

FINAL

**ESTABLISHING A BUSINESS INCUBATOR
IN ARMENIA**

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EXECUTIVE SUMMARY

This research examines the feasibility of a Business Incubator (BI) for today's Armenian business environment through the study of local economy, business environment, market research and study of experience of BI-s in USA. The techniques used were literature review, economic forecasting and surveys as well as personal interviews with government officials, Small Business (SB) managers, consultants, and local public leaders. Much of the information and analysis presented herein is applicable not only for creation of BI but also for creation Small Business Development Center (SBDC) or any SB support structures. Recommendations are given based upon the unique approach given by the presence of AUA in Armenia and willingness of Yerevan City Government to provide necessary support and space for operation.

The major objective for this project is development of a business plan for creating a BI in Armenia. The BI itself is going to meet the needs of today's Armenian newly created private business environment.

The Business Plan will help generate interest from international financial organizations in order to receive some financial assistance and support from them. The project research has the following objectives:

- understand the legal status of BI,
- define the relationship with tenants,
- clarify the organization structure and exactly define the functions of each department,
- determine the types of services which the BI is going to provide,
- determine the necessary equipment and facilities for the BI,
- estimate the number of employees for BI and their qualification,
- prepare development and implementation plans,
- identify the possible ways of developing and expansion of the idea of BI in Armenia.

The findings of our research are summarized in separate chapter, which can also be treated as independent business plan for development of BI in Armenia. Coming from the results of market

survey we determine the urgent need of BI or even any other small business support structure in today's Armenian business environment. The economic and financial analysis of the venture itself promises good return on equity. The BI is expected to reach to break-even point in 18-24 months from the beginning of operation. The study also reveal the organizations which can be involved in process of foundation and the necessary organization structure and key management people which the BI should have.

The BI will have two types of customers:

1. inside users - tenants,
2. outside users - broad network of businesses using BI services on basis order - execution, without special obligations to each other.

The BI should have the following principal departments: Physical Facility (PF), Small Business Development Center (SBDC), Capital Fund (CF), Application Committee (AC), and Operational Incubator (OI) itself.

It is recommended that comparing with US BI our incubator should have stronger PF department due to current shortage of energy supply the BI managers should try to be as much autonomous from environment as it is possible. Also it can be recommended that incubator managers must very carefully target the businesses to be incubated and plan a distinct strategy to deliver the services to effectuate small business development. And we have to understand that this one of the first such type of creations in newly independent countries and we have to be very carefully implementing idea of BI created in US here.

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1. INTRODUCTION

1.1. BACKGROUND

The idea of creation a BI in Armenia was generated in March 1992 in the Center for Business Research and Development (CBRD) by the Director of Center Prof. S. Karamardian. In a few months after this a short Concept Paper was prepared in CBRD and presented to "CARE" International relief organization and thereafter to USAID. One of our group members also participate at the preparation of that paper. After a few months another copy of that document was presented to the representative of European Bank for Reconstruction and Development (EBRD). Up to now the CBRD didn't get final decisions from above mentioned organizations about the funding or any other type of support from them but we hope that sooner or later we will get the required support or aid for the project and we together with CBRD can implement BI idea in Armenia. That was the reason why the Associate Director of CBRD Dr. M. Kouchakdjian suggested us to start up the preparation of business plan of development of BI in Armenia as a Business Project.

Business Incubators (BI) first began to emerge in US business environment in the early 80's. Today, there are over 1,000 BI currently operating in the US. Business Incubators are organizations formed to support and aid businesses by creating incubation conditions for small businesses (SB) newly born or developing. They provide a start up environment which gives SB an improved chance of success.

BI accomplish their purpose by providing professional management, administrative services, facilities, and equipment all at the subsidized cost. They also offer a guidance to inexperienced entrepreneurs and SB helping them to produce and market their services and products. The BI can help the new businesses keep down costs by sharing its office services and equipment with developing businesses. Eventually, the successful businesses will grow up and

move into the community without the continued help of the BI. In the case of success they can help back to the BI and new tenants.

It's well known that the probability of success for SB, which passed the BI, increases sufficiently. Statistics compiled in USA by the National BI Association shows that there is more than 80% success rate for businesses nurtured in BI, and the overall success rate for SB is 15% (US SB Administration)¹.

Probably, they can be more effective in the countries with economies that are either trending downward, or, as in the republics of the former USSR, with economies that have collapsed and now are being rebuilt on a new basis.

Coming from this discussion one can see that BI and also other structures for SB support are very important for Armenia especially at the times of transition from one type of economy to another. The significance of the problem is that it can accelerate creation of new business environment in Armenia. It's especially important now because due to the blockade and shortage of energy and other resources the majority of the heavy industrial enterprises in Armenia are closed, and the development of SB is now even more important issue here in Armenia than in any other country. Flexibility and ability to maintain activities with scarce resources give SB more chances to survive in current conditions in Armenia.

1.2. OBJECTIVES

Major goal for this project is to develop a business plan for creating a BI in Armenia. The BI itself will meet the needs of today's Armenian business environment. This prepared Business Plan will help generate interest from the side of the above mentioned organizations or some other international financial institutions and receive financial assistance and support from them. The basic objectives for the project are the following:

1. Understand the legal status of BI.
2. Define the relationship with tenants.

¹ Concept Paper for Developing BI in Armenia. CBRD

3. Clarify the organization structure and exactly define the functions of each department.
4. Determine the types of services which the BI is going to provide.
5. Determine the necessary equipment and facilities for the BI.
6. Estimate the number of employees for BI and their qualification.
7. Prepare development and implementation plan.
8. Identify the possible ways of developing and expansion of the idea of BI in Armenia.

The only serious problem which can arise in front of developers of BI is lack of financial resources. The Armenian government has a tremendous budget deficit and can't now finance long term projects even they are for the benefit of country. Banks or any other local financial institutions due to inflation do not finance any long term projects (more than 6 months). Foreign or international financial organizations afraid now to make serious investments in Armenia due to high riskiness of investments. But we hope that in near future the political climate around Armenia will stabilize and the flow of foreign investments to Armenia will increase and we will have more chances to convince them to finance our project.

1.3. STRUCTURE

The report has the following structure. It begins with a methodology of research, which will become the main part of project - findings, this part can be treated separately as a business plan for development of a BI in Armenia. The business plan starts with background and history of BI in Armenia and necessity of such type of organization for today's Armenia justified by the results of market survey. Then we present the results of economic analysis for understanding the profitability of business and estimating time necessary to reach break-even point. Then we discuss the basics of internal legislation of BI and principles of BI - tenant relationship. After we consider organizational issues and assign the necessary key management personnel. At the end we present our plan for implementation of the idea and necessary costs for each step.

2. METHODOLOGY

In order to determine the methodology to be used, we have to identify the research objectives first. The main objective is to identify the existing market and customers' needs for establishing a Business Incubator in Armenia. For that purpose we distinguished several sources for data gathering. The following sources have been identified:

- Interviews with the managers of five successful and five unsuccessful businesses (see Exhibit 1 for the names and addresses of that businesses). It is obvious that this size is very small one for such a project, but it was enough to realize the major trends and factors for success and failure in the current economic conditions.
- State Committee of Statistics.
- Interviews with the officials of Taxation Departments of local councils.
- Interviews with the officials of City Council.
- Interviews with the officials of Supreme Council.
- Interviews with the officials of Supreme Court.
- Literature analysis.
- Consultants.

These interviews helped to reveal problems concerning entrepreneurial activities in Armenia.

Each of these agencies were targeted to get relevant to their activities data, such as the Taxation

Departments gave information about the proportion of successful and unsuccessful businesses, the

officials of the Supreme Court familiarized us with the existing legislation and legal environment

(see section 3.7, part D, "Regulatory and Legal Issues") for entrepreneurial activities in Armenia.

Their recommendations and insights were taken into consideration. Long discussions were

organized with several officials of the City and Supreme Councils.

3. BUSINESS PLAN

3.1. EXECUTIVE SUMMARY

Armenia is now in transition from command economic system to market economy. After the collapse of the planned economic system and creation of new free market oriented economic legislation, people with entrepreneurial skills got chances to develop their own businesses. But there are no presently organized structures which can support inexperienced entrepreneurs and businessmen. The lack of necessary knowledge, skills, experience, and business infrastructure doesn't allow them to do their jobs successfully enough. That is why the idea to create some structures or tools for supporting SB is of vital importance for Armenia. The concept of BI is well developed in USA, and now our problem is how to implement it in our legal and business environment. Several thousands newly created SB are struggling trying to find "space under sun". Majority of them with some initial support can perform their activities successfully enough and pay back to organization which will provide initial help.

As far as we know no one in Armenia even the National government have no up to now serious plans for providing support to SB. That is why our initiative will be the only one and we hope that together with Armenian government and local governments we can enlarge our activities trying to target not only to tenants of BI but to provide services to all possible customers of BI and maybe create in future some structure for this similar to SBA in USA which can make changes in the whole business environment.

The profitability of BI itself, as a separate business unit, will be enough large to attract potential foreign investors. According to financial calculations the return on equity will be 35.44% in average for the first year of operations, the internal rate of return will be approximately 24% for three years of activity.

We already assembled a competent management team. Our group members, the authors of this project, are one of the few graduates of AUA and we will have an MBA's in coming fall.

months and we have enough knowledge about business environment of today's Armenia for making serious changes.

3.2. BACKGROUND OF BUSINESS INCUBATOR

There is no any specific industry in which the BI could fit in. As the BI is the first of such type of venture in Armenia, it will put the start of new industry, the Industry of Small Business Creation.

A. The Concept

Business Incubators are organizations formed to support and aid new and small businesses by creating incubation conditions for small businesses (SB) newly born or developing. They provide a start up environment which gives SB an improved chance of success. Incubators typically offer tenants counseling and assistance in many areas, including research, customer contacts, and suppliers. It is like an industrial park for start-up companies.

B. Definition of BI

Business Incubator (BI) is an economic development tool consisting of a facility where new or developing small businesses (SB) can be located and where a network of services to assist those businesses is centered which has the goal of making small businesses successful. They have been successfully used for those purposes during the last 10 years in USA. Armenia, which is currently in the process of transition to the market economy and creation of a new business environment, greatly needs some tools like this to support newly created businesses. We hope that the BI can accelerate the creation of new business environment in Armenia.

C. History of BI and Reasons for Creation of BI in Armenia

Business Incubators (BI) first began to emerge in US business environment in the early 80's. Today, there are over 1,000 BI currently operating in the US. It's well known that the probability of success for SB, which passed the BI, increases sufficiently. Statistics compiled in USA by the

National BI Association shows that there is more than 80% success rate for businesses nurtured by BI, and the overall success rate for SB is 15% (US SB Administration). Incubators do not guarantee success; however, evaluating potential clients on Critical Success Factors can minimize failures once the firm joins an incubator. Probably they can be more effective in the countries with economies that are either trending downward, or, as in the republics of the former USSR, with economies that have collapsed and now are being rebuilt on a new basis.

Coming from this discussion it is clear that BI and also other structures for SB support are very important for Armenia especially at the times of transition from one type of economy to another. The significance of the problem is that it can accelerate creation of new business environment in Armenia. It's especially important now because due to the blockade and shortage of energy and other resources the majority of the heavy industrial enterprises in Armenia are closed, and the development of SB is now even more important issue here in Armenia than in any other country. Flexibility and ability to maintain activities with scarce resources give SB more chances to survive in current conditions in Armenia.

D. The Product(s) or Service(s)

The most important point here is that whatever the product of BI would be (manufacturing goods or services) that the tenants will produce, the Business Incubator's product itself will be Small Businesses.

The tenants share overhead costs such as utilities, computer services, labs, receptionists, so the cash flow needed to start a business is greatly reduced. In addition to office space and shared facilities, incubators provide psychological support for entrepreneurs. They offer a guidance to inexperienced entrepreneurs and SB helping them to produce and market their services and products. University related BI use university faculty, students, and university associated trained professionals to provide management and consulting services. The BI can help the new businesses keep down costs by sharing its office services and equipment with develop-

businesses. Eventually, the successful businesses will grow up and move into the community without the continued help of the BI. In case of success they can help the BI and new tenants.

One of the most important aspects of the incubator mission is the provision of critical services for new businesses. This provision is dictated by present situation and conditions in the Armenian economy, lack of high quality services, deficiency of information, etc. The incubator can provide different kinds of services not only to the tenants housed in, but also for other small businesses in Armenia as well. It is important to mention that the incubator will focus on those services which are crucial to the new businesses.

Here is a list of services that can be offered by the incubator:

• photocopying, audio/video	• answering service
• conference room	• information*
• <i>telephone equipment, fax, e-mail</i>	• transportation
• <i>custodial</i>	• government and other types of loan assistance
• <i>building security</i>	• receptionist
• shipping/receiving	• clerical
• cafeteria	• <i>accounting</i>
• research and development	• <i>advertising/marketing</i>
• <i>business plan preparation</i>	• legal environment consulting**

* This service includes providing the tenants with the latest business information, information on existing businesses (using CD-ROM InfoTrac), information on market situation via organized lectures and seminars.

Library is also included in this service.

** A little bit detailed information about this service is given below.

Services mentioned in italics are mandatory for all tenants.

Legal Environment Consulting

As other republics of the former Soviet Union, Armenia also declared its independence started to form new society based on democratic principles. On this way Armenia faced difficulties concerning legal aspects: new laws and regulations are coming to replace the old ones.

This process seems to be very harmful, and the establishment of legal environment consulting, the Business Incubator is of vital importance, as rapid changes in the laws concerning business and entrepreneurial activities may create barriers to the tenants unaware of these laws.

Following is a list of services that can be offered by the incubator to its tenants:

- legal consultations
- advisory service
- clarification of the legislation to the tenants
- documents' preparation (Charter, contracts, juridical forms, etc.)
- presentation and defense of the tenants' interests in the court and arbitration
- conducting of legal (juridical) investigation of the projects of contracts to be signed, charter or other projects if they relate somehow to the legal issues
- creating codified library-database of active legislation (laws, regulations, resolutions, etc.)
- follow and check the legitimacy of BI's administrative deeds, their pertinence to the existing laws, resolutions (decisions of the BI's board must not contradict to the laws).

As a conclusion, the anchored tenants will share all the above mentioned services. Later on development and installation of a whole computerized network might be of vital importance which will sufficiently save time, thus making the functioning of the Business Incubator facilities more efficient and effective.

E. Growth Strategy and Enlargement Possibilities

As was mentioned, this is a new type of industry in Armenia, therefore it is worthless to talk about competition at this moment, as there is no such kind of company in Yerevan and in Armenia as a

whole. Maybe in the future the problem of competition will arise and in this case key success variables could be the demand for such kind of organization, relatively low costs, high quality services, western-style management, promotion of new technologies in "High Tech" mode, manufacturing of high quality products in later stages, etc. Concerning the time, incubators take time from concept to opening, from opening to full occupancy. However, the obvious advantages will highly contribute to the entry and growth strategy of the Business Incubator.

The growth rate will depend on several factors such as political and economic conditions in Armenia. However, we intend to grow from a service-oriented company in its early stages (start-up) into production-oriented company (including also services). We anticipate this period to be from five to six years (*Ceteris Paribus*). Another thing is the nationwide growth of the Incubator throughout Armenia. Establishment of branches and representations will follow this approximately 4 to 5 years after foundation. The physical size of the facility should be between 5,000 m² and 10,000 m² for the start-up, and designed to house in approximately 5 to 6 tenants (10 to 15 tenants in later stages).

3.3. MARKET RESEARCH & ANALYSIS

A. Customers

Legal definition of Small Businesses in the Republic of Armenia is old and is derived from specific political, economic needs of Soviet State structures, so it does not fit our purposes, and is irrelevant. We use own approach to determine major market segments. We consider two main features of potential candidates, time of operating, and quantity of employees. Thus, start-up or early stage companies, developing a technology driven (see Introduction) product or service as well as already working ones with quantity of employees less than 50, can be accepted by Business Incubators' authorities as candidates.

Business Incubator will provide service only for Small Businesses registered in Armenia. The location inside the Republic makes no differences between candidates.

Eligible candidates wishing to be admitted as a tenant must complete and submit a special application form available from Business Incubator, that contains mostly legal information about registration, owners and so on (see 3.6). Besides this form they must submit a detailed Business Plan. Application Committee of the Incubator must make decision (see section 3.6) after predetermined period of time. Accepted tenants and Business Incubator sign a standardized treatment. Thus from this point of view the customers are easy to reach (see 3.5).

During preliminary negotiations with 10 Small Businesses, all of them have asserted that they would be trying to become a tenant of Incubator. According to Ashot Babayan, Chief of Department of Social-Economic Development of Yerevan City Council, Business Incubator services will meet negative customer reaction only in case of enormous high prices, that will decrease substantially tenants' profits.

B. Market Size and Trends

There is no centralized gathering of pertinent information in the Republic of Armenia. According to present legislation Small Businesses must be registered in Regional Councils' Executive Boards. Since starting an activity they become obligated to submit accounting reports to Regional Taxation Department. The Regional Taxation Department sends periodic reports to Central Taxation Department. State Committee of Statistics gets reports from the Central Taxation Department and does not collect periodical information from Regional Councils. Additional difficulty is caused by temporary, interrupted activity of substantial part of Small Businesses. So the information about registered but not operating Small Businesses is lost. Thus accurate information about Small Business' overall performance in Armenia is not available.

According to the estimations of the State Committee of Statistics' authorities, the present amount of registered Small Business in the Republic of Armenia is ~25,000. Currently, or from the beginning of the year up to now, approximately 4,500 businesses have submitted corresponding reports. We can assume that at least ~75% of them are operating now. Data

gathered from Regional Councils shows that ~80% in average of Small Businesses are not operating now, so it coincident with State Committee of Statistics estimation.

Despite shut down, many Small Businesses wait for more convenient general conditions to reopen and restart activities, so we consider as our potential customers not only currently working enterprises. Very probably, separate services of Business Incubator will be premise to encourage entrepreneurs to reopen temporary closed enterprises. Evidently, existent Business Incubator will encourage some entrepreneurs to start-up their own business, which has been not registered yet.

According to City Council's and State Committee of Statistic's officials, the number of registered Small Businesses varies very little in time, while proportion of active ones oscillates by well tracked seasonal pattern, it grows during spring and summer, and decreases in fall and winter. However, the average number of operating businesses decreases at a slow rate during the last two years.

Business activity strongly depends on economic and political conditions in Armenia. Severe blockades, enormous inflation, war, hardly press opportunities to operate effectively. So any positive change in this circumstances will cause apposite movement in Small Business activity and vice-versa.

C. Competition and Competitive Edges

According to the City Council, Central Taxation Department, and State Committee of Statistics officials there are no Business Incubators in Armenia. We have no information about any organization, or group of people that are going to start the BI or something similar.

D. Estimated Market Share and Sales

As we have estimated the all market, it will be approximately ~6-7 thousand Small Businesses in Armenia (we have added ~3,700 currently operating enterprises and the number around that of enterprises which could be restarted and new open; in any case Business Incubator will be able to provide services for no more than ~100 Small Businesses, so enough long time it will be faced on

excessive demand). Information derived from the State Committee of Statistics and the Council asserts that about half of them (~3000-3500) are located and registered in Yerevan. They will be the candidates for In-Facility service, and another half for Out-Facility service. It is most probable but not necessary correspondence.

The accurate amount of real tenants (and consequently our sales) will be estimated at cost analysis. It will be derived from our financial performance and funding targets only.

E. Ongoing Market Evaluation

Our market will vary with general economic conditions in the Republic of Armenia. If they continue to be on present level, substantial changes are rare to occur. Some increase in Small Business activity is possible after privatization conducted by the Government. Principles of evaluation of our target markets can be changed after enough long term of the Business Incubator activity and caused by desire to raise its overall efficacy.

3.4. THE ECONOMICS OF THE BUSINESS

A. Gross and Operating Margins (all numbers are in \$ format)

All analysis is provided considering three (best, worst, most likely) scenarios. The exact definition of each is given in the section 3.11 and exhibits because we need clarification about costs incurred. We will try to maintain our Gross Margins near 0.3-0.35 in each scenario. Such pricing is possible while our tenants are in condition to maintain their Contribution Margins higher during enough long period of operations. It is possible in our almost empty markets without competition (the main force that pushes down Contribution Margins), although such pricing will make the market narrower. The average fees for the small businesses are in the section 3.11.

The figures obtained are slightly higher because some assumptions and simplifications were made to do calculations easy (detailed explanation in the correspondent section). They are for the first year of operations:

Best Scenario

Gross Margin (for Services only) 42040 or 45%; Overall Operation Margin (including Interest Earned) 62136 or 67%.

Worst Scenario

Gross Margin (for Services only) 16317 or 48%; Overall Operation Margin (including Interest Earned) 36413 or 109%.

Most Likely Scenario

Gross Margin (for Services only) 19954 or 47%; Overall Operation Margin (including Interest Earned) 49954 or 78%.

High Operation Margins indicate the fact that interest charged against loans is larger than earnings from service operations (see exhibits).

B. Profit Potential and Durability

High profit margins can be maintained enough long time because of two main reasons. The first is our monopoly that we expect continue at least 3 year, the second is enormous high interest rates.

The Capital Fund that we maintain for only lending purposes provides very high (from West economy's point of view) return. The monthly interest (in \$ terms) we are going to charge against loans is from 5% to 9% monthly and it is outstanding low in Armenian (the prime rate is 10%) business environment, but however is sufficiently high to cover all our expenses for the main services we perform.

Corresponding before tax returns on equity according to scenarios are:

	First Year	Second Year	Third Year
Best Scenario	0.39	0.40	0.39
Worst Scenario	0.27	0.31	0.34
Most Likely Scenario	0.34	0.36	0.39

Comparing with the average returns in US economy the one provided by our business is enough high to meet overall riskiness of investment in the Armenia.

We have opportunity to differentiate our services on quality base because of educational advantage (in local environment) and there is no reasons to push down the interest rates. Thus we are sure in durability of our profit stream.

C. Fixed, Variable, and Semivariable Costs (US Dollars)

As **fixed costs** we are considering the equipment of Business Incubator

Computers	2500	Tank	455
Laser Printer	2000	Boiler	1820
Copier	1500	Generators (2)	3640
Faxes	600	Cars(2)	10000
Telephones	25	Trucks(2)	20000
Miscellaneous	500	Forklift	1000

The forklift price is negotiated with Yerevan forklift plant. The Miscellaneous item includes office supplies and audio/video equipment. The repair work, operating costs, if occur without wrong handling case, are divided among tenants apposite to usage time.

Annual Rent for Building 4500 (Assumed that the building surface distribution is the following: Office 100 sq.m., Garage 200 sq.m., Warehouse 500 sq.m., Operational 4200 sq.m., and the average rate per 1 sq.m. is 1.13\$). According to City Council Resolution the Rent for an empty (not furnished) area is 950 Rubles per sq.m. per year.

Annual Utility Expense 1000.

As a service company the most convenient way to calculate the relevant costs is to imply as **variable cost** the direct labor of employees, and detect it by busy hours times the average hourly rate. The initial labor allocation is (see 3.8): 20 Office Employees, Salary \$100 per month on the average, 5 Drivers, salary \$50 per month on the average, 4 Workers, 4 Guard, 4 Technicians with salary of \$50 per month on the average. Thus, by taking the average numbers we obtain that our variable cost is \$0.45 per hour and employee, or if we make input of unit variable cost (one busy hour), then we get \$0.70 revenue with cost \$0.45 incurred, assuming 0.35 contribution margin.

The 100% work load corresponds to 75480 busy hours per year, the last number is equal to $37 \text{ (Employees)} \times 8 \text{ (working hours per day)} \times 255 \text{ (working days)}$. The rent we are going to charge for space is \$1.74 per sq. meter, which is determined by the 0.35 contribution margin requirement from space rental rate \$1.13 per sq. meter per year for Business Incubator, the space on average in tenants usage during 100% occupancy is suggested 4000 sq. meters. The rent for facilities is determined from depreciation figure (the economic life of assets is considered to be 10 year) for one year \$4404 and 35% contribution margin requirement, or $\$4404 / (1 - 0.35) = \6775 for 100% equipment usage.

D. Months to Break-even

The amount of months to break-even depends on the scenario considered. The Capital Fund will work as an ordinary bank (see 3.8), so we do not include assumptions about its operations, but calculate the interest on loans, and usage of main part of Retained Earnings as increase in it.

The scenarios imply:

1. **Best.** The occupancy (busy) rate among personnel is 150% (it means that direct labor input will be 113220 hours for year, so new employees can be hired). The occupancy (busy) rate for Facilities is 100%. The growth of business (these rates themselves) is 15% during the next 2 years.
2. **Worst.** The occupancy (busy) rate among personnel is 50%. The occupancy (busy) rate for Facilities is 50%. The growth of business (these rates themselves) is 10% during the next 2 years.
3. **Most Likely.** The occupancy (busy) rate among personnel is 100%, (it is not high, assuming the IN and OUT of facility services together). The occupancy (busy) rate for Facilities is 80%. The growth of business (these rates themselves) is 15% during the next 2 years.

The break-even is defined as ratio ($Fixed\ Cost/Contribution\ Margin$) divided on monthly revenue, the Contribution Margin here is percentage number. The interest earned from the loans is considered as revenue too. The break-evens are 13, 24, 17 months correspondingly. Detailed calculations are shown in the section 3.11.

E. Months to Reach Positive Cash Flow

In the all scenarios considered the interest on business loans is supposed to be receipt monthly. This is sufficiently realistic assumption because in our business environment it's common to take the dollar credits (which have the prime rate 10% monthly) and return it back after couple of weeks, that is the average term of trade operations, the main usage of the hard currency credits.

Thus we expect to have positive cash flow during the first month of operations already. Operations will begin after the all work for starting the Incubator itself will be finished (see section 3.11).

For the supporting of current activities, maintaining necessary liquidity of the Business Incubator, approximately the 5~9 thousands dollars should be kept in cash balance (this is shown

in the financial statements), all other additional inflows will be added to Capital Fund and used for loans. The cash flows during the first months of the activity under the above written assumptions are pretty straightforward.

3.5. MARKETING PLAN

A. Overall Marketing Strategy

In nowadays Armenia because of economic recession, blockade of transportation channels, and inadequate electricity supply, 20,000 small businesses of Armenia out of 25,000 (see section 3.3.B.) are temporarily shut down. In this situation BI will integrate financial and other sources of its tenants and develop centralized power house, procurement and other services which will cost much more less due to centralization. Therefore, BI can offer its services to tenants on discount basis and because it have no competitor in Armenia (BI is a new type of organization here and the only one) and therefore will enjoy all potential market of Tenants at least for 4-5 years. Business incubator will provide three major groups of services to Tenants: physical/logistical, administrative, and business consulting.

The final product of business incubator is graduated tenant - a strong, rapidly growing, and successful Small Business.

A1. Tenants' Market

Short market research indicates that all interviewed managers of Small Businesses are willing to become tenants of BI, due to favorable conditions for operating that will be created, therefore we assume that all currently operating 3700 Small Businesses (see section 3.3.D) are our potential customers.

A2. SBDC Services' Market

BI will develop specialized department for consulting and other services including in the first graduates of AUA in order to provide services which are consistent with the transition free market economy and thus gain in consulting and other services competitive advantage. All Tenants must take some mandatory services, while other services could be provided based on the contract and therefore BI will be fully utilization in terms of its capacities on scheduled basis which keeps costs low.

B. Pricing

When ten businesses have been interviewed, they were told about services' costs below, all of them said that these prices are affordable for them.

For services described in the section 3.2.D. above, in order to calculate costs of services, the following procedure is applicable:

1. In case of services for each service which utilizes BI's employees' labor time will be charged 45 cents per hour plus 35% profit margin (markup) that is $45/(0.65)=70$ cents. This procedure is applicable for any service listed there.

2. Physical facilities' lending costs will be evaluated by finding out depreciation rate per hour for the facility and plus 35% profit margin and Tenants will be charged at that amount.

C. Sales Tactics.

We assume that volume and timing of all services will be defined in details when BI signs contract with the Tenant and only minor changes contingent upon changes of situation can occur in timing of services.

Some small portion of capacities will be filled by outside consulting using backlog in order to avoid inefficient use of labor time.

Some (previously negotiated with Tenant) part of cost of renting or services provided by BI to Tenant will be invested in Tenants' business as loan provided to Tenant and will be due when break-even takes place.

D. Advertising

A. BI will advertise in three central newspapers for two days (cost is \$5 per one article-total; \$30) and once by TV for two days (will cost \$30) before choosing Tenants and this announcement will be postured (one month before the admission date) on the walls of Regional council's office buildings, where every month all of currently operating businesses are required to submit their reports, so this activities will assure that we will reach needed audience.

B. BI's marketing service will prepare advertising materials and buy media for promotion of Tenant's product/service and charge for that services on the negotiation basis with the Tenant.

E. Identification of Target Tenants.

There is no lack of Tenants, as the short market research shows that at least 3700 Small businesses are our potential customers but BI will choose among them using the following criterias:

1. Is the service/product suggested by Tenant innovative?
2. Is the BI's environment appropriate for the business?
3. Will the business fit well with other Tenants of the BI, and probably render services to them?
4. Does the new business owner have the requisite skills to run a business?
5. Could the business benefit from specific management services?
6. Does the business compete with other Tenants?
7. Has the Tenant business plan (we expect that some potential applicants will order BI prepare business plan as out of facility service)?

8. Is the business owner willing to give some portion of equity to cover some portion of costs of services provided by BI.

F. Tenants' Selection

Selection must be done by screening criteria in item (E) above and on the basis of the charter that regulates legal issues among Tenants and BI on the negotiation basis.

3.6. BASICS OF BI'S CHARTER

"Between Business Incubator and Tenant"

This instrument serves as agreement between Business Incubator, hereafter BI, and the existing or new Cooperative or Limited Partnership, hereafter Tenant, on mutual obligations, rights, and preconditions that are mandatory for parties.

Part 1. Definitions

- a. BI is an economic development tool consisting of a facility where new or developing Small Business may be physically located and where a network of services to assist those businesses are centralized (coordinated) which has the goal of making Small Businesses successful.
- b. Tenant is a new or existing Small business, cooperative or Limited Partnership officially registered by local authorities as one of stated above types of businesses.

Part 2. Preconditions for Admission

- a. Tenants' projects payback period cannot exceed its graduation period (see part 7 of this chapter).
- b. It is preferable to have such Tenants which render/receive (exchange) services buy/sell each other products/services.

- c. Tenant's business opportunity must be evaluated by BI as the most important issue while accepting (by using IRR or NPV or other methods).
- d. Tenant must take all required services, and is free to take some additional portion of consulting or other services (in quantities previously both parties have agreed upon).
- e. BI must be allowed to own some portion of stockholders' equity of Tenant's firm (on negotiation basis, but not less than 15% of equity).

Part 3. Basis of Mutual Payments

- a. BI must provide some services to the tenants on discount basis.
- b. Any losses incurred by Tenant as the result of low quality service served by BI's consultants will be covered by BI in twofold size (provided that it is not connected with probabilistic situation; for instance sales forecasting).
- c. No less than 20% of the future benefits (net profits) of Tenant is the BI's share (on negotiation basis) and must be paid at the graduation.

Part 4. Bankruptcy

- a. In the case of bankruptcy of a Tenant after liquidation of Tenant's property BI receives only 60% of credit given to Tenant (as recognition of BI fault if Tenant have been in BI's settings more than one year).
- b. In the case of bankruptcy of BI after liquidation must pay 100% of his debt to Tenant (provided money or assets are available).

Part 5. Official Prosecution of Contract Violation Cases.

- a. Each constituent party is free to make claim to State Arbitration only after submitting facts (arguments) to the other party (one month before the claim) otherwise the other party will be sued for violation of this contract.

Part 6. Allowances for Contract Termination

- a. Tenant is free to terminate contract if an official auditor confirms (by official document) that performance of Tenant have been declined for one year period while tenant was served by BI.
- b. BI is free to terminate contract with tenant any time when organizational policies and/or management style of Tenants' organization, by the opinion of BI isn't proper one and tenant was officially informed about that one month before and submitted recommendations how to deal with situation, but tenant does not answer to that request officially or refused them. BI does not need to prove in court or any other government agency or organization his argument. This kind of termination can be regulated only by this contract.
- c. Tenants have no right to change drastically their financial leverage by raising more debt from outside sources except of that after consulting with BI. Violation of this point can serve as a cause for termination of this contract by BI.

Part 7. Contract Duration (or which is the same as GRADUATION duration)

- a. Contract is effective starting from the time when it is signed during three to five years (specified by contract, unless it will graduate on the basis of point (b) below.)
- b. Parties are free to choose any financial activity or other ratio(s) and define value(s) to them so that when Tenant will reach that value will graduate automatically (but not late than period stated in point (a) above).
- c. Each constituent party after signing contract takes obligation to comply with the term of this contract until its expiration date.

3.7. OPERATIONS PLAN

A. Operating Cycle

It is anticipated that the operating cycle in the incubator will be three to four years depending on the type of business, production capacities, availability of resources, etc. On the other hand it depends on the estimate of the break-even point of the tenants' business. They are expected to exit the facility when the requisite business growth has been attained. For some businesses the period of being anchored to the BI may be less than three years, while for some other businesses this period may exceed three years.

The operating life cycle of the tenant may be separated into three stages: start-up, business development, and maturity.

1. The start-up stage could be defined as the stage from concept initiation to full occupancy of the facility. The primary concern of the sponsor is allocating suitable space and building in the BI campus.
2. In the development phase, when the incubator is operating at full capacity, the manager provides management assistance to new businesses. In this stage the tenants' need for more sophisticated managerial and other types of assistance increases.
3. The maturity stage is the start of the tenants' entrepreneurial activity outside of the incubator (hatched businesses). In this stage they break-even and can operate independently.

B. Geographical Location

There is an oral agreement with the City Council and the Mayor of Yerevan concerning provision of area and building for BI but as there is no any space yet specially for the Business Incubator, the initiative group will use AUA building, Marshal Bagramian Ave 40, Yerevan, Armenia, for its start-up activities. The building itself is not the one that covers Incubator's requirements but it will be used for administrative purposes only (management, offices). Later on, with development,

the BI will move to the provided by the City Council building. The selection of AUA building for BI offices has some advantages, particularly it has power and water supply almost all day long, it has large, comfortable, and light offices, etc. Another advantage of this building is that it is located in the city center closer to the business life (environment, atmosphere). The closeness to the customers, access to main transportation means also gives undeniable advantage to the selection of this building.

One of the major reasons why the building of AUA is chosen is that the BI will be affiliated of the CBRD at AUA at its start-up, and closeness to the students, faculty, and foreign advisors are essential in this case and highly contributes to the accomplishment of its main goals (i.e. engage MBA specialists, graduate students, and faculty in its activities).

The major disadvantage of the mentioned building is that it is an education center and lacks production/operations space (area), warehouses, etc., as a variety of businesses, starting from services and ending up with production enterprises, are intended to be anchored tenants of the incubator that carry on their business inside the incubator.

C. Facilities and Improvements

Buildings

Business Incubator's physical characteristics can play a big role in how well the incubator is able to carry out its mission. The incubator itself can be housed in new buildings, in older buildings that require minor renovations, or in older building that require major renovations. Each alternative should be evaluated in terms of advantages/disadvantages, costs and the decision to select the appropriate building should evolve from this evaluation. An important thing is that incubators are multi-tenant buildings and flexible space is a "must".

By its definition the incubator must provide small, entrepreneurial businesses with affordable space, shared services, and business development services at below-market rates. Thus for the start-up of the Business Incubator an office space of 100 m² is required for management group, computer center, Research & Development Center, etc. It is desirable if BI facility will be

closer to the railway station and the airport as well. Later on, in order to meet the needs of prospective tenants and to build the image of the area as a center for innovation and business development, the facility will be new construction designed in a "high tech" mode. The size of the facility should be between 5,000 m² and 10,000 m² for the start-up, and designed to house in approximately 5 to 6 tenants (10 to 15 tenants in later stages). Following the growth, development, and expansion of the incubator, land should be leased or bought, as BI itself assumes to be an independent unit with its facilities which include production/operations space, shipping/receiving docks, storage, parking, garage, R & D Center, Training Center, etc., combined in one campus.

The experience of the past two winters showed that there is a need to acquire a boiler for heating purposes and a generator to provide electricity which is essential for normal operations of the incubator. Therefore, a small building should be provided specially for the boiler and the generator. The incubator also will need storage space to accumulate fuel (petrol, diesel fuel, oil) for the boiler and generator.

In-built conference room large enough to hold seminars and/or meetings with 20 to 30 people should be considered in selecting a building or renovating an old one. Needless to mention that a library, small cafeteria, restrooms, and common amenities are required.

The building should satisfy the criteria of freeway access that looks at the ease and quickness with which people, goods, and services can move in and out of the incubator's area.

Equipment

The minimum amount of equipment needed for the Incubator is determined taking into account services that BI will offer to its tenants. Computer hardware will be needed, including word processing and CD-ROM InfoTrac at the start-up of the incubator and its further development, as well as photocopying, audio/video equipment, telecommunications equipment and services. Along with further development electronic mail will be acquired. AUA's facilities might be used in the earliest stages (it will cost approximately \$250 per month). Later on, depending on the type

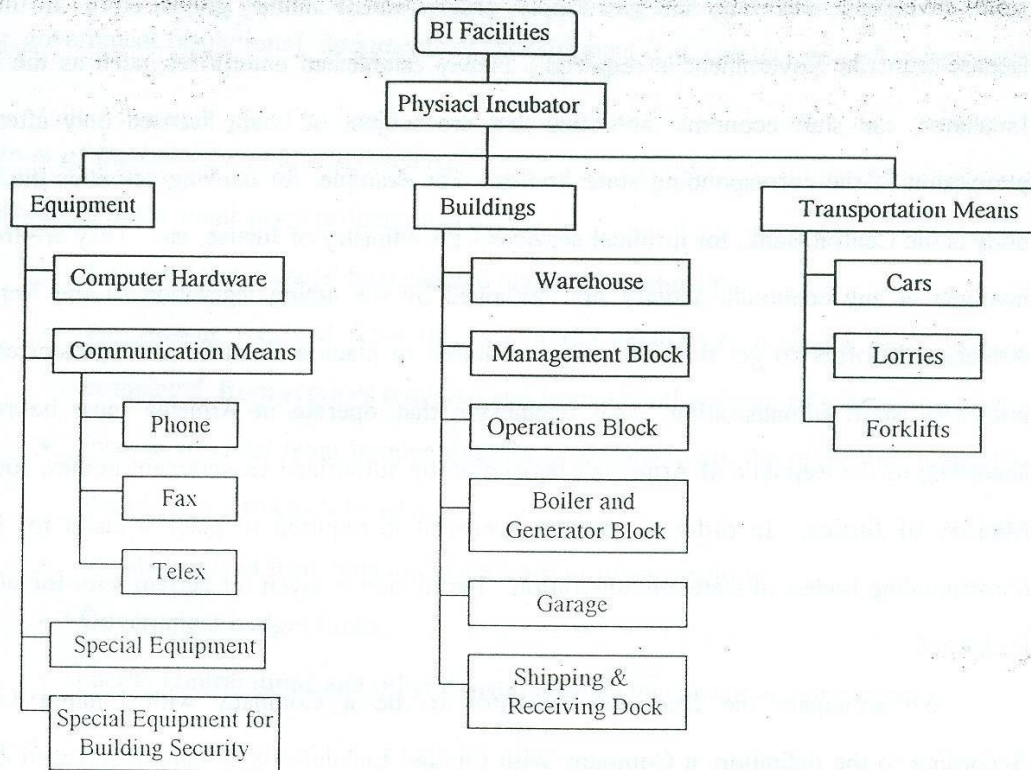
of business and expansion and development, some other kind of equipment and facilities will be acquired. The necessary special equipment will be obtained according to the business of the anchored tenant by means of leasing or purchasing (taking into account all associated costs). For proper custody as well as for security, some special equipment will be obtained to maintain building security. It is not possible now to determine costs associated with the exact location, size, and equipment needed, as decisions on the type of special equipment and machinery will be made after the type of businesses and tenants are selected and housed in.

Transportation Means

Transportation means are of vital importance to the tenants and it is assumed that the Business Incubator will provide also transportation services to the tenants thus minimizing cost of moving in procured raw materials and delivery and shipment of finished goods. This means that one to two lorries should be acquired and shipping and receiving docks should be installed. Beside lorries, two cars will be needed for making business trips. In addition to these, forklifts will be needed for normal operations of the Incubator, as finished goods will be stocked and moved inside the building to the shipping/receiving dock.

The Physical Facility Chart on the next page illustrates the way BI facilities will be organized. It consists of Physical Incubator which in its turn divided into three major sections: Equipment Buildings, and Transportation Means. The centralized structure is the best way to organize facilities for attaining maximum control, efficiency, and effectiveness. This type of structure will highly contribute to the overall success of the Incubator. Each of the above mentioned division will be consisted of corresponding entities, such as: *Equipment* include computer hardware communication means, special equipment, and special equipment for building security, *Building* include warehouses, management block, operations block, boiler and generator block, garage shipping/receiving dock, *Transportation Means* consist of cars, lorries, and forklifts.

PHYSICAL FACILITY CHART



D. Regulatory and Legal Issues

After the collapse of the former Soviet Union and its structures, each republic started the creation process of new legislation and laws appropriate to new conditions on the way to market economy.

Armenia also went through that way to create laws and regulations for free entrepreneurship and entrepreneurial activities.

As any business in the world, the Business Incubator also will act and be regulated by acting legislation and regulations. It is necessary to introduce briefly what type of laws and regulations exist in Armenia concerning entrepreneurship and business activities as a whole.

According to the Government resolution No.161 from March 5, 1991, all enterprises and economic units are free to be engaged in all kinds of economic activities, except those activities

that are considered to be as state monopoly (e.g. manufacturing and production of gem stones, gold, silver, etc., electricity and gas supply, production of military goods, etc.). In this case a license from the Government is required. Newly established enterprises, such as the Business Incubator, can start economic activities that are subject of being licensed only after getting permission of the corresponding state bodies. For example, for banking activities the licensing body is the Central Bank, for juridical services - the Ministry of Justice, etc. They are free to get involved in any economic activity not outlawed by the acting legislation of the Republic of Armenia. In order to get the license it is required to place a claim for it to the corresponding bodies of state administration. All businesses that operate in Armenia must be registered according to the Republic of Armenia's legislation by authorized Government bodies, such as the Ministry of Justice. In order to get the license it is required to place a claim for it to the corresponding bodies of state administration. Permission is given for certain term for which fee is charged.

We anticipate the Business Incubator to be a Company with Limited Liabilities. According to the definition, a Company with Limited Liabilities is an enterprise based on joined property, which is a juridical person (legal entity), and with the obligatory property participation of its owners (resolution No.400 from July 13, 1992). Such partnerships can sign contracts, obtain property and non-property rights, carry liabilities, be petitioner and respondent in the court or arbitration. According to the law, the BI has the right to establish its branches and representations on the territories of other countries, if it is not outlawed by that country's legislation.

The Business Incubator will be created and registered on the basis of the establishment contract and the charter, which are considered to be the establishment documents of the partnership. The control of financial and economic activities of the Incubator will be executed by financial and other relevant (authorized) bodies, auditing services, according to the acting legislation of Armenia.

Business Incubator's activities will be regulated by the Law on Enterprises and Entrepreneurial Activities of the Republic of Armenia, Armenia's Civil Code, other legislative acts (e.g. government resolutions), documents of establishment (e.g. charter), as well as by contracts.

Sources of Business Incubator's Property

The sources of the Incubator's property can be:

- founders' and owners' financial and material investments;
- any income received from the sale of the enterprise's products, from work it has completed, from services rendered and from any other forms of economic activities;
- income received from issuing stock in accordance with the procedure defined by the Republic of Armenia's legislation;
- credits received from banking institutions or other creditors;
- Government budget funds;
- charity contributions and other donations given by citizens and organizations.

3.8. MANAGEMENT TEAM AND ORGANIZATION

We are going to create a unique type of organization for Armenia. That's why for better understanding the organization and management structure first we need to define who can involve in the process of foundation of the BI, then determine the legal status of BI and possible ownership of BI as a legal entity. On the basis of this one can choose the members of the board of directors then after the key management personnel and staff. Coming from this we will create our scenario for foundation process and possible version of organization which can be discussed with supposed founders after.

A. Foundation and Legal Status

We suppose that our group members are the people who will be the main generators of the creation of BI here in Armenia. But for foundation of BI we need support and help from official

organizations. Which are the best organizations for this? First is, of course, AUA, where the idea of the creation of BI in Armenia was suggested, the other can be the City Council of Yerevan. So the private people (members of our project group), AUA (or CBRD of AUA) and the City Council of Yerevan can join together to create a partnership for developing this idea. We have oral agreements with those organizations about their willingness to participate in the process of foundation.

B. Ownership

We are going to start the discussion of the ownership of the proposed BI from the analysis of possible types of ownership or affiliation of BI in US. There are four different types of BI in USA:

1. Not-for-profit - main priority is to create jobs for local workers, this type of BI are usually sponsored by local government.
2. Private BI - focus on the return of equity, or making profit.
3. Academic BI - are affiliated by colleges or universities.
4. Public/Private - are partnership between the private people and public organizations.

The incubator which we are going to organize is more likely to the last type of BI which is the sum of the first two types plus some features from the third type. So this will be the partnership between private persons and City Government Yerevan combining affiliation with AUA.

C. Initial Investments from Founders and Expected Return

We suppose that BI will be a profitable venture in the long run. Different founders will participate in the process of foundation by different types of investment. The authors of this proposal will invest their knowledge in business administration, time and ability in fund generation and organization. For this they suppose to get long term profit from this venture and create good jobs for themselves.

The City Government can invest building and some other facilities and expected benefit is to create good businesses and jobs for citizens, and maybe some profit for city budget in future coming from the taxes from successful tenants.

AUA is the initiator of the idea and it can provide the expertise of their specialists for consultance and for management. Also AUA has a unique for Armenia information and communication facilities which can also be utilized in some extent for BI needs. For this AUA can create successful businesses for the graduated students and also can get some share from future profits.

D. Organization Chart

The practice of organization of BI in US clear up some general features of organizational structure of BI. But it's very important to take into consideration the specifics of current conditions in business environment in Armenia, and also the fact that this is the first such type of organization in Armenia and it's need sufficient initial support from local government structures. Things very easy for solution in US can become a great insoluble problem here.

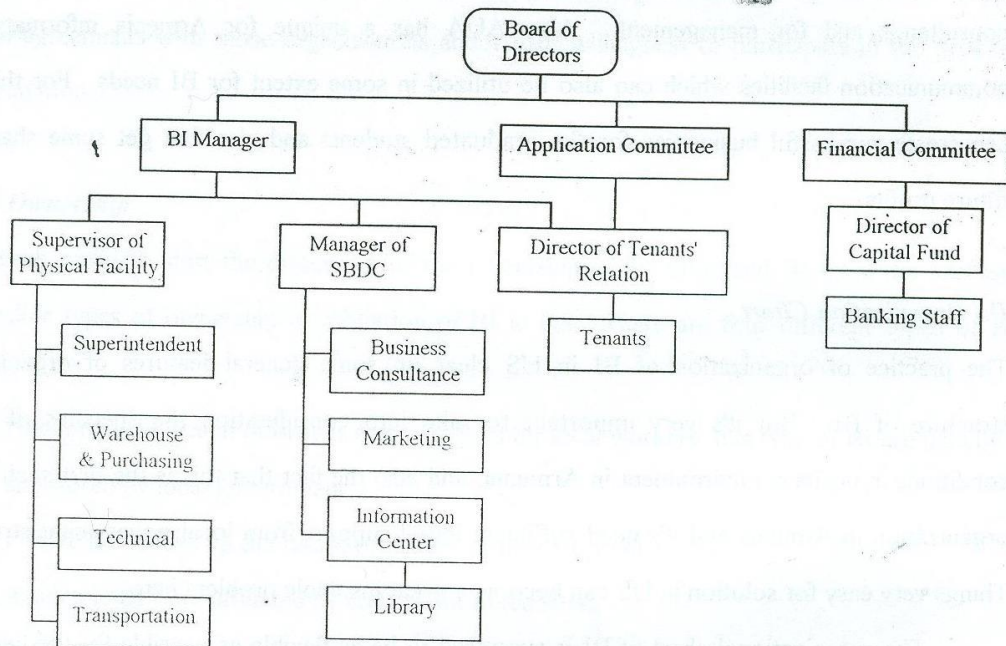
The organizational chart of BI is supposed to be as flexible as possible for the beginning. Shortage of communication facilities and difficulties with access to any information networks and even more easy things: transport, fuel, computers, electricity, heating, etc.

The general outline of organization chart is presented on the next page. The main difference from the similar organization charts in US BI is more developed Physical facilities department. We cannot hope that business environment can provide us with heat, electricity etc. That is why we have to have as much autonomy from environment as it is possible.

The other difference and also one of the reasons why we should need flexible structure is the following. Some initial structures in BI can grow up into separate businesses in future and they have twofold roles: first, as departments in BI and second, as tenants. For example, Capital Fund can grow up to commercial bank, or may be a branch of any foreign bank, which will

provide services not only for the tenants of BI. The business consultancy department can grow up to business consulting firm, etc.

ORGANIZATION CHART



DUTIES AND RESPONSIBILITIES OF THE KEY MANAGEMENT TEAM

BI manager:

- manage operation part of BI,
- coordinate activities of different departments,
- present the BI with external organizations,
- be a liaison with the Board of Directors,
- sign on behalf of BI contracts with tenants and other organizations.

SBDC manager:

- choose managing personnel for SBDC departments,
- determine necessary amount of equipment,
- create a network of consulting and educational organizations,

- be responsible for information facilities and library,
- organize training courses for tenants,
- figure out with the BI manager the best way of cooperation between SBDC,
- and operational incubator itself,
- figure out ways for developing departments of SBDC into separate ventures, which
- in future can get the status of tenants too.

Physical Facilities Supervisor:

- prepare a list of necessary equipment,
- purchase and maintain equipment for BI,
- building maintenance: electricity, heating, cleaning, etc.
- responsible for transportation facilities warehouse.

Director of Tenants relation:

- develop a charter of BI,
- work on application forms, procedures, etc.
- testing of tenants,
- advertisement of BI for attracting new potential tenants.

Capital Fund Director:

- main responsibility is fund generation for BI,
- develop a procedure for fund lending,
- keep accounts of tenants,
- try to create a bank on the base of the Capital Fund department.

Here we present key management roles duties and responsibilities and this are individuals from our project group who will fill each position.

1. BI Manager - David Akopyan
2. SBDC Manager - Haik Papian
3. Physical Facilities Supervisor - Arthur Chilingarian
4. Capital Fund Director (BI Bank) - Artyom Adamian

5. Director of Tenants Relation - Georgy Petrossian

This also will be the number of employees which the BI will need for the first stage.

For the second stage we need some more people under each manager of each department:

1. BI manager + assistant + secretary,
2. SBDC manager + persons for each department:
 - business consultancy -2,
 - marketing - 2,
 - Infocenter - 1,
 - Library -1;
3. PFS + persons for each department:
 - building maintenance (superintendent, cleaner, person responsible for energy and heat supply) - 6 persons,
 - technical (computer, fax, copier) - 4,
 - warehouse and purchase - 4,
 - transport - 5 drivers
4. CFD + staff (6 persons) - 7
5. DTR + legal advisor - 2.

Total second stage number of employees will be $3+7+18+7+2=37$.

David Akopyan, Arthur Chilingarian, and Haik Papian work together in CBRD more than a year with the George Petrossian and Artyom Adamian they have been studied at the Business School of AUA beginning from 1991. So the experience of studying together and work on several projects, especially this feasibility study of BI in Armenia clearly indicate that the skills of group members complement each other and probably will lead to successful management team work.

E. Key Management Personnel

David Akopyan worked several years as a marketing director in one of the biggest high technology producing companies in Armenia, then after he works as a Senior Research Associate at

CBRD of AUA and helps to manage more than 20 employees. Also he is a deputy of Yerevan City Council. So he has a good experience of management and is very suitable person as a liaison with City Council and AUA.

Haik Papian has clear analytic approach to problem solving and good theoretical background in economics, finance, and accounting. And he is able easily pass his understanding of the problem to the others. So we think that he is the best suitable person for the position of SBDC manager.

Arthur Chilingarian's major is mechanical engineer and he is highly experienced in working with computer software packages as well as with machines and other electronic devices. This abilities can be very useful for the position of Supervisor of Physical facilities.

Artyom Adamian is working for several years in one of the first private banks in Armenia. He has experience in operation of banking system and even he dropped his graduation at AUA we continue to consider him as Capital Fund Director of BI.

Georgy Petrossian - we suppose him to be the Director of Tenants' Relations. He is working currently on the first draft of charter of BI. So he can prove the validity of the written charter by his own experience.

F. Management Compensation and Ownership

Salaries for managers will come from the fees for services, which the BI is going to provide. If we can generate enough funding for development of the idea of BI we supposed that the salaries nominated will be enough for current conditions in Armenia. If not we as the key managers came to the agreement to accept possible modest salaries and only after finishing the first stage we will decided what to do. More serious type of compensation for managers is possibility to create future businesses for themselves. As we said before each department can grow up to independent separate business in future and the managers can share the ownership of newly created businesses. Also some of the best managers can share the ownership in BI itself which in the case of success we suppose to be a profitable venture.

G. Other Investors

We can't hope that any government structure in Armenia can make serious financial investment in BI, and we don't think that any private people (investors) will be ready to make any investment due to the total scarcity of financial resources here. Also private financial institutions are not well developed here for making such long term investments. So we suppose that the main source of external investments can become any international financial institution or organization (IMF, World Bank, EBRD, USAID, UN). They have a lot of plans for support and development of Armenian economy and if we convince them in necessity of our venture for today's Armenia they will be ready to make an investment. We suppose that the financing for Physical Facility and for Operational part of BI can be given as a grant and loan can be given to Capital Fund. Some draft proposals were already presented to USAID and EBRD from CBRD of AUA and they are under consideration. And we are going to continue the advertisement of idea.

H. Employment and Other Agreements and Stock Options and Bonus Plans

As we said before we are going to limit the number of employees for the first stage by the members of working group. Second stage will need 21 people. Department chiefs can be compensated by ownership in the same manner as key managers. Others can get beside salaries some bonuses depending on quality of their work.

I. Board of Directors

Board of Directors have to include representatives from founding organizations:

- from Yerevan City Council - we suppose that the Mayor should be included, we has also a good background in economics and highly appreciate the idea of BI,
- from CBRD of AUA - director of CBRD should be included, he is also the author of creator of BI in Armenia.

Also we think that we need a representative in Board of Directors from the Ministry of Economy, one representative from group and also may be some one main investing organization (EBRD, USAID or ?).

So the Board of Directors will have 5 members.

Also we will need some other boards in BI.

- APPLICATION COMMITTEE,
- FINANCIAL COMMITTEE.

We have to have the following individuals - representatives from different organizations in each board:

application committee - director of tenants relation, representatives from AUA, Yerevan City Council, ministry of Economy;

financial committee - director of Capital Fund, ministry of finance, Armenian National Bank, foreign financial organization.

J. Supporting Professional Advisors and Services

As it was mentioned one of the main responsibilities for SBRD managers will be to create a network of advisors and consulting services for tenants of BI as well as for BI itself. Also we suppose to receive support in consulting from CBRD associates and AUA Business School professors as well as from City Council and Ministry of Economy specialists. Of course AUA professors are transient but we can create mechanisms for their involvement on temporary basis in BI activities. Also we create a preliminary contact with US National BI Association and will try to use their specialists consulting abilities.

3.9. DEVELOPMENT PLAN, OVERALL SCHEDULE, IMPLEMENTATION

First step for launching the venture is to conduct the feasibility study and prepare business plan for venture. It has been done already in general and can be finished up to September 1993 (6 months).

The second step is development and early start up period. It has to begin in four different directions (12-18 months).

Physical facility:

- generate initial funding for physical facility,
- create working group,
- construction and reconstruction of building and other supporting constructions,
- purchasing of necessary equipment,
- installation of equipment;

Operational Incubator:

- create working group,
- find set up capital,
- develop budget,
- develop BI objectives,
- set up fees for services;

SBDC

- assemble board of advisors,
- generate initial funding for SBDC,
- create working group,
- established links with other educational and consulting centers,
- develop SBDC consultancy network,
- develop training programs,
- develop in incubator services: marketing, Infocenter, library etc.;

Capital Fund:

- create Financial Committee,
- work with different international organizations for initial capital fund,
- design loan processing mechanisms,
- design seed and venture capital system;

Application Process:

- design BI charter,
- work out admission criterias for tenants,
- advertisement program to attract tenants,
- selection of first tenants.

The third stage is the beginning of operational part itself up to graduation of the first tenants (3-4 years). We suppose that working cycle in our BI for newly entering businesses will be something like 3-4 years. About this time now we can make now only rough estimations. So here are deadlines and milestones critical to venture success:

Incorporation of the venture	January, 1994
Completion of the design and development	August, 1994
Starting of operation	September, 1994
First tenants' graduation	September, 1998.

3.10. CRITICAL RISKS, PROBLEMS, AND ASSUMPTIONS

Development of any business has risks and problems and depends on a lot of assumptions. Especially development of such a unique type of business for Armenia will has tremendous amount of assumption and problems. And for having a success on that way one need to define and understand existing problems and try to find ways to overpass that assumptions and risks.

To start the realization of the idea we need a serious initial financing, which we assume to get from some international financial institutions in the form of either grant or loan, but there is no guarantee that EBRD or any other organization will be ready to provide that start up funding and without this the implementation of the idea of BI in Armenia can not be begun.

Current economic conditions in Armenia: blockade, shortage of any materials, energy supply, etc. and unclear economic regulation create in Armenia business environment conditions which are far from normal. It means that with current expenses for production only a few

products can be produced here, it is sufficiently easier and cheaper to produce everything elsewhere and bring it to Armenia.

3.11. THE FINANCIAL PLAN

Because of current dynamic legislative activity in the relevant scope (for example the income earned in hard currency is not taxed), the Taxes are not considered, for rough estimations they can be rendered as approximately 30% of net income. The analysis of the Best and Worst scenarios is in exhibits.

A. Pro-Forma Income Statements

Most Likely scenario

	<u>1st Yea</u>	<u>2nd Yea</u>	<u>3rd Yea</u>
Sales Revenue	63824	73404	83611
Cost of Sales	33966	39061	38690
<i>Gross Margin</i>	29858	34343	44921
Expenses:			
Rent for Building	4500	4500	4500
Utilities	1000	1000	1000
Depreciation	4404	4404	4404
Total	9904	9904	9904
Earnings Before Taxes	19954	24439	35017
Other Income (Interest Earned)	30000	60000	114000
<i>Net Income before Taxes</i>	49954	84439	149017

Cost of Sales item includes Direct Labor only, the cost of leased equipment is taken as periodic (depreciation), thus we get the Contribution Margins slightly higher (10%-15%) than they will be.

We assume that no procurement of equipment will occur (for BI itself), there will be no change in salaries, rent. Thus, during the first year we expect to receive on average \$65 monthly fee for services provided from each of Small Businesses we work for. The total number of In and Out Facility served Small Businesses are considered as approximately 70.

B. Pro-Forma Balance Sheets

Balance Sheet of Business Incubator Before Operations Start

<i>ASSETS</i>		<i>LIABILITIES & STOCKHOLDERS' EQUITY</i>	
Cash	5000	Common Stock	99040
Capital Fund	50000	Retained Earnings	0
Fixed Assets (Equipment)	44040		
<i>TOTAL</i>	<i>99040</i>	<i>TOTAL</i>	<i>99040</i>

The "Common Stock" Equity Item is conventional here. The Business Incubator can be financed by debt as well, the point is that the interest charged against it must not exceed 24% annually (more detailed information about that issues is in apposite section). In this case the numbers in financial analysis will differ from the given not substantially, because the Business Incubator will be able to receive the 5% monthly interest again, maintaining the total interest charged not more than 9% monthly, so this will be rather "cheap" loan to be sure for total and quick usage of Capital Fund in Armenian business environment.

Most Likely Scenario

	1st Year	2nd Year	3rd Year
ASSETS			
Cash	59358	98201	161622
Capital Fund	50000	100000	190000
Fixed Assets (Equipment)	39636	35232	30828
<i>TOTAL</i>	<i>148994</i>	<i>233433</i>	<i>382450</i>

LIABILITIES & STOCKHOLDERS' EQUITY

Common Stock	99040	99040	99040
Retained Earnings	49954	134393	283410
<i>TOTAL</i>	<i>148994</i>	<i>233433</i>	<i>382450</i>

C. Pro-Forma Cash Flow Analysis

Most Likely Scenario

	1st Year	2nd Year	3rd Year
NET CASH FLOW FROM OPERATING ACTIVITIES			
Net Income	49954	84439	149017
Non Cash Expenses, Revenues, Gains & Losses Included in Income			
Depreciation	4404	4404	4404
Net Cash Flow from Operating Activities	54358	88843	153421

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of Investment Securities	0	(50000)	(90000)
Net Cash Used by Investing Activities	0	(50000)	(90000)

CASH FLOWS FROM FINANCING ACTIVITIES

Net Cash Provided by Financing Activities	0	0	0
NET CHANGE IN CASH	4358	38843	63421
Cash at the Beginning of the Year	5000	59358	98201
Cash at the End of the Year	59358	98201	161622

D. Break-even Calculations

The fixed cost is \$44040, so the break-even volume is $\$44040/0.35 = \125829 . If we divide this number by monthly revenue we get the break-even in months.

The Best Scenario

The revenue is obtained from the numbers of occupancy, i.e.

150% of Labor = $75480 \text{ hours} \times 1.5 = 113220$ or $\$0.7 \times 113220 = \79254 .

100% of occupancy rate for equipment implies \$6775, and 100% space occupancy implies $4000 \text{ sq. meters} \times \$1.74 = \$6960$. Thus the revenue from operations is \$92989. The interest earned is \$30000, consequently the break-even is defined from $\$125829 / (92989 + 30000) / 12 = 12.28$.

The Worst Scenario

The revenue is obtained from the numbers of occupancy, i.e.:

50% of Labor = $75480 \text{ hours} \times 0.5 = 37740$ or $\$0.7 \times 37740 = \26418 .

50% of occupancy in space and equipment implies $(\$6960 + \$6775) \times 0.5 = \$6867$

Thus the revenue from operations is \$33300, and the same interest earned \$30000, consequently the break-even is defined from $\$125829 / (33300 + 30000) / 12 = 23.85$.

Most Likely Scenario

The revenue is obtained from the numbers of occupancy, i.e.

100% of Labor = 75480 or $\$0.7 \times 75480 = \52836 .

80% of occupancy in space and equipment implies $\$5568 + \$5420 = \$10988$.

Thus the revenue from operations is \$63824, and the same interest earned \$30000, consequently the break-even is defined from $\$125829 / (63824 + 30000) / 12 = 16.09$.

3.12. PROPOSED COMPANY OFFERING CAPITAL SOURCES

A. Desired Financing and Overview of Capital Sources

One of the greatest challenges facing any business is acquiring the capital to cultivate the business. This is the lifeblood of an emerging company. There are major obstacles raising in front of the business owner: one is knowing about and choosing among the plethora of financing options, and second, having the proper influence to acquire the chosen financing. As of sources of initial capitalization, there are some alternatives such as the Armenian Business Forum, IMF, the World Bank, the European Bank for Reconstruction and Development, the European Community, the Government, or just private investors. It is not the purpose of this research to delve into the pros and cons of various options, but there will be certain advantages or disadvantages which the entrepreneur must understand before selecting any option. The more difficult task is to assist in the actual acquisition of the capital. However, based on the Financial Plan (see section 3.11 of this report) and pro-forma balance sheet of the Incubator, we will need a total of \$99,040 for assets (Cash of \$5000, Capital Fund of \$50,000, and Fixed Assets (equipment) of \$44,040) to start the business. The Capital Fund will be used only for lending purposes.

B. Phases of Capital Requirement

It is obvious, that successful economic development of the Business Incubator depends on the coordination of two different process: research and development. Research provides the basic

information on the feasibility of new ideas, and development determines which products or services can be produced in a successful and profitable manner. This process can be divided into several steps, which are associated with different capital/financing requirements, represented by phases. The capital requirement may be divided into three distinct phases: (1) Research on Service/Product and Market Feasibility; (2) Service/Product Development Phase; and (3) Production Phase.

Phase 1. This phase is the investigation stage. Is the service/product feasible? Is there a market for the service or product? For this phase, a limited and small amount of capital should be expended.

Phase 2. After ascertaining the viability of the idea, money is usually needed to develop the product or service. Funds are necessary to purchase the initial capital equipment for that business, and start-up working capital is needed.

Phase 3. This is the final phase after the first phases demonstrated the market need and the product/service viability. In this stage it needs funds to meet the market demand.

These phases are helpful in pinpointing the capital funding weaknesses in the small business development process.

C. Capitalization and Uses of Funds

Capitalization is an important point to focus on, but since economic conditions in Armenia are not in a good shape, it is difficult and even impossible to predict the number of outstanding shares of stock. There are no concrete (certain) steps to issue stocks now, but there will be attempts to issue preferred stock any time. The "Common Stock" Equity is conventional here.

According to the sections 3.4. and 3.11. of this report, the funds will be used to acquire computers, laser printer, copier, faxes, telephones, tank, boiler, generators, cars, trucks, forklift,

etc. to start the business. Also the fund will be used for annual rent for building and annual utility expenses. As described above, some money will be used for the three phases of capital requirement: on Research on Service/Product and Market Feasibility, on Service/Product Development Phase, and on Production Phase. A substantial amount of the funds will be used to establish the Capital Fund of the Business Incubator. The Capital Fund of the Incubator will then be formed into a bank. Its initial objective is to provide loans to the Incubator's tenants at lower than in the external environment rates.

D. Debt and Equity Financing

As it was mentioned earlier, except equity financing, the Business Incubator can be financed by debt as well. In the worst scenario, if we are financed totally by debt then we can pay back up to 24% annually. The Incubator will be able to receive 5% monthly interest maintaining the total interest charged not more than 8% monthly. If no interest will be charged for the first stage (deferred payment schedule), then we can take more money from the investor. Another important issue here is that there are no laws about securities. Taxation issue also faces us as we don't know how much will be charged from the income. According to the preceding laws, no tax was being charged from the income in currency. This issue now is in the process of definition.

E. Procedure of Financing Tenants

The tenants of the Incubator will be financed by the Capital Fund which consists of \$50,000. The Capital Fund will act here as a bank and lend money at relatively low interest rates as described in the preceding chapters. The tenants will order a claim for loan and this claim will be reviewed by the management of the Capital Fund and after considering the feasibility and reliability of the idea, the loan will be given to the tenant or denied. These procedures are common for financial institutions (i.e. banks). We will use also the notion of collateral in the case of financing risky ventures.

4. CONCLUSIONS

The strong need for developed small business in the country will cause the favorable attitude toward the BI in business, legal, political environment of the Armenia, cause the possibility for easier overcoming the common barriers for starting business.

The point about financial performance, overall profitability, is that there is crucial necessity to maintain the definite level of cash in Capital Fund. Thus supporting the main but not enough earning service business by enormous high interest against the outstanding loans, is the main strategy of BI that we are going to implement.

Substantially high returns on equity, average IRR, should maintain the attractiveness of BI as good investment opportunity for foreign investors.

5. IMPLEMENTATION PLAN

Development plan was presented in detail in the section 3.9. But before beginning the required steps for development we need to clarify the reality of expected initial funding for Physical Facility, SBDC and, of course, for Capital Fund. Due to the high riskiness of investments in Armenia, and lack of local financial resources nobody can predict how much time will take this preparatory stage. May be it will be better to wait a few years up to the times when the political climate around the Armenia will stabilize.

But anyway we are going to continue the advertisement of the idea, and knock the doors of international financial organizations trying to generate initial funding for the project. The other opportunity, which appeared recently is the possibility to get start up funding from Armenian Government from the money which was given by Russian Government to Armenia with a very low interest. For having access to that money we need to develop with Armenian Government

program for Small Business Development in Armenia, which will have as a part Development of a BI.

So anyway there is some uncertainty with the beginning of implementation and group is needed to continue the advertisement of the idea up to clear identification of financial sources.

EXHIBITS

EXHIBIT 1. LIST OF SMALL BUSINESSES, MANAGERS OF WHICH HAS BEEN INTERVIEWED.

Laser R&D Company, Shopron str 21, Yerevan, Armenia, 375002

<u>Company Name</u>	<u>Type of Business</u>	<u>Director</u>	<u>Phone Number</u>
"AGUITS" Ltd	Production of laser cryst and artificial jewelry sto	Hakob Darbinian	65-20-91
"HAKINT" Ltd	Medical laser devices	Toros Papasian	65-05-51
"AREVTRI KENTRON" Ltd	Trade and Commerce	Vahagn Asatrian	65-20-31

"ARO HOLDING", Leningradian str 4, 37, Yerevan, Armenia, 375078

"ARO AVTO"	Sales of foreign cars	Vardan Zakarian	39-15-74
"ARO LUMIN"	Crystal lamps trading	Armen Abrahamian	39-15-74

"DECOR", Nor Nork IV Dct, II Block 5, Yerevan, Armenia

"DECOR"	Office design	Haira Khachaturova	64-39-80
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"POLARM" Co. Ltd, Mashtots str 46, Yerevan, Armenia

"POLARM"	Import and sales of "Mercedes-Benz" cars	Karen Mikaelian	NA
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"ORPHEY" Small Enterprise, Davidashen 37/3, Yerevan, Armenia, 375054

"ORPHEY" Small Enterprise	Commercial, publishing	Victoria Ter-Nikogossian	NA
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"AYGESTAN" Manufacturing Cooperative of Wooden Goods, Sportintern str 46, Yerevan, Armenia

"AYGESTAN"	Production of wooden g	Albert Grigorian	64-29-43
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"GIND" Small Enterprise, Ordjonikidze str 3, Yerevan, Armenia

10. "GIND" Publishing, trade, and commerce Oleg Babadjanian 53-86-62

EXHIBIT 2. Pro Forma Income Statements**The Best Scenario**

	<u>1st Year</u>	<u>2nd Year</u>	<u>3rd Year</u>
Sales Revenue	92989	104877	118548
Cost of Sales	50949	58591	67380
<i>Gross Margin</i>	<i>42040</i>	<i>46286</i>	<i>51168</i>
Expenses:			
Rent for Building	4500	4500	4500
Utilities	1000	1000	1000
Depreciation	4404	4404	4404
<i>Total</i>	<i>9904</i>	<i>9904</i>	<i>9904</i>
Earnings Before Taxes	32136	36382	41264
Other Income (Interest Earned)	30000	69000	129000
<i>Net Income Before Taxes</i>	<i>62136</i>	<i>105382</i>	<i>170264</i>

The Worst Scenario

	<u>1st Year</u>	<u>2nd Year</u>	<u>3rd Year</u>
Sales Revenue	33300	36644	42141
Cost of Sales	16983	18682	21484
<i>Gross Margin</i>	<i>16317</i>	<i>17962</i>	<i>20657</i>

Expenses:

Rent for Building	4500	4500	4500
Utilities	1000	1000	1000
Depreciation	4404	4404	4404
<i>Total</i>	<i>9904</i>	<i>9904</i>	<i>9904</i>
Earnings Before Taxes	6413	8058	10753
Other Income (Interest Earned)	30000	54000	90000
<i>Net Income before Taxes</i>	<i>36413</i>	<i>62058</i>	<i>100753</i>

EXHIBIT 3. PRO FORMA BALANCE SHEETS

The Best Scenario

	<u>1st Year</u>	<u>2nd Year</u>	<u>3rd Year</u>
<i>ASSETS</i>			
Cash	71540	116326	190994
Capital Fund	50000	115000	215000
Fixed Assets (Equipment)	39636	35232	30828
<i>TOTAL</i>	<i>161176</i>	<i>266558</i>	<i>436822</i>

LIABILITIES & STOCKHOLDERS' EQUITY

Common Stock	99040	99040	99040
Retained Earnings	62136	167518	337782
<i>TOTAL</i>	<i>161176</i>	<i>266558</i>	<i>436822</i>

The Worst Scenario

	<u>1st Year</u>	<u>2nd Year</u>	<u>3rd Year</u>
<i>ASSETS</i>			
Cash	45817	72279	117436
Capital Fund	50000	90000	150000
Fixed Assets (Equipment)	39636	35232	30828
<i>TOTAL</i>	<i>135453</i>	<i>197511</i>	<i>298264</i>

LIABILITIES & STOCKHOLDERS' EQUITY

Common Stock	99040	99040	99040
Retained Earnings	36413	98471	199224
<i>TOTAL</i>	<i>135453</i>	<i>197511</i>	<i>298264</i>

EXHIBIT 4. PRO FORMA CASH FLOWS**Best Scenario**

	1st Year	2nd Year	3rd Year
<i>NET CASH FLOW FROM OPERATING ACTIVITIES</i>			
Net Income	62136	105382	170264
Non Cash Expenses, Revenues, Gains & Losses Included in Income			
Depreciation	4404	4404	4404
Net Cash Flow from Operating Activities	66540	109786	174668
<i>CASH FLOWS FROM INVESTING ACTIVITIES</i>			
Purchase of Investment Securities	0	(65000)	(100000)
Net Cash Used by Investing Activities	0	(65000)	(100000)
<i>CASH FLOWS FROM FINANCING ACTIVITIES</i>			
Net Cash Provided by Financing Activities	0	0	0
NET CHANGE IN CASH	66540	44786	74786
Cash at the Beginning of the Year	5000	71540	116326
Cash at the End of the Year	71540	116326	190994

The Worst Scenario

	1st Year	2nd Year	3rd Year
<i>NET CASH FLOW FROM OPERATING ACTIVITIES</i>			
Net Income	36413	62058	100753
Non Cash Expenses, Revenues, Gains & Losses Included in Income			
Depreciation	4404	4404	4404
Net Cash Flow from Operating Activities	40817	66462	105157
<i>CASH FLOWS FROM INVESTING ACTIVITIES</i>			
Purchase of Investment Securities	0	(40000)	(60000)
Net Cash Used by Investing Activities	0	(40000)	(60000)
<i>CASH FLOWS FROM FINANCING ACTIVITIES</i>			
Net Cash Provided by Financing Activities	0	0	0
NET CHANGE IN CASH	40817	26462	45157
Cash at the Beginning of the Year	5000	45817	72279
Cash at the End of the Year	45817	72279	117436

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