

**A Business Plan for StartupChina:  
An Incubator for Chinese E-Commerce Start-Ups**

By  
Tyler L. Worden

B.S., Mechanical Engineering (1993)  
M.S., Mechanical Engineering (1993)

Massachusetts Institute of Technology

Submitted to the Sloan School of Management  
in Partial Fulfillment of the Requirements for the Degree of  
Master of Business Administration

at the

Massachusetts Institute of Technology

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MIT Sloan School of Management  
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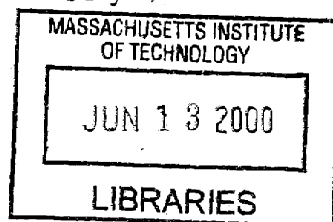
Certified by .....

Edward Steinfeld  
Mitsubishi Career Development Assistant Professor  
of International Management  
May 8, 2000

Accepted by .....

Margaret Andrews  
Executive Director of the MBA Program  
MIT Sloan School of Management  
May 8, 2000

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## **Abstract**

StartupChina is a Business Accelerator for e-commerce startups in China focusing on B2B opportunities and technology companies that support the e-commerce revolution. The key to understanding StartupChina's opportunity is to examine the current divide separating the venture capital community from entrepreneurs in China. Venture capitalists increasingly seek to invest greater than one million dollars per deal, in order to maximize fund management fees and minimize operating costs. In China, VC's frequently claim that qualified deals are few and far between. However, there is no lack of entrepreneurs with great ideas. Many young management teams merely need an initial infusion of capital--totaling not more than five hundred thousand dollars--accompanied by an experienced team and professional services to lead them through the startup process and connect them with the venture capital community on the other side.

StartupChina thereby serves the needs of three customers: seed round investors, Chinese entrepreneurs, and the international venture capital community. First, StartupChina provides a mechanism for foreign investors to participate in a diversified portfolio of early-stage e-commerce companies in the Chinese market. StartupChina finds the best deals and incorporates them into a balanced portfolio network of companies. Second, entrepreneurs are provided with much needed capital, value-added services, and physical office space so they are able to accelerate the development of their company in preparation for VC financing. The third beneficiary is the venture capital community. By pre-screening, selecting, and developing business plans and management teams that have the highest potential to succeed in the Chinese marketplace, StartupChina will become a crucial sourcing ally for venture capital firms. Over time, StartupChina will become a critical link connecting foreign venture capitalists to high-quality startups in the Chinese e-commerce market.

Thesis Supervisor: Prof. Edward Steinfeld

Title: Mitsubishi Career Development Assistant Professor of International Management



<b>EXECUTIVE SUMMARY .....</b>	<b>6</b>
<b>BACKGROUND: E-COMMERCE IN CHINA.....</b>	<b>10</b>
INTERNET OVERVIEW.....	10
INTERNET USER.....	10
SUPPORTING INFRASTRUCTURE FOR THE INTERNET.....	11
E-COMMERCE OPPORTUNITIES.....	11
FUTURE OPPORTUNITIES.....	14
<b>THE INCUBATOR INDUSTRY, THE COMPANY, AND THE PRODUCT .....</b>	<b>15</b>
THE INCUBATOR INDUSTRY (US BASED).....	15
THE PROBLEM.....	15
THE COMPANY.....	15
THE PRODUCT.....	16
OUR INVESTMENT FOCUS.....	19
<b>MARKET RESEARCH .....</b>	<b>20</b>
CUSTOMER'S NEEDS.....	20
MARKET SIZE AND TRENDS.....	35
COMPETITION AND COMPETITIVE FACTORS.....	38
OPPORTUNITY AND PRICING FOR STARTUPCHINA.....	39
<b>MARKETING PLAN.....</b>	<b>41</b>
OVERALL MARKETING STRATEGY.....	41
GENERATING AND FINDING IDEAS.....	41
ADVERTISING AND PROMOTION/BRAND AWARENESS.....	42
<b>DESIGN, DEVELOPMENT, AND PRODUCTION.....</b>	<b>44</b>
LEGAL AND REGULATORY BACKGROUND.....	44
CORPORATE STRUCTURE.....	44
INVESTMENT PROCESS.....	47
DEVELOPMENT PLAN.....	49
<b>FINANCIALS.....</b>	<b>54</b>
OVERVIEW.....	54
ESTIMATED EXPENSES.....	54
FINANCING.....	54
PORTFOLIO COMPANIES VALUATIONS GROWTH.....	54
STARTUPCHINA VALUATIONS GROWTH.....	55
ESTIMATED RETURNS.....	56
<b>MANAGEMENT TEAM AND RESPONSIBILITIES .....</b>	<b>57</b>
<b>CRITICAL RISKS .....</b>	<b>58</b>
<b>APPENDIX A: FOUNDER'S RESUMES .....</b>	<b>59</b>
<b>APPENDIX B: ADVISORY BOARD .....</b>	<b>63</b>
<b>APPENDIX C: FINANCIALS (STARTUPCHINA CASH FLOW MODEL) .....</b>	<b>64</b>
<b>APPENDIX D: EVALUATION PROCESS FOR SELECTING PORTFOLIO COMPANIES.....</b>	<b>69</b>
<b>APPENDIX E: PROCESS PLAN FOR ACCELERATING GROWTH OF E-COMMERCE COMPANIES</b>	<b>71</b>
<b>APPENDIX F: COMPETITOR MAP .....</b>	<b>72</b>
<b>APPENDIX G: LEGAL STRUCTURES.....</b>	<b>73</b>
<b>APPENDIX H: INVESTMENT OPPORTUNITIES.....</b>	<b>74</b>

## EXECUTIVE SUMMARY

StartupChina is a Business Accelerator for e-commerce startups in China focusing on B2B opportunities and technology companies that support the e-commerce revolution. We place Internet companies in the startup or development stage on the fast track to expansion stage financing. Our value-added services and smart capital give companies the edge to successfully bring product to market quicker.

The key to understanding StartupChina's opportunity is to examine the current divide separating the venture capital community from entrepreneurs in China. Venture capitalists increasingly seek to invest greater than one million dollars per deal, in order to maximize fund management fees and minimize operating costs. In China, VC's frequently claim that qualified deals are few and far between. However, there is no lack of entrepreneurs with great ideas. Many young management teams merely need an initial infusion of capital--totaling not more than five hundred thousand dollars--accompanied by an experienced team and professional services to lead them through the startup process and connect them with the venture capital community on the other side.

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StartupChina will focus on the B2B e-commerce market and supporting Internet infrastructure startups in China. As Internet-based network reliability, speed and security have improved in recent years on a global scale, and as more businesses have connected to the Internet, traditional businesses have begun to use the Internet to conduct e-commerce and exchange information with customers, suppliers and distributors. While the consumer e-commerce market is significant in size, estimated by International Data Corporation ("IDC") to have been \$15 billion in goods and services in 1998, the business-to-business (B2B) e-commerce market is larger and is predicted to grow dramatically. According to Forrester Research, B2B e-commerce in the U.S. alone is projected to grow from US\$43 billion in 1998 to over US\$1.3 trillion in 2003, representing almost 100% compounded annual growth.

The international B2B e-commerce market is experiencing explosive growth as well. In the next few years, there will be a dramatic increase in online business-to-business international trade using auctions and exchanges: Forrester Research predicts that revenue from B2B Internet auctions will grow to \$52.6 billion by 2002. China is expected to take a significant portion of this market based upon its large manufacturing base, the desire of the government to expand access to new and existing customers and suppliers, and the need to increase efficiency and reduce costs. Currently, China is using a closed network to conduct B2B transactions, allowing for centralized control and monitoring. B2B companies overcome major obstacles such as online credit transactions and distribution. B2B sites can utilize old fashion billing between companies and in addition can utilize distribution channels that exist within a specific vertical industry.

Startup China wishes to participate in this B2B boom and projects to deliver a 1,100% return to initial investors within three years. Within four years, first round VC investors are projected to receive a 1,600% return and later stage investors are projected to receive a 650% return. These projections are based upon a similar financial structure found in the US, but reflect the opportunities for B2B portfolio companies in China.

While the incubator business model has proven to be extremely powerful in the U.S. market, StartupChina believes that the model is even more powerful in China. The Chinese market is currently at a very early stage of development. In general, the Chinese government, businesses, and consumers are very aware of the potential benefits of the Internet. However, entrepreneurs lack critical resources to push their business models from the idea stage to successful execution. In order to position their companies as major players in the market with the potential to execute a successful IPO outside China or get acquired by an international company, entrepreneurs require access

to capital, legal advice, international technology, and high-quality management expertise. StartupChina will provide the services that these startups need in order to be successful, and will house them in a subsidized building providing them with a synergistic environment and an "open" culture. As a result, startups will be attracted to our e-commerce campus environment in the heart of the high tech district near Beijing University and Tsinghua University (the top two Universities in China).

Funds will be raised through private, corporate, and venture capital sources to fund the operations of the incubator and to support seed round financing for portfolio e-commerce companies. These funds will then be invested into e-commerce companies in China's emerging market for an equity position in the company ranging from 17%-50%. Initially funds will be invested at the seed round for a small % of the equity of the company with the right to co-invest in the first round of financing. In this way, Start-Up China will increase the success of high returns for its investments by including other well known VC's as co-investors in the companies that it incubates.

Potential portfolio companies will be sourced through multiple channels, including the Internet, entrepreneurial networks (i.e. the Beijing Entrepreneurial Club and a local chapter of the MIT Enterprise Forum that we are working to establish), the Tsinghua Business Plan Competition, and a business plan competition that we will sponsor. StartupChina will have a major online presence that will provide an invaluable source of knowledge for entrepreneurs wishing to pursue opportunities in China's rapidly growing market. In addition to our online presence, we will be providing a physical library of information for the future entrepreneur (VC contacts, private investors, success stories of other Chinese companies, etc.). Finally, we aim to set up a non-profit Entrepreneurship Center that will provide assistance to the ad-hoc entrepreneur. The most promising entrepreneurs from these various networks will be invited into our incubator.

While StartupChina is primarily a long-term equity play in the Chinese e-commerce market through equity positions in our portfolio companies, we will also generate revenues from the services that we provide. Once portfolio companies have been invited into our organization and provided with seed capital, revenues will be generated through the use of our services and rent. These revenues are expected to cover our ongoing operation costs. However, the majority of StartupChina's returns will be generated through its evolving equity investments.

Our competition includes any organization or individual that can provide the capital and resources to help an entrepreneur in China start an e-commerce business. The most direct form of competition comes in the form of other incubator models. Numerous incubators exist in the United States, Europe and in developing nations in Latin America. In the Far East, a number of incubators have started up in Hong Kong to serve the local Asian markets. In addition, a small number of incubators exist in the mainland market to provide capital in combination with services. Those that do exist in Mainland China are primarily located in the South (Zhuhai and Shenzhen). Our competition in Beijing consists of government controlled science parks that offer reduced rent without the benefit of much needed services or capital. In general, local venture funds are government-supported efforts to stimulate economic growth. However, the government rarely understands the business it invests in and cannot support rapid growth.

The second source of competition comes in the form of venture capitalists that are willing to fund seed-stage projects (investments smaller than US\$500,000). In fact, many venture capitalists in the mainland market are merely middlemen who match startup ideas with investors. This matchmaking process has the wrong incentive structure. Instead of representing the interest of either party, the middleman pushes ideas to generate a transaction commission. By providing seed investment and holding equity in portfolio companies, it will only be in StartupChina's interest to fund, develop, and secure later-stage financing for the highest quality startups.

The last area of competition is the international investment community. Foreign investors (both individual and institutional) often find the cultural and geographic constraints separating China from the outside world to be too vast. As a result, many investors either watch China develop from afar, or participate in later-stage investments behind the large venture capital funds. StartupChina offers a vehicle to mitigate risk while investing in the lucrative seed-stage of the Chinese e-commerce industry.

By establishing an incubator in Beijing, our aim will be to satisfy the diverse needs of the entrepreneur, the incubator investor, and the international venture community. As competition intensifies in today's e-commerce sector, entrepreneurs and investors are realizing that only the strong will survive. Entrepreneurs have few resources to turn to for advice and seed capital. Angel investors, local and foreign, have limited means of assessing startups

and matching with teams where they can deliver the most value. And finally, it is extremely difficult for the foreign venture community in China to find the right idea and the right team at an early stage. By reviewing a screened list of business ideas from our incubator, they will welcome the opportunity to invest in ideas that have already been accelerated on a strong, professional foundation.

Our team comes from strong operational backgrounds in software, Internet, strategy consulting and investment management. Many of the issues that entrepreneurs need to wrestle with at an early stage is the definition of the business model and its subsequent execution. Speaking with Softbank China representative, David Kim, he stressed that many Chinese teams that he sees are made up of management consultants and financial managers. They may be able to write a plan that mimics a US model, but have they ever made a sale, wired a network, or built a product? They lack operational experience, which we can provide based upon our backgrounds. In addition, as a young and hungry team being both Chinese and American, we can relate well with the younger generation that we will serve.

Our team has been on the ground working with entrepreneurs in Internet startups in Beijing. One member has been working extensively with students at Tsinghua B-school for the past year, providing guidance, knowledge and support. His summer Internship at the school enabled him to establish strong networks within the administration and also with multinational firms that he worked with. A second partner management consulting experience with a top tier US firm and has spent the past two years consulting with Internet startups to refine their business model and help them seek funding. A third partner has extensive experience evaluating investments and establishing joint ventures in China. She has extensive knowledge and contacts throughout the regulatory environment. The fourth partner has extensive consulting experience aiding e-commerce companies in the United states and has a unique perspective on what would and would not work in China. Through our combined involvement in the Internet and in China, we have formed a strong network and cultivated relationships. We understand the unique issues that entrepreneurs face and will build the incubator to serve those needs.

Our team has strong ties to MIT, the world leading engineering school with a strong entrepreneurial emphasis. Members of the team have either attended or worked with MIT programs. Additional team members will be returning Chinese students from MIT. Through work for MIT Sloan, one member has a strong relationship with the Deans office of Sloan. Strong links with MIT and MIT Sloan will aid in the development of an Entrepreneurial network through the Beijing Entrepreneur Club, the MIT Alumni Club, and the MIT China Program.

We have established strategic relationships with ChinaLabs, the premier Internet service provider in China, Perkins Coie, a premier technology law firm operating in Beijing and San Francisco, and BrainRush, a San Francisco incubator best known for its portfolio company, MySimon. In addition, we have established a strategic relationship with the MIT China program and the Tsinghua IMBA program to source potential summer and full time hires of MIT students that want to work in China, and Tsinghua MBA students who wish to manage e-commerce companies. We plan to extend this program to other college campuses around the country. Finally, we have signed on key advisors including Gordon Baty, founder of Boston based VC firm ZeroStage and experienced entrepreneur; Jim Short, professor at the London School of Economics and expert on establishing new companies in emerging markets; and MIT Professor Ed Steinfield, a noted expert economist on conducting business in China.

StartupChina will go through four stages of financing, the final stage being an IPO on a US or Hong Kong exchange. The first financing round will raise a total of \$500,000 in funding from angels or corporate sponsorships, which will be used to establish the incubator and pay for salaries, legal fees, and the incubator's initial facilities. During this time, StartupChina will use the funds to hire additional team members, build our incubator services, and spearhead our marketing effort to attract and evaluate business opportunities. Within six months, StartupChina will need to raise an additional \$3M in funding through international venture capital and corporate sources. Two million dollars of this funding will go into four portfolio companies at an average of \$500K each. The rest of the funding will cover current expenses and future expansion of the incubator in services, facilities, and personnel. The incubator's capacity must grow to handle six incubating portfolio companies, up from four. First disbursements to portfolio companies are made during Q3 of the first year, with the remainder disbursed during the fourth quarter. Portfolio companies will be given six months within the incubator, before they are spun out.

After nine months of operation based upon the previous rounds of financing, StartupChina will need to raise \$20M through venture capital sources and corporate investments, in order to incubate more portfolio companies and accelerate its own transformation into an Internet holding company. Six million will go to two groups of six new



portfolio companies. In addition, ten million dollars will be invested in four early stage partner companies without incubation. However, these four partner companies will enjoy synergies with the other partner companies in the group, and will join our facilities, as room becomes available.

After two years of operation, StartupChina will raise \$50 million through an IPO, and in turn provide an exit vehicle for previous investors. Through the IPO, StartupChina raises a war chest to complete its transformation into a holding company with a strong incubator element. Such Internet holding companies enjoy healthy multiples over asset values, a phenomenon that is crucial for strong post-IPO valuations. These strong post-IPO valuations are in turn critical for attracting the funding needed at the earlier stages.

**BACKGROUND: E-COMMERCE IN CHINA**

**INTERNET OVERVIEW**

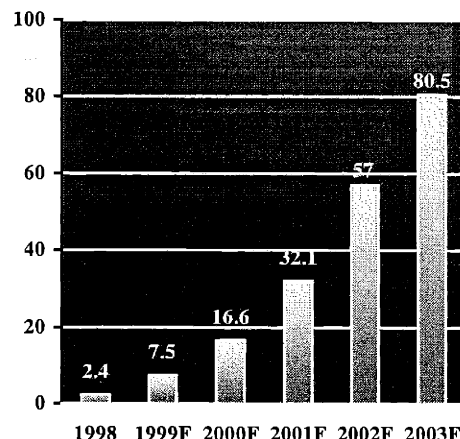
There are five major networks operating in China: CSTNet, ChinaNet, CERNet, GB Net, and UNINet. The CSTNet is a not-for-profit network serving the research and academic community connecting more than 300 institutions in about 40 cities. The CERNet also is a not-for-profit network for higher education, connecting about 450 universities. The biggest network and the dominant Internet service provider (ISP) in China is the commercial ChinaNet, connecting more than 200 cities, providing about 1.6 million end-users with leased lines and dial-up access. The only other commercial network in China is Golden Bridge, or GB Net.

According to a report by the China National Network Information Center (CNNIC), in January 2000, China's international Internet traffic capacity totaled 351 Mbits/s, with ChinaNet alone accounting for 291 Mbits/s. As of the same date, China had 3.5 Million computers linked to networks. Of these, 410,000 were connected through leased lines and 3.09 Million were linked using dial-up access. As of January 2000, nearly forty-nine thousand sites were registered within the .cn domain extension. There are more than 15,000 web sites in Chinese and English languages targeting the Chinese Mainland Market.

**INTERNET USER**

According to the China Network Information Center, the number of Internet users grew from 60,000 in September 1996 to 8.2 Million at the end of 1999. IDC projects that in 2003, the number of users will reach 80.3 million. A survey of 202 thousand Chinese Internet users, released in January, 2000 by the State Council Information Office and the China National Network Information Center, found that Net use is still mostly concentrated in Beijing (21.2 %), Guangdong (12.9 %) and Shanghai (11.2 %). The average Internet user is Male (79%), between the age of 18 and 30 (75%), earns RMB 500-2,000 per month (65%) and spends 17 hours per week online. Eighty-four percent of users have or are pursuing a college degree. Twenty-one percent of the users are students, 13% work in the computer related industry, 9% percent of the users work for the party or government, and 8% work in foreign or joint ventures.

FIGURE 1: PROJECTED GROWTH OF CHINESE INTERNET USERS (SOURCE: IDC)



Sixty percent of the users pay their own access fees, while about 20% use the Internet at school or work. Almost all users are enjoying electronic mail. The primary reason for Chinese users to access the Internet is to gather information (58%). The most frequently used services are email and search engines. Respondents to the survey criticized the Net as too slow (53 percent) and too expensive (35 percent). Most (75 percent) indicated they would like to buy things online but fear that there is inadequate legal protection and they may be sent inferior goods.

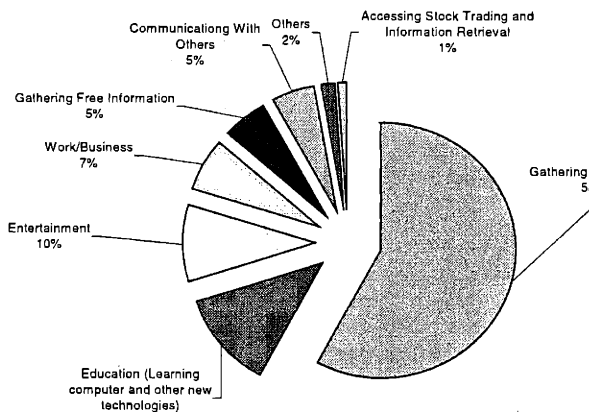


FIGURE 2: REASONS FOR ACCESSING THE INTERNET

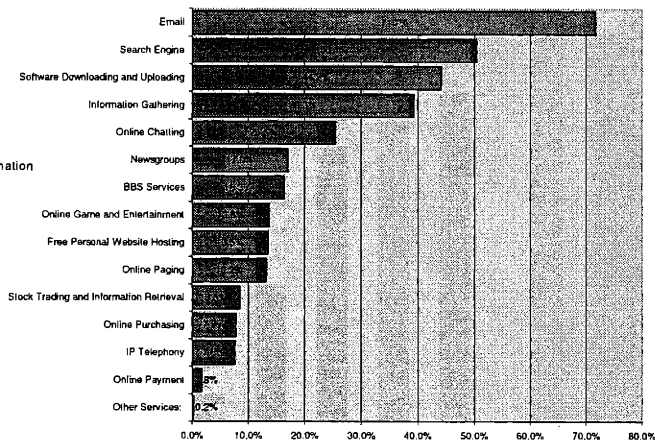


FIGURE 3: PRIMARY APPLICATIONS FOR USING THE INTERNET

In the past, the expense of the Internet and its lack of Chinese-language content limited its use to teachers, students and researchers who understood English and had access to university or institutional Internet connections. Even now, less than three percent of China's urban population uses the Internet, so the potential for growth is enormous. China aims to make the Internet accessible in Chinese to all Chinese. Its efforts to promote information networks have focused on a low-cost, domestic-only, convenient Internet service, a no-registration-required service with the cost simply added to users' telephone bills and expanded Chinese-language content on the Internet.

## **SUPPORTING INFRASTRUCTURE FOR THE INTERNET**

### ***Front-end technology***

Most of China's Internet users access the web the same way Americans do – through browsers installed on computers connected by modems to Internet service providers. Establishing an account is easily transacted through local post offices throughout China, where people normally pay their utility bills. However, Internet access in China is expensive, even by western standards. Setting up an account costs many tens of dollars, and access costs a dollar per hour during the day, half that at night – a huge sum by Chinese standards.

The price of personal computers – equivalent to prices in America, or the equivalent of two years average salary in China – is also a problem for Chinese Internet access. Less than 3% of Chinese households currently own a computer. Despite this, personal computer sales are growing at 60% per year; prevailing expectations are that 25% of Chinese households will own a computer by 2010, and most of those households will use the Internet.

### ***Back-end technology***

China Telecom, the monopoly Telecommunications Company in China, is creating Internet infrastructure as quickly as it can to meet the growing needs of the country. However, Internet access in China is still characterized by slow speeds and unreliable connections, which interfere heavily with the content-rich applications that make e-business possible. The situation is improving, though; because the recent WTO agreement will for the first time allow foreign competition in the Chinese telecom market, the speed of infrastructure development and the speed and reliability of Internet connections is expected to improve over the coming years.

Besides being the infrastructure provider for the country, China Telecom is also the dominant Internet service provider (ISP). The company runs the largest commercial Internet network, through its ChinaNet service. Formerly a monopoly industry, the ISP market has opened up to domestic competition in recent years; however, ChinaNet remains far in front of its rivals. As many as two hundred ISPs operate in China now, but most, if not all, are losing money on Internet service operations, due to low entry barriers and intense competition.

### ***Emerging technologies***

The need for reliable, low-cost Internet access creates different opportunities in China than in the western world, and Internet users there will enjoy a variety of access choices over the coming years. Television and cable provide one solution to the need for low-cost access: over 80% of Chinese households have a television (while only a few percent have computers), and nearly half of those have cable access. This creates an opportunity for cable broadband – Internet access through cable onto television through an inexpensive set-top box – and many companies, such as Microsoft with its Venus system, are attempting to move into this market. Satellite provides another possible broadband channel, but its use raises regulatory problems within China because of government media control. Wireless Internet access will provide another low-cost solution in China, particularly due to the popularity of cellular phones; third-generation mobile phones will be able to download data much faster than today's modems, by nearly two orders of magnitude.

## **E-COMMERCE OPPORTUNITIES**

China has the greatest potential for Internet development given its large population and sustained economic growth. Particularly in the non-service industrial sector (contributing 49% to the GDP), B2B e-business will play an important role enabling the manufacturing industry to be "plugged" into the global supply network. Since B2B e-business requires less substantial legal and banking infrastructure development, these systems will enter the market more quickly than B2C e-business systems.

Macro Economic Forces have also paved the way for a strong consumer market. GDP in 1997-1999 were \$US 903.1 billion, \$960.9 billion, and \$991.3 billion respectively. GDP growth in China, which slowed in 1999 for the seventh consecutive year to 7.1%, is expected to expand by 7.4% in 2000 and by 7.5% in 2001.

Robust export expansion is raising the incomes-and therefore private consumption growth-among those people living on China's eastern seaboard. The national average (excluding Hong Kong and Macau) for GDP per Head was \$735 at 1998 prices, which makes China somewhat poorer than Indonesia. That average, however, conceals great regional inequalities.

The poorest province, Guizhou, has a GDP per head of \$280, similar to what is seen with Bangladesh or Yemen. Sichuan, with a figure of \$525, is even with Pakistan. Shanghai at \$3,400, is up there with Turkey or South Africa, demonstrating a strong B2C market in the major metropolitan areas and along the Eastern Seaboard.

Inflation has been going through a period of deflation where prices declined by 1.3% in 1999. Consumer price inflation is forecast to average just 0.9% in 2000 and 2.2% in 2001

### B2C Opportunities

E-commerce is still in its infancy in China, partly due to the fact that the country still lacks the financial infrastructure, such as a developed credit system. The tiny number of credit-card holders currently limits the prospects for electronic commerce.

In addition, since citizens in China don't get a real benefit from online shopping, not many of them visit online stores, and even fewer buy things online. As a result, online stores are having a hard time staying economically viable on their own. Online stores in China are just like traditional stores, and some of them are not as good as a traditional store in some respects. Customers of online stores must pay high Internet connection charges and telephone charges. This would be similar to a traditional store propping up a sign in front of its gate that reads "you will be charged \$.50 for every minute you stay in this store". Clearly many issues must be resolved in China, before e-commerce will take off. Just a few issues that currently plague the widespread adoption of on-line consumer purchasing include the following:

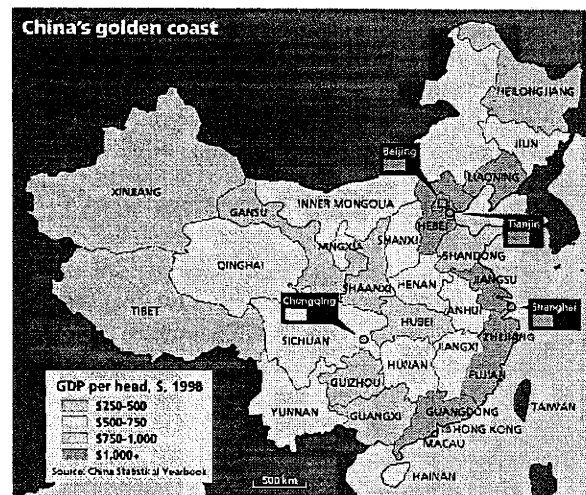


Figure 4: GDP per Head (Source: China Statistical Yearbook)

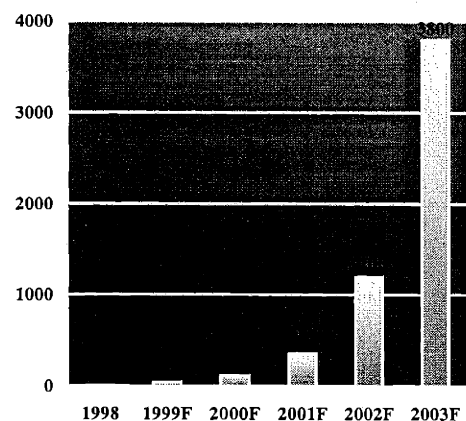


Figure 5: China Online Spending (Source IDC, Goldman Sachs Research)

<b>Slow Connections</b>	➤ Connections are usually at speeds too slow to download the content-rich applications that make online shopping possible.
<b>Low Number of Users</b>	➤ There are only a small number of people online, although this number is growing at a rapid rate due to portal adoption.
<b>Poor User Interfaces</b>	➤ Repeated requests for demographic information at each on-line web site, including ID, before being allowed to browse store content.
<b>Low Quality Products</b>	➤ Current reputation that products in China are at risk of being counterfeit or shoddy when received. This increases the risk of buying high-ticket items on-line.
<b>Lack of electronic payment mechanisms</b>	➤ There are very few credit cards in circulation. One example is an on-line music store that requires customers to remit their payment by a money order before it will deliver the product. To buy a CD, a customer would have to walk for half an hour to the nearest post office to send the money order. The product would not be delivered until a week after the store had received the payment. And then, the customer would have to stay at

	<ul style="list-style-type: none"> <li>➤ home to receive his order in person</li> <li>➤ Some online stores do not require prior payment, but payment upon delivery, which is more like TV shopping in China.</li> </ul>
<b>Online payment systems (security)</b>	<ul style="list-style-type: none"> <li>➤ "E-commerce requires a lot more than just having the basic telecom infrastructure. How many suppliers would you give your credit card number to in China?" asks Robert Mao, president of Nortel Networks in China.</li> </ul>
<b>Delivery</b>	<ul style="list-style-type: none"> <li>➤ Delivery mechanisms (shipping) door to door delivery networks are erratic at best.</li> <li>➤ Some retailers require that products ordered online have to be picked up at their stores' physical locations.</li> </ul>
<b>China's low per capita income</b>	<ul style="list-style-type: none"> <li>➤ IDC forecasts that China's total e-commerce business will be worth about \$4 billion in 2003, compared to Australia's \$9billion with a fraction of the population. E-commerce requires much higher average incomes</li> <li>➤ High resistance of consumers to a new way of shopping.</li> </ul>

Overcoming these issues will not be easy. However, numerous retailers and players in the B2C market recognize the huge potential for retail sales on-line, but must grapple with the daunting task of providing secure credit card transactions on-line and a dependable delivery mechanism. The government is aiding in this effort by launching a program to introduce credit cards to the masses, making on-line transactions possible. As consumers gain the ability to shop online (credit cards) and gain the confidence that shopping online is cheaper, more reliable, and more efficient than shopping in a store, than on-line shopping will take off.

Alternative models have been explored, such as COD or payment at the local post office. This model has been gaining acceptance in the market and may minimize the need for credit cards and a separate delivery mechanism in the short term, paving the way for rapid penetration

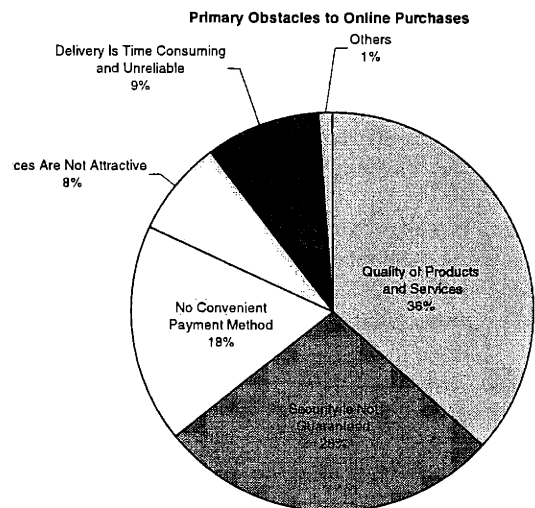


Figure 6: SemiAnnual Survey Report On Internet Development In China (2000.1)

Acceptance of e-commerce will almost be as quick as the acceptance of the Internet. "E-Commerce is the next wave. The main hurdle is conceptual and China has shown itself capable of leap-frogging in many areas of technology. The government has been playing a positive and proactive role in encouraging e-commerce. Especially, since the beginning of the 1999, on the e-commerce front, the government has worked with the Bank of China to issue credit cards for the masses.

In addition there is a definite desire to do online shopping. The latest CNNIC survey showed that the most promising online business for the future would be online purchases.

**B2B Opportunities**

The real opportunities in China will be in B2B e-commerce. This is true elsewhere in the world where B2B trade is several times larger than the volume of consumer transactions online. It will be even truer in China, which is one of the world's great export dynamics. Already, Chinese suppliers are beginning to flock to business portals, such as Asian Sources, to widen their network of buyers. No Asian B2B company has yet listed, though at least ten are seen as likely candidates this year. They include Softbank-backed Alibaba.com in China, MeetChina.com, Hutchison E-Commerce in Hong Kong and Advanced Manufacturing Online in Singapore. Because Asia is a manufacturing hub, B2B stocks can become more successful than B2C companies that focus on e-commerce for consumers - and have to contend with inadequate-to-non-existent credit-card and postal-delivery infrastructures.

One portal category where Chinese companies are already present involves creating trading communities around electronic cataloguing and online ordering. These portals act as market makers or serve as windows for the real-

time monitoring of orders, goods, work-in-progress, or inventory. As such, B2B internet is helping Asia make most of its manufacturing base, in effect expanding demand for its products to new markets. Greater outsourcing to, and procurement from, Asia appears to be one result of Internet growth.

One example, MeetChina.com, is a business-to-business commerce portal dedicated to bridging the cultural, financial, and bureaucratic gaps that currently exist between Chinese manufacturers and their US customer. The Ministry of Information Industry is driving the development of the site. The Ministry was recently formed through the merger of the Ministry of Postal and Telecom and The Ministry of Electronics. The Ministry of Information is playing an active role in putting business-to-business transactions online. MeetChina.com will play a significant role in boosting the export economy by allowing Chinese manufacturers to deal with foreign buyers directly. The site will act as a standard electronic portal as well as a consultant connecting suppliers of raw materials, components and finished products in China to buyers in the West.

B2B commerce still faces several challenges, some similar to the B2C marketplace: 1) Online security, 2) Different standards when connecting to up-and downstream companies; 3) Costs for training up-and downstream partners; 4) Network access cost and transmission quality; 5) Software language difficulties; and 6) lack of MIS and technical support personnel. However, there is a strong trend for B2B sites to issue lines of credit to their customers, thus billing them every month using standard methods. B2B firms such as AsiaEC, which focuses on Office supplies has acquired its own distribution system in order to control the entire logistical chain and provide products within five hours. In addition, companies are increasingly providing additional services to their customers beyond just purchases. They are providing value-added services such as inventory control, purchasing procedures (chain of command for making a purchase), and data management.

There is a large manufacturing sector in China. Numerous companies would benefit from a streamlined system for matching suppliers with buyers. The benefits from what they have now and what they could be provided are huge and would provide substantial profits to companies that provide such services. The B2B sector has far less obstacles to overcome, and are favored by the government to help their manufacturing sector become more competitive.

Other areas of potential growth are in the ASP and ERM (Enterprise Resource Management) market. Many companies will emerge that will service companies' enterprise resource planning (ERP) operations. In addition, software will be leased over the Internet to companies who wish to utilize expensive software installations, but minimize the amount of maintenance that they would have to do. Software examples would be targeting mostly backend activities, such as billing and monitoring account receivables and payable.

### **FUTURE OPPORTUNITIES**

The Internet is a rapidly growing industry in China. There is an enormous opportunity for reaching the nearly 1.2 billion consumers living in China for e-commerce, advertising, and application service providers. However, significant challenges lie ahead for China to harness the growth of the Internet and bring it into the mainstream. Regardless of the obstacles, the Internet is growing in popularity led by the rapid explosion of homegrown portals such as Sohu.com, Netease.com and Sina.com. Their focus on becoming providers to the Chinese speaking community has brought legitimacy to the Internet in China and is attracting numerous people to their content. Access fees are reducing with the introduction of competition and government pressures, and alternative technologies are promising higher speeds and increased penetration into the Chinese populations. As more and more users sign-on, E-commerce will move from a portal/advertisement model to a transactional B2C play.

The development of the Internet in China will be extremely interesting to watch in the ensuing years. It could easily outpace the US market, once all of the pieces are put into place, and rapid changes in government policy and foreign investment (WTO agreement) promise to speed up the growth of the Internet even further. The Chinese Internet Industry has the advantage of having observed and learned from the successes and failures of the U.S. Internet market. The Chinese infrastructure has the advantage of no legacy hardware and can quickly utilize modern

## **THE INCUBATOR INDUSTRY, THE COMPANY, AND THE PRODUCT**

### **THE INCUBATOR INDUSTRY (US BASED)**

Specialized high-tech incubators have emerged over the past several years as bastions of innovation in local markets. As capital has poured into the Internet space and created opportunities to build thousands of Internet companies around the world in a compressed period of time, some of the basic building-blocks of new companies—managers, accounting skills, personnel, legal advice and technology support—have become scarce. Incubators aim to provide expertise, scarce resources, and seed capital in exchange for equity. In addition, Internet incubators aim to accelerate the development process for early-stage startups, often attempting to graduate incubees in as short a time-span as six months. With "speed to market" as their motto, they relieve entrepreneurs of the need to perform time-consuming tasks such as finding office space, building software, or hiring employees. In addition, incubators aim to infuse startup organizations with the right advice, the right capital, and the right expertise at the critical development stages where they can be of most use.

The concept of business incubators is not new. Incubators have existed in the U.S. since the 1970s. Many of the early incubators were linked to universities, supporting science-based spinouts from academia. Others were government-funded projects set up to revitalize distressed economies. Unlike the newer incubators, though, few of the early models were linked to aggressive venture capital sources.

The new Internet incubators bridge the widening gap between venture capitalists and young entrepreneurs. In the 3rd quarter of 1999, venture capitalists infused Internet-related start-ups in the United States with \$5.2 billion, almost five times as much as during the same period in 1998, according to PricewaterhouseCoopers. Venture capitalists increasingly manage such large funds that they lack the time to support startups requiring less than \$1 million in seed financing. As a result, incubators offer a supportive, service-loaded, and earlier alternative financing source that can be used as a bridge to later-stage venture capital funding.

In sum, Internet incubators have emerged to support the explosion of Internet-related companies enabled by a period of rapid expansion and liberal capital. They have emerged to meet the needs of entrepreneurs, who frequently have difficulty building and executing powerful business models in compressed "Internet time." And finally, the new wave of incubators has emerged to bridge the financing gap between early-stage startups and venture capitalists.

### **THE PROBLEM**

The value proposition for an incubator is even higher for e-commerce startups in China. A situation currently exists in China in which enabling capital sources are present and entrepreneurs are being nurtured and encouraged in the Universities. However, based on StartupChina interviews with venture capitalists working in the Mainland market, they find it increasingly difficult to find high-quality deals and experienced teams. Where is the disconnect? On one side of the equation, international investors often have a limited presence on the mainland and limited access to some of the major hubs of innovation, such as the university districts. On the other side of the equation, entrepreneurs often lack the resources to develop their ideas into strong execution-oriented businesses. The new startups often have compelling business concepts, as well as raw management and technology talent. However, they frequently lack the networks, experience, and exposure to rapidly build their businesses from the initial concept to the more developed stages of a young company which international-standard investors are interested in funding.

As a result of these factors, StartupChina believes that the Internet incubator business model is stronger in China than in the United States. The gap between entrepreneurs and international caliber investors is greater than the U.S., due to geographic, market, and cultural factors. In addition, the general management sophistication of entrepreneurs is lower than in the U.S., thereby requiring a more hands-on investment approach. As a result, StartupChina is developing an aggressive strategy to capitalize on this market gap by rapidly building a major presence as a business accelerator for startups in the Chinese marketplace.

### **THE COMPANY**

StartupChina is a Business Accelerator for e-commerce startups in China focusing on B2B opportunities and technology companies that support the e-commerce revolution.

The company was founded to foster and support entrepreneurs in jump-starting the Internet revolution in China. StartupChina will provide a full range of resources to infuse startup companies with the development strategies, resources, and financial support necessary to rapidly introduce innovative products and services into the Chinese

market. Our goal is to become the premier e-commerce holding company in China by establishing a presence in major segments of the infant Chinese Internet economy.

### ***The Mission***

StartupChina was created with the basic belief that the Internet will radically alter the development of China's business environment. In the process of developing companies to seize the numerous opportunities that the Internet presents, entrepreneurs are faced with significant challenges to reach the market ahead of their competition. Our goal is to help them.

The company's mission is to develop individual business concepts into highly focused and successful Internet businesses. StartupChina's leaders believe that to succeed in the dynamic Chinese Internet market, companies must achieve rapid speed of execution by tapping the services, support and knowledge of individuals and organizations that have extensive experience in both the Chinese and international markets. StartupChina will combine the best elements of a small and nimble company with the financial strength and wisdom of a much larger organization -- sharing these benefits with its operating companies.

Many Chinese Internet companies currently lack direct access to the financial, strategic, legal, and general business expertise of the U.S. and other international markets. As a business incubator, StartupChina will provide best-practice, proven business processes and systems from the U.S. and other international markets to accelerate and nurture the growth of startup companies in the Chinese market. In addition, the company will seek to develop business models that are uniquely suited to the Chinese market. In return for equity, StartupChina will foster a portfolio of companies by providing entrepreneurial teams with initial funding, a full suite of services to jump-start their business, a physical infrastructure that they can step right into, and access to later-stage funding sources to support future growth. StartupChina seeks to radically compress the business development cycle for its portfolio companies, empowering the entrepreneurs to focus on the execution of their business plan within the Chinese market.

### **The Product**

StartupChina's capital and services are expressly designed to meet both the needs of the startup entrepreneur and the needs of international investors. On the one hand, StartupChina's services are designed to ease the entrepreneur's pain in facilitating and streamlining the startup process. On the other hand, however, the services are designed to build enterprises that will be attractive to investors by facilitating overseas public listings or acquisitions.

### Seed Capital

StartupChina is seeking to invest between US\$50,000-\$500,000 in each portfolio company. The capital will be used to cover the portfolio company's initial startup expenses during the crucial phase during which the business plan is developed, the management team built out, the technology developed, and the initial steps of execution undertaken. The objective is to cover the initial expenses until later-stage funding can be secured. This money will be provided to the start-ups in return for equity of the company. The equity percentage will vary between 10% and 33% of the company based upon the agreed upon valuation. StartupChina will also retain the right to invest in the first round of funding from outside sources. StartupChina will be able to invest up to an amount that maintains StartupChina's initial percent ownership.

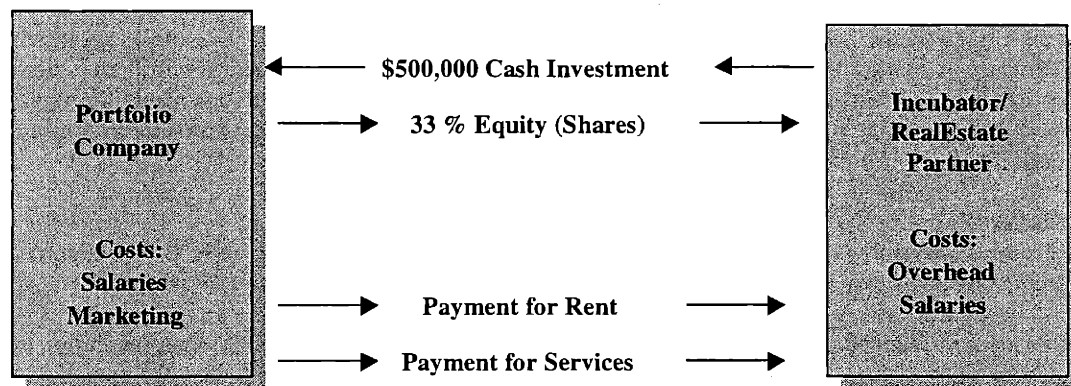


Figure 7: Investment/Equity flow



StartupChina will charge the companies at a subsidized rate for services and physical infrastructure in order to allocate costs appropriately, and incentive portfolio companies to utilize funds appropriately. Rent payments will be paid directly to our real-estate partner at a previously negotiated reduced cost.

Services for Start-ups

StartupChina is not merely a seed investor. Rather, a primary source of StartupChina's value to both entrepreneurs and investors is the services and management expertise that the company injects into its portfolio companies. StartupChina's mission is not only to bridge the financing gap between startup entrepreneurs and the venture capital community, but also to bridge the skill and experience gap.

Once entrepreneurial teams accept an invitation to enter the incubator, StartupChina will support every stage of the development process. The objective is to insure that each portfolio company is built on the strongest possible foundation from the founding moment. In order to achieve this goal, StartupChina will deliver a package of services that lends portfolio companies both the in-house expertise of the incubator and the services of StartupChina's premium service partners. In doing so, economies will be gained through the sharing of resources among startups within the incubator and through the reduced rates and increased access to the service partners. In addition, external relationships with partner service firms, venture capitalists, the government, and the media will be strengthened by aggregating the needs of the portfolio companies and accessing the external parties through StartupChina channels.

Through a combination of internal capabilities and external partner relationships, StartupChina will provide the following facilities and services to portfolio companies:

<b>Function</b>	<b>Roles and Responsibilities</b>
<b>Strategy</b>	<ul style="list-style-type: none"> <li>➤ Support the business plan development process through internal team resources and consultation with leading Advisory Board members</li> <li>➤ Cooperatively develop a well-researched business plan that not only provides clear direction and focus, but meets the expectations of the international investment community</li> <li>➤ Assist in the ongoing direction of strategy</li> </ul>
<b>Finance</b>	<ul style="list-style-type: none"> <li>➤ Manage the foreign financing process, including the maintenance of relationships with the top venture capital firms and investment banks</li> </ul>
<b>Accounting</b>	<ul style="list-style-type: none"> <li>➤ Develop metrics and internal accounting system in cooperation with StartupChina's partner accounting firm</li> <li>➤ Establish an accounting structure that protects the portfolio company's mainland positions, while also appealing to the international investment community</li> </ul>
<b>Legal</b>	<ul style="list-style-type: none"> <li>➤ Work with partner legal firm to establish an ideal legal structure that protects the company's mainland positions, while also appealing to the international investment community</li> </ul>
<b>Marketing</b>	<ul style="list-style-type: none"> <li>➤ Cooperatively develop an on-going marketing plan</li> <li>➤ Work in cooperation with market research firm to gather and analyze data (studies focus groups, etc.)</li> <li>➤ Work to develop sales and distribution partnerships</li> </ul>
<b>PR</b>	<ul style="list-style-type: none"> <li>➤ Work with management teams to formulate a media campaign that expresses the management's passion about their venture and communicates that excitement to potential investors, customers and mentors.</li> <li>➤ Leverage StartupChina relationships to gain access to premium advertising channels</li> <li>➤ Promote portfolio companies in the international press and in the international Internet community</li> </ul>
<b>HR</b>	<ul style="list-style-type: none"> <li>➤ Define HR needs and develop personnel growth plan</li> <li>➤ Assist in recruiting and developing effective management teams</li> <li>➤ Work with partner HR firm to recruit top-caliber managers from both China and international markets</li> </ul>

### Physical Infrastructure

Forty percent of an entrepreneur's time is spent on administrative tasks when first setting up to conduct business. Pressing issues range from finding an office space, buying/leasing furniture and business equipment, setting up an IT infrastructure, and hiring the staff to support the various business activities that need to be completed. StartupChina minimizes this time for an entrepreneur and allows him/her to focus on building the business.

StartupChina will provide physical office space that will include high-speed Internet access, computers, digital phones, shared conferences rooms, shared photocopiers, shared fax machines, and shared administrative services. High quality servers and server software will be on sight and made available to companies for use. The hardware and software will allow the various portfolio companies to share the costs and also enable them to scale quickly as the company grows. In addition, computer labs with installed software will be available for companies to use on an as needed basis to quickly develop and test new sites and technology. State of the art technology will be utilized in order to give portfolio companies a competitive edge in the market.

A strategic relationship will be developed with an offshore hosting service to enable further expansion and a smooth transition once the portfolio company leaves the incubator.

A high speed Intranet will be developed that utilizes the web to collect information about each company in the portfolio. Detailed expense accounts will be established so that companies can track their own expenses, revenues, and web statistics. This information will be available to all members of a portfolio company, executives of the Incubator and available to potential investors.

An internal database system will be established to provide ease of communication among members of a portfolio company and across the various portfolio companies. This database system will be used to monitor progress and also to provide valuable information to the portfolio companies.

The physical layout of the incubator will foster communication among portfolio companies and allow easy access to the executive team for advice and support. In addition, the structure will be highly flexible to allow for growth in participating companies. A hard working culture as well as a play hard attitude will be encouraged and facilitated with the addition of various artifacts. Portfolio companies will be encouraged to recommend additions to the incubator to create a sense of style and "coolness"

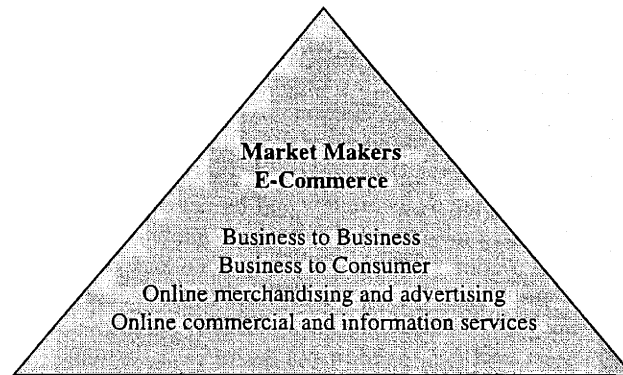
### First Round Financing

In the final months of the incubation process, StartupChina begins its final task for portfolio companies-- researching, networking, and making the connection to venture capital firms and other later-round financing alternatives. In this stage, the portfolio companies become StartupChina's products. By first developing a fine-tuned screening process to evaluate candidates for the incubator, and second, providing a professional, sophisticated means of creating and executing only the highest quality businesses in the Chinese market, StartupChina provides a valuable service to venture capitalists and other later-stage investors (including potential acquiring firms).

StartupChina will establish a strong relationship with the Venture Capital community as well as potential industry players. Through these relationships, StartupChina will introduce portfolio companies and seek potential investments. Information about the progress and development of the various portfolio companies will be available for investors via a secured Internet site. Investors will have up to date information and will be asked to visit the incubator in order to pursue deals further. Once StartupChina obtains first round financing for a portfolio company, the portfolio company is transitioned to a new location where it can rapidly grow utilizing the infusion of capital.

**Our Investment Focus**

StartupChina will invest in three distinct areas that capitalize on the growth of the Internet in China. Each investment area represents a different risk profile and cash flow generation. The goal is to diversify the risk in the portfolio and invest in synergistic companies that will support the growth of all companies supported by the incubator. The three areas of investment will be market makers (E-commerce B2C and B2B with an emphasis on B2B), Internet/Intranet Enabling Technologies, and Internet Enabling Services. Companies representing the two areas, Enabling Technologies and Enabling Services, will be selected based upon their ability to support Market Makers within the portfolio.



**Building a Foundation of Support**

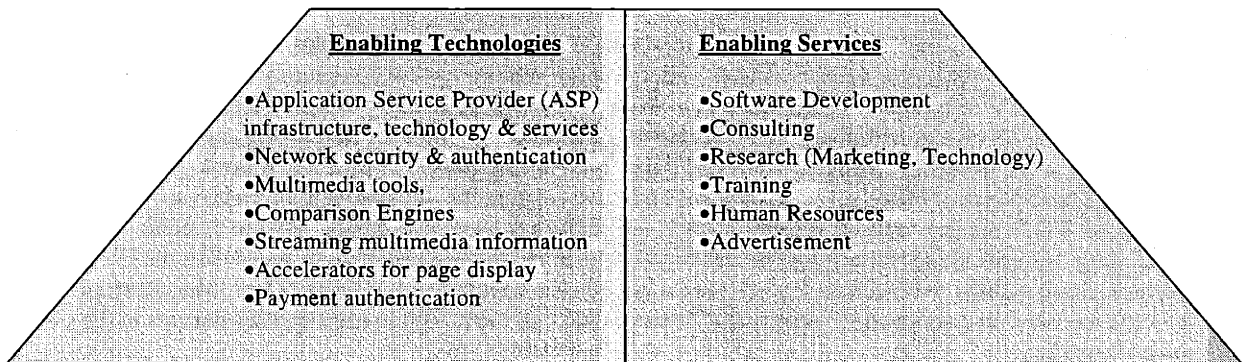


Figure 8: Synergies of Investment Focus

Enabling Services Breakout:

Software Development	Consulting	Research	Training	Human Resources	Advertisement
<ul style="list-style-type: none"> <li>▪ Software Provider</li> <li>▪ ASP</li> <li>▪ Software Licenses</li> </ul>	<ul style="list-style-type: none"> <li>▪ Strategy</li> <li>▪ IT</li> </ul>	<ul style="list-style-type: none"> <li>▪ Market Research</li> <li>▪ Technology Research</li> </ul>	<ul style="list-style-type: none"> <li>▪ Entrepreneurship</li> <li>▪ Web Design</li> <li>▪ Software Programming</li> </ul>	<ul style="list-style-type: none"> <li>▪ Head Hunting</li> <li>▪ Project Management Training</li> </ul>	<ul style="list-style-type: none"> <li>▪ Multimedia Content</li> <li>▪ Banner Ads</li> <li>▪ Trade Shows</li> <li>▪ Promotion</li> </ul>

## MARKET RESEARCH CUSTOMER'S NEEDS

The key to understanding StartupChina's opportunity is to examine the current venture capital and entrepreneurial environment in China. Venture Capital is flooding the Mainland China market. Funds are being established to invest in the next Ebay, Amazon.com, or VerticalNet. Clearly, the race is on to find the right Internet Company to invest in, whether it is a portal, B2C, B2B or an infrastructure company. However, with this increased amount of capital, Venture Capitalists are faced with the problem of putting it to good use. At first, many Foreign VC firms were participating in early stage seed financing. The thought was if you invested small amounts of capital in many different ideas, and in some cases, same idea but different team, you would win in a few. Those winners would then obtain further financing from the original seed investor.

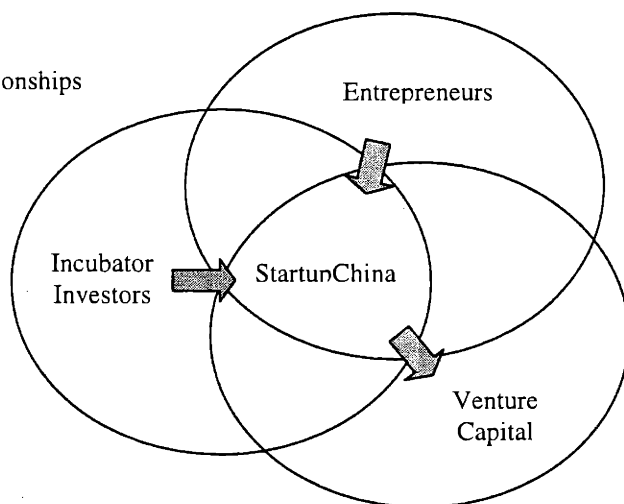
The game has changed somewhat. Entrepreneurs have recognized that it was a buyers market and the prices for participating at an early stage were starting to reach an extremely high level. The few good ideas available were starting to become very expensive. In addition, Venture Capital firms had too much money that they needed to invest. Increasingly, VC firms need to invest greater than one million dollars per deal, in order to maximize fund management fees and minimize operating costs.

In China, VC's frequently claim that qualified deals are few and far between. There are many entrepreneurs who have good ideas. Some of them are coming out of undergraduate or graduate school with an idea on how to capitalize on the Internet growth in their country. However, they often lack the ability to articulate the business idea or how to define and develop a revenue model. The basic problem is that the ones that are willing to take the risks in starting a company are usually not the ones that have the abilities to package it and sell it. Their ideas have value, their ability to learn quickly is an asset, and their passion and desire are what will push them to succeed.

Many young management teams merely need an initial infusion of capital--totaling not more than five hundred thousand dollars--accompanied by an experienced team and professional services to lead them through the startup process and connect them with the venture capital community on the other side.

In order to establish and operate the incubator, StartupChina must serve the needs of three customers: investors for the incubator itself, Chinese entrepreneurs, and the international venture capital community. First, StartupChina will provide a mechanism for investors to participate in a diversified portfolio of early-stage e-commerce companies in the Chinese market. Investors will invest in the Incubator itself to cover costs for developing the incubator and also capital to invest in the portfolio companies. Second, entrepreneurs are provided with much needed capital, value-added services, and physical office space so they are able to accelerate the development of their company in preparation for VC financing. The third beneficiary is the venture capital community. By pre-screening, selecting, and developing business plans and management teams that have the highest potential to succeed in the Chinese marketplace, StartupChina will become a crucial sourcing ally for venture capital firms. Over time, StartupChina will become a critical link connecting foreign and domestic venture capitalists to high-quality startups in the Chinese e-commerce market.

Figure 9: Customer Relationships



### ***Investors for the Incubator:***

StartupChina is pursuing various strategies for identifying and obtaining investors for the incubator. Capital will be used to support the development and operation of the incubator and will be used to invest in various portfolio companies. Investors, however, bring more than just capital. Ideal investors will bring knowledge, skills, experience, customers, extended network, and strategic relationships. In addition, investors in the incubator may be looking for more than just a significant return. Investors may be looking for potential acquisitions, the development of technology they would need, and a driving mechanism for the generation of new customers (i.e. Motorola would be interested in supporting the development of business that drive the use of Motorola products). Lastly, investors may have an altruistic goal in that they wish to give back to China or present a good will gesture to the country.

Ideal investors will be a combination of domestic and foreign parties. Various types of investors include **Angel investors, Corporate investors, Real Estate Developers, Incubators, Venture Capitalists, Financial Institutions, Service Providers, and the Government**. Each type of investor brings something different to the table and also has identifiable motivations for investing in an incubator. It is important to address each investor's needs to understand how best to support them, and also to attract them to the incubator. In addition, it is important to determine what each type of investor brings to the table and how difficult would it be for StartupChina to reach these investors.

### Angel investors:

Startup China will work to establish relationships with Angel investors who wish to invest in early stage companies in China. These Angel investors will be individuals of high net worth from the United States, Hong Kong and Mainland China. Additional angel investors could potentially come from other parts of the Far East including Taiwan, Japan, and South Korea. These individuals will be looking to invest in areas that promise high return but with an acceptable level of risk. Currently, foreign angel investors have very little access to the China market. However, they are recognizing the dizzying returns that are being achieved in the United States, and they see the potential for the Chinese market.

Angel investors usually provide capital to developing companies. In addition, they bring credibility to the venture and a network of contacts. Some angel investors may provide other forms of assets in return for equity such as real estate, hardware, network access, etc. The level of involvement that angels play within the development of a company varies from one venture to another. Many angels want to take a leading role in the venture, while others wish to provide access to their extended network, but let the entrepreneurs do the day to day work. All Angel investors want to make their investments successful and also want to be able to cash out at some future point. Most Angel investors do not want to take on day-to-day operational roles, but wish to be in an advisory capacity. They wish to be kept informed, up to date, and utilized if needed. Some wish to be on the board of directors, but most do not.

Many Angels in cities like San Francisco and Boston have formed Angel groups. These groups work together to find investment opportunities and are available to help young entrepreneurs. The structure of the groups varies. Some groups pool their money together into a fund and have professionals identify, screen, and recommend early stage investments. The band of angles that are on call to aid the further development of the ventures, and from time to time can be called upon to take on an operating role. Other angel groups meet monthly or bi-weekly to listen to presentations by young entrepreneurs who have made it through an initial cut. Any individual angel can invest in the idea, and others can co-invest. Money is not pooled together into a single fund. Very few angel groups exist in Mainland China. Individual investors do exist but hire firms to find potential ideas for them. Many angel investors today are becoming more risk averse, according to Mike Moritz from Sequoia Capital Partners. He sees angles increasingly inviting in VC firms to co-invest at a very early stage, or bands of angles investing together. Many angles are finding that they do not have the time or the ability to sufficiently support start-ups.

Angel investors usually cannot provide the level of service and advice to startups that are needed to succeed. In addition, there is not a large number of angel investors in the United States and in addition, they are not the easiest people to find, or approach. Each angel often has direct experience in a particular area, but remain a generalist for other areas. Many are currently seeking out early stage Internet companies, based upon the high valuation that they are receiving. In many cases Angel investors are investing to obtain a high return, and are not as interested in building value for the long term. Many Angel investors wish to exit in the next round of financing. It is difficult for them to analyze the large number of ideas that come across their desk, thus they are interested in banding together to

minimize the work. Access to foreign markets is difficult, since they understand very little of markets outside of their region.

Ideally, an incubator would provide the services that an Angle group needs in order to be successful. By having a group of Angle investors fund the incubator, they are pooling their resources together and investing in a portfolio of companies. They have people that will dedicate their full effort in screening deals, supporting the growth of the companies, and obtain future financing for the portfolio companies. Angle investors will still be called upon to provide contacts, advice, and in some cases operational involvement. The money that the angles invest is diversified among a diverse portfolio, minimizing their risk.

#### Corporate Investors:

*Demographics:* Both foreign and domestic corporations are interested in the growth of the Internet in China. Large technology firms and current Internet players are developing venture arms to identify strategic investments that will help them grow. Firms involved in Software, Computer Hardware, Telecommunications, Mobile products, E-commerce (B2B, B2C, and portals), distribution, retail, and/or manufacturing all have strategic interests to see the Internet grow.

*Leading Firms:* Recently, U.S. corporations started taking an active interest in investing in Chinese Internet startups. For example, one of the most popular Chinese web portals, Sohu.com, was funded partly by Intel and Dow Jones. Other prominent U.S. corporate investment in China includes AOL's strategic investment in China.com, a greater China region web portal company. Motorola, Kodak, Nortel, and UPS, all of who have ventures in Mainland China, have been asked by the Chinese government to invest in China's Internet sector. The trend is that more and more U.S. businesses will consider making strategic investments in Chinese startup as the technology platform of the business is going web on global basis. It is reported in Chinese press that GM's joint venture with Shanghai Auto is considering investing in a number of local web-based supply aggregators.

Constrained by internal bureaucracy and financial resources, few Chinese corporations have managed to establish dedicated equity funds to invest in the mainland technology sector, even though they enjoy significant competitive advantage in this sector. However there are exceptions. China International Trust and Investment Corp. "CITIC" co-invested with Softbank Japan in Alibaba.com, a Chinese B2B web entity. Even Chang Zheng Ming, Chairman of CITIC Securities, has agreed to sit on the board of Alibaba.com. This sets the precedent for senior Chinese corporate leaders joining the board of domestic startups. There are also speculations that some of the leading Chinese technology companies such as Stone, Legend, and Great Wall Technology may soon enter the venture market. Currently, the Internet portal China.com is becoming a major force in Mainland China, investing in numerous companies throughout the country. In addition, Sina.com, a Mainland Chinese portal, recently issued a public offering on NASDAQ, thus raising capital to expand its assets and invest in other companies. Other Internet companies may follow suit.

*Unique Needs of Investor:* Many corporate venture arms are just beginning to invest in China. They have substantial knowledge of their industry, the regulations surrounding the investment environment, but are often find them at a disadvantage compared to VC firms. The primary reason is speed for making a decision. In addition, corporate venture arms do not have the manpower to attract, evaluate, and support the various companies that they may be interested in. Corporate venture arms could outsource their screening process to an incubator and only evaluate the ones that filter to the top. Strategic investments in certain areas will drive customer growth for their own products, develop technologies that they may need, and in addition provide a support structure to nurture companies.

An incubator provides a location for employees that wish to join a startup. Instead of losing people to a competitor, corporate resources can still be connected to their parent firm and aid in generating wealth for the company. For U.S. technology companies involvement, they wish to leverage new international market dynamics of the hi-tech business. In order to obtain more Internet market share, companies require simultaneous launching of products in all major markets. These companies therefore need to establish Asian presence as soon as possible. It is clear those U.S. companies interesting in the China market view investments in local web companies as a small price to pay for a strategic business opportunity. Corporate investors will be able to leverage their assets strategically and will benefit from being part of a partnership amongst an incubator and other corporate investors in strategic industry sectors. The corporate investor will have in-depth knowledge of portfolio companies and will be able to assess future financing or acquisition with deeper insight. Given these companies' close ties to science and engineering institutions in the

country, and their understanding of the local technology market, their involvement with StartupChina can be rewarded with handsome returns as well as provide real value-added service to young Chinese startups.

*Benefits for the Incubator:* Corporate venture arms provide extensive on the ground support and localized network. They bring knowledge in technology, infrastructure, and government relationships. They provide an ideal exit strategy for portfolio companies, via a strategic acquisition. Corporate venture arms provide industry knowledge and provide access to potential customers of portfolio companies. One example would be Motorola's unique understanding of Mobile phone users in Mainland China for aiding the development of a wireless Internet service. Corporate Venture arms could aid in the recruiting process for both the incubator and the various portfolio companies, and also will be potential future investors during the first or second round of financing. Lastly, Corporate venture arms bring operational and logistics knowledge that StartupChina will be able to access and utilize appropriately.

#### Real Estate Developers:

*Demographics:* During the past 12 months, several leading real estate developers in Hong Kong have launched venture capital initiatives. Many of these developers have a strong presence in Mainland China and have substantial assets located in major metropolitan areas, specifically office space. These organizations mostly have no prior experience in hi-tech investment but command substantial financial and operational clout in their localities.

*Leading Firms:* Funds have been established by Hutchinson Sun Hung Kai Properties, Shanghai Industrial Holding, Hutchinson Whampoa, and New World Development. These firms are utilizing their capital to invest in the rapidly growing Internet industry, and also leveraging their network and office complexes.

In 1999, Hong Kong-based Sun Hung Kai Properties established SUNeVision to manage the firm's technology investments and initiatives. In addition to managing five venture capital funds, SUNeVision is also involved in providing IT operations to Internet start-ups and small-to medium-size information technology portal companies that want to outsource their IT operations so that they may focus on their core businesses. To support this activity, SUNeVision formed a strategic alliance with Microsoft and Hewlett-Packard in March 2000. Also, to take advantage of investors' appetite for internet-related stocks and to create an acquisition, SUNeVision went public in Hong Kong's Growth Enterprise Market ("GEM") in March 2000, around the time of the recent all-time high in the Hong Kong stock market.

In 2000, Shanghai-based Shanghai Industrial Holdings announced that it would establish a venture - capital fund with Temasek, an investment arm of the Singapore government, and Vertex, a venture - capital arm of Singapore Technologies Group. The three parties will jointly commit an initial amount of \$20 million to the fund. The fund's size will be increased to \$50 million sometime later to allow participation from additional foreign investors. The fund, to be called SI.Technology Fund, will invest in high-technology projects in Shanghai and the greater China region.

Another conglomerate that entered the venture capital business is Li Ka Shing's Hutchinson Whampoa, the largest mobile phone service provider in Hong Kong. In March 2000, Hutchinson Whampoa, Swedish giants Telefon AB L.M. Ericsson and Investor AB announced that they would take over a small property company, Guoco Land, and turn it into an internet investment platform. The three partners would acquire 50.1% of Guoco Land for US\$177 million with the aim of creating a venture capital company that will focus on capturing growth opportunities in the mobile wireless Internet sector.

New World Ventures is the venture arm of New World Development, one of the largest Hong Kong property developers. It is reported in the Asian press that New World Ventures made a US\$ 56 million investment in GWcom.com, a wireless company in China. In addition, New World Infrastructure, a unit of New World Development, has an 18% stake in China.com, making it the biggest single shareholder in the only China-related Internet company listed in New York.

*Unique Needs of Investors:* Asian real estate developers see financial goals as their principal investment objective. With that in mind, they are rapidly looking to the Internet sector to provide substantial returns. However, the Internet is not their primary business, thus they rely on strategic partnerships to support the management and infrastructure of their portfolio companies. In addition, they need experienced managers to build the companies and must get the moving in the right direction. Many of the large real estate developers that have substantial influence in the region

are operated out of Hong Kong. There is very little day-to-day involvement that these firms would be able to supply to portfolio companies. A real estate developer needs expertise and local knowledge to evaluate Internet companies, resources that they do not have in abundance. Lastly, Real estate developers have vast assets in the form of office space that currently sit unused in Beijing and Shanghai. A potential use of these assets would be Internet startups, both while they are part of the incubator and after they leave and need space for accelerated growth.

*Benefits to Incubator:* As an investor a real estate company will provide access to an influential network and will provide aid in taking many portfolio companies public, via purchasing a listed firm on the Hong Kong exchange. Real Estate developers are looking for a substantial return and are not as interesting in running the company. They will be able to provide office space and equipment at a substantial discount in order to maximize the return for all parties involved. In addition, a strong relationship with a real estate developer will aid portfolio companies as they continue to grow and seek warehouses, larger office spaces, and distribution centers.

#### Investment Banks:

Demographics: Investment banks have been involved in principal investments for a long time. Such investments are generally of the following types:

- Technology investments: Venture capital investments in high growth companies bringing new and unproven technologies to market.
- Mezzanine lending: Deeply subordinated or high loan to value lending typically characterized by equity participation.
- Growth investments: Investments in promising young companies seeking capital to fund further growth through acquisition or expansion.
- Management buyouts: Investments with experienced managers to purchase the companies they operate.
- Recapitalizations and restructurings: Investments to facilitate the recapitalization or operating restructuring of attractive businesses or real estate companies and partnerships. Additionally, REPIA has a substantial business purchasing non-performing loans secured by real estate assets or issued to troubled corporations.
- Industries in transition: Special situations that arise because of market dislocations, regulatory changes, or investor disfavor with a specific industry.
- Loan syndicates: Purchase of interests in bank syndicates in order to gain influence in credit restructurings.
- Emerging markets: Purchasing companies or real estate in emerging economies with substantial risks but expected high returns.

*Leading Firms:* All of the bulge bracket investment banks are active in principal investing. The two most active firms in Asia are Goldman Sachs and Morgan Stanley. Other firms, including Merrill Lynch, CS First Boston, and Lehman Brothers are in the process of expanding their activities in the venture capital areas. Goldman Sachs manages a worldwide mezzanine fund (GS Mezzanine Partners, with US\$800 million of committed capital) that invests in private, subordinated debt securities of companies. Morgan Stanley manages several worldwide mezzanine funds (most recent fund is Morgan Stanley Venture Partners III, with US\$275 million of committed capital). Both the Goldman and Morgan funds are worldwide funds and are not dedicated to Asia alone.

*Unique Needs of Investor:* An investment bank invests to earn high returns, and will eventually want to cash out. In fact, the fund from which the investment is originally made generally specifies an expected liquidation date for the fund. An investment bank typically exits shortly after the IPO. Investment banks do not have operational experience or a strong presence in Mainland China. The Goldman and Morgan professionals in charge of evaluating investment opportunities in Asia are all based in Hong Kong. There is a strong need to have experienced managers work with early stage companies to get them off the ground. In addition, they need help in identifying and evaluating investment opportunities from the local market. By being an investor in the Incubator itself, the Investment bank is in a unique position to identify exceptional early round investments and also a future client list for IPO transactions. In fact, the largest investment banking investor in a portfolio company generally will be awarded the IPO mandate. The IPO mandate and the direct return from the investment are the two primary benefits for the investment bank.



*Benefits to Incubator:* The level at which an investment bank is involved in its portfolio companies varies from portfolio company to portfolio company. However, an investment bank will generally demand a Board seat, but will leave the portfolio company's day-to-day work to the portfolio company's management. In addition to providing capital, an investment bank also provides prestige and access to the investment bank's valuable network, a network that was established through the bank's extensive experience in advising clients in nearly all industries of the economy. Investment banks can also help tremendously in the IPO process, both for the incubator and for the portfolio companies.

Service Providers:

*Demographics and Leading Firms:* In the U.S., management consulting firms and IT firms are leveraging their knowledge assets to provide services to startups, especially those related to the Internet industry. Multinational management consulting firms such as McKinsey, Boston Consulting Group, Bain, and Anderson Consulting have established incubator services of their own, but are currently far behind in establishing a presence in Asia. Their primary goal is to retain employees who would have left to join an Internet company, and the attrition rate has been increasing at a rapid pace. McKinsey alone has alumni in many of the well-known Internet companies. These service firms are in the process of expanding globally, but have limited operational experience. Their previous roles have been recommending strategy, not executing it.

*Unique Needs of Investor:* Service firms, like others, are interested in participating in the boom of .com companies. Their main needs are keeping employees motivated and employed as well as making a substantial return. They have a short history of evaluating potential Internet companies, and in many cases with Asian firms, they have difficulty obtaining customers. Partnering with StartupChina enables the service company to rotate its own people into assignments with portfolio companies. This gives them an opportunity to work in a startup environment but with the stability of a good paying job. In addition, a service firm does not need to establish its own incubator but participate in one where they can be involved in a consortium of industry players. Lastly, the service firm will be exposed to potential future clients as the portfolio companies graduate from StartupChina.

*Benefits to Incubator:* The main benefit to StartupChina is the additional human capital and knowledge that a service firm can bring to the portfolio companies in the Incubator. The vast experiences of the service firms will also be leveraged in the incubator, and their extended network will be tapped for resources and expertise. Lastly the service firms can bring additional customers to various portfolio companies. If a B2B company is being incubated, a service firm may be able to provide valuable links to companies within the targeted industry.

Incubator Investors:

*Demographics and Lead Firms:* Incubation has become wide spread in the United States and is just now beginning in Europe and Hong Kong. These firms are similar in nature to StartupChina, but currently do not expand their operations globally. Leading firms in the US would be IdeaLab, BrainRush, CampSix, Cambridge Incubator, I-Cube, and Knowledge Cube. These leading firms are currently focusing on E-commerce related activities. In Hong Kong, firms such as IncubAsia, TechPacific and iMerchants are leading the way. In Europe some leading firms for the E-Commerce sector include E-Start and StartupAvenue located in Great Britain and Paris respectively.

*Needs of Investor:* The main needs for a foreign incubator is access to the local China market. Many incubators wish to have the ability to expand globally, i.e. their portfolio companies expanding globally. Through a partnership they would have access to the China market for either services or goods of their portfolio companies or they could expand the operations of a portfolio company by co-investing in a joint venture in China. They need to have an on the ground presence or extension so that they can become familiar with market dynamics and needs of consumers. Ideally an investment in StartupChina would provide them with a foothold into the China market.

*Benefits to Incubator:* Startup China will benefit from additional knowledge on supporting e-commerce companies in other regions. It will expand the incubators reach and global network and provide an opportunity for co-investments in transferable business models. Resources could be shared on a global scale, as well as deal flow. Finally, a partnership with a global incubator will provide an exit vehicle for portfolio companies in StartupChina. Sister portfolio companies from other incubators could acquire companies.

### International Venture Capital:

*Demographics:* Treating China as a portfolio country, many famous venture capital companies have recently entered the Chinese market. Much of the venture capital investments in China come from Hong Kong and Taiwan. While certain US second-tier venture capital firms also invest in China, US first-tier firms usually only invest in their close vicinity because of their strong deal flow. Typically, venture capitalists would take 10-30% of the equity and tend not to involve in the day-to-day running of the companies. Most Asia based venture capital claim that they run the business exactly the same way as their Sand Hill Road counterparts. However, they are generally less specialized and invest less in each deal. They sometimes drive hard bargain on the investment and believe in "buy low sell high" in the dealing. Therefore, the entrepreneurs must be very clear on their funding target. The upside is that Asia venture capitalists are less close-knitted so care less about companies shopping around for term-sheets.

*Leading firms:* International Venture Capital firms can be divided into two categories. The first category can be described as pure VC and include companies such as Extant Asia Ltd., AsiaTech Ventures, ChinaVest, Walden Investment Group, Crystal Investment, and Advent International Corp to name a few. A second category could be termed Internet holding companies, and includes companies such as IDG, Softbank, Pacific Century CyberWorks, CMGI and ICG. Many of these firms invest in Mainland China and some have a strong resource base. However, others are just beginning to enter the market and find the going rough.

The largest Hong Kong-based venture capital entity is CyberWorks Ventures, the venture capital arm of Pacific Century CyberWorks. As of the end of first quarter 2000, it has invested in 42 companies. Although CyberWorks Ventures did not disclose many financial details, analysts estimated the company's investments had reached about US\$700 million. In early 2000, Pacific Century CyberWorks agreed to buy Cable & Wireless HKT Ltd., **Hong Kong**'s largest telecommunications company for \$38.1 billion. With this large telecommunication company in the network, CyberWorks Ventures can add substantial value to potential startups.

In March 2000, CyberWorks Ventures partnered with US-based CMGI (venture capital firm) and Hicks Muse (private equity firm) to form a \$1.5 billion fund to invest in Web businesses in Asia, Europe and Latin America. Each partner contributed US\$500 million to the venture.

*Needs of Investor:* Venture capital firms need to support their investments and their own incubator arm would allow them to support these companies at a local level. VC's who currently do not have their own incubator arm in China include ChinaVest, Walden and Draper. In addition, PCCW does not have a presence in Mainland China, but has made substantial investments in various companies in the region. Primarily, the VC firms would be looking for local knowledge, support and on the ground presence. Venture arms would like to have a sourcing agent to screen the numerous deals that cross their desk, and by investing in the incubator itself, they have a unique advantage of seeing deals before other investors and in addition, they can participate in seed round financing through an indirect route. With the flood of money being raised for Chinese Internet companies, VC's now have the problem of finding good deals and not spreading themselves too thin by investing small amounts in early stages. By investing a large amount in an incubator, they will be investing indirectly in the seed round, and will be in effect generating better deals for themselves to finance in later rounds.

*Benefits to Incubator:* Venture Capital investors bring strong brand recognition and credibility. Entrepreneurs will wish to work with StartupChina because they see the potential for getting future financing through the VC's supporting the incubator. The Venture Capital investor has a strong global network, and significant resources and knowledge from portfolio companies that they have invested in, in other regions. In addition, the VC investor would be able to help in identifying management talent to build the incubator and various portfolio companies.

One target investor would be PCCW. A main benefit of having CyberWorks Ventures is the benefit from being associated with the Li family (K.S. Li and Richard Li). This association can open many doors not otherwise open to a startup. An incubator startup can add significant value to CyberWorks Ventures by bringing relatively more mature companies (companies that are already incubated) to CyberWorks Ventures.

Most of the people who work in CyberWorks Ventures are execution specialists. Many are former investment bankers, consultants, accountants, and lawyers that could be tapped for additional expertise for our portfolio companies.

Government:

*Demographics:* The State Council has allocated RMB1 billion (US\$120 m) for the Ministry of Science and Technology (MST) and granted loans worth RMB 2 b (US\$240 m) to high-tech companies developing high-tech projects. Local governments, such as Shanghai, Shenzhen, Wuhan, Suzhou, Chengdu, Shenyang, and Harbin, have also set up venture capital investment funds to encourage investment in local high-tech projects and new industries. For example, Shanghai will invest RMB 600 million (US\$72 m) annually over the next three years. Many local governments have set up zones for high-tech venture capital investment. All levels of government, including the central government, regional governments, and various municipalities wish to participate in investment activities.

*Needs of Investor:* The government wishes to stimulate economic growth and job creation. They are also interested in supporting the development of the infrastructure that will enable the country to become more prosperous. Local governments use the funds to attract the entrepreneurs to establish their business. According to Chinese law, a business must pay their tax to the locality where they register their company, thus generating revenue for the local municipality. Since StartupChina will be based in Beijing, the most likely target for government funding will be from the Beijing government.

Since the governments have little experience with venture capital, they are not in the best position to advise or bring the necessary connections to startups, although they may be useful allies in specific areas. The officials running the venture funds are not familiar with the western business norms so the term-sheets are also haphazard. It is not uncommon for the government to demand unreasonable amounts of equity for their investment, and the reverse is probably equally true. The Chinese government would be more successful if it could call on the resources that an incubator could provide to screen, invest, and support new enterprises.

*Benefits to Incubator:* StartupChina would benefit through a strong relationship with the government. Buy-in is incredibly important and will aid in navigating through the myriad of regulations. The government's vast network and resources could also be leveraged for the portfolio companies. The most important benefit for StartupChina is the possibility for fast tracking procedures such as licensing, permits, corporate structuring, and listing (IPO) procedures. Lastly, a strong relationship with the government through an equity participation will enable StartupChina to have access to future regulations before they are announced and StartupChina will have a unique position to influence the development of new policies in order to benefit portfolio companies within the incubator.

### **Chinese Entrepreneurs**

Entrepreneurship is sweeping the Chinese landscape. With the Internet frenzy, capital is pouring into China and young students are jumping in with both feet to catch the wave. Numerous ventures are started up with a single computer, a piece of board on boxes to act as a desk, and an office in a nearby building. Many of today's young entrepreneur's come from an educational institution, either a student or a professor from a Chinese University, or come from industry where they have strong connections and a deep knowledge of a particular industry segment. Neither has ever started a company before. A third area that seems to have spawned a large number of Internet Startups is the Service Sector, Management Consulting and Investment Banking. Many of these ideas aren't getting off the ground because they face so many obstacles. Many lack the operational experience to move quickly, have difficulty raising smart capital, and find frustration in pulling together the infrastructure and human resources to successfully grow their company.

When starting a company in China in the Internet space, an entrepreneur faces a series of challenges. The first challenge is to develop a unique business model that leverages the Internet and provides substantial value to its customers. The second challenge is establishing the plan to carry out the execution of the business model. The execution requires expertise in a host of areas and often includes market research, prototype development, and customer analysis. The third challenge is establishing the infrastructure necessary to launch and operate the company, including technology, office space, working capital, resources, and operating licenses. The fourth challenge is structuring the company correctly to navigate the dynamic Chinese regulatory environment and to understand the various legal aspects of the Internet. The fifth challenge is securing first round funding from sources that will provide more than just capital and at a valuation and equity arrangement that is acceptable to both parties.

**Speed:** Entrepreneurs see a need and quickly develop an idea to satisfy that need. It often requires creativity, knowledge of the customers, and a sense of dedication. In order to be successful it also requires the experience and knowledge on how to execute an Internet strategy. Many of the entrepreneurs from Universities, Industry, and other Internet companies are first generation entrepreneurs. The idea of capitalism and market economies is a fairly new concept in China, so a great deal of education must take place.

Entrepreneurs need help establishing themselves right away. In the Internet Market, speed to market is everything. If you are not first, then you will not win. They need to tap into an established network to help with funding, customers, and hiring needs. They need to access capital that brings knowledge and expertise. They need access and insight to foreign capital and the knowledge on how to negotiate terms between their company and the investor. How should they present? How can they gain their attention?

**Expertise in Human Capital:** Many entrepreneurs have great ideas and passion, but lack the experience to build a company. Even though there is a great deal of money available to them, they find it difficult to qualify for that money, or obtain the help they need in order to execute a strong business plan. It is very difficult for entrepreneurs to gain the knowledge they need to build a successful company. Few educational programs exist to teach this information, and very few people have experienced it before. Only 26 MBA programs exist in the country, turning out 3000 MBA students each year. Multinational Corporations such as Motorola, Ericsson and GE have also established internal Management training programs to satisfy their needs. China needs 350,000 executive managers, but at present has only 3,000 MBAs. The disproportionately small number MBAs has led to an acute problem in regards to training future entrepreneurs and also expanding startups where entrepreneurs find it increasingly difficult to hire middle managers that can manage projects. Entrepreneurs often don't possess the skills for starting an Internet company and often have to participate in long competitive endeavors to lure experienced managers to their teams.

Knowledgeable programmers and web developers also pose a significant issue for China's Internet development. A vast majority of programmers and developers in China are self-taught; few have formal training. This provides a significant challenge to companies attempting to determine the varying capabilities of potential employees. Only 25% of the 6 million high school graduates can go on to colleges and universities. One move in the right direction to improve the labor pool and placement of recent graduates and helping the growth of the private sector is that the Chinese government has implemented a new system. This system will force graduates to make a choice to swap the option of free education and an assigned job for the responsibility of paying their own way through college and the freedom to find their own work afterwards.

**Infrastructure:** State of the art office facilities are needed so that the entrepreneur can step into the office and immediately start focusing on the business, not administrative headaches. According to Softbank executive managing director Gary Rieschel, Softbank Venture Capital surveyed its early-stage companies last winter and found that during their first six months, some 40 percent of their time was spent on administrative needs. Levy knows this fact from personal experience. He grappled with setting up an office in 1996, when he co-founded RelevantKnowledge, a Web-audience-measurement firm that he eventually sold to Media Metrix in 1998. "So much time was spent on finding an office, getting a phone system, hiring a receptionist. All those things you need to have a real company," he recalls. "But they weren't moving the business model forward."

**Working Capital/Bank Loans:** Chinese Entrepreneurs find it very difficult to obtain a line of credit from banks, based upon banks' preference to lend to the state sector, and also the high risk involved to lending to a start-up. In addition, the banking sector has to serve itself (fix things!) before it can really serve the needs of the entrepreneur. The state run banks lack a reasonable management system, leaving many banks overstaffed; provide low quality service in their products, efficiency, and quality; possess in-experienced personnel when compared to their foreign counterparts, and provide low returns. Internal control mechanisms are "loose" and insufficient, not transparent and give rise to poor operations or even illegal behavior<sup>1</sup>. These issues have lead to the banks amassing a huge amount of debt, making the entire system close to insolvency.

Foreign banks are not available to entrepreneurs at this time, unless they structure themselves as an offshore company, such as in the Cayman Islands or in Bermuda. Entrepreneurs need a strong line of credit to support their working capital when certain unforeseen cash crunches appear. Group bargaining power, or a partnering organization to act, as collateral would aid entrepreneurs. Things are improving. With the admission to the WTO in the near future the government has gone through the process of restructuring the banking system, writing off bad loans, and preventing state enterprises from getting easy money in the future.

**Navigating the Regulatory environment: Corporate Structure and IPO:** Entrepreneurs want to structure their company in the most appropriate way to successfully navigate through regulations overseeing exit strategies such as an IPO or an acquisition. In addition, they need legal advice on intellectual property protection, operating within the dynamic regulatory environment, establishing benefits packages, and negotiating contractual arrangements. The Chinese government has enacted regulations governing Internet access and the distribution of news and other information. These regulations have directly shaped the Chinese Internet industry. In the early days, it dictated which sector and region that private companies could pursue. Entrepreneurs were only allowed to set up ICP, B2B or B2C companies. Only people with strong government connections and local funding could get into the ISP sector. It was almost impossible for any foreign funded companies to operate in the ISP and telecom related sectors.

ICP companies must subject their web contents to government censorship to ensure political correctness. They are liable for contents included on their portals and the actions of subscribers and others using their systems. Because many Chinese laws, regulations and legal requirements with regard to the Internet are relatively new and untested, their interpretation and enforcement of what is deemed to be socially destabilizing by Chinese authorities may involve significant uncertainty.

In preparation to join WTO, earlier this month, Chinese government made an effort to clarify some regulations and to further open the market internationally. However, enough ambiguity and constraints still remains. Foreign investors are allowed to invest controlling interests in Chinese Internet companies. However, investments in ISP companies still pose ambiguity. Government still imposes censorship on web contents. The Ministry of Public Security has the authority to cause any local ISP to block any Web site maintained outside of China at its sole discretion.

The government has long realized that the Internet – knowledge transfer – is a must in today's evolving economy. Although it has restrictions on some content issues, on the telecommunication and hardware side, it has been pushing the growth of the Internet with companies like Legend, China Telecom, and even cooperation's with Microsoft on the Venus project. On the content side, small glitches still remain. However, the government does not have the means to check each page of content, leading the local ICPs or web site owners to self-sensor material. Many Chinese web sites' chat room hosts stick a poster on the log-in window saying something like "we shut up

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<sup>1</sup> Yang Jun, "Banking Industry faces foreign competition", *Business Weekly News*, Jan. 15, 2000, pp. 3

rude speakers.” An Internet user in China is known as a wangchong (net bug.) Rather than try to crackdown on disapproved sites, China is trying to lure the wangchong to its own approved sites such as the China Wide Web.

The main problem for many entrepreneurs is obtaining capital, and for foreign VC firms the legal and regulatory issues surrounding private equity investments are very challenging and also prone to risk. The key issues facing many foreign investment firms are the following: 1) Limited legal framework for foreigners to own shares in Chinese private companies; 2) Lack of proper investment channels to transfer funds into China; and 3) Weak Chinese contract law compared with those in US/UK/HK. Since most of the capital in China comes from foreign participants, a large problem for startups is to establish proper structures to infuse capital and provide transparent structures.

*1. Limited legal framework for foreigners to own shares in Chinese private companies:* Chinese regulations are very clear on the ability for foreigners to own Chinese listed companies. However, despite the huge demand by foreign investors, the legal framework for owning private companies is quite limited. As a result, most foreign investments into China come in the forms of joint ventures and WFOE's (wholly foreign owned enterprise). These Chinese legal entities are in actuality foreign purchases of assets rather than purchases of stock. These entities are unable to issue stock and list on public exchanges.

*2. Lack of proper investment channels to transfer funds into China:* Under the current legal and regulatory environment, there is no official channel for investors to transfer funds into China (company to company). Until regulations become clearer, investors wishing to use official channels would probably be blocked. As a result, many unofficial channels to transfer investment funds are used instead. Most of these channels involve using a PRC national to use his or her personal accounts to transfer the money into China. Often this PRC national sets up a company offshore to channel the funds to personal accounts. Even this arrangement is not fully legitimate under Chinese regulations unless the individual is a dual national and registers the company as a citizen of a country other than China.

*3. Weak Chinese contract law compared with those in US/UK/HK:* Without proper Chinese government issued regulations to govern foreign investors taking equity stakes in Chinese companies, many private equity contracts that are being written between investors and startups are only supported at best by Chinese contract law. These contracts are hard to enforce, especially if certain contract clauses contradict past or future regulations on foreign ownership of Chinese Internet companies.

Most companies that wish to avoid Chinese regulations in regards to % foreign ownership and listing process have incorporated themselves offshore and set up WFOE's within China in order to operate. For ease of set up and tax reasons, many firms choose either Bermuda or the Cayman Islands as the offshore locale for its incorporating and financing operations. The British Virgin Islands is also possible, but may not be as appealing to investors due to few disclosure requirements and limitations for listing on the Hong Kong GEM market. If an entrepreneur could understand up front the corporate structural issues that would place them in the best position to accept and utilize capital and then perform an exit strategy, than they would be in a much better position to succeed in the long run.

***Operating within the Legal Environment:*** The present legal system provides little protection for property rights, does little to support contracts nor does it ensure the quality of corporate governance that protects owners from being ripped off by their managers. The basic problem is that there is not a strong civil code or enforcement vehicle to protect individuals or corporations. The Chinese government has gone to great lengths to crack down on the piracy of videos, music, and software, but it has a long way to go. Today, most business is done through “guanxi”, or connections.

China's is not a rules-based economy, at least not yet; it is still an economy based on relationships. Business transactions are made on the strength not of contracts but of personal agreements. Transactions are purely private. They are neither verifiable nor enforceable in the public sphere. Basically “guanxi” here merely implies that in the absence of law and defendable property rights, people do business with those they know and trust. Personal relationships matter in a low-trust society. Unfortunately, building these relationships require time and energy, which for Internet companies can be the kiss of death.

In addition, the Chinese legal system is a civil law system in which decided legal cases have little presidential value. As a result, it is difficult to determine the type of content on a web site that may result in liability. Earlier this year, Sohu was asked to shut down for two days due to questionable contents. Their CEO was also escorted to the Department of Public Security due to questionable contents. To succeed in such an environment, it is very important for an entrepreneur to have the ability to navigate among Chinese officials.

Without a clear legal structure and enforcement mechanism it often makes it very difficult for an entrepreneur to maintain a competitive advantage and reap the rewards of his efforts. In addition, the government still maintains effective control over business and favors local ownership versus foreign ownership. In this type of system it is extremely important to establish strong relationships with those you trust in order to succeed. Even though the regulatory environment is not favorable, it is getting better. Chinese companies are forcing change on the government and are shaping the regulatory environment for the better.

**Capital:** The vast potential of the China market has lured venture capitalists for years. Over the last four years, China has attracted more venture capital than any other developing country in Southeast Asia. According to a World Bank report, China absorbed two-thirds of venture capital investments in Southeast Asia in 1995, or \$2.1 billion<sup>2</sup>. And the Asia Venture Capital Magazine revealed that of US\$4 billion invested in Hong Kong in 1996, nearly 60% ended up in China<sup>3</sup>. However, investments primarily went into construction, Industrial products, consumer products, transportation, and energy mostly to fund the growth of existing companies.

With the introduction of the Internet in China, some of technology's biggest names have thrown hundreds of millions of dollars at China's Internet market and found influential local partners in recent months, even while the government was issuing new restrictions on cyberspace. Primarily the Venture Capital is coming from foreign players, the domestic market not having a substantial VC presence. International players such as Softbank, IDG, CMGI, and Pacific Century CyberWorks are raising hundreds of millions of dollars to invest in China's Internet market. Venture Capitalists such as ChinaVest, KLM, and AsiaTech are leveraging their years of experience in China and switching to Internet related ventures. Corporations such as Intel, China.com, Kodak, Nortel and Motorola are also beginning to invest with the encouragement of the government.

The main problem is that most of the money is in foreign hands and it is very difficult for an entrepreneur to access this capital, and in addition many of these VC's do not bring operational knowledge to the table. Numerous entrepreneurs spend countless hours submitting business plans one after another only to get silence in return. Many of them don't meet the investment criteria of sophisticated investors. Many don't know what criteria are necessary! So much time is taken to raise the capital, that many companies find themselves at a disadvantage once they obtain it. Or in order to obtain the capital quickly, they had to give up a majority of the company. What will continue to incentivize them in the future?

In addition, little of the money sloshing around in China and Hong Kong really deserves to be called venture capital. In Silicon Valley and elsewhere venture capitalists bring more than cash to the party. Unlike other investors, they can size up new technologies and applicants, and then nurture them through the difficult early years as small businesses. China lacks such people, especially those practiced at helping Internet and software companies rather than more familiar IT hardware firms.

#### Innovativeness and Culture

One shortcoming that has been attributed to the Chinese people is the lack of an innovative workforce<sup>4</sup>. China is often considered to have an "entrepreneurial" culture, but this label confusingly brings together two distinct aspects: a desire to chase profits, and an ability to think up clever new ways of making money. It is definitely true that Chinese businessmen have proved willing to take risks and to start their own businesses. But they often imitate others: if somebody makes a fortune selling knock-off purses, a dozen others will rush in to do the same thing. Many examples are already seen today in the Internet Space in China where many companies are just Chinese versions of an American model. And over 70% of these companies are predicted to go under. They are not looking at the

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<sup>2</sup> World Bank Report, 1999: "Foreign Investment in China", pp. 45

<sup>3</sup> "The 1999 Guide to Venture Capital in Asia", *Asian Venture Capital Journal*, pp. 49-50.

<sup>4</sup> FT McCarthy, "China Survey: Now Comes the hard part", *Economist*, April 8-14<sup>th</sup>

market and solving a real problem. The problem begins with an educational system that stresses rote learning instead of creativity. Even so, there is a fundamental shift in the student population where innovativeness is being rewarded and ambition is being nurtured. New ideas are being formed, but how can they execute?

### **Ideal Candidates**

#### University Affiliation

The legends of Bill Gates and Jerry Yang have inspired young Chinese talents to bet their fortune at an early age. Student run companies are gaining momentum on Chinese University campuses and the Government backed educational system is encouraging this development. Qinghua, Beijing and Fudan Universities have all voiced their support for the numerous start-ups that are forming on their campuses.

Qinghua University in Beijing, considered to be the MIT of China, was the first to acknowledge and embrace the idea of students running their own businesses. In 1998, the university sponsored the first business plan competition, attracting 320 participants with 114 technology rich projects. The second competition was held last May. One of the teams, [www.funso.com.cn](http://www.funso.com.cn), received \$6.2 million from Shanghai No. 1 Department Store Shareholding Ltd. One of the founders is a good friend of mine from the Tsinghua School of Management.

Universities in China have long been cherished as academic and research centers. Traditionally, students devote themselves to academics and are not encouraged to take part in business. However, especially at Tsinghua, things have become more practical and more market focused. Tsinghua partnered with MIT to establish a new joint International MBA program, in which students are trained in Western business principles. Only two years into the program, many of the students have formed teams and started companies, as well as joined other startups in progress.

A survey conducted at four Universities by Shanghai TV Station found that 43.3% of university students are in favor of student companies; 26.7% said they often consider owning their own business while 59% said they never thought of doing so<sup>5</sup>. Tellingly, 85.3% of respondents said their university education did not do enough to prepare them for market competition.

In addition the government will allow students to suspend their studies to start a business. The state will also step up the development of university-based high-tech businesses and the construction of scientific parks near universities. The Zhongguancun subdistrict surrounding Beijing University and Qinghua University is considered China's equivalent of Silicon Valley. Qinghua University is also working on a new credit system to give students more room to pursue independent business projects. The University system is working hard to support the growth of student run enterprises and this is a good direction for the educational systems to take, but with lack of experience and access to venture capital, many student run start-ups may find the road ahead very difficult. The next step is to provide students with a better understanding on the start-up process and increase the likelihood of success.

#### Industry Experience

Another deal entrepreneur for the incubator comes from industry and consistently attends speeches held on university campuses as well as conferences held in the city. Many of them spend a great deal of time searching for relevant information on the Internet and frequent networking events such as IandIAsia, Beijing Entrepreneur's Club, and various Internet Conferences. Word of mouth is the most rampant method for obtaining information as well as various business plans that are currently taking place in Beijing and throughout China. Trade magazines, newspapers, and periodicals are also mechanisms to reach these entrepreneurs.

Many such entrepreneurs have a unique background that supports the development of the business, such as a deep knowledge of an industry, or special understanding of a new technology. These entrepreneurs may have strong networks within their respective fields, but have a very small network in regards to the Internet or Venture Capital world. These entrepreneurs have open attitudes and are willing to seek out help in order to become successful. They are willing to share equity in the company in order to build their companies, and are willing to accept new ways and styles in order to conduct business. They are moldable, energetic, passionate, and determined. With these qualities, StartupChina is in a position to help them.

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<sup>5</sup> Ibid.



### ***Down stream Investors/ Acquirers***

The last customer for StartupChina is the downstream investor. StartupChina will incubate a portfolio company for up to six months and during the time will diligently work to obtain first round financing. The downstream investors will be of two forms, corporate investors or Venture Capitalists. In both cases, investors are rushing into China to capture the opportunities that the Internet brings.

### **Venture Capital**

Venture Capital firms are raising \$150 million to \$1 billion funds for investing in Mainland China. A large amount of money is being raised, mostly foreign, increasing the pressure to put the money to work. In addition, with the Internet industry moving at lightening speed, Venture Capitalists are racing against time to find and invest in good opportunities.

The problems that VC's face in China's market is a lack of good deals. VC firms must spend more time than ever weeding out the good from the bad. In many cases they just can't spend the time that they need to based upon market pressures. In conversations with Softbank, it was learned that many teams lacked the operational experience to put together a good company. Due to this lack of experience, many Venture Capital firms want a higher % of the company at the onset to compensate for the risk they are taken. In addition, VC firms find themselves investing a small amount in many different companies with the hopes that one of them will prove to be successful, and take a larger amount of money from them in the future. Thus many VC firms have found themselves spread very thin, and not able to support companies in early stages. Entrepreneurs that take seed round funding from VC's at a very early stage find themselves with little equity in the company, and little support.

Many Venture Capital firms that are interested in investing in Mainland China are new to the game and to the country. Most are partnering with local firms to gain the experience and support that they need.

VC firms wish to Invest between \$1-\$5 million in a first round investment in a company. In doing so, the average percentage equity that they wish to take is 33% of the company. At earlier stages they often take more. The VC community is made up mostly of foreigners represented by HK, Japan, Taiwan, Singapore, and America. Most VC firms in Asia are made up of individuals that come from a strong financial background (Investment Banking, Trading, or Real estate) versus an operational background. In order to save time and reduce the amount of due diligence that is necessary for internet companies, investors look for business models that are very similar to models that exist in the United States and have proven themselves to be successful. Ideas that deviate from these norms usually do not see the light of day. In addition, many Venture Capital firms take cues from the US market and have recognized the growth of the commercial incubator and their role in the startup process.

Venture Capital firms are looking to make a substantial return on their investment, which also means they are looking for an exit strategy in every business plan. They want to make sure that companies are structured in a proper way to seek an IPO on a foreign exchange, and they also want to make sure that the company's financials are completely transparent so that they can observe the progress of the company. VC's need a way to streamline the investment process so that they are looking at only high potential deals. They need a funnel to reduce the thousands of ideas that they see to a hundred qualified ideas. Since many of them are foreign firms, they need people on the ground that can provide operational support for the companies and help them build a strong foundation and continue to provide them support. Right now VC firms complain that there are not enough qualified deals. They are either spending a great deal of effort to find those rare qualified deals, or little effort and taking the low hanging fruit. Instead of looking for what is currently there, why not work with firms that find ideas and teams in their earliest stage and build them into qualified deals?

Most VC's source deals through referrals, email, Industry conferences, Brokers, multinationals or through rep offices that are on the ground in China. However, the VC business and investment business is a personal one and one that requires real interaction. By establishing a strong relationship with a series of VC firms, StartupChina provides a well-known face for various entrepreneurs that are seeking funding.

### **Corporate Investors:**

Portals, B2B, and B2C players will be listing soon. The primary method of growth from many portals in the United States is through an acquisition and merger strategy. Many companies in China will be listing soon on various stock

exchanges around the world. This will enable them to have the capital to acquire many other early players before these companies go public, or even after they go public.

In addition, various high tech industries are establishing venture arms in China. Motorola, Intel, Legend, and a host of other International firms are investing in the Internet space. They see the development of these companies essential for driving future growth for their own companies (i.e. increasing consumer spending on their own products), and also vehicles for developing future technologies at a faster pace than within their own organizations.

There is a stronger need for companies to source deals and also to support the companies that they invest in. In many cases, venture arms within a corporation cannot support the companies that they invest in, because they are used to large organizations. In addition, many entrepreneurs are attracted to VC's and usually do not think of working with a corporate entity until later rounds. Corporations face the problem of competing against a highly aggressive VC community and a small staff to support the many companies that it invests in.

**MARKET SIZE AND TRENDS**  
**Venture capital flow into China.**

According to the 2000 Guide to Venture Capital in Asia, the Venture capital pool, primarily from Asian countries (over 50%), grew steadily from 1991 from \$184 million to \$3.5 billion in 1997, but dropped in 1998 to \$3.1 Million. Annual Venture capital invested from 1992-1997 increased from \$65 million to a peak of \$678 million in 1995, but then tapered off to \$550 million in 1997. In the years 1992-1997, the invested value of the Venture Capital Investment Portfolio grew from \$274 million to \$2.8 billion, but the returns were starting to drop off.

With China's growth rate dropping to below 9% from the 10%-12% recorded in previous years, and the impact of the Asian financial crisis, investment opportunities in China had become more difficult to source<sup>1</sup>. New funds raised dropped off dramatically in 1996 and 1997 from \$294 million to \$96 million, but picked up in 1998 to \$196 Million. From 1997 to 1998 funds were being shifted towards investments in startups at a very early stage, highlighting the beginning rush of Venture firms to capture the next great Internet company. However this pattern begins to reverse in the beginning of 2000, as many firms wish to invest in later stage rounds. In addition, more funds were being earmarked for Technology related firms.

Figure 10: Disbursements by Financing Stage

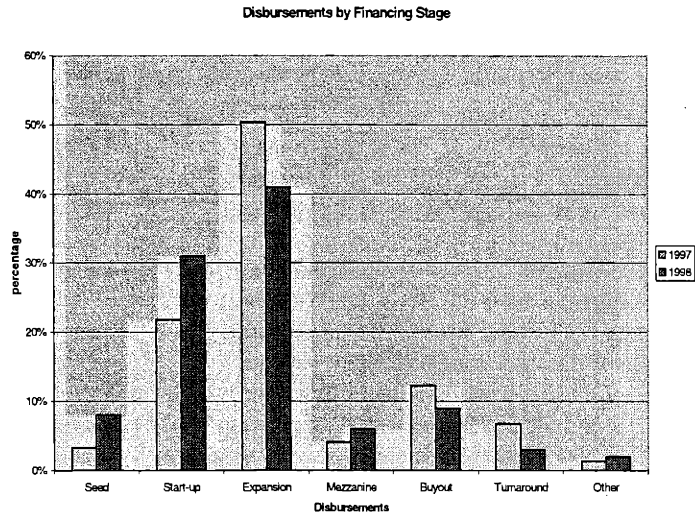
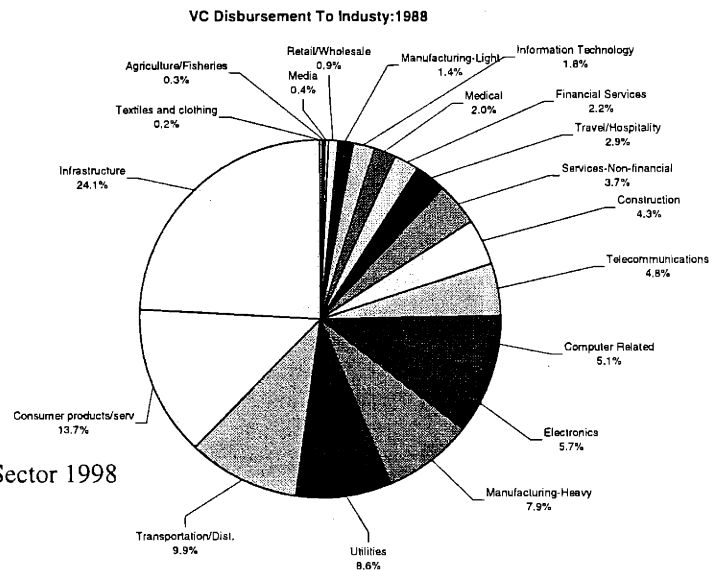


Figure 11: Disbursements by Industry Sector 1998



Number of Businesses Being Created

According to the China Insurance News and the CNNIC, the past six months has seen a new Web site created in China every day. China today has more than 9,000 commercial Web sites, attempting to capture market share in a very small but growing market. Enterprise growth has been expanding at a rapid clip in Beijing itself. The Zhongguancun area near the universities Tsinghua and Beida, now have some 4500 enterprises, of which 920 are foreign funded. Growth in the area has accelerated from 1988 when there were only 11 foreign invested enterprises to the current level today. Total foreign investment in the zone now tops US\$1.4 billion.

Enterprises in Zhongguancun										
	1988	1989	1990	1991	1992	1993	1994	1995	-	1999
Total Enterprises	527	850	974	1,343	2,441	3,769	4,229	4,438	-	4500
Foreign-invested enterprises	11	36	70	140	300	700	780	806	-	920

Venture capitalists in HK see 20-30 business plans daily. According to VC firms TechPacific, Softbank and ChinaVest, they usually invest in 1 out of 100 plans that cross their desk. This is a much lower percentage than seen

in the US. Much of this is attributed to the poor presentation of the idea and lack of operational skills to execute the plan.

#### High Failure Rate

China's Internet companies are under siege. According to the China Insurance News, authoritative observers at the China Internet conference on April 28 predicted that some 70% of the country's Internet companies will be merged or go bankrupt by the end of the year. According to the newspaper, speculative and spendthrift Internet companies are the norm in China. Over half of the country's Internet companies spend 60% to 80% of their funds on public relations and advertising. In addition, problems such as a lack of original thinking, straight cloning of the U.S. business model and disorganized management "are now demonstrating their negative effects," the newspaper said.

Some Chinese Internet companies have already left the arena quietly. In Beijing, only two of the city's 16 student-run start-ups have survived, while a search on Yahoo! And Sina.com found that 40 of the country's more than 200 online bookstores have perished. According to the newspaper, industry insiders agree that only four categories of Chinese Internet companies will survive:

1. Internet companies that have built a barrier to entry for latecomers.
2. Web sites that can help conventional companies reduce costs, increase their efficiency and create new value. Such Web sites have a clear and realistic method for earning profits. These sites include B2B.
3. Web sites that have been favored by large venture-capital investors. According to an official with the U.S. International Data Group (IDG) venture-capital firm, Internet companies that have money in their hands possess the prerequisite for succeeding. The official said IDG would continue to put more money into Internet companies it has already funded so that it can grow bigger and even take over smaller companies.
4. Internet companies that have transformed themselves after starting as a conventional business. Such companies have established brands, created marketing channels and possess rich managerial expertise and abundant funding.

This high failure rate points to a set of logical conclusions. First is that without strong managerial and business knowledge, startups will not succeed in developing a unique business model for the Chinese environment nor be able to execute the strategy successfully. It is now believed that only established companies have the management talent to execute. However, it is a question if they have the speed to execute. Second, Business to Business is a profitable opportunity for China based upon its manufacturing base and huge inefficiencies that could be eliminated. Finally, many International Venture firms wish to abandon the early seed stage investments and put their money into companies that they have already funded. This creates a huge need for other parties to play the seed investment role.

#### Potential Entrepreneurs:

##### Students:

The quality of human capital available for entrepreneurship can be roughly split into engineering and management graduates from many of the local universities. This is further supplemented in China by returnees from studying/working abroad. From 1978 to 1998, more than 320,000 Chinese went to 103 countries for further studies, 50,000 of whom were sent by the state, 100,000 by the government units they work in, and 170,000 at their own expense. More than 110,000 out of the 320,000 Chinese students who went abroad for further studies have returned to China after graduation and many have set up their own businesses. In Shanghai alone, there are over 750 companies set up by returnees. Statistics show that more than 5,000 students returned to China in 1995, and the figures for the following years are 6,000, 7,000 and 7,400 respectively, signaling a yearly increase of 13 percent. Thus, there is an increasing trend of Chinese studying abroad returning to China, in some cases to start their own companies. Domestically, Chinese Universities graduate 1.5 Million students that enter the work force. A recent survey in Shanghai showed that fewer than 50% of the students wanted to start their own company, so a high degree of potential exists in this sector.

##### Industry:

The role of multinationals cannot be underestimated in China. At the end of 1998, more than 300 of the Fortune 500 have invested in China. Primarily MNC's provide much needed capital and employment. In addition, multinationals train employees on western business practices and techniques. The Chinese government gives priority to

multinationals that transfer advanced technology and management skills. In this regard, both IBM and Microsoft have established research centers in Beijing and formed relationships with a number of universities including, Fudan University, Shanghai Jiaotong University, Beijing University and Tsinghua University. Intel and General Motors have established development centers in Shanghai. Most multinationals believe that to succeed in China they must be there for the long run and provide technological transfer and export.

This emphasis by the Chinese government on attracting multinational investment and particularly favoring investments in high-tech, encourages the development of future entrepreneurs by exposing them not only to the latest technology but to management styles that were not present in China before reforms. One can imagine that future Internet entrepreneurs in China will be drafted from the ranks of multinationals, where they see the need and visualize a solution.

China has a relatively high quality of engineering talent. This can be traced to China's focus on research into the basic sciences and the high quality of its academic institutions. One of the reasons for this fact is that China has had to develop its own defense-related technology for its military, the PLA. Indeed the origins of Chinese software industry can be traced back to the late 1960s with efforts by the PLA to develop software for missile guidance systems and other military uses. In the software industry alone today, there are over 150,000 engineers employed in over 2,000 independent software firms. Each of these engineers could identify a new technology that could be capitalized in the formation of a new Internet company.

## **COMPETITION AND COMPETITIVE FACTORS**

StartupChina's competition includes any firm or individual that can provide seed capital and development support services to startup entrepreneurs in the Chinese market. However, while the broader competitive threat from individuals and non-traditional players should be kept in mind, this section will analyze the more visible players that have the potential and intent to provide direct competition for StartupChina. Specifically, the direct competitors can be broken down into four different categories: Commercial incubators, venture capital firms, corporate conglomerates, and government technology parks.

### ***Commercial incubators***

**U.S./Global Market:** In the past six months, new entrants have rapidly filled the Internet incubator market around the world, encouraged by the success stories of firms such as Idealab and holding companies such as Internet Capital Group. While the most successful incubators have the potential to go public and expand internationally, the majority of incubators are regional players. Many of these players are working to build global networks of incubators in order to facilitate equity sharing agreements where the most successful business models are incubated around the world by partner incubators. StartupChina is negotiating with several different incubators in the U.S. to explore such options.

**Greater China:** A number of incubators have been established in Hong Kong to foster Internet startups in the Greater China region. The business models differ, from Internet-based match-makers that connect startups to venture capital funding (AsiAlliance) to more traditional incubators fostering the growth of several different startups under one roof (Incubasia). In general, the Hong Kong incubators have shown a resistance to directly entering the mainland market, choosing instead to incubate Hong Kong companies that can later enter the mainland market from Hong Kong.

**Mainland Market:** The mainland market is developing quickly as various virtual B2B matchmakers such as Sinobit, VC-link, and VCChina enter the market. These firms currently do not provide a physical infrastructure nor do they provide seed capital. They do provide services in return for equity. Over the next six months it is expected that operations expand into Beijing, as Honk Kong incubators expand into the Mainland. There are many players that are expected to enter the market, but there is a great deal of room for others. Over 600 incubators exist in the US, over 25 in the Boston area alone. Each incubator brings a unique competitive advantage that will enable entrepreneurs to move faster.

### ***Venture Capital Firms***

Venture capital firms are aggressively pursuing growth in the Chinese market. While VC firms often lack the resources to invest in seed-stage companies, a number of firms have been exploring methods of exclusively incubating startups from the seed-stage through IPO. Softbank has been leading this type of effort through the development of a franchised network of incubators around the U.S.--branded Hotbank. In China, Softbank has set-up two major funds (including one in partnership with the World Bank) and has been working with UTStarcom to develop a network of incubators on the mainland (starting in Shanghai).

### ***Corporate Conglomerates***

Corporate conglomerates have traditionally dominated the Asian business environment. The conglomerates--backed by strong management teams, powerful networks, and immense financial resources--typically seek to enter into any market or industry where major opportunities exist. As a result, conglomerates such as the large Hong Kong property developers have recently been transforming themselves into sleek Internet investment vehicles. In their new capacity as ambassadors for the high-tech revolution, they have been courting the major American Internet corporations to develop partnerships and alliances that will position themselves on the leading edge of the Asian Internet market. The most prominent of these emerging alliances include Pacific Century CyberWorks/CMGI/Intel and New World Infrastructure/China.com/AOL.

These conglomerates have the ability to leverage their management expertise, strong mainland connections, and financial resources to enter the mainland market. In the long run, they represent both a competitive threat to StartupChina, and potentially powerful partners/strategic investors.

### ***Government Technology Parks***

The final--and weakest--competitive threat comes from government controlled science parks that offer reduced rent without the benefit of much needed services or capital. In general, local venture funds are government-supported efforts to stimulate economic growth. However, the government lacks understanding of the businesses it invests in and has difficulty supporting rapid growth.

The average Silicon Valley entrepreneur sees government more as a problem than a solution. But Asia has a long history of government-led economic transformation. The Chinese government has established many Economic Zones that promote Western Economic Principles and also has developed science parks around various top tiered Universities such as Qinghua in Beijing and Fudan University in Shanghai. Qinghua has actually used its own money to take technology ideas of the University and turn them into profitable enterprises on its extended campus.

To further encourage the development of its high-tech sector, the Chinese government has established "overseas scholars pioneer parks" featuring free or low-cost rent, one-stop registration, free accommodations and reduced taxes. After getting his doctorate from Stanford University, Jason Wu worked at the Xerox Palo Alto Research Center for nearly five years before succumbing to the entrepreneurial bug. Two years ago, he established NetFront Communications, an online security firm that uses digital watermarks to protect documents from tampering. Wu developed the technology in Beijing utilizing the new park to achieve significant savings compared to developing the product in the US.

### ***Competitive Advantage***

By establishing an incubator in Beijing, we will satisfy the diverse needs of the entrepreneur, the individual investor, and the international venture community. As competition intensifies in today's e-commerce sector, entrepreneurs and investors are realizing that only the strong will survive. Entrepreneurs have few resources to turn to for advice and seed capital. Angel investors, local and foreign, have limited means of assessing startups and matching with teams where they can deliver the most value. And finally, it is extremely difficult for the foreign venture community in China to find the right idea and the right team at an early stage. By reviewing a screened list of business ideas from our incubator, they will welcome the opportunity to invest in ideas that have already been accelerated on a strong, professional foundation.

Our team has years of experience developing businesses in China and a unique perspective on the development of the Internet in China. We will be taking best practices for starting companies in the United States and combine it with the knowledge we have learned in China. Strong links with MIT and MIT Sloan will aid in the development of an Entrepreneurial network through the Beijing Entrepreneur Club, the MIT Alumni Club, and the MIT China Program. In addition, we have strong ties to the Tsinghua University Business School and Beijing University. Finally we have an extended network of local contacts in Beijing and Hong Kong, coupled with strong relationships in Boston and San Francisco that will aid us in servicing our companies. We will be establishing a strong international network of incubators that can share best practices and aid each other when expanding globally.

By establishing ourselves as one of the first e-commerce incubators, we envision ourselves as the lead source of information for entrepreneurs, via the Internet and through our entrepreneurial network. As other incubators begin, it will reinforce the incubator model in the Chinese market. Our focus will be on e-commerce, and we will establish relationships with experts in the field--both in China and abroad. By remaining focused and bringing in the finest talent to aid our portfolio companies, we will be the first resource that entrepreneurs and investors turn to satisfy their needs.

### **OPPORTUNITY AND PRICING FOR STARTUPCHINA**

StartupChina will aim to invest between \$50,000 and \$500,000 in capital to its portfolio companies. This money will be based upon the needs of the individual companies and the state at which they are in their plan. In return, we will obtain 10%-30% in the company. The money will be used to pay, at a discount, for the services that we provide in the incubator. In addition the money will be used to cover salaries and basic expenses for the various portfolio companies. We wish to take a low % of equity up front in order to incentivize entrepreneurs to use our services. In return for a lower equity percentage at the onset, we will require that companies allow us to maintain our equity % in the first round of funding, and we will be able to purchase series A stock at a discount. This will provide an additional incentive for the incubator to obtain funding for the companies that we incubate, and will also be

attractive to the venture capital community because they will see deals that have not already been given away to someone else. Investors in the incubator will be assured that major investments will be done in the first round, where other established Venture capitalists will be invited to participate and will increase the risk of the companies success.

StartupChina will require that it have at least one position on the Board of Directors and will maintain that position until the IPO of the company, or acquisition. At the point where an exit strategy is possible for StartupChina, the company will relinquish control of its board seat.



## **MARKETING PLAN**

### **OVERALL MARKETING STRATEGY**

The overall Marketing strategy for StartupChina can be separated into three overlapping areas. The first area is fund raising. In order for the incubator to remain successful, it must raise the funds for both operation and investment into portfolio companies. Fund raising is an important function of the incubator and should be addressed in regards to the marketing effort to support it. A second area of importance is deal generation. Various avenues will be used to generate idea flow across the desks of StartupChina. We will be looking at ideas generated from local entrepreneurs and students. In addition we will identify ideas within the United States that could easily be transported to China, either by establishing a partnership with an existing company in the states, or by investing in a new company in China with a similar model found in the US. We will work with other incubators to co-invest in a Chinese expansion of their portfolio, and will invest in ideas of our own. The third and final part of our marketing strategy is to gain access to the financial community to access later stage capital for the companies in our incubator. Later stage capital will come from Venture Capitalists, corporate entities, Conglomerates and government funds.

The first goal of the incubator is to raise funds for the operations of the business. This includes funds to support the day to day operations as well as invest in future portfolio companies. In order to raise the initial funds for the incubator, we will be utilizing the entire team in a direct effort to raise funds. We will be utilizing networks through MIT Sloan, MeetChina.com, and through various contacts in Beijing. Initial funds will be sought from individual investors and angel fund investors, as well as corporate funds from companies such as Motorola, Sohu, Sina, NetEase, IBM, etc. In addition, we will approach large holding companies that have a vested interest in the China market. Such companies would include Softbank, CMGI, ICG, and IDG. In order to market ourselves to this group of investors, it is key to have a clear description of our business and plan for operating in China.

### **GENERATING AND FINDING IDEAS**

There will be four methods for sourcing potential deals for StartupChina. The four methods include sourcing from the local market through our website, transferring successful business models from the United States, partnering with International Incubators, and internally generating ideas through our marketing efforts. Each idea will go through our evaluation process shown in Appendix D.

#### ***Local market***

The best ideas will be the ones that provide solutions to a unique problem for China. These ideas will come from the local community that understands its own market well. In addition, these ideas will leverage off of experiences in the local market and will take advantage of the uniqueness of the Internet, where the real world would not be sufficient.

Ideal candidates from the local market will come from universities (students and professors), industry experts (which have no prior knowledge of company building nor the Internet), multinational firms, and to an extent other Internet companies. Some candidates will be sponsored by their former companies (one of our incubator investors) and will be provided an environment that fosters accelerated growth versus stagnant bureaucracy.

The local market is an ideal place to find and nurture ideas. The local entrepreneur will be able to identify a problem that is unique in China and will be able to provide a unique solution. However, they will need the support and services that StartupChina provides in order for them to succeed.

#### ***International market (copying business models)***

An office in the US as well as one in Europe will be established to research, identify, and track business ideas and business models that are successfully implemented utilizing the Internet. These offices will have individuals that have a unique understanding of China, its market and its infrastructure, to determine which models will be applicable for transfer. Ideally, the foreign offices will develop an exhaustive database that can be referenced when a need or problem is identified in China. The database will be a source of modifiable ideas to be imported into China. Offices will be established in Boston, San Francisco, Paris, and the UK and will be a source of ideas, current technology trends, networking contacts, and trends in the Internet business.

### ***International incubator partnership***

Leveraging strategic relationships with incubators located in different parts of the world, StartupChina will source deals that are currently being incubated overseas. The idea must be capable of being modified for the China market. The portfolio company could be either a 1) joint venture with the foreign startup, enabling rapid global expansion in Internet time, 2) co-investment between the two incubators in which each takes a higher percentage of the company than if the idea was sourced locally, or 3) based upon a contractual agreement in which StartupChina, agrees to pay a royalty fee to the foreign enterprise/incubator for the rights to develop the idea in China.

### ***Generation of own ideas***

StartupChina can also generate ideas from within its own walls. Based upon the experience of the executive management team, and the marketing research that the firm does, StartupChina will be in a unique position to identify, assess, and establish new companies to capitalize on the growth of the Internet in China. StartupChina's role will be to validate the concept through analysis, develop a detailed business plan, staff the company with experienced personnel, and secure future rounds of funding. This model has proven to be very effective in the United States based upon IdeaLab's success with companies such as eToys.

## **ADVERTISING AND PROMOTION/BRAND AWARENESS**

Advertising and Promotion will be conducted to accomplish two things: Generate awareness of the services of the Incubator to establish its credibility with investors and partners, and second, stimulate deal flow (i.e. business ideas crossing StartupChina's desk.) In order to obtain these goals, StartupChina will 1) Establish a Web site that will provide resources for the Entrepreneur, including industry articles, news, legal advice, and a calendar of events, 2) establish an independent entrepreneurial Center (Similar to MIT's Enterprise Forum) that is tightly linked with MIT, Stanford and a Chinese University, 3) Establish a mentor network comprised of Chinese nationals in the US and in China that wish to be available to help entrepreneurs in China, and 4) Conduct or sponsor entrepreneurial events in China that focus on new enterprise creation.

### ***Online Presence via Internet Site that Aids Entrepreneurs***

This website will be located under the StartupChina domain name. It will include information about the company, its services, its mission, and also resources available to the entrepreneur. In order to attract entrepreneurs to our site, we will place information that is vital to an entrepreneur: Case examples of other entrepreneurs in China, business plan template, industry information, term sheet negotiation, job network, and links to potential mentors. In addition, we will have a mechanism for people to submit their business ideas to StartupChina. They will be asked to submit answers to a series of questions. Based upon those answers StartupChina will determine whether to continue to pursue the idea or not. In order to use the services of StartupChina, users must submit their names and email addresses in order for us to contact them for future events. Currently StartupChina is looking for a potential partner, or acquisition target that would be able to supply these resources.

### ***Entrepreneurship Center***

Modeled after the MIT Enterprise Forum, an Entrepreneurship Center will be established in Beijing. Members from the StartupChina team will be key members that establish this center. The Center will be non-profit and StartupChina will be a main sponsor for the Center, helping to establish brand awareness for the Incubator. The Center will seek sponsorships from various companies within China, both multinational and local enterprises. It will establish strong ties to MIT, Stanford, and a local Chinese University. The center's aim is to bring western knowledge of entrepreneurship to China. This knowledge will be disseminated through entrepreneur workshops, speakers, and networking events. In addition, a mentor network will be established tying members from the various chapters throughout the world together. A highlight of the event will be "pitch" sessions, where entrepreneurs will be able to speak before a panel of investors, industry experts, and successful entrepreneurs. This will be an elevator pitch and will provide very useful feedback to entrepreneurs and may help them in obtaining funding.

One may see this as a potential competitor. However, StartupChina sees this as a mechanism to establish strong ties in the community and generate brand awareness. In addition, this is an opportunity for extensive deal flow and constant interaction with entrepreneurs. In establishing this center, StartupChina will be solidifying contacts with sponsors (local service providers, high tech companies, and other start-ups). StartupChina will be in a position to leverage these strong personal contacts to obtain the best services for companies that it chooses to incubate.

### ***Mentor Network***

StartupChina will establish a virtual mentor network via the Internet. The concept is to match successful Chinese entrepreneurs in the US with local entrepreneurs in China. In addition, mentors could be successful businessmen or business school students that wish to help future aspiring entrepreneurs in China. This is a free service provided either through the E-Center or through the Incubator. Chat sessions will be organized as well as virtual presentations to bring experiences of successful entrepreneurs to a large audience to China. Chinese entrepreneurs will be able to use the service to match themselves with individuals that would have the expertise to help them. Mentors would be reaching out to give something back, and in addition could become future investors in these companies.

By establishing this mentor network, StartupChina is in a unique position to tap into this mentor network to seek out advice for its portfolio companies. In addition, this network brings added value to the Chinese community and also works to establish credibility with the government. This mentor network will reach out to overseas Chinese and will enhance communication and generate renewed interest in what is taking place in China.

Initially, ideal mentors will be sought through Alumni from Stanford and MIT. In addition, key individuals from the Chinese population will be sought out in San Francisco, Seattle and Boston, to aid in recruiting mentors and publicizing the mentor network. By making the service free and without restrictions, StartupChina feels the mentor network will take on a life of its own.

### ***Event sponsorship and creation:***

StartupChina will expand its brand and generate awareness through joint sponsorship of entrepreneurial related and networking events. Events will be targeted toward the Chinese entrepreneur and will focus on basic education of the startup process. Events will include business plan workshops, presentation skills, entrepreneurial self-assessments, IP protection, legal, etc. In a way, the program will be a Business School boot camp for those that are interested in learning more. The goal is to bring the entire entrepreneurial community up to a higher standard. By being a part of the development of these workshops, StartupChina will generate cashflows by charging for the events and identify potential ideas and teams that would be interested in joining StartupChina's incubator. These events are ideal ways to identify potential hires for companies currently in the incubator. Many people that are attracted to these types of events are those that are curious as to what all of the hype is about. They may not have an idea of their own, but they have genuine interest.

### ***Targeted Alliance Network:***

In order to support the development and operation of the Incubator a series of strategic relations will be sought out and formed. These relationships will be mutually beneficial and will be used to support portfolio companies with their advice and efforts and will aid in generating deal flow. In return, strategically aligned companies will benefit through increased access to portfolio companies and also a future flow of customers. The following list includes companies and contacts that have already been approached and have expressed interest in working with us.

<b>Human Resources</b>	<b>Market Research</b>	<b>Internet Consulting</b>	<b>Accounting</b>	<b>Legal/Law</b>
Resume Broadcast	China Labs	BCG	PWC	Perkins Coie
www.51Job.com	BDA	China Labs		
	BCG	BDA		

<b>Education</b>	<b>Venture Capital</b>	<b>Real Estate</b>	<b>Entrepreneurial</b>	<b>Government</b>
MIT	ChinaVest		BEC	IFC/WorldBank
Stanford	Softbank		IandIASia	Haidian Local Gov.
Fudan	ZeroStage		MIT Enterprise Forum	
Tsinghua	Morningside		Stanford Vlabs	

<b>Internet</b>	<b>Incubator</b>	<b>IT</b>		
Sohu	CyberCity (Shenzhen)	LycosLabs		
NetEase	StartUpAvenue (France)			
Sina	TechPacific (HK)			
MeetChina.com	BrainRush (San Fran)			

## DESIGN, DEVELOPMENT, AND PRODUCTION

### LEGAL AND REGULATORY BACKGROUND

The PRC legal and regulatory environment is an evolving entity. Significant progress has been made in the recent years towards opening up industries for foreign investment and creating a stronger legal framework. However, foreign companies in China still face regulations restricting investment in key industries and limited investment structures.

In addition, as a first-mover in the foreign invested private incubator space focusing on Chinese e-commerce startups, StartupChina does not have the luxury of relying on past “ready-made” legal models to support full incubation and investment activities. StartupChina is setting precedence in a frontier-like legal and regulatory environment.

StartupChina believes it is necessary to quickly build strong competencies allowing it to thrive in this environment. StartupChina must work with a strong China legal team that will come up with and execute creative legal structures allowing StartupChina to meet its operational and strategic goals. In addition, StartupChina must develop a strong relationship with key government officials to interpret regulations favorably to StartupChina, instigate future regulatory changes that will benefit StartupChina, as well as keep StartupChina informed of impending regulatory risks or opportunities.

StartupChina has already established a relationship with a premier law firm that combines strong China knowledge and experience with legal expertise in US Internet startups. Such a strong combination is difficult to find in China. StartupChina has also begun developing relationships with local government officials. These officials have agreed to assist StartupChina in applying for and being one of the first incubators in Beijing to obtain a wholly foreign owned enterprise status. StartupChina needs to further develop these relationships especially on the senior level by adding individuals to the team holding strong “guanxi” with high officials in key government bureaus.

### CORPORATE STRUCTURE

StartupChina’s internal structure will comprise of two main components- the offshore holding company and the PRC entity. The PRC entity will be a wholly owned subsidiary of the offshore holding company. In general terms, the offshore holding company will act as the investment vehicle and eventual listing vehicle, while the PRC entity will act as the vehicle to provide incubation services to PRC startups.

#### *Offshore Holding Company*

The offshore holding company will be set up in a jurisdiction that provides tax advantages, ease of setup, a strong legal framework, and sufficient disclosure requirements for eventual listing purposes. Ideal locations include the Cayman Islands and Bermuda.

A limited liability structure will be chosen. The structure will be sophisticated enough to provide flexibility in issuing and transferring shares, setting rules governing board control through a shareholders agreement, etc. If possible, a structure allowing tax-pass through to individual shareholders would also be ideal for tax purposes (similar to the LLC in the US). Such a structure may be unavailable in the chosen jurisdiction subject to English Common Law.

Although the optimal structure and jurisdiction has yet to be decided upon, the most likely outcome will be a LLC or corporation structure in the Cayman Islands or Bermuda.

The targeted exchanges for eventual listing are currently either the US NASDAQ or HK GEM. Although the US NASDAQ currently has greater liquidity and valuations, a resulting registration as an investment company under the Investment Company Act of 1940 may pose a significant risk to StartupChina’s ability to operate in a manner consistent with its strategy. Furthermore, the high valuations currently enjoyed by NASDAQ may no longer exist in three years time, when StartupChina plans to list. Compared with NASDAQ, the HK GEM is currently in its nascent stage and suffers from lack of liquidity and investor understanding. Furthermore, GEM authorities may have to seek China Securities Regulatory Commission approval for companies having PRC “Internet assets”. The development of these and other exchanges will be monitored closely.

### ***StartupChina PRC Entity***

StartupChina has an option of setting up a Rep Office, a Joint Venture (JV), or a Wholly Foreign Owned Enterprise (WFOE) in the PRC. The rep office is just an offshoot of the foreign parent entity, while a JV/WFOE is an actual PRC entity with Chinese legal status.

StartupChina will first establish a Rep Office but immediately try to apply and lobby for a WFOE with an incubator business license. A JV can also be considered in the meantime. Such a strategy would allow StartupChina to operate immediately without any legal complications, and increase flexibility later if a WFOE is later approved.

### **Rep Office Option**

The Rep Office vehicle offers the following advantages: 1) quick on the ground presence and operations startup, 2) a Rep Office is the only structure which currently allows the incubator to operate well within the legal parameters (the rep office is only providing consulting and monitoring services for its parent company which is performing investments from abroad in China), 3) the parent can easily inject capital at will to support the rep office's expenses.

The main disadvantages of the Rep Office is 1) inability to issue invoices and receipts, 2) inability to lease, 3) restrictions on office location, 4) local employees must be hired through FESCO, and 5) increased immediate tax liability though expenses that are taxed at 9.76%.

#### **1) Inability to issue invoices and receipts**

The Rep Office's inability to issue invoices and receipts would make it more difficult for StartupChina to receive payment for any non-incubating service fees, and recover expenses incurred for a startup that StartupChina in the end was unable to get equity for.

#### **2) Inability to lease**

The Rep Office's inability to lease is no different from the WFOE and JV's inability to lease property. However, the rep office can enter an arrangement with a landlord to sign leases to startups for property next to or in StartupChina's leased property. These leases can then be paid for by either StartupChina or the startups.

#### **3) Restrictions on office location**

Although a restriction on office location would make it harder for StartupChina to use a defunct warehouse as a facility, in general, rep offices in Beijing usually do not have a problem finding an office location that meets their requirements.

#### **4) Local employees must be hired through FESCO**

Local hiring through FESCO is a minor inconvenience that for all intents and purposes does not pose any major problems in hiring local employees.

#### **5) Increased immediate tax liability though expenses that are taxed at 9.76%**

Finally, tax liability must be minimized by keeping as much expense offshore as possible. This is the most significant disadvantage of StartupChina choosing a Rep Office vs. a WFOE.

### **WFOE Option**

Other than the leasing restriction, a WFOE carries none of the disadvantages described above for the Rep Office. A WFOE can issue invoices and receipts, has fewer restrictions on office location, can directly employ local employees, and is taxed on income rather than expenses. In addition, WFOE's are usually given favorable tax treatment for the first few years and can hold PRC intellectual property rights.

Although the rep office does not restrict StartupChina from legally performing its incubation functions, given the increased flexibility, a WFOE is an ideal long-term structure for StartupChina's incubating activities in the PRC. However, WFOE's are generally only approved for businesses in China that have a production element as their main business. WFOE's are generally off-limits for service industries. In addition, the approval process for a WFOE is significantly longer and more expensive than a Rep Office. The WFOE is also must heavily scrutinized if the WFOE does not appear to have production as its main business activity.

Although StartupChina will start with a Rep Office, it will aim to get WFOE status for its incubating activities as soon as possible.

### ***Investment Structure***

StartupChina's investments will be carried through its Offshore Holding Company using the following structures.

#### PRC OffCo:

The Offshore Holding Company will provide seed capital in exchange for shares of another offshore company either in the same or similar jurisdiction. This offshore company, called PRC OffCo, will act as both the investment vehicle into China as well as the eventual listing vehicle. The PRC startup founders will own equity in this PRC OffCo as PRC individuals subject to a vesting schedule.

#### PRC OpCo:

The PRC OffCo will then set up a PRC WFOE or JV entity, which will carry out product development, PRC business transactions, etc. The approval process of this PRC entity, called PRC OpCo, will be dependent on various factors explained in the tables below including size of investment, business scope, etc. In general, StartupChina can obtain approval for WFOE's and JV's normally within a month from the Haidian Hi-Tech zone local government as long as the investment size is below \$10 million and business scopes are in encouraged industries, also described below. The entire OpCo setup process should take 6 weeks including preparing all the approval documentation. In addition, StartupChina will maintain a close relationship with the local government to try accelerating the process even further.

Prior to approval, any funding transferred offshore from StartupChina to support the OpCo will be structured as monetary gifts to the individual founders. These initial funds transferred will be subject to risk and would be difficult to recover if the approval fails or the founders renege on their agreement. To minimize this risk, StartupChina will keep the amount transferred to a minimal until the OpCo is approved.

If for various reasons, if the investment approval process of a WFOE is forecasted to take longer and/or there are higher stakes involved, StartupChina may choose to elect to use the following means to legally take action against the founders if they renege of their agreement. The founders would form a PRC LLC, which would enter into an asset purchase agreement with the PRC OffCo or StartupChina offshore company. This agreement would state that the offshore company intends to purchase assets in the LLC through the WFOE after the WFOE has been approved. Once the WFOE is approved, the WFOE pays the LLC for its assets. Since these assets are most likely intangibles and IPR's, the value of this purchase could be offset as a form of deferred salary payment to the PRC founders. This deferred salary payment could be used as an incentive for the founders to stick with the agreement. After the assets are sold, the PRC founders would liquidate the LLC and receive this "deferred salary". If the founders renege on their agreement prior to the WFOE being formed, the offshore company could file a claim against the LLC. A possible problem with this structure is that the government may consider this as a contrived means to operate a WFOE prior to the WFOE being formed. Because of the time and expense involved in this process of using this PRC LLC structure, the decision to do so must be done on pure cost-benefits basis.

For the case of a JV OpCo, the PRC founders must form a PRC LLC before starting the JV approval process. This PRC OffCo and the PRC LLC would both contribute assets to the formation of the JV (the PRC OffCo would contribute mostly capital while the PRC LLC would contribute mostly intangibles and IPR's). Because the PRC LLC's contributions would be mostly intangibles, its equity participation is limited to 20% of the JV. However, a cooperative joint venture (CJV) can be formed such that property rights and control structure can be set separately from equity distributions, similar to a partnership structure. For example, the CJV equity structure may be (OffCo 80%, LLC 20%), but the property rights and control structure can be set at (OffCo 50%, LLC 50%). To maintain maximum flexibility for future investors, a (OffCo 95%, LLC 5%) property rights and control structure mimicking a WFOE will be used if possible.

## INVESTMENT PROCESS

### *Investment Restrictions*

The decision whether to choose a WFOE or JV for the OpCo will depend on what is allowable under government regulations surrounding foreign investment in certain industries. (Note: JV <49% means that the PRC OffCo must take a minority stake in the joint venture)

<b>Business Scope (Revenue Generation Source)</b>	<b>Structure</b>	<b>Note</b>
<b>Software Developer</b>		
Software Provider (sell software)	WFOE	Encouraged industry.
ASP Provider ("lease" software)	WFOE/JV	Regulations evolving, make argument for software provider status
E-commerce market makers (software licenses, membership fees, training, reports, ads)	(see below)	Regulations evolving, make argument for software provider status
(transaction fees, agent fees for third party services)	WFOE/JV	Ad space must be sold through advertising agent
	JV <49%	
<b>Internet Service Industries</b>		
Technology Consulting	JV	
Strategy Consulting	JV	
System Integration	JV	Can't purchase system components directly
Education/Training	JV	
Pure Content Provider	JV	Regulations evolving
<b>Traditional Industries Using Internet as Integral Part of the Business</b>		
Retail/Distribution	JV <49%	Restricted B, Difficult to get approval
Travel Agency	JV <49%	Restricted B, Difficult to get approval
Sales Agent	JV <49%	Restricted B, Difficult to get approval
Market Research	JV <49%	Restricted B, Difficult to get approval
Advertising Agency	JV <49%	Restricted B, Difficult to get approval
Freight forwarding- China only	JV <49%	Restricted B, Difficult to get approval
Electronic Publications	JV <49%	Restricted B, Difficult to get approval
<b>Other</b>		
ISP/Telecom Services	barred	Post WTO, foreign minority controlled JV allowed

StartupChina will focus on investments where WFOE and JV's are allowed. Investment in Restricted B industries will be kept to a minimum due to the complications and hence greater risks involved.

### *Approval Authority and Time*

When the PRC OffCo is ready for post-seed level financing, preparation must be made well in advance to increase the registered capital of the WFOE or joint venture. If the total registered capital stays within \$10 mil USD, only local approval is needed and should take less than a month. This is beneficial for StartupChina since its incubatee companies should not require more than \$10 mil USD in the next round of financing.

<b>Registered Capital</b>	<b>Approval Authority</b>	<b>Approval Time</b>
<b>WFOE or JV in Non-Restricted industry</b>		
< 10 mil USD	Haidian Local Level	< 1 month
10 mil < 30 mil	Beijing Municipal Level	1 months +
30 mil < 100 mil	MOFTEC	2-3 moths
> 100 mil	State Council	2-3 months
Note: Time is cumulative. MOFTEC approval first requires local and municipal approvals		
<b>WFOE or JV in Restricted B industry</b>		
n/a	MOFTEC	3 months

***Additional financing and liquidity event process***

When receiving additional financing, the PRC OpCo may need additional approval from authorities if the registered capital crosses certain thresholds shown in the above table. As long as registered capital does not exceed \$30 mil, only 1-2 months are required to obtain local and municipal level approvals. To minimize complications to a listing process, startups should cross the \$30 mil USD threshold and complete MOFTEC approvals in a financing stage prior to listing. As long as the IPO does not lead to events that increase the registered capital exceed \$100 mil USD, MOFTEC approval is then not required again.

The liquidity event for the portfolio company is carried out through the PRC OffCo. In general, most of the value of the PRC OffCo lies in its ownership of PRC OpCo assets through the WFOE or JV structure. In the case of an IPO, the PRC OffCo will be the listing vehicle. If the portfolio company is being acquired, the acquiring company will purchase the PRC OffCo.

The PRC government is currently in the process of possibly regulating listing of offshore companies with PRC Internet assets. Because of StartupChina's focus on investments in non-restrictive industries, new regulations regarding listing should have minimal impact on StartupChina. If listing does become problematic, acquisitions are the alternative liquidity event option.



## DEVELOPMENT PLAN

### *Incubation Services*

StartupChina plans to develop capabilities through in-house expertise and outside professional service firms to assist portfolio companies during their incubation phase. Key in-house capabilities include helping to develop an aggressive strategy and realistic execution plan, strengthen the business model and document in a well thought out business plan, find investors for the next financing round and help pitch the company, assist in business development which meets the company's strategic objectives, and constant monitoring and forecasts of the company's financial condition and competitive environment. StartupChina plans to also initially develop relationships with key professional firms and negotiate service packages with favorable terms to the portfolio companies. These partner service firms will be internationally reputable firms, have experience dealing with the needs of startups, and have operations in China. These partner service firms will assist startups in critical accounting, PR, advertising, legal, marketing, and human resource needs. Use of these firms will greatly enhance the portfolio company's level of professionalism and increase its attractiveness to subsequent investors. Some of the professionals from these partner service firms may be eventually hired by StartupChina to provide a more cost effective, startup focused solution.



Figure 12: Functional Areas

### *Physical and IT Facilities*

StartupChina plans to create an office environment designed to meet the intense needs of a growing startup as well as promote interaction and synergies between incubating startups. An average of 50 sq. meters will be budgeted for each startup. Another 100 sq. meters will be initially budgeted for shared areas and StartupChina administrative facilities.

StartupChina plans to choose a real estate developer with international property management experience. The facilities must have the infrastructure to efficiently support internal IT networks and ISP access. Security, 24hr accessibility, and leasing flexibility are also important factors.

In order to register a legal address at the incubator facility, portfolio companies must sign separate leasing agreements with the real estate developer. Portfolio companies must lease directly from the real estate developer because of PRC regulations restricting foreign invested enterprises like StartupChina directly engaging in real estate leasing. In addition, each portfolio company must have a separate sign and door that are accessible from the outside hallway. However, the portfolio companies and incubator leased offices will be interconnected inside. To realize this arrangement, StartupChina plans to work with a property developer as a partner who will provide StartupChina specific options to guarantee portfolio company leasing space as they come in.

Figure 5: Leasing Arrangement

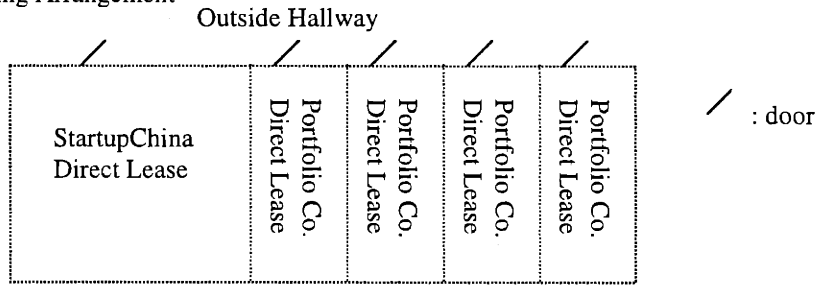
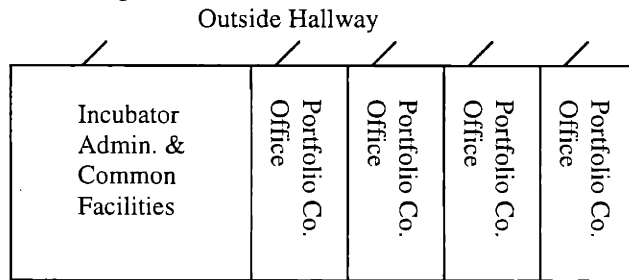


Figure 6: Functional Arrangement



At a minimum, StartupChina will employ multiple ISDN access for Internet, data, fax, and phone needs. StartupChina is also exploring the use of broadband access to servers in PRC, Hong Kong, and the US depending on aggregate portfolio company needs.

StartupChina will also set up a network of desktops and workstations to host product development and operational needs. Test servers will also be available. StartupChina will have arrangements with PRC and foreign ISP's to support co-location and virtual hosting activities for portfolio company needs.

**Financial and Resources Growth Plan**

StartupChina's growth plan can be divided into one preparation stage and four growth stages involving financing.

Schedule		2000				2001				2002			
Stage	Main Focus	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Prep	Develop team and concept	█											
I	Build Up Incubator		█										
II	Prove-out Concept			█	█	█							
III	Expand Capabilities						█	█	█	█	█	█	
IV	IPO												█

Figure 13: Schedule for Incubator Development

Growth Stages		
Stage	Incubating Capacity	Positioning
Prep	n/a	Incubator
I	assist but not incubate	Incubator
II	4 startups X 1 group	Incubator
III	6 startups X 2 groups	Transform into holding company
IV	6 startups X 2 groups	Holding company with incubator subsidiary

Figure 14: Schedule for Portfolio Company Inclusion

Prep Stage

This stage is the initial team forming and concept and feasibility development stage. StartupChina has met with lawyers to design the vehicles and structures needed to operate the incubator business model in China. StartupChina has also worked on accessing the needs of entrepreneurs and investors in China, and developing a business that focuses on better addressing those needs. A competitive study and analysis has been completed. Financial models and objectives have been developed to show the feasibility of the business model as well as show returns that would be attractive enough for investors. Talks have been initiated with the Haidian government officials regarding WFOE registration and approval processes. Professional service companies have been contacted and have shown interest in being a long-term partner to service portfolio companies. An initial financing plan and investor roadshow has been scheduled.

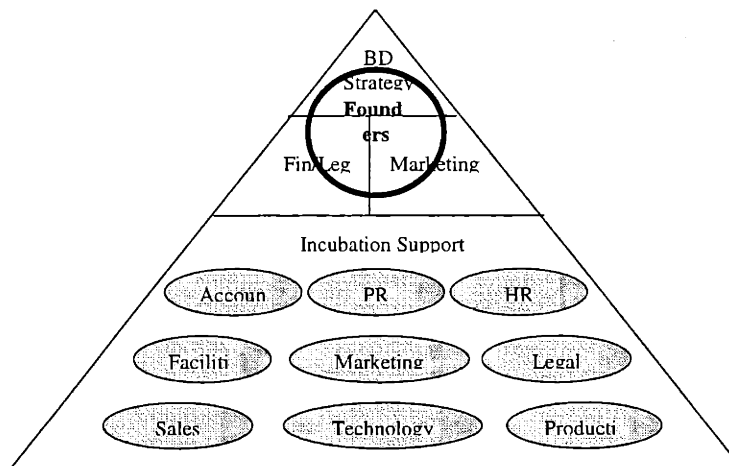


Figure 15: Capabilities Development- Prep Stage

Stage I

StartupChina begins as an incubator play, and plans to raise a total of \$500K in funding from angels, which is disbursed between March and May. This funding is used for setting up the incubator and pays for salaries, legal fees, and the incubator's initial facilities. During this time, a CEO, a legal/finance professional, and staff will be added to the team. At this time, StartupChina may offer some consulting and brokerage services for startups that StartupChina does not wish to invest in. During this period, StartupChina will also develop relationships and negotiate deals with partner service companies. Founders will focus more on the firm's marketing and incubation operations side.

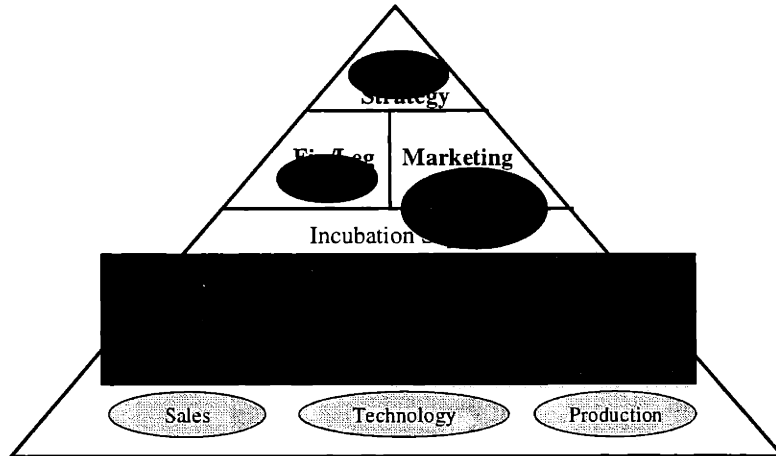


Figure 16: Capabilities Development – Stage I

Stage II

StartupChina needs to raise an additional \$3M in funding this time from non-competing VC's and large companies, with the understanding that StartupChina plans to eventually transform into a China e-commerce holding company play (read: the ICG of China). \$2M of this funding is targeted to go into 4 partner companies (ICG terminology-portfolio companies are called partner companies) at an average of \$500K an investment. The rest of the funding goes towards expenses. First disbursements to partner companies are planned for 3Q '00, with the remainder disbursed during 4Q. Partner companies are given 6 months within the incubator.

Investments in partner companies are made such that the valuation of a group of investments as an aggregate quadruples in three years. For the case of Stage II's 4 partner companies, in three years StartupChina must own 5% of a \$100M company, 5% of a \$50M company, break-even on a third company, and allow total loss of investment in the fourth.

StartupChina plans to grow the capabilities of the incubator by expanding the facility and the team. The incubator's capacity must grow to handle 6 incubating partner companies, up from 4. StartupChina plans to also hire more professionals to serve as in-house resources to the portfolio companies.

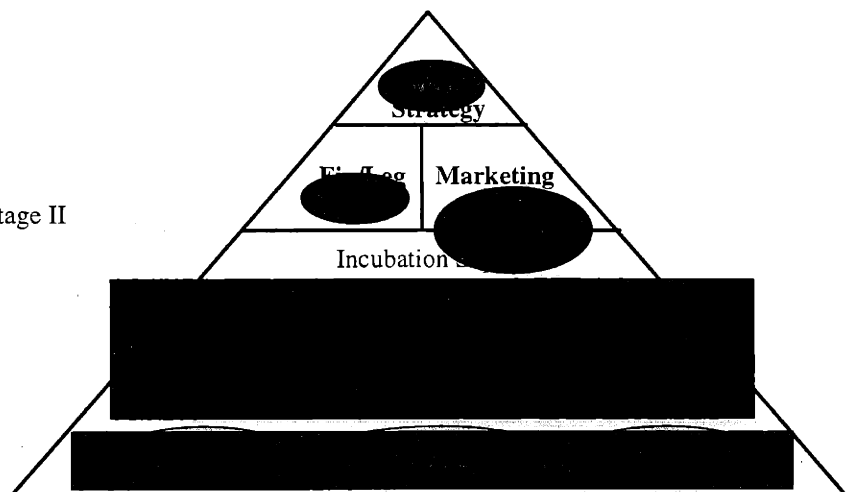


Figure 17: Capabilities Development – Stage II

### Stage III

StartupChina plans to raise \$20M to incubate more partner companies and also accelerate its transformation into an Internet holding company. \$6M is targeted to 2 groups of 6 new partner companies each. \$10M is planned for investments in 4 early stage partner companies without incubation. However, these 4 partner companies will enjoy synergies with the other partner companies in the group similar to those enjoyed at ICG. StartupChina plans to continue the expansion of its resources and activities.

### Stage IV

Through an IPO raising 50M, StartupChina plans to raise enough capital to complete its transformation into a holding company with a strong incubator element. Such Internet holding companies typically enjoy healthy multiples over asset values, a phenomenon, which is crucial for strong post-IPO valuations. These strong post-IPO valuations are in turn critical for attracting the funding needed at the earlier stages. A major expansion of resources and activities is planned.

## **FINANCIALS OVERVIEW**

StartupChina's main financial objective is to maximize its valuation by 1) increasing the valuation of the portfolio companies it holds interests in, and 2) increasing its share price to total asset value multiple through value added as an active Internet holding company. In the short to medium term, StartupChina does not expect to receive significant revenues through its incubation activities or portfolio company profit dividends. Revenues in the short to medium term will possibly be derived from sales of portfolio company shares. To cover the balance of cash flow shortfalls during this period, StartupChina plans to raise a series of financing by offering shares to private investors and the public markets. Long term, StartupChina expects to receive significant profit dividends from its portfolio company holdings to sustain ongoing operational cash needs.

## **ESTIMATED EXPENSES**

During Stage I, StartupChina's expenses costs will main go towards development of the incubator's capabilities as described above. StartupChina expects to ramp up to \$100,000 of monthly recurring expenses by June, 2000. Non-recurring capital expenses are forecasted to be \$80,000 spent during the second financial quarter of 2000. The bulk of recurring monthly cash expenses will go towards salaries, IT, and communications costs. The rest of the expenses will mainly cover travel expenses, public relations, advertising, tax, leasing, and administrative costs.

Because StartupChina's business is not capital intensive, costs are mostly variable and grow in relation to the amount of activity needed to support incubating portfolio companies. Costs are expected to grow according as StartupChina expands its capabilities after Stage I.

## **FINANCING**

StartupChina currently aims to raise four rounds of funding to support the corresponding Stages I-IV described above. StartupChina plans to finance Stage I by raising \$500,000 from mostly angel investors during the first financial quarter of 2000. StartupChina subsequently intends to finance Stage II by raising \$3,000,000 from early stage venture capital firms during the third financial quarter of 2000. To finance Stage IV, StartupChina plans to raise \$20,000,000 from late stage venture capital firms during the second quarter of 2001. An IPO is planned for the fourth financial quarter of 2002 to raise an additional \$50,000,000 from the public markets as well as private placements.

## **PORTFOLIO COMPANIES VALUATIONS GROWTH**

StartupChina's investment objective is to own 5% of a portfolio company worth \$100,000,000 in three years after the initial investment. The percent equity taken during the initial seed investment will reflect the portfolio's long term valuation potential, execution schedule, and additional financing needs.

Due to the historical high risk of failure among startups, StartupChina expects that for two out of four companies it incubates, one will attain a \$100 million valuation and the other a \$50 million valuation in three years. For the other two companies, StartupChina will get its investment back on one, and lose its investment entirely on the other. Based on this model, a total of \$2 million in investments made in these four companies would be worth \$8 million in three years. While these success/failure ratios are higher than historical averages, the higher success ratios are justified by the value-added services that the incubator provides and the high market valuations that typically have existed for the growing e-commerce industry.

During Stages II and III, StartupChina will invest in three groups of portfolio companies for incubation. The first group will comprise of four companies with investments totaling \$2 million made during Stage I. The second and third groups will comprise of six companies with investments totaling \$3 million each group. The targeted IRR for these investments is 59% in three years.

During Stage III, StartupChina will also invest larger amounts in early-stage companies. Although these companies are past the need for incubation, they are still at an early development stage and can partake in the same synergies that have been developed between the group of companies incubated. Investments totaling \$5 million will be made in two non-incubating companies in 2001, followed by \$5 million in another two companies in 2002. The targeted IRR for these investments is 41% in two years.

<b>StartupChina Assets Value</b>	2000	2001	2002	2003	2004
<b>Incubating Companies</b>					
Group I: Portfolio Companies 1-4	2.0	3.2	5.0	8.0	8.8
Group II: Portfolio Companies 5-10		3.0	4.8	7.6	12.0
Group III: Portfolio Companies 11-16		3.0	4.8	7.6	12.0
<b>Investment Only Companies</b>					
Portfolio Companies 17-18		5.0	7.1	10.0	11.0
Portfolio Companies 19-20			5.0	7.1	10.0
<b>Post IPO Holdings</b>					30.0
<b>Cash</b>	0.5	8.0	3.0	40.0	10.0
<b>Total Asset Value</b>	<b>2.5</b>	<b>22.2</b>	<b>29.6</b>	<b>80.2</b>	<b>93.8</b>

Figure 18: Asset Valuations over time

### STARTUPCHINA VALUATIONS GROWTH

StartupChina aims to achieve valuation multiples enjoyed by other Internet holding companies such as Internet Capital Group (ICG) and CMGI. These valuations are justified by the synergies created, strengthened branding, domination of emerging markets, reduced management risk within a high competitive industry, and increased diversification to the investor in a volatile market.

Pre-IPO valuations will be primarily determined by private valuations during financing rounds while post-IPO valuations will be determined by the public market. By Stage III, StartupChina intends to obtain a \$50 million valuation, followed by a \$125 million valuation during the IPO process planned for the end of 2002. Assuming a market capitalization to asset value ratio of 6 (ICG achieved this one-month after IPO), StartupChina will be worth \$481 million in 2003. Assuming a conservative market capitalization to asset value ratio of 20 (ICG achieved a ratio of 50 only six months after IPO), StartupChina will be worth \$1.9 billion in 2003.

<b>StartupChina Valuation</b>	(\$mil USD)				
<b>Based on Private Equity Valuations</b>	2000	2001	2002	2003	2004
Stage 0 (1Q '00)	0.1				
Stage 1 (1Q '00)	3.3				
Stage 2 (3Q '00)	10.0				
Stage 3 (1Q '01)		50.0			
Stage 4 (IPO, 4Q '02)			125.0		
<b>Based on ICG Mkt Cap/ Asset Value</b>					
Mkt Cap/ Asset Value = 6 (1 mo after ICG IPO)				481	563
Mkt Cap/ Asset Value = 20				1,604	1,876
Mkt Cap/ Asset Value = 50 (6 mo after ICG IPO)				4,010	4,690

Figure 19: Market Valuations

**ESTIMATED RETURNS**

StartupChina plans to raise \$500,000 of seed investment by offering a certain amount of preferred shares equivalent to 15% of the total amount of issued shares including both common and preferred. This fund will be used to set up the incubation facility's Stage I development phase.

Investor returns are forecasted through the following model:

<b>Investor Hurdles</b>						
<b>Share Price</b>		2000	2001	2002	2003	2004
Founders	\$	0.1				
Angels	\$	2.8				
VC-early	\$	6.0				
VC-late			\$ 17.9			
Public (IPO)				\$ 26.8		
Nasdaq Trading Price					\$ 103.1	\$ 401.8
<b>ROI upon liquidity event</b>						
Angels				373%	1112%	3446%
VC-early				125%	477%	1588%
VC-late				50%	189%	650%
<b>IRR upon liquidity event</b>						
Angels				207%	231%	245%
VC-early				112%	159%	187%
VC-late				50%	140%	182%

Figure 20: Expected Investor Returns



## MANAGEMENT TEAM AND RESPONSIBILITIES

**Chris Thun (Founder):** Mr. Thun is responsible for developing the incubator services and creating the synergistic environment in the incubator for the portfolio companies. Prior to founding StartupChina, Mr. Thun was a strategy consultant at Mercer Management Consulting in Boston. At Mercer, he worked extensively in the telecommunications industry, advising both Fortune 100 corporations and startups. In the past year, Mr. Thun has worked with the Beijing Internet Institute and venture capitalists in analyzing opportunities in the Chinese Internet market, and has worked with several startups to develop and execute leading edge Internet products in China. Mr. Thun speaks Mandarin and holds a bachelor's degree from Williams College.

**Tyler Worden (Founder):** Mr. Worden is responsible for StartupChina's marketing initiatives, generating deal flow, and fostering relationships with investors and venture capitalists. Mr. Worden brings extensive experience to StartupChina in international business, marketing and sales. Mr. Worden has considerable knowledge in the software business and in the Internet through his recent role as Director of Product Marketing at Parametric Technology Corporation. In his last position, Mr. Worden was successful in launching PTC's first e-commerce site for product demonstration, distribution, and purchase of a consumer visualization software application. Mr. Worden holds a BS and MS in Mechanical Engineering from MIT, and is currently a member of the MIT Sloan MBA class of 2000.

**Xiaohua Yang:** Ms. Yang is an E-Commerce professional with more than five years of experience in e-commerce strategy, marketing, business development, strategic partnering, and client management in the pure Internet arena, and financial services and publishing industries. She has spent the past five years consulting for US e-commerce companies. She possesses strong analytical, research, and presentation skills, as well as experience in project management. They include developing overall strategies and implementation plans for various web businesses; developing e-distribution strategy and creating business development pitch and revenue models for Web-based 401(k) services; designing affiliate marketing programs; creating new processes for producing web content; and designing an intranet for sales support and training. She has extensive media experience in China, including introducing foreign programming on China's Central Television, and establishing foreign advertising as a new revenue source for the state TV station.

**Feiyan Zhang:** Ms. Zhang has been investing in Chinese/American Joint ventures with CATIC (China National Aero-Technology Imp.& Exp. Corp.) for more than seven years. She is very experienced in the entire investment process in China, from initial project screening, investment analysis, and government approval to investment implementation and after investment control. She has successfully set up numerous joint ventures with MNCs, such as Joint Ventures with Boeing and with AlliedSignal. She has also helped a Taiwan Investment Fund to target screening and implementation of their investment of US\$ 16 million. Ms. Zhang is very familiar with government policies and laws related to investment and brings a strong Chinese network of Internet, industry and government contacts.

StartupChina is in the process of filling the management team, including a seasoned industry veteran with a strong entrepreneurial and/or e-commerce background and an experienced professional with a strong venture finance background. In general, StartupChina is also looking to add Mandarin Chinese speaking professionals and PRC nationals to the team to add to StartupChina's bi-cultural and language expertise.

## CRITICAL RISKS

*Legal and industry regulations:* StartupChina may be subject to legal and regulatory complications if new PRC laws and regulations are established that hinder StartupChina's ability to meet its operational and strategic objectives. Although China's entry into the World Trade Organization (WTO) promises to decrease the likelihood of such events, current posturing by PRC ministries regarding China's Internet industry may lead to an unfriendly regulatory environment.

*Cash flow and financing:* StartupChina's outgoing cash expenses may exceed its ability to secure equity financing. This situation would result in a cash liquidity problem that which would adversely affect StartupChina's ability to operate in a normal fashion.

*Incubation industry and competition:* The incubator industry around the world has become quickly saturated and subject to intense competition. StartupChina expects no less for China, although little competition currently exists. Such competition would affect StartupChina's ability to source quality deals, find venture capital for itself and portfolio companies, and maintain advantageous relationships with partner service companies.

*Economy and financial markets:* StartupChina's performance is affected by economies and financial markets, particularly those in China, Asia, and the US. The current economic growth rate in the PRC and US may not be sustainable, affecting the profitability of portfolio companies and availability of investment capital. The current high market valuations of US markets may also not be sustainable, affecting the availability of investment capital and exit opportunities.

*Currency risk:* StartupChina's investments in China through the PRC OffCo's are subject to certain international currency risks which could minimize the return StartupChina could receive on its investments. Although the US-RMB exchange rate is currently controlled within a narrow band, this rate is subject to change in the future.

*Political:* StartupChina may be subject to significant risk if the political situation in China deteriorates or the US-China relationship sours. Possible effects are dampened foreign investor sentiment, clampdown on or loss of StartupChina operations, etc.

*Portfolio Company- Startup:* Startups have traditionally high failure rates. As an investor in seed stage startups, StartupChina is subject to high failure possibilities of its portfolio companies. These failures would greatly reduce StartupChina's internal returns and affect its ability attract equity financing.

*Portfolio Company- Deal Sourcing:* StartupChina may have difficult finding good portfolio company deals either as a result of limited supply or heightened competition. A lack of quality deals would reduce StartupChina's internal returns and affect its ability attract equity financing.

*Portfolio Company- Post seed investment liquidity:* StartupChina's portfolio companies may have difficult finding venture capital firms or acquisition oriented companies to make additional equity investments. A lack of investment liquidity would greatly increase the probability of startup failure, reduce StartupChina's internal returns and affect its ability attract equity financing.

*Management and Human Resources:* As a new company, StartupChina may not be able to execute and meet its operational and strategic objectives. The StartupChina founders may not be able to fill the rest of the management team, affecting its ability to execute and raise additional financing.

*Incubation- New business model:* The private incubator business model is relatively new and has yet to be tested in an economic or financial market downturn. Although there are many incubators being created, this business model is yet unproven.

## Appendix A: Founder's Resumes

TYLER WORDEN  
58 West Rutland Sq.  
Boston, MA 02118

617-247-7948; mobile: 617 821-8950; e-mail: worden@mit.edu

### Education

9/98 - 6/00 **MIT SLOAN SCHOOL OF MANAGEMENT** **CAMBRIDGE, MA**

MBA Candidate, June 2000: Concentration in New Product and Venture Development

- Teaching Assistant, New Product Development, Fall 1999
- Co-Founder of the Sloan 2000 Leadership Forum; Officer, Graduate Management Society
- Semi-Finalist, MIT 50K Business Plan Competition: "GlobalPeople"

9/88 - 5/93 **MASSACHUSETTS INSTITUTE OF TECHNOLOGY** **CAMBRIDGE, MA**

BS, MS in Mechanical Engineering Concentration in Product Design

- Member of Pi Tau Sigma and Tau Beta Pi Honor Societies
- Captain, MIT Heavyweight Crew 1992 (varsity), 1988 (freshman)

### Experience

6/99 - 8/99 **MIT SLOAN/ TSINGHUA UNIVERSITY IMBA PROGRAM** **BEIJING, CHINA**

- Acted as independent consultant to develop and implement a Marketing and Promotional Campaign Program for a new collaborative International MBA program.
- Established infrastructure for MBA corporate recruiting including policies, contact database, marketing collateral, and interview training for Chinese MBA students.
- Developed an understanding of the Chinese business climate through numerous personal interviews with multi-national corporations, government agencies and independent research.

6/93 - 6/98 **PARAMETRIC TECHNOLOGY CORPORATION** **WALTHAM, MA**

*Director, Technical Marketing Engineering Information Technology Products*

- Identified and qualified new business opportunities in Enterprise Software Applications through customer interviews, focus groups, and market research.
- Defined and implemented marketing policies, strategies, and pricing for achieving EIT product and department goals for twenty-two product lines.
- Managed and developed Product Line Managers and Application Engineers who oversaw and promoted the development of Web based EIT applications.
- Launched two new products in 3-D visualization and Web based engineering over a six-month period, generating \$500,000 in the first three months after launch.

*Product Line Manager, Vertical Applications*

- Led a cross-functional team to deliver a web-based application for streamlining the design and manufacturing of automotive engines. Product awarded Industry Week's Technology of the Year Award and generated \$4 million in '97 sales.
- Established a clear product strategy with functional specifications, identified and negotiated resources from a limited pool, as well as implemented an accelerated project schedule.
- Motivated and managed fourteen international resources through a time critical six-month period, internally championed the product, and presented to prospective customers.

*Manager, Benchmark Group*

- Qualified and led competitive product evaluations for customers where potential revenues exceeded \$500,000. Leadership role required effective decision making in crisis situations and anticipation of potential problems and consequences of actions.
- Generated \$3 million in product sales through identification and management of benchmark tasks, resources, project plans, and customer expectations at Sun Microsystems and Diebold.

*Application Engineer*

- Aided in the generation of over \$20 million in product revenue through the execution of competitive pre-sale CAD/CAM evaluations and consulting assignments utilizing CAD/CAM tools at major international automotive and consumer product companies.
- Strengthened teamwork skills, developed superior salesmanship techniques, demonstrated creative problem solving, and honed objection-handling skills.

## Christopher Thun

Warwick International Building  
No. A7 Nan Shui Guan Guangqumen, #1115  
Chongwen District  
Beijing, China 100061

Tel: +86-1370-1121617  
Chris@StartupChina.com

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### Education:

**Williams College**, Williamstown, MA (1996)  
Graduated *Magna Cum Laude* with Honors in Political Science and a concentration in Economics.

**Oxford University**, Oxford, England (1994-1995)  
Selected to study at Exeter College through the Williams-Oxford program.

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### Experience:

**Founder**, StartupChina Ventures, Beijing, China (10/99-Present)  
Currently building an e-commerce incubator to support entrepreneurs in launching leading-edge e-commerce companies in the Chinese market.

**Senior Analyst for New Ventures**, Beijing Internet Institute, Beijing, China (1998-1999)  
Led strategic consulting projects on the development of the Chinese Internet market for multinational client-base. Managed the development of business plans and the initial execution of several new ventures, including:

- The successful seed financing of a B2B online auction site that will represent large corporate buyers in procuring components from Chinese manufacturers (Received \$600,000 seed financing).
- The development of a Chinese-language content site based on the Salon.com model and targeted at university students on China's mainland.

**Analyst**, Mercer Management Consulting, Lexington, MA (1996-1998)  
Casework experience in Asia, Latin America, and North America. Extensive communications industry experience, including casework:

- Developing the communications software strategy for a Fortune 100 telecommunications equipment manufacturer
- Developing the business strategy for rolling out DSL High Speed Access for an RBOC

**Global Studies Intern**, Williams College (Summer 1994)  
Researched the role of the Internet in the rise of global social movements.

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### Language Skills:

Proficient in Mandarin Chinese

# Xiaohua "Show" Yang

112A Inman Street  
Cambridge MA 02139  
(617) 247-9561/(617) 876-0101  
[xyang@eudoramail.com](mailto:xyang@eudoramail.com)

## PROFILE

- E-Commerce professional with more than five years of experience in e-commerce strategy, marketing, business development, strategic partnering, and client management in pure Internet arena, and financial services and publishing industries.
- Strong analytical, research, and presentation skills, as well as experience in project management. They include developing overall strategies and implementation plans for various web businesses; developing e-distribution strategy and creating business development pitch and revenue models for Web-based 401(k) services; designing affiliate marketing programs; creating new processes for producing web content; and designing an intranet for sales support and training.
- Media experience in China, including introducing foreign programming on China's Central Television, and establishing foreign advertising as a new revenue source for the state TV station.

## EXPERIENCE

### E-COMMERCE CONSULTING

1999-2000

#### E-channel distribution development, Goldk.com

##### Developed e-channel strategy and target map for Web based 401(k) services

- Evaluated the company's business model and needs.
- Designed strategy and analytical structure for e-channel development; developed e-distribution target map.
- Identified, analyzed, and selected targets for electronic distribution partnerships.

##### Developed e-channel business development approach

- Designed and developed e-channel business development pitch.
- Created e-distribution revenue models for non-broker/dealer channels.

### Sloan School of Management, M.I.T.

E-channel development projects, Sloan Management Review

##### Created Web affiliate marketing strategy and implementation plan:

- Identified, analyzed, and selected targets for partnership and affiliate development.
- Researched competing affiliate marketing firms' offerings, including tracking technologies, and recommended a service provider.

##### Developed Web Strategy and implementation project plan:

- Evaluated company's needs and resources, reviewed current web site, and determined reasonable short- and long-term objectives.
- Researched best in-class Web sites and e-commerce practices and recommended e-marketing and Web development strategies.
- Assisted publisher in prioritizing e-commerce initiatives based on potential business success.

### Business Development Project, Entrepreneurship Lab

- Participated on a team that identified, analyzed, and selected targets for affiliate growth at Be Free.
- Initiated contacts with MSN and Netscape and co-developed the presentations to Netscape and Alta Vista which helped yield partnerships with MP3 and Shopping.com.
- Approached several ISP's and developed analysis of high growth targets for follow-up business development.

### E-Commerce Consulting, Industrial Liaison Office, M.I.T.

- Advised visiting executive of Shanghai Mart on e-commerce business models and strategies to help the company develop a business-to-business portal complementary to its off-line business.

**FIDELITY INSTITUTIONAL INVESTMENT SERVICES, INC., BOSTON, MA,**

**1997-1998**

**Product & Process Analyst/Web developer & Producer, Retirement Strategic Marketing**

- Assessed and met e-communication infrastructure needs, and developed and executed Intranet strategy.
- Developed 401(k) recordkeeping services information for product re-launch and new product development; developed 401(k) plan sales process information by working with business experts and coordinating multi-departmental review and approval.
- Designed an Intranet for sales support and training.
- Developed and implemented procedure for database maintenance and upgrade.
- Created integrated process for producing Web training materials and assisted corporate trainer on implementation. Web training materials were subsequently used to support new product launch.
- Conducted competitive analysis of the 401(k) business in the bank distribution channel.
- Studied and selected on-line document management tools and managed their implementation.

**CHARLES SCHWAB & CO. LTD., SAN FRANCISCO, CA,**

**1994-1997**

**Corporate Action Analyst & Trader**

- Researched and analyzed terms of corporate actions for domestic and foreign securities.
- Managed clients' accounts, including examining their portfolio holdings, analyzing the impact of corporate actions on their holdings, contacting and educating clients about such impact, and providing guidance on appropriate decisions.
- Traded equities, mutual funds, and options.
- Recommended ways to move fixed income processing from a functionally structured to a product-oriented teamwork system on an internal Teamwork Task Force.
- Suggested and implemented improvement of workforce training as member of Training Subcommittee.

**OTHER RELEVANT EXPERIENCE**

- Researched and analyzed online fund raising options, and developed strategy for matchschool.org to raise funding online using Charitable Gift funds.
- Created strategic plan for a business-to-business apparel web site.
- Wrote working paper on China's auto industry to expand MIT International Motor Vehicle Program's research scope and attract funding from auto makers and parts suppliers. Paper affected establishment and funding of globalization as a key research area and financial support from corporate sponsors.
- Interpreted negotiations and coordinated contacts between China Central Television (CCTV) and non-Chinese corporations and governments. Co-designed and introduced international programming in CCTV, and selected and structured TV program procurement deals from BBC, Granada, UPITN, and American TV companies.
- Initiated business negotiations with American corporations on advertising sports products through the newly established China Television Service.
- Facilitated establishment of foreign advertising as a new revenue source for China Central Television.

**EDUCATION**

- **Ph. D.**, International Political Economy, Boston University
- **M. A.**, Law and Diplomacy, Fletcher School, Tufts University
- **B. A.**, English Language and Literature, Xiamen University, China

**PUBLISHING**

- *Globalization of the Automobiles Industry: The United States, Japan, and the People's Republic of China* (Praeger, 1995)

**PERSONAL**

- Series 7 and 63
- HTML, Dreamweaver, FrontPage, HyperSnap, Adobe PhotoShop, Excel, PowerPoint, Word.
- Fluent in Mandarin Chinese.

## **Appendix B: Advisory Board**

**Edward Haynes (Founder):** Provides expertise as an experienced executive in a premier China e-commerce company, holding a strong corporate finance background. Mr. Haynes is currently working for MeetChina.com as Vice President, China Business Development and Treasurer. MeetChina.com is a Chinese B2B e-commerce portal that connects Chinese manufacturers to global buyers. Prior to joining MeetChina, Mr. Haynes worked at AT&T as the Regional Treasury Manager and at Chase Manhattan Bank. His background includes over 10 years in corporate finance, including corporate and investment banking. Mr. Haynes speaks Mandarin and holds an MBA from Boston College and a BS in Economics from the University of Florida.

**Gordon Baty:** A co-founder of Zero Stage Capital, a Boston based VC firm, Dr. Baty has more than 30 years operating experience in the formation, financing, operation, and merger and acquisition of new companies. Most recently, he has worked with Mercury Computer Systems, Novitron International, Cognex Corporation, and Ibis Technology, all of which have had successful public offerings. An accomplished writer and speaker on the subject of venture formation, Gordon has published *Entrepreneurship for the Nineties* (Prentice-Hall, 1990), a practical guide for entrepreneurs seeking to build successful venture companies. Gordon earned three degrees from the Massachusetts Institute of Technology—an SB and an SM in industrial management and a Ph.D. in Finance. He is a founder of the MIT Enterprise Forum.

**Prof. Ed Steinfeld:** Mitsubishi Career Development Assistant Professor of International Management at MIT (thesis advisor). Prof. Steinfeld studies enterprise restructuring and industrial policy in transitional economies, with an emphasis on China. In *Forging Reform in China* (Cambridge University Press, 1998), he examines the complex web of institutional factors that inhibit market-oriented behavior in Chinese State firms. His findings underscore the difficulty of establishing property rights in former command economies, and challenge widely held assumptions about the viability of rapid privatization. Prof. Steinfeld also looks at corporate strategy in emerging markets and general issues of East Asian development and is currently researching the State Banking system of China for an upcoming book.

**Prof. Jim Short:** James Short is a visiting professor at the MIT Sloan School of Management, and professor of Information Management and Strategy at London Business School. His expertise is in market creation and growth strategies in Internet businesses, and teaches courses in starting companies in emerging markets. He studies ways in which early-stage Internet businesses resolve market, human resource and technological uncertainties to sustain high rates of market and product growth. He is the founding director of the LBS i:Lab, a digital media learning center sponsored by twenty leading new media companies

**Appendix C: Financials (StartupChina Cash Flow Model)**

Date:	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
<b>Expense Activities</b>										
<b>Salaries</b>										
CT/JT/TW		\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000	\$ 15,000
Legal/Fin		\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000
CEO			\$ 6,667	\$ 6,667	\$ 6,667	\$ 6,667	\$ 6,667	\$ 6,667	\$ 6,667	\$ 6,667
Local Staff			\$ 3,614	\$ 3,614	\$ 3,614	\$ 3,614	\$ 3,614	\$ 3,614	\$ 3,614	\$ 3,614
<b>Salaries Subtotal</b>	\$ -	\$ 20,000	\$ 30,281	\$ 30,281	\$ 30,281	\$ 30,281	\$ 30,281	\$ 30,281	\$ 30,281	\$ 30,281

<b>T&amp;E</b>	\$0	\$6,000	\$9,084	\$9,084	\$9,084	\$9,084	\$9,084	\$9,084	\$9,084	\$9,084
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<b>Legal</b>	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
Caymen Islands Incorp Holding Co.										
Caymen Islands Incorp Incubator	\$2,500									
Term Sheet	\$500									
China Rep Office		\$500								
Secondary govt registrations		\$500								
General Legal Advice		\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000
Real Estate Contract		\$500								
<b>Legal Subtotal</b>	\$5,500	\$4,000	\$3,500	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000

<b>Accounting</b>		\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000
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<b>PR/Advertising</b>		\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000
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<b>Banking</b>	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
HK Bank Account	\$100									
China Bank Account		\$100								
Transaction Fees	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100
<b>Banking Subtotal</b>	\$200	\$200	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100

<b>Facilities (Depreciable)</b>	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
Furniture				\$10,000						
Remodeling			\$30,000							
<b>Facilities (Depreciable) Subtotal</b>	0	0	30000	10000	0	0	0	0	0	0



Appendix C: Financials (Startup/China Cash Flow Model)

Facilities (Non-Depreciable)	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
Rent Downpayment		\$ 24,000								
Electricity and Water			\$300	\$300	\$300	\$300	\$300	\$300	\$300	\$300
Repair and maintenance				\$50	\$50	\$50	\$50	\$50	\$50	\$50
Rent			\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000
<b>Facilities (Non-Depreciable) Subtotal</b>			<b>\$ 8,300</b>	<b>\$ 8,350</b>	<b>\$ 8,350</b>	<b>\$ 8,350</b>	<b>\$ 8,350</b>	<b>\$ 8,350</b>	<b>\$ 8,350</b>	<b>\$ 8,350</b>

Communications Services	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
Fixed Line Installation Fees				\$2,000						
Mobile Installation Fees				\$300						
PBX				\$4,000						
Local/DDD		\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100	\$100
IDD		\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000
Travel calls		\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000
Mobile Fees		\$200	\$200	\$200	\$200	\$200	\$200	\$200	\$200	\$200
ISDN Leased Line				\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000
<b>Communications Services Subtotal</b>			<b>\$ 3,300</b>	<b>\$ 13,600</b>	<b>\$ 7,300</b>	<b>\$ 7,300</b>	<b>\$ 7,300</b>	<b>\$ 7,300</b>	<b>\$ 7,300</b>	<b>\$ 7,300</b>

IT/LAN Infrastructure	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
Fixed Phones				\$1,000						
Mobiles				\$1,000						
Desktops				\$10,000						
Laptops				\$10,000						
Servers				\$6,000						
Hubs/LAN Connectivity				\$500						
Router				\$2,000						
Software				\$5,000						
<b>IT Infrastructure Subtotal</b>				<b>\$ 35,500</b>						

ISP/WAN/Web Fees	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
ISP Fee				\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000
ISDN Fees				\$20,000	\$20,000	\$20,000	\$20,000	\$20,000	\$20,000	\$20,000
Hosting Service				\$500	\$500	\$500	\$500	\$500	\$500	\$500
<b>ISP/WAN/Web Subtotal</b>				<b>\$ 21,500</b>	<b>\$ 21,500</b>	<b>\$ 21,500</b>	<b>\$ 21,500</b>	<b>\$ 21,500</b>	<b>\$ 21,500</b>	<b>\$ 21,500</b>

Appendix C: Financials (StartupChina Cash Flow Model)

PRC Tax	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
Rep office expense tax		\$ 387	\$ 2,059	\$ 2,991	\$ 2,424	\$ 2,424	\$ 2,424	\$ 2,424	\$ 2,424	\$ 2,424
Foreign individual income hypo-tax			\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000
<b>PRC Tax Subtotal</b>	\$ -	\$ 6,387	\$ 10,059	\$ 10,991	\$ 10,424	\$ 10,424	\$ 10,424	\$ 10,424	\$ 10,424	\$ 10,424

<b>Accrued Prior Expenses</b>	\$ 30,000									
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<b>Total Expenses</b>	\$ 35,700	\$ 65,887	\$ 96,625	\$ 144,406	\$ 92,039	\$ 92,039	\$ 92,039	\$ 92,039	\$ 92,039	\$ 92,039
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Revenue Activities	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
Investment Brokerage Income			\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Incubator Service Income			\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 8,000
Rental Income				\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000
Interest Income		\$ -	\$ 268	\$ 827	\$ 1,334	\$ 823	\$ 8,866	\$ 6,490	\$ 8,314	\$ 8,045
Other Income				\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000
<b>Total Revenues</b>	\$ -	\$ -	\$ 18,268	\$ 21,827	\$ 22,334	\$ 21,823	\$ 29,866	\$ 27,490	\$ 29,314	\$ 29,045

Financing Activities	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
First Round (Angel Investor)	\$ 100,000	\$ 200,000	\$ 200,000							
Second Round (VC Round)					\$ 2,000,000					
Loans										
<b>Total Financing</b>	\$ 100,000	\$ 200,000	\$ 200,000	\$ -	\$ 2,000,000	\$ -	\$ 1,000,000	\$ -	\$ -	\$ -

Investment Activities	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
Partner Company Investments						\$ 500,000	\$ 500,000		\$ 500,000	\$ 500,000
<b>Total Investment</b>	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 500,000	\$ 500,000	\$ -	\$ 500,000	\$ 500,000

<b>Net Change in Cash</b>	\$ 64,300	\$ 134,113	\$ 121,643	\$ (122,580)	\$ 1,930,294	\$ (570,216)	\$ 437,826	\$ (64,549)	\$ (562,725)	\$ (562,994)
<b>Cash On Hand Beg of Month</b>	0	\$ 64,300	\$ 198,413	\$ 320,056	\$ 197,477	\$ 2,127,771	\$ 1,557,554	\$ 1,995,381	\$ 1,930,831	\$ 1,368,106
<b>Cash On Hand End of Month</b>	\$ 64,300	\$ 198,413	\$ 320,056	\$ 197,477	\$ 2,127,771	\$ 1,557,554	\$ 1,995,381	\$ 1,930,831	\$ 1,368,106	\$ 805,112
<b>Burn Rate (Recurring Expenses Only)</b>			\$ 66,125	\$ 92,606	\$ 92,039	\$ 92,039	\$ 92,039	\$ 92,039	\$ 92,039	\$ 92,039
<b># months of cash on hand</b>	643	5	5	2	23	17	22	21	15	9

(@Current Month Burn Rate, no revenues, no financing, no investments)

**Appendix C: Financials (Pricing Structure and Balance Sheet)**

<b>Pricing Structure</b>	
<b>Investment Brokerage Income</b>	
% of financing transaction taken as commission	1%
Average size of financing transaction	\$500,000
Average # transactions per month	2
Monthly income	\$10,000
<b>Incubator Service Income</b>	
Average fee charged per service	\$2,000
Average # one-time fees per startup	2
Average number startups requiring services per month	2
Monthly income	\$8,000
<b>Rental Income</b>	
\$ per sq. m. (gross)	\$10
Average area taken (gross sq m)	50
Average number startups renting per month	4
Monthly income	\$2,000
<b>Interest Income</b>	
Interest Rate	5%
<b>Other Income</b>	
	\$1,000

**Projected Income and Balance Sheet**

	Mar-00	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00
<b>Balance Sheet</b>										
<b>Assets</b>										
Cash/ Current Assets	\$ 64,300	\$ 198,413	\$ 320,056	\$ 197,477	\$ 2,127,771	\$ 1,557,554	\$ 1,995,381	\$ 1,930,831	\$ 1,368,106	\$ 805,112
Ownership interests in Partnership Companies										
PP&E	\$ -	\$ -	\$ 30,000	\$ 75,250	\$ 74,621	\$ 73,992	\$ 73,363	\$ 72,733	\$ 72,104	\$ 71,475
Total Assets	\$ 64,300	\$ 198,413	\$ 350,056	\$ 272,727	\$ 2,202,392	\$ 2,131,546	\$ 3,068,743	\$ 3,003,565	\$ 2,940,210	\$ 2,876,587
Total Shareholder Equity	\$ 64,300	\$ 198,413	\$ 350,056	\$ 272,727	\$ 2,202,392	\$ 2,131,546	\$ 3,068,743	\$ 3,003,565	\$ 2,940,210	\$ 2,876,587
<b>Income Statement</b>										
Total Revenues	\$ -	\$ -	\$ 18,268	\$ 21,827	\$ 22,334	\$ 21,823	\$ 29,866	\$ 27,490	\$ 29,314	\$ 29,045
Depreciation	\$ -	\$ -	\$ 250	\$ 629	\$ 629	\$ 629	\$ 629	\$ 629	\$ 629	\$ 629
S&A	\$ 41,400	\$ 125,387	\$ 153,190	\$ 210,822	\$ 152,155	\$ 152,155	\$ 152,155	\$ 152,155	\$ 152,155	\$ 152,155
Other Income						\$ (100,000)	\$ (200,000)	\$ (200,000)	\$ (200,000)	\$ (200,000)
Net Income	\$ (41,400)	\$ (125,387)	\$ (135,172)	\$ (189,624)	\$ (130,450)	\$ (230,961)	\$ (322,918)	\$ (325,294)	\$ (323,470)	\$ (323,739)



## **Appendix D: Evaluation Process for Selecting Portfolio Companies**

Startup China believes that both ground-breaking ideas and robust execution capabilities are needed for the kind of commercial success we are looking for. We expect the start-up to supply the ideas and at least some of the execution capabilities. We are ready to provide additional capabilities, contacts and access to service partners.

Our screening process will be initiated through a series of stages. Each stage will require the completion of a series of questions that we feel should be addressed sufficiently to warrant further investigation. By answering these questions, we feel that sufficient scope and thought have been placed in this idea. The submission process will take place via our web site.

### **Stage I: Fit with incubator and business opportunity**

To determine fit within the incubator we ask that the following questions that can be answered yes or no. In order to proceed to the next stage, the applicant must be able to reply in the affirmative for all of the questions below.

1. Is your business focused on either business-to-business, or business-to-consumer with a transactional element? Technology based companies that serve this industry are also welcome.
2. Are you at the seed stage for financing with a pre-financing valuation less than \$5 Million?
3. Do you have a Product/service that can be in beta release within a few months.
4. Are you excited about moving into an exciting, fast paced, high-energy, collaborative environment of StartupChina, located within a few miles of Beida and Tsinghua Universities?
5. Are you greatly motivated to succeed in a focused, accelerated mode?
6. Are you capable of learning from others, taking in new ideas, and modifying them to your issues?

To determine value of opportunity the following questions must be addressed either question by question or in an executive summary format.

1. What is the concept of the business and its products and services that you will be offering? What pain will you be solving? Use this as your elevator pitch.
2. What is the market that you wish to serve, how large is it and what is its growth rate? Who are the potential customers and why would they purchase your company's goods and/or services?
3. How will you market and sell the product? What assumptions are you basing your plan on? At what rate will you penetrate this market?
4. Who are the current and future competitors in this market? What is your competitive advantage against each of them?
5. A business development roadmap with milestones, hiring plan, risks, contingencies, and various options. What stage are you at now?
6. Please provide a set of resumes of the principal founders, the amount of money they have currently invested, and the responsibility each person will take within the company.
7. Do you have any Intellectual Protection for the ideas that you are developing?
8. What capital needs do you currently have? How long do you expect that amount to last?
9. What drives you and your team?

### **Stage II: Evaluation**

After a prospective company submits answers to the questions posted on our web site, their answers will be entered into our database. Based upon this information we will perform a pre-screening to determine if the business is in the area in which we invest and if any information is missing. We may contact the submitter by email to ask for additional supporting information.

After the submission has been pre-screened it will be sent to our venture group where the application will be reviewed for potential investment. We will use sound business principles to evaluate each idea for its potential. The submitter will be notified if their plan has made it to this stage.

### Stage III: Team Interview

Within two weeks of submission, the company will be informed whether we are interested or not in the plan. If we are interested we will bring the group in for a presentation and discussion with the team. A series of additional requests will be made in preparation for the meeting:

1. A presentation outlining the business opportunity and the motivation behind the idea
2. Information on how the team was formed.
3. An example of their decision making process as a group.
4. Team responsibilities.
5. How is your company currently capitalized? Please show what is the value you put on your company now (pre-money valuation), the requested investment, and the shares already issued
6. A set of projected pro forma financial statements, built from the bottom up, that includes cash flow analysis, balance sheets and profit and loss statements for a minimum of four years
7. What are the stages and amounts of financing that you are looking for, consistent with the expenditures that you outlined above?

We will be assessing teamwork, leadership abilities, motivation, and presentation skills. Both in English and in Chinese.

### Stage IV: References

1. We will ask for a set of references from people that they know that would be able to act as advisors to their company. In addition, we will explore their needs and desires to make sure that they are a good fit within the incubator as well as a good investment.
2. We will ask for a list of potential customers for their idea and any contacts they have with these firms.

### Stage V: Term sheet

Upon complete disclosure and due diligence of their references, we will negotiate terms with the company and welcome them into the incubator.

Startup China will maintain the confidentiality of the materials received. However, due to the large number of business plans that it will receive each year we will not enter into non-disclosure agreements. StartupChina does not expect a business plan to detail any software source code, hardware design or other material that should be considered confidential.

**Appendix E: Process plan for accelerating Growth of E-Commerce Companies**

Incubating Schedule	Month						
	Pre	1	2	3	4	5	6
<b>Strategy</b>							
Rough out business plan	█	█					
Identify business plan gaps	█	█					
Create execution plan	█	█					
Start weekly strategy meetings			█				
<b>Facilities</b>							
Move into incubator facilities		█					
Set up IT infrastructure		█					
<b>Marketing/Sales</b>							
Develop marketing plan		█					
Collect data and analyze			█	█			
Develop sales and distribution partnerships			█	█	█	█	█
Create test marketing focus groups					█	█	
Initial sales							█
<b>Product Development</b>							
Develop product development plan		█	█				
Develop product			█	█			
Finish initial betas					█		
Refine prototypes						█	
<b>Finance/Accounting</b>							
Agree upon financing goals	█						
Develop metrics and internal accounting system		█					
Start daily/weekly financial control and budget reports			█				
Begin testing VC firm interest					█		
Pitch to VC's						█	
Close financing deal with VC							█
<b>PR/Advertising</b>							
Develop PR/advertising plan		█					
Develop PR/advertising partnerships			█	█	█	█	█
Begin PR/advertising campaigns					█		
<b>Legal</b>							
Initial structuring and legal documents	█	█					
IP Protection documents						█	
Secondary financing and structuring documents							█
<b>HR</b>							
Fill out product development team	█	█					
Fill out management team			█	█	█		

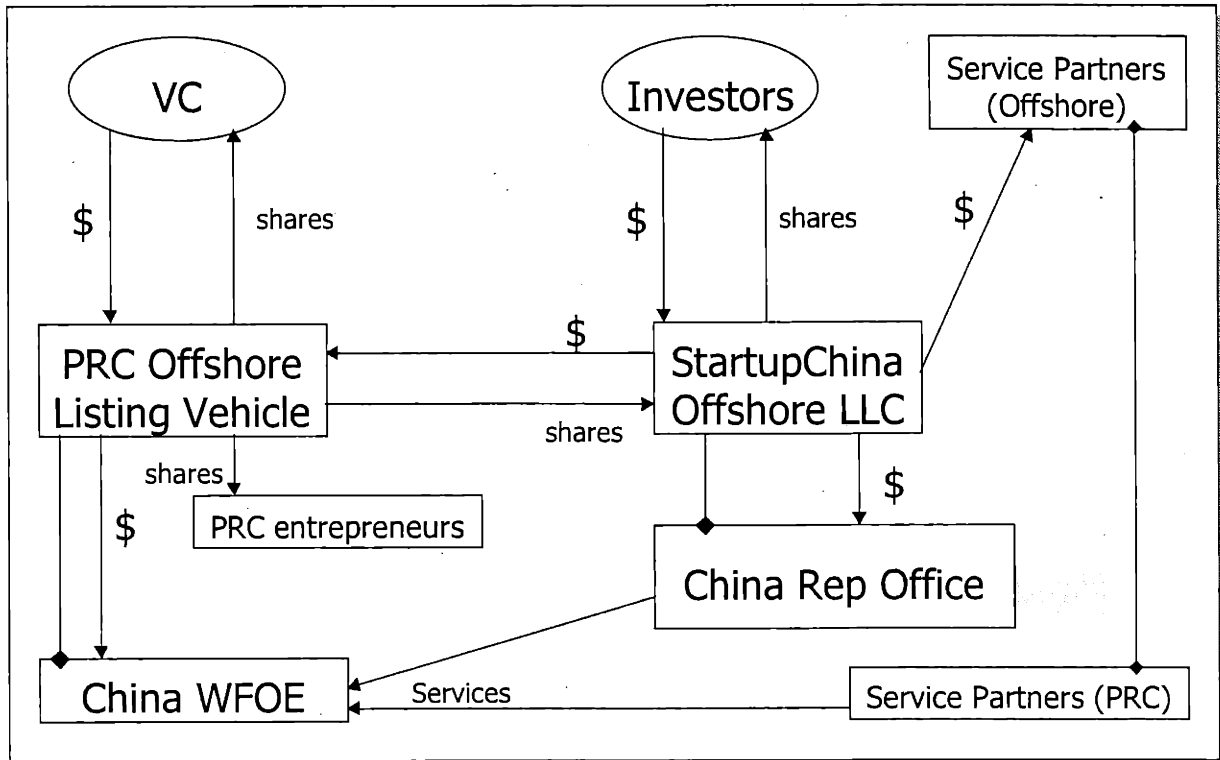
Appendix F: Competitor Map

	International/US	Greater China (HK)	Mainland China
<b>Science Parks/High Tech Zones</b>		CyberPort	Tsinghua Enterprise Group
		Hong Kong Technology Dev. Center.	Tsinghua Tech Park
			Torch
			Zhongguancun High-tech Dev. Zone
<b>Corporate</b>		Motorola (Venture Arm)	China.com
			Intel
			Legend
			MyRice.com
<b>Venture Capital Firms</b>		Walden	Softbank/UTStarcom
	Kliener Perkins		IDG
	HotBank		PCCW/CMGI
	Benchmark		
	ChinaVest		
	KLM		
<b>Commercial</b>			
	Digital Ventures	Tech Pacific	CyberCity
	Garage.com (virtual)	IncubAsia	Sinobit (Virtual)
	IdeaLab	AsiaAlliance	VCCChina (Virtual)
		iMerchants	VC-link (Virtual)
<b>Service</b>		BainLabs	
		Morgan Stanley	BCG

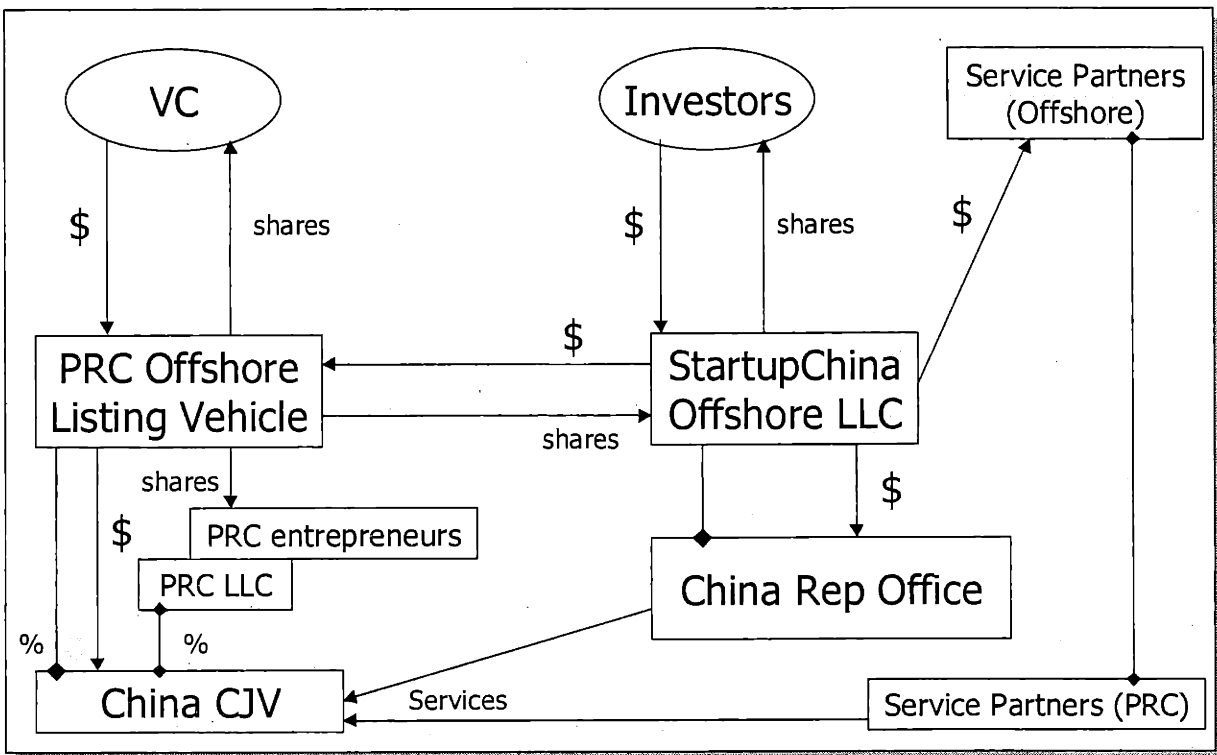


**Appendix G: Legal Structures**

**Legal Structure (WOFE Option)**



**Legal Structure (JV Option)**



## Appendix H: Investment Opportunities

1. Chinese Vault.com
2. Chinese Wetfeet
3. Partnership with McDonalds for distribution and payment outlets
4. Partnership with Kodak for distribution and payment outlets.
5. Develop stores utilizing corporate payment system. Build services for companies HR and then use the web to deduct purchase items from people's payroll.
6. Develop HR services via the web and Intranet.
7. Job matching B-school students site
8. Web site for student recruitment
9. Tawainese culture portal
10. Distant learning
11. Event planning with email and real mail
12. Price comparison software agent
13. Software services firm to develop B2B sites or B2C sites for mortar companies.
14. Sell chinese fake antiques over the internet to US markets
15. Quality verification company.
16. B2B site focusing on the construction business.
17. Sell online books (text format) to an electronic reader. Download via web.
18. Sell small PDA's for viewing web text? Web tablet that works wirelessly?
19. Build a new type of game (board game) or maybe develop and electronic version of majan (sell and play in Starbucks coffee outlets? McDonald's)
20. Food outlet's similar to Microbrewer's? Icecream outlet's?
21. Create a Sunday-newspaper insert for Web sites wishing to advertise economically off-line. Good for China?
22. Web sites following sports events.