated by the NBIA as a “Soft Landing” for international companies; established partnership with the prestigious Kauffman Foundation to provide tech entrepreneur training; in the last two years, 25% of clients have been acquired by Silicon Valley corporations.

- **Successes of the San Jose Incubator program include the placement of promising start-ups in the incubators by highly reputable and savvy private partners.**
 - Angel and venture firms backing incubator clients include Interwest, Kleiner Perkins, Venrock, CMEA, Khosla, GGV Capital, Sierra Ventures, August Capital, Claremont Creek, Founders Fund, etc. (\$1.4B in capital raised).
 - Big companies have “spun out” start-ups to our incubators: Sony, Samsung, Applied Materials, IBM, among others.

- **The highly innovative San Jose Incubator program model has leveraged the RDA investment and embraced partnerships, sponsorships, and collaboration with local, regional and global organizations.**
 - Among our partners today are private sector institutions including: Chevron, Cisco, Samsung, Sony Ericsson, Autodesk, Bayer Health, Merck, Orrick Herrington Sutcliffe, Bay Point Benefits, Kilpatrick Townsend, Alston Bird, Fenwick and West LLC, SNR Denton, Fleishmann Hillard, Midori Law, Morgan Keegan and more. These partners, leveraging the investment of the RDA, have invested financially through sponsorships totaling \$281,210 in FY2010-11 alone, and increases are planned for FY2011-12. Additional public sponsors have included National Renewable Energy Lab and California Energy Commission.
 - Unlike many incubators across the country focused on exclusive corporate, investor-driven, or university spin-out, the San Jose Incubator Program is open to all start-ups who meet the standards for entry. This provides a broad base of incubator business activity in San Jose. In fact, 25% of the BioCenter clients come from outside California or the US.
 - Similarly, faculty and student involvement includes San Jose State University, but also includes Stanford, UCSF, Cornell University, all of whom are bringing business and economic activity to San Jose.
 - Despite all these interactions across the region and the world, promotion of incubation in general by our incubator management has had no impact on the incubator program’s pipeline: today all incubators are at full capacity, and the BioCenter has a pipeline of companies, as it has had since 2005.

All of the above speaks to the reputation of and response to the extraordinary offering of the San Jose Incubator Program, and demand for services and partnerships can continue to climb. The incubators have successfully delivered a world class product befitting “the capital of Silicon Valley;” our task is to ensure the success of that product through the transition before us and for years to come.