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What Do Accelerators Do? Insights from Incubators and Angels

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What Do Accelerators Do? Insights from Incubators and Angels

What do accelerators do? Broadly speaking, they help ventures define and build their initial products, identify promising customer segments, and secure resources, including capital and employees. More specifically, accelerator programs are programs of limited-duration—lasting about three months—that help cohorts of startups with the new venture process. They usually provide a small amount of seed capital, plus working space. They also offer a plethora of networking opportunities, with both peer ventures and mentors, who might be successful entrepreneurs, program graduates, venture capitalists, angel investors, or even corporate executives. Finally, most programs end with a grand event, a “demo day” where ventures pitch to a large audience of qualified investors.

You may think this all sounds familiar. After all, don't incubators and angel investors help nascent ventures? Accelerators certainly are similar to incubators and angel investors. Like them, accelerators aim to help nascent ventures during the formation stage. Thus we might expect that many of the activities provided by accelerators would also be provided by angels and incubators. But accelerators differ in several ways. Perhaps the most fundamental difference is the limited duration of accelerator programs as compared to the continuous nature of incubators and angel investments. This one small difference leads to many other differences, as I discuss in more detail below. (See table 1 for a summary of the differences between incubators, angel investors, and accelerators.)

INCUBATORS AND ANGEL INVESTORS

According to the National Business Incubation Association, incubators shelter vulnerable nascent businesses, allowing them to become stronger before becoming independent. According to the association's website,¹ 93 percent of all incubators

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	Incubators	Angel Investors	Accelerators
Duration	1 to 5 years	Ongoing	3 months
Cohorts	No	No	Yes
Business Model	Rent; non-profit	Investment	Investment, can also be non-profit
Selection	Non-competitive	Competitive, ongoing	Competitive, cyclical
Venture Stage	Early, or late	Early	Early
Education	Ad hoc, human resources, legal, etc.	None	Seminars
Mentorship	Minimal, tactical	As needed, by investor	Intense, by self and others
Venture location	On site	Off site	On site

Table 1. Key Differences between Incubators, Investors, and Accelerators

are nonprofit organizations focused on economic development, and roughly a third are affiliated with a university. While no two incubators are exactly the same, in general, incubators receive rent and fees from tenant firms in exchange for office space and administrative support services.² Several incubators also provide introductions to financiers, and connections to legal, technology transfer, and accounting consultants.³ When they are affiliated with a university, they may also provide services related to intellectual property; the university may also use them to transfer knowledge from faculty members to firms that are commercializing the university's intellectual property.⁴

Some of what incubators provide to entrepreneurs, however, might not be consistent with what the nascent firms actually need. For example, ventures might develop in a way that allows them to survive inside of an incubator, but not outside of it, and thus in a manner that is not optimal for the market. Some firms may survive longer in an incubator than they would otherwise. Survival may seem attractive, but if the firm will inevitably fail, then the resources it is consuming might be better used by other, more fruitful endeavors. Moreover, if ventures are being shielded from market forces, they might be missing out on important feedback that could enable them to adapt. Early adaptation is critical for early-stage firms before they become more rigid with age, which occurs naturally.

Angel investors also aim to help fledging ventures. Angels are individual investors, or groups of individual investors, who provide seed capital and varying

amounts of advice to young firms. According to the Center for Venture Research, 28,590 entrepreneurial ventures received \$9.7 billion in investment during the first quarter of 2013.⁵ Clearly, angel investors are an important part of the entrepreneurial ecosystem. Often, but not always, they are entrepreneurs who want to help the next generation of entrepreneurs. They also may be friends or family members who provide financial investment.⁶ Angel investors help their portfolio firms in a unstructured manner, often providing advice and introductions as needed. The lack of structure often translates into limited involvement and mentorship.

COMPARING ACCELERATORS AND INCUBATORS

Accelerators also help fledging nascent ventures. Philosophically, incubators tend to nurture nascent ventures by buffering them from the environment to give them room to grow. In contrast, whereas accelerators speed up market interactions in order to help nascent ventures adapt quickly and learn. Practically, accelerators and incubators differ in four key ways.

Duration

The limited duration of accelerators, usually three months, is the characteristic that most clearly defines accelerator programs. Research on incubators suggests that firms graduate from incubators anywhere from one to five years after they begin. Established timelines and strict graduation dates reduce the amount of codependence between ventures and accelerators and force ventures to face the selection mechanisms that operate in the market. A pioneer in the industry, one of 70 people I interviewed for my dissertation, explained it like this:⁷

The fundamental difference between an incubator and an accelerator is [that] . . . having a finite duration . . . really forces these companies to get a lot done get in a very short period of time . . . If you have something that has a 6-12 month duration you end up in a codependent relationship that is not particularly healthy. We are trying to help very aggressively at the front and then help continually through the life of the companies in the next one to ten years. But if you stretch out that intense period you start to build more dependencies between each other, and that's not good.

Since accelerators graduate firms in a short, pre-set time period, they reduce the amount of codependency; firms have to address market selection mechanisms quickly. Participating in an accelerator program may not necessarily keep the venture (or the venture idea) alive; instead, it may speed up the cycle of the venture—leading to quicker growth or quicker failure. Quicker failure does have a benefit if those entrepreneurs move on to higher-value opportunities: they can help grow different ventures and the overall economy.

The limited duration also focuses founders' attention. Founders work at an unsustainable pace during the three-month programs, often working seven days a week, doing little else but work and sleep. Of course, they could not sustain this pace if the programs were longer or ongoing.

Cohorts

Another byproduct of structured, limited-duration programs is that ventures enter and exit the programs in groups, known as cohorts or batches. Accelerator participants liken members of their cohort to their peers in summer camp or high school. Venture founders become very close to the others in their cohort, helping and motivating each other during the program. While venture founders in an incubator may also develop relationships, the experience of starting in the program at the same time fosters uncommonly strong bonds and communal identity between the founders. I asked venture founders about their relationships with the other members of their cohort. One said that they would do “anything for those guys.” Peer bonds form quickly, but deeply.

Business Model

Most of the original accelerators are privately owned and take an equity stake in the ventures participating in the programs.⁸ Moreover, some accelerator managers are also active angel investors who provide additional financing to some of the ventures, either directly or via a fund. Incubators, on the other hand, are mostly publicly owned, managed by managers, and generally do not have their own investment funds.⁹ This difference is theoretically interesting because the incentives of accelerator directors who are investors in the firms they are helping are more closely aligned with the ventures than are professional incubator managers. Furthermore, some accelerator owners have extensive prior experience as entrepreneurs or angel investors, giving them the firsthand experience they need to assist ventures with a myriad of tasks, from customer development to fundraising and hiring. It is telling that ventures in incubators are called tenants, while those affiliated with accelerators are called portfolio companies. Consistent with the terminology, for-profit accelerators usually make equity investments in participating firms. Less frequently, accelerators are nonprofit organizations. Accelerators want growth that leads to a positive exit, while the best outcome for an incubator might be slower growth, which delays graduation and prolongs the venture’s tenant status.

Selection

Another byproduct of accelerators’ limited duration is that they accept ventures in batches, usually once or twice a year, while incubators accept and graduate new ventures on an ongoing basis. The batching selection process focuses the accelerator’s marketing and outreach around key dates. Moreover, the open application process attracts ventures from a wide, even global, pool. Ventures frequently relocate so they can participate in top programs. Top accelerator programs accept as few as one percent of applicants.

Education, Mentorship and Network Development

Research on incubators suggests that incubator tenants rarely take full advantage of available advice.¹⁰ Mentorship is typically offered for a fee by professional serv-

ice providers, such as accountants and lawyers. On the other hand, intense mentorship and education are cornerstones of accelerator programs and often a primary reason that ventures participate.

Education often includes educational seminars on a wide range of entrepreneurship topics, including unit economics, search engine optimization, and term sheets. Such seminars are usually given by either the directors of the program or by guest speakers, who often provide one-on-one guidance after their talks. Seminars teach entrepreneurs about a plethora of entrepreneurial topics, which rounds out their limited experience, and connect them to speakers who are experts in their fields.

Mentorship is also frequently cited as a valuable aspect of accelerator programs, but it varies quite substantially among programs. Some programs schedule meetings with up to 75 different mentors during their first month. Others may either make introductions on an as-needed basis, or simply hand entrepreneurs a list of preselected mentors. Meeting with four or five mentors a day for nearly a month can delay other aspects of new venture development, including coding, but it provides a unique opportunity for ventures to build their social network and learn about alternate strategies. Generally, network development is cited as an important aspect of accelerator participation.

Finally, managing directors provide guidance throughout the program, helping entrepreneurs absorb and apply the knowledge they are garnering through mentor meetings, seminars, and other means.

COMPARING ACCELERATORS AND ANGEL INVESTORS

While accelerators are often compared to incubators, they may be more like angel investors. Importantly, both invest in nascent ventures, which they call portfolio firms. Because both are investors, their incentives are aligned with those of the founders, who want to grow their businesses and eventually go out on their own. The entrepreneurs who participated in my research concur. While none of them considered applying to incubators, nearly all either tried, or planned, to raise seed capital from angel investors. Moreover, while none of the accelerator founders who participated in my study had prior experience running incubators, nearly all were active angel investors. The accelerator format helps resolve two problems for angel investors: picking winners and modifying ventures' courses. Angel investors differ from accelerators in three key ways.

Duration

Paradoxically, the limited duration of accelerator programs increases the influence the programs have on portfolio ventures. An accelerator director who had been making angel investments before he started his accelerator explained that, as an angel, he was frustrated by the limited contact and influence he had with ventures, often seeing founders only at quarterly board meetings. He started the accelerator "to put structure around" the way he helps companies. Because they make invest-

ments in batches, accelerator directors spend more time with ventures. That is, they work nearly full time helping a batch of young firms for three months, and then move on to the next batch. This focused and highly structured time with nascent ventures influences the direction of the portfolio companies.

The limited duration of programs also helps assemble mentors, guest speakers, and other resources for the ventures. External supporters, like mentors, can more easily commit to the ventures since the program is short. One mentor explained that she participated in the accelerator because the required time was defined, limited, and cyclical, giving her the option to terminate the relationship periodically, though she has not done so. The limited duration also forces ventures to graduate at a prespecified time. Graduations are marked by “demo days,” where venture founders pitch their businesses to large audiences of potential investors. Again, the structured duration of the program enables the accelerators to periodically assemble impressive groups of local, regional, and national investors. It is unlikely that individual angel investors could assemble such impressive groups or attract the same level of media attention. Overall, accelerators’ time-compressed programs and social norms encourage frequent dialog between accelerator directors and participating ventures, and encourage ventures to learn and adapt quickly.

Selection

One of the most difficult aspects of angel investing is selecting the most promising ventures from groups of early-stage companies. The accelerator format helps investors select firms by combining the funds of many investors, enabling accelerators funds to spread risk across more portfolio firms. Thus accelerators hedge their bets and increase their odds of picking a home run. Moreover, accelerator fund investors can, and often do, increase their investments in some companies accelerator program. Thus, the accelerator serves as a real option for investors, enabling them to learn about a batch of ventures before taking a larger financial stake in them.

Education, Mentorship, and Colocation

Another challenge for angel investors is being able to influence the strategic direction of portfolio companies, as one managing director explained:

At the time when a venture raises money it should be hard to change their direction. You become an investor and you have some impact on them. As an angel investor everyone has the best intentions to help companies, but the reality is as an angel investor you do this as an amateur. You either have another job or you just do this as a hobby—almost as crazy as it sounds. Everyone is busy, the founders are busy, you are busy.¹¹

Angel investors might have a seat on the board and meet with their portfolio firms periodically to mentor them. They typically do not colocate with portfolio companies. In contrast, accelerator directors work alongside their participating ventures and connect them with mentors, including investors and active or former

entrepreneurs. An angel investor who was also a mentor explained that accelerators are “all about the mentoring process versus the investment business.” She elaborated: “There are similarities in that we’re evaluating opportunities, and looking at the same types of features.”¹² However, as mentioned earlier, the accelerator provides significant amounts of education, mentoring, and advice throughout the program.

SUMMARY

In sum, accelerators have much in common with incubators and angel investors. In particular, they all want to help fledgling ventures. However, accelerators are a new type of organization and differ, sometimes substantially, from incubators and angel investors. Essentially, accelerators disaggregate the financial resources and knowledge resources previously offered by incubators and angel investors, and provide more advice and less money than either one. The limited duration of accelerator programs is the feature that most clearly defines them. A consequence of this limited duration is that cohorts or batches of firms start and graduate together; this intensely focuses the attention of the founder, mentors, and accelerator directors on the nascent ventures for the duration of the programs. Periodic graduations, marked by demo days where ventures pitch groups of investors, further distinguish accelerator programs from incubators and angel investors. While accelerators are often compared to incubators, they may actually have more in common with angel investors.

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