

China Venture Capitalist Confidence Index™

(Bloomberg ticker symbol: CVCCI)

Second Quarter – 2005
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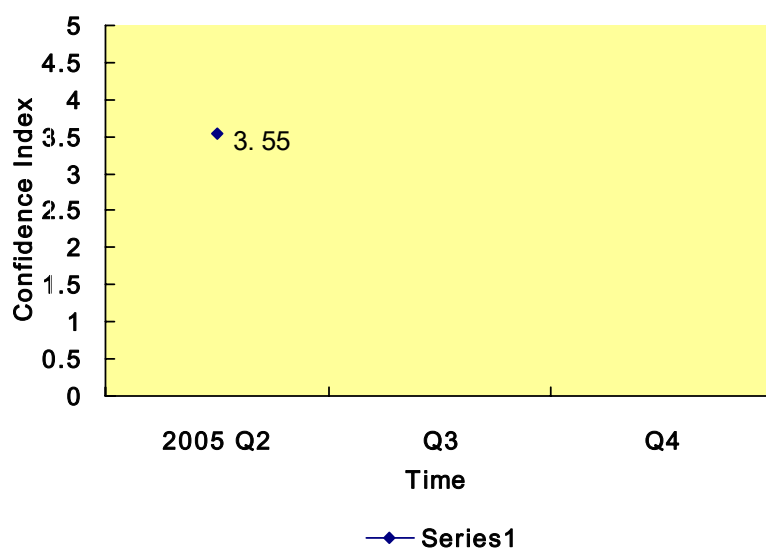
The quarterly *China Venture Capitalist Confidence Index* (Bloomberg ticker symbol: CVCCI) is based on a survey of mainland China and Hong Kong venture capitalists. Created and authored by Professor Mark Cannice, the China VC Index measures and reports the opinions of China-based professional venture capitalists in their estimation of the high-growth venture entrepreneurial environment in China over the next 6 - 18 months.

Global venture capital investment into China has risen to \$1.27 billion in 2004 (Zero2IPO), indicating increasing venture capitalist interest from sources outside of China. U.S. venture capital firms invested in 43 Chinese deals in 2004 (National Venture Capital Association). This recurring report and index, however, focus on the views and insights of China-based venture capitalists. In publishing a recurring confidence index of China-based venture capital investors, we intend to utilize the local knowledge and insight of our respondents to provide an on-going *leading indicator* of local investment in new high growth businesses in the Greater China Region. We expect that this local insight will provide a unique perspective into the dynamic Chinese entrepreneurial business environment. Further, by tracking what local venture investors project about the high growth venture environment rather than what has already occurred in terms of investment flows, we hope to provide actionable insight for all interested parties.

While the venture capital industry is still in an early stage in China, with significant change likely to occur in the near to mid term, this initial report and index reading will provide a base-line from which to compare future index levels to judge the relative gain or loss of local professional investor confidence in the environment for investment in high-growth ventures in China.

The China Venture Capitalist Confidence Index for the second quarter of 2005, based on a July 2005 survey of 10 China and Hong Kong venture capitalists, came in at 3.55 on a 5 point scale (with 5 indicating high confidence and 1 indicating low confidence), and suggests a modest level of China based venture financings in entrepreneurial activity in the coming months. (Please see Table 1.) This initial index reading is based on a relatively small sample of ten venture capitalists in the China region. However, we expect

Table 1
China Venture Capitalist Confidence Index Trend Line



that it does still shed some light on current and on-going issues in the China venture capital and high-growth venture environment. As more index readings are taken in the coming quarters, a trend of Chinese investor confidence should begin to emerge.

We can also compare this reading to the Silicon Valley Venture Capitalist Index for the same quarter. The Silicon Valley VC Index (based on a survey of 40 Bay Area venture capitalists) indicated a reading of 4.13 and is predictably higher than the index reading for China. We see this difference emanating primarily from the more settled legal and regulatory environment now prevalent in the US market for venture investment. Please see the report for the second quarter 2005 USF Silicon Valley Venture Capitalist Confidence Index at http://www.usfca.edu/sobam/nvc/cindex_2_2005.htm. As the potential for China venture investment is quite high and is even cited by some Silicon Valley VCs as a growth area for them, we expect that the confidence reading for China venture investment will gain as its regulatory environment becomes more certain.

All of the Index respondents' names and firms for this report are listed in Table 2, save those who wished to remain anonymous. Some of the responding venture capitalists also went on the record with commentary that supported their degree of confidence in the upcoming venture investment environment. In the following analysis, we provide many of their comments.

Concerns about the legal infrastructure to support a venture capital industry were voiced by some.

For example, Alex Yu of Baring Private Equity Asia indicated that, "China lacks the legal system to support it (venture investing)." Similarly, an anonymous venture capitalist respondent indicated medium confidence "...because of the regulation inconsistency and the market disturbance since early this year, ... and poor corporate governance." Continuing, he stated, "...it is a good government action to push the reformation in regulation, financial market and the banking system restructuring. However the over-investment caused by the unusually low borrowing rate (or too high RMB liquidity in the bad market..) & over-expansion leading to a low utilization rate, stop us from investing in China for a year's time. We believe a more complete regulation and efficient market will be set up in 2 to 3 years time, together with the banking system restructuring. These could lead to better corporation governance and a higher quality of management team, and a more open financial market and currency system. We would then start to consider investing in the direct investment sector and listing in China exchanges when they are set up. In addition, we also account for the legal system, taxation on exit, and exit opportunities for our investment planning."

Short term caution and medium term optimism were voiced by others. For example, Ray Hsiao of Sycamore Ventures commented that "The worldwide economic situation is not encouraging to the high-growth venture entrepreneurial environment; the high tech break through technologies are also not so positive within next couple of years; however, Greater China (including China, Taiwan and HK) could be the best area for the high-growth venture entrepreneurial environment in the world within next couple of years."

Optimism in the continuing high growth economy of China and the resulting local investment climate was also a central theme.

Xuanlin Qin with the China Finance United Holding Company stated, "The micro-environment of economy in China is good. China is an express train on the way to be a booming country. The government has issued relevant law and policy to secure the growing of economy. So we are confident of investing throughout China." Additionally, George Li of China Merchants & Fortune Assets Management Ltd also expressed optimism "because China has become a member of the WTO which helps build up a more open business environment, and the high growth of the economy offers more chances for success to venture entrepreneurs. We are doing venture investment in China, and

have received more and more venture deal proposals since 2004. The venture investment industry has grown very fast in the past 4 years in China, due to this reason."

While concerns over the regulatory environment for venture investment were offered, in sum, the sentiment for local venture investing was modestly positive. This is heartening given the relatively early stage of VC investment in China. This reading suggests health in entrepreneurial activity and new company formation in the greater China region for the balance of 2005.

Table 2

Participating China based Venture Capitalists in the 2005 2nd Quarter Confidence Index Survey

Alex Yu	Baring Private Equity Asia
Ray Hsiao	Sycamore Ventures
George Li	China Merchants & Fortune Assets Management Ltd
Vincent Chan	JAFCO Asia
Xuanlin Qin	China Finance United Holding Company
Hongbin Liu	China Merchants & Fortune Assets Management Ltd
Anonymous	Anonymous
Anonymous	Anonymous
Anonymous	Anonymous
Anonymous	Anonymous

Venture capitalists who wish to participate in next quarter's Index survey or become involved with the Hong Kong UST or USF Entrepreneurship Program are asked to contact Professor Mark Cannice at Cannice@usfca.edu. Please find additional information about the University of San Francisco School of Business and Management Entrepreneurship Program (rated Top Tier by Entrepreneur Magazine – 2004 & 2005) and its International Business Plan Competition at: <http://www.EntrepreneurshipProgram.org>.

Mark V. Cannice, Ph.D. is an Associate Professor of Entrepreneurship and the Founding Executive Director of the University of San Francisco Entrepreneurship Program (Cannice@usfca.edu). The author wishes to thank the participating venture capitalists who generously provided their expert analysis and commentary as well as Ms. Ling Ding (USF MBA 2006), USF Entrepreneurship Program research fellow, who provided expert analysis and essential and extensive support in the survey effort. Webmasters are welcome to link to this report with courtesy notification to Cannice@usfca.edu. To post this report on your website, please request permission by email to Cannice@usfca.edu. When citing the index, please refer to it as: The China Venture Capitalist Confidence Index (Bloomberg ticker symbol: CVCCI), and include the associated Quarter/Year, as well as the full name and title of the author.