

China Venture Capitalist Confidence Index™

(Bloomberg ticker symbol: CVCCI)

Third Quarter – 2005
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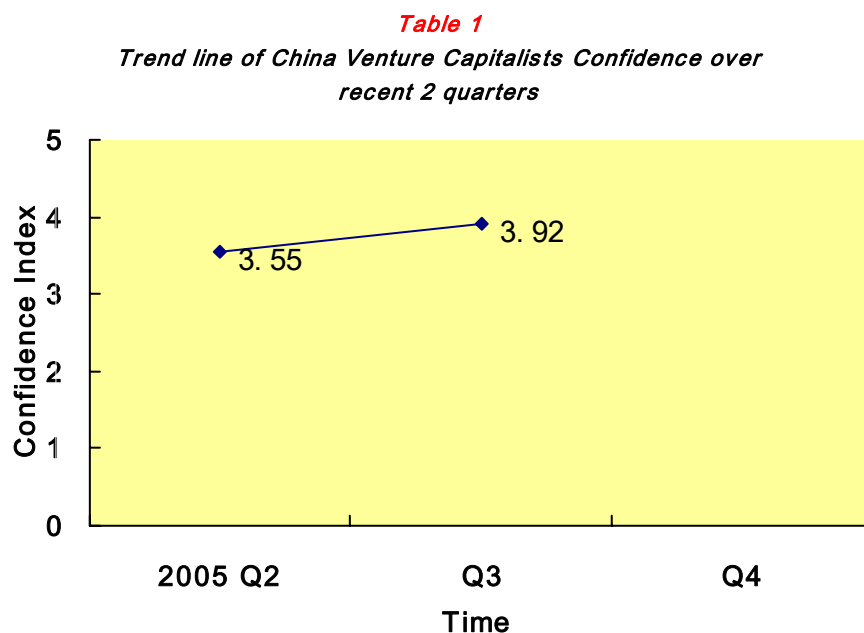
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The quarterly *China Venture Capitalist Confidence Index* (Bloomberg ticker symbol: CVCCI) is based on a survey of mainland China and Hong Kong venture capitalists. Created and authored by Professor Mark Cannice of the University of San Francisco and the Hong Kong University of Science and Technology, 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.

According to the National Venture Capital Association, U.S. venture capital firms invested in 43 Chinese deals in 2004. 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 relatively early stage in China, with significant change likely to occur in the near to mid term, these initial reports and index readings will provide a base-line from which to compare future index levels to better 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 third quarter of 2005, based on an October 2005 survey of 12 China and Hong Kong venture capitalists, came in at 3.92 on a 5 point scale (with 5 indicating high confidence and 1 indicating low confidence), and suggests



a healthy level of China based venture capitalist confidence in entrepreneurial activity in the coming months. This quarter's reading is up significantly from last quarter's index of 3.55 on a 5 point scale. (Please see Table 1 for trend data.) While the index reading is based on a modest sample size of twelve venture capitalists in the China region, we expect 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 clearer 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 45 San Francisco Bay Area venture capitalists) indicated a reading of 3.97 (down from 4.13 in the previous quarter) and is only marginally higher than the confidence reading for China's venture capitalists over the same time period. This convergence of confidence between the US and Chinese Index is somewhat surprising given the much more settled legal and regulatory environment now prevalent in the US market for venture investment. Some of the responding U.S. venture capitalists did point to China and other emerging growth nations as likely future destinations of increasing venture investment. Perhaps it is in part the recognition of this potential shift in flow of venture investment capital that has led to this convergence of confidence readings. (Please see the report for the third quarter 2005 USF Silicon Valley Venture Capitalist Confidence Index at <http://www.EntrepreneurshipProgram.org>).

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.

Highlighting the increasing links between the venture industry between China and California's Silicon Valley, George Li of China Merchants & Fortune Assets Management Ltd, indicated, "In the past months, many Silicon Valley VCs have come into China, bringing in more and more capital for investments. This will surely enlarge the VC industry's investment intensity, and will also be a great promotion to the entrepreneurial environment in China. In addition to this, China is in the process of increasing the liquidity of the Stock Exchange markets by allowing more and more listed stocks free flow. This is a great improvement to the investment environment in China." Also pointing to some positive trends in the China venture environment, Vincent Chan of Jafco Investment (Hong Kong) Ltd. commented, "The quality of the management team is improving. The business models are innovative and disruptive." An anonymous contributor pointed to the good track record of Chinese VCs and to comparable low cost centers such as South Korea that developed first as a strong export economy.

Optimism about the opportunities but concern over the level of valuations was another theme. For example, one venture capitalist who responded but wished to remain anonymous indicated, "There are plentiful investment opportunities [in China]. But the competition between investors is getting more fierce, resulting in higher prices." Another anonymous contributor agreed, saying, "Valuations are too high in China".

But regulatory uncertainty remained a concern for some. For example, Helmut Struss of Siemens Acceleration in Communications validated his rating, indicating, "The main reason for not voting 5 is the uncertainty regarding the SAFE regulations." Supporting this view, Roger Zha of China Merchants & Fortune Assets Management Ltd indicated he saw opportunities in China but acknowledged that regulatory difficulties remain.

Projecting a slower entrepreneurial growth as a global phenomenon, Ray Hsiao of Sycamore Ventures suggested a difficult venture environment in the near future stating, “Worldwide total high-growth venture entrepreneurial environment will be very low in next 6 to 18 months, but the Greater China Region may be better than average level.” Providing an alternative view on economic growth as a trigger for venture investment, an anonymous contributor offered, “Based on the strong demand of goods & services (in China).. , and considering the gap of living standards between China & other developed countries, there is room to grow. Since the government is developing the network aggressively toward western & northern China, it is believed that logistics and the development for 2nd tier cities will pick up soon. What makes people worry is the quality of goods, management, food safety & water pollution.” Another anonymous contributor exhibited high confidence in the China’s high growth venture environment, but gave this warning: “Don’t go to China unless you really know how Chinese people do business”.

While concerns over high valuations of prospective portfolio companies and the regulatory environment for venture investment were offered, the sentiment for local venture investing was positive and increasing over last quarter. 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 and early 2006.

Table 2

Participating China based Venture Capitalists in the 2005 3rd Quarter Confidence Index Survey

Chang Sun	Warburg Pincus Asia LLC
George Li	China Merchants & Fortune Assets Management Ltd
Grace Zhang	Siemens Acceleration in Communications
Helmut Struss	Siemens Acceleration in Communications
Hongbin Liu	China Merchants & Fortune Assets Management Ltd
Jessica Mak	Electra Partners Asia Ltd.
Ray Hsiao	Sycamore Ventures
Roger Zha	China Merchants & Fortune Assets Management Ltd
Vincent Chan	Jafco Investment (Hong Kong) Ltd
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 University of Science and Technology (www.ChinaEntrepreneurship.org) or the University of San Francisco (www.EntrepreneurshipProgram.org) entrepreneurial activities are asked to contact Professor Mark Cannice at Cannice@usfca.edu or Cannice@ust.hk.

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). He is also an Adjunct Associate Professor with the Hong Kong University of Science and Technology School of Business and has been a visiting associate professor at Peking University’s Beijing International MBA Program. 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), former 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, and the name/title of the author.

