

# JESA INVESTMENT & MANAGEMENT CO., LTD.

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## **Challenges and rewards of setting up your own incubator in China**

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The “Incubator Mania” has invaded China in a major way. Technology incubators are popping up like never before all around the country in an effort to discover, and cash in, from the Chinese technology giants of the future. Many foreign incubators have already invested millions and set up their own network of offices in China in order to get a piece of the local fast-growing startup market.

### **Defining Business Incubator**

A Business Incubator, also known as Accelerator, is an organization that nurtures startup companies during their early months by providing them with a wide range of services and networking activity.

Many young entrepreneurs lack resources, experience and know-how: incubators help them fill those voids.

Services offered usually include providing office and R&D space, intellectual property management, marketing and legal support, mentoring and, in some situations, also some early form of financing.

### **Types of Private Business Incubators in China**

Most of private incubators operating around China can be divided into 2 main groups, based on their different business model and offer of services: AI Incubators and Co-working Incubators.

#### **Angel Investor Incubators (AI Incubators)**

AI Incubators are characterized with a high level of involvement with the startups incubated, both in terms of day-to-day operations and equity. Startups that want to join these incubators’ programs have to first pass a selective interview process. Successful startups receive a small amount of capital (\$20k -\$120k) to get started, called seed money, in exchange for equity (5%-15%).

For a period of 3 to 4 months, called “Graduation Program”, entrepreneurs focus on making their companies ready for potential investors. Incubators assist them by providing services and networking activities for free. At the end of the Graduation Program incubators organize meetings among startups and VCs (Venture Capital Funds).

In the event of a VC investment, the invested startup exits the Graduation Program and starts to operate independently, with the

incubator keeping its stake. AI Incubators profit when incubated startups get big and successful enough for a M&A or IPO deal.

Opening an AI Incubator is a high-risk, high-return type of investment. The following list illustrates activities that should be executed to open a successful AI Incubator.

First of all, a significant amount of upfront capital is necessary. These incubators are state-of-the-art facilities with high-end technology, fast internet connection, meeting rooms and even bars and restaurants. Moreover, AI incubators hire experts and advisors that help nurture the incubated startups. As startups get access to services for free, it is all at the incubators' expenses.

Secondly, it is important to build an experienced team. AI Incubators select, and fund, only startups that have groundbreaking ideas. Consequently, they also need to help these startups develop quality products/services and a long-term business model. In order to be successful, AI incubators need a competent team of professionals with a strong knowledge of the startup world.

Third, to open an AI Incubator a strong VC network is needed. AI Incubators provide seed money but the real game-changing investments come from Venture Capital Funds. Since AI incubators own a small stake in each startup incubated, it is in their best interest to help startups finding the right VC fund as partner.

Many AI incubators have gone bankrupt over the years as they did not follow the mentioned requirements. Very few incubators, on the other hand, have been able to do so; and by doing so to win big. An example

is Y Combinator, the very first AI Incubator that has incubated over 1450 startups, such as present tech giants Airbnb, Dropbox and Stripe. The current combined total market capitalization of its startups is of over \$80B.



### **Co-Working Incubators**

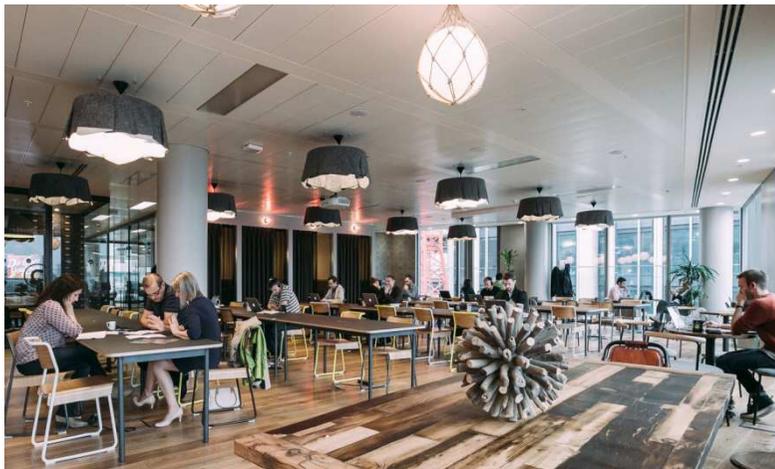
Co-Working Incubators give their startups more freedom than AI Incubators. These incubators provide shared working space, organic networking, and a wide range of services and amenities for an annual flat fee. In addition, startups do not have to go through a strict interview process to be admitted and do not receive seed money in exchange for equity. Co-working incubators usually help startups get started with a low-interest loan and/or reduced rent for the first few months.

Compared with AI Incubators, the service offered by Co-working Incubators is less tailor-made and more community oriented. Co-working incubators do not provide individual mentoring or legal support as AI incubators do. On the other hand, they focus on pro-

moting a friendly environment by encouraging co-working and organizing workshops and social events.

Before getting started with a Co-working incubator, some aspects need to be considered.

A big amount of capital is needed upfront, but it has to be invested differently from AI incubators. With AI Incubators it is the startups that ask to be incubated; Co-working incubators have to convince startups to join their programs. This means that, to reach and maintain a high occupancy rate, incubators need to heavily invest in their facilities. Co-working incubators do not only provide office space and meeting rooms but also unlimited food and drinks, napping rooms and even fitness classes.



In general, strategic location and strong community values are also crucial factors. Incubators need to be present in cities with a high density of local entrepreneurs and startups. More specifically, they need to be located in highly connected and easy-to-reach areas; for

example they should be close to a railway station or airport. Promoting a sense of collaboration and community living is also crucial for the success of a Co-working incubator. These incubators do not make money by making their startups investor-ready but through renting fees. This is why it is important to create a dynamic and innovative environment where entrepreneurs feel connected and productive.

	AI INCUBATORS	CO-WORKING INCUBATOR
<b>Investment Risk</b>	High	Medium-High
<b>Investment in Staff</b>	High; team of full-time mentors and experts	Low; mainly maintenance workers
<b>Investment in Facilities</b>	Medium; offices and R&D space	High; office space, recreational facilities and catering
<b>Campus Location</b>	Not important; close to VCs	Very Important; in big cities
<b>VC Network</b>	Very Strong	Weak
<b>Incubator Priority</b>	Make startups investor-ready	High occupancy rate

### Other types of Incubators

Besides these two main types, there are also other kinds of incubators operating in China, such as Tech Company Incubators (TC Incubators) and University Incubators.

Tech-Company Incubators are run and owned by an established tech company that could be for example Alibaba, Tencent, and even Microsoft. TC Incubators let startups use their technologies, facilities, and work with their best experts for free. Moreover, they focus on helping startups develop high tech products that can easily integrate with their own technology. After the incubation stage, successful startups can either be 100% acquired and become a division of the

company or receive funding by the company’s own VC Fund and start operating independently.

University Incubators are programs set up by one or more universities or R&D centers. These incubators support students, researchers and/or professors develop startups by letting them use the school’s technology and facilities. They can also finance startups through University VC Funds in case of spin-offs. -

**The Chinese Startup Incubators Market**

The Chinese startup incubators market is becoming increasingly competitive. With over 2400 active incubators, China is by far the country with the highest number of active tech incubators in the world. The U.S., home of the Silicon Valley, trails behind with just 1500.



*Jesa elaboration from 2016 iiMedia report*

It seems that more competition brings opportunities. During the last 5 years, China has shifted from being the “land of copycats” of successful foreign startups to becoming a launching pad for innovative and breakthrough business ideas. This is mainly due to the Chinese Government. In particular, the over 800 Government VC Funds controlled by local and central agencies helped the country performing well in the sector. These funds promote entrepreneurship and, at the same time, support the national priorities in innovation and development. The priority areas include electric vehicles, renewable energy, healthcare and big data.

**Incubators per country (May 2017)**



*Jesa elaboration from 2017 NASSCOM report*

Interestingly, the number of incubators is expected to reach 5000 by 2020 and has been growing 19.7% compound annual rate in the last 16 years, as shown by a report from Chinese research institute iiMedia.

With the government pumping billions of RMB into these funds, more and more young people are joining the startup business with high hopes on possible investments. A mature and entrepreneur-oriented market, as well as a supportive government and advanced technology, brings great opportunities for those looking to invest in the incubator sector.

**The maternity leave in China: how does it work?**



**Some Data about Fertility in China**

According to Catalyst, nowadays the Total Fertility Rate (TFR) in China is 1.6 births per woman. The TFR shows the average number of children a woman *would* potentially have during a given time at a particular age. In other words, TFR can show the potential population change in one country. Normally, a rate of two children per woman is considered the replacement rate for a population, resulting in relative stability in terms of total numbers. Rates below two children indicate population is decreasing in size and it is growing older. Global fertility rates are in general decline; and this trend is strongly pronounced in industrialised countries.

As stated by latest surveys carried out in China, women represent 48.6% of the entire population. As of 2014, 64% of the total Chinese feminine population is working and, normally, women have less important jobs than men. Even if this trend is slightly changing, gender

discrimination for instance due to pregnancies and to a misdirect use of maternity leaves, still persists.

**Something about Maternity Leave in China**

The State Council updated the 1998's *Provisions on Female Labor Protection under Special Circumstances* (State Council Decree No. 619) in 2012. However, it is worth to state beforehand that maternity leave in China varies according to locations. Also, for the employer it can be difficult to calculate how many days its female employees are entitled to have as maternity leave, as well as how much allowance they should get.

Moreover, a new law was issued in January 2016 named *Population and Family Planning Law of the People's Republic of China* (Order of the President No.63 - it was a provision before 2016). The Family Planning Law came into effect with the abolition of the one-child policy. After the law was issued, Chinese families are allowed to conceive more than one child. Consequently, each Chinese province adjusted the Regulation of Family Planning and rewards additional leave-days as maternity leaves, as well as marriage leave.

1. Maternity Leave:

- Basic Maternity Leave: 98 days (for any childbirth, including public holidays and weekends);
- Extra Maternity Leave: from 30 up to 82 days, it varies according to provinces (for 1<sup>st</sup> and 2<sup>nd</sup> childbirth, excluding holidays but including weekends).

Under special circumstances (i.e. dystocia) the maternity leave can be extended. Plus, if the employee has twin childbirth, an additional 15-day maternity leave shall be recognized for each child.

Foreign employees in China have the same right to take the 98-day maternity leave, but they are not entitled to take the extra maternity leave.

**2. Marriage Leave:**

From 3 up to 30 days, it varies according to provinces (excluding public holidays, but including weekends).

**3. Breastfeeding Period:**

Female employees are entitled to get one hour per day during the one year breastfeeding period. Until the baby turns 1 year, the female employee can use her 1 hour/day breastfeeding period in the early morning, arriving one hour later at work, or in the afternoon, leaving the office one hour earlier. The employer and the employee can even agree to accumulate the one hour breastfeeding period in one unique solution, ideally during the employee’s vacation time. However, the decision regarding how to plan the breastfeeding period depends on each company.

**4. Maternity Allowance:**

It is provided by the Social Insurance Center for female staff who has participated for 12 months in Social Insurance for their Maternity Leave. Actually, it is the replacement of their salary during the maternity leave.

Standard Calculation = Average monthly salary paid by the company ÷ 30 days

\* number of days of total Maternity Leaves

If Maternity Allowance is lower than the staff member’s actual salary, the employer should pay the balance.

**Annex: List of Marriage Leave & Maternity Leave**

Province	Marriage holiday (Day)	Maternity leave (Day) *extra maternity leave is included
Beijing	10	128 days to 7 months
Tianjing	3	128
Shandong	3	158
Shanghai	10	128
Zhejiang	3	128
Anhui	3	158
Jiangxi	3	158
Fujian	15	158 to 180
Guangdong	3	178
Guangxi	3	148
Hubei	3	128
Shanxi	30	158
Ningxia	3	158
Sichuan	3	158
Liaoning	10	158
Qinghai	15	158

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