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Tymbals - Start-Up Incubators

Digital Partners

5-6 minutes

It has been 5 years since we undertook an in-depth study of Start-Up Incubator Economics (See Start-Up Incubator Economics Revisted)

That study coincided with YCominator's 10th birthday. This year YCombinator turns 15. So let's take the opportunity to revisit the economics of incubators

In that post we discovered the probability of achieving an exit for a start-up graduating from the program dramatically reduces after the first 2 years of operations.

We also concluded the Incubator Factory Complex was not about reducing the rate of failure as a pathway to achieving success. It was all about amplifying it.

So has anything changed?

There is no doubt that YCombinator has radically changed the why the world thinks about germinating ideas into business models… But what about the efficiency of the model?

Are start-up incubators still a recipe for failure? Or, has time proven the original study to be wrong?

Is the model today significantly better than the old Venture Capital seed investment model it professed to disrupt?

Let’s take a look at the big data to separate the facts from the fiction…

The year YCombinator launched (2005) there was also a timely study into 'The Exit Rates of Liquidated Venture Capital Funds' by T Markus Laine (Eqvitec Partners) and Sami Torstila (Helsinki School of Economics) - See PDF of the study here

The authors created a sample of 138 liquidated U.S. venture capital funds and investigate the outcomes of their 4,549 portfolio companies.

In their sample 19% of portfolio companies exited through an IPO, 7% through a sale of listed equity, and 23% through mergers or acquisitions (Basically 49% achieved an exit. Just over half being IPO’s)

If we drill deeper into the study we discover seed stage investors represented 9% of the sample

The average number of portfolio companies of this group was 33 with an average life of 15.4 years

18.6% of seed stage exited via an IPO with a additional 8% listing and then M&A (i.e. 26.6% IPO'd). Add to that M&A exits 24.4%

This equals the average number of exits for seed funds being 51%

Now let’s take a look at YCombinator’s portfolio

The data has been extracted from Seed-DB (See Seed-DB YCombinator)

Analysis of the 2005 to 2011 cohorts reveal >1% of this sub-portfolio have achieved an IPO.

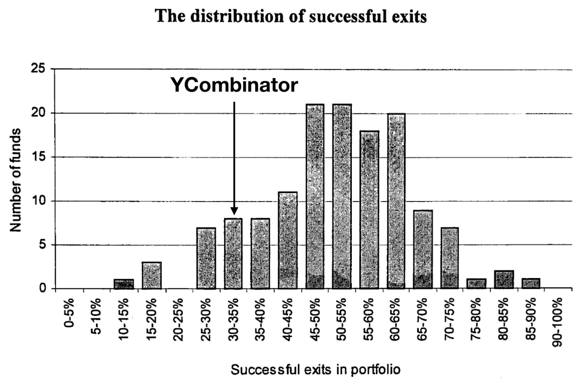
If we include a forecast the potential IPO’s of the remaining companies in the portfolio (e.g. AirBnB & Stripe) we discover that about 2% of the portfolio may achieve IPO status.

This suggests the YCombinator innovation model is about 10x less effective at unearthing IPO’s than the traditional Venture Capital seed investment model.

But what about YCombinator's ability to achieve any type of exit?

If we look at the cohorts between 2005-2011 we discover 33% of the portfolio have exited to dated.

This would place YCombinator in the bottom 15% percentile of the 2005 research sample.



Only the original 2005 cohort achieved the industry benchmark established in the 2005 study.

Now admittedly the potential exists for this figure to rise in the next 5 years but, at the moment, the traditional Venture Capital model appears to be 1.5x more efficient at achieving an exit than the YCombinator model.

If we expand our study to include other popular incubators we discover the same pattern.

For example about 35% of the Techstars pre-2012 portfolio has exited and less than 1% has IPO'd.

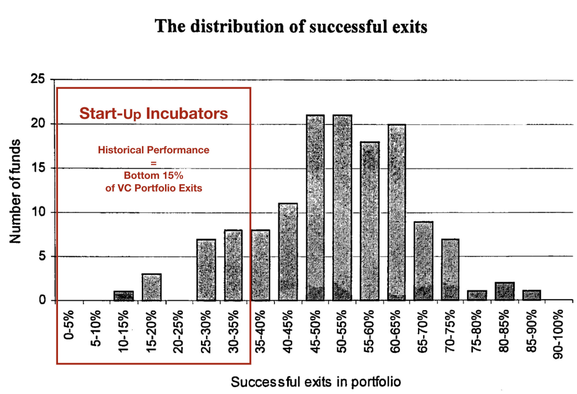
Seedcamp has achieved no IPO's to date and less than 30% of the portfolio has exited.

While of 500 Startups' original 2011 portfolio less than 25% have exited.

The percentage of exits across all startup incubators is just under 15%

This suggests, when it comes to exits, the best of breed start-up incubator model sits uncomfortably within the bottom 15% of Venture Capital portfolio efficiency

While the incubator sector average equates to the lowest bracket of portfolio efficiency



In each case the early success of the original cohort merely meeting - rather than exceeding - the historical benchmark has result in an expansion and ultimately a dilution of the quality of the incubator portfolios.

Now there is of course the opportunity for more exits in the future. But these figures have to be assessed in the context of the longest tech bull run in US history.

And we have to ask the question, given that less than 6.5% of the YCombinator portfolio has achieved an exit today, what happens to the prospects of these start-ups if and when the bull run ends?

I guess we'll know the answer to that question when we revisit the data in 5 years time.