

# China Venture Capitalist Confidence Index™

(Bloomberg ticker symbol: CVCCI)

**Fourth Quarter – 2007**

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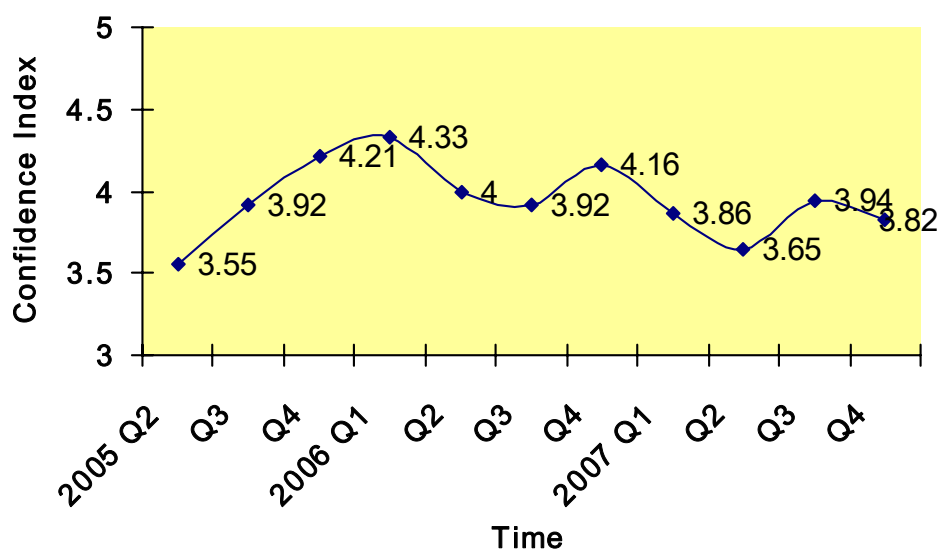
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The quarterly *China Venture Capitalist Confidence Index* (Bloomberg ticker symbol: CVCCI) is based on a survey of Mainland China and Hong Kong venture capitalists. The China VC Index measures and reports the opinions of China-based professional venture capitalists in their estimation of the high-growth venture entrepreneurial environment in China over the next 6 - 18 months. 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 market participants.<sup>1</sup>

**Table 1**

*Trend line of China Venture Capitalists Confidence over recent 11 quarters*



<sup>1</sup> The venture capital industry in China is in a relatively early stage, and significant change is likely to occur in it in the near to mid term. These reports and index readings are intended to provide a base-line from which to compare 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 fourth quarter of 2007, based on a January 2008 survey of 19 Mainland China and Hong Kong venture capitalists, indicated **3.82 on a 5 point scale** (with 5 indicating high confidence and 1 indicating low confidence). This quarter's reading is down modestly from last quarter's index of 3.94 and suggests a healthy albeit declining level of China based venture capitalist confidence in the future high-growth entrepreneurial environment in China. Please see Graph 1 for trend data. All of the Index respondents' names and firms for this report are listed in Table 1, save those who wished to remain anonymous. Some of the responding venture capitalists also provided commentary that supported their degree of confidence in the near term venture investment environment. In the following, we provide many of their comments along with our analysis.

**The modest decline in the 4<sup>th</sup> quarter index reading reflects the responding venture capitalists' concerns over Chinese government policy changes and inflated venture valuations.** For instance, Stephen Chiao of Sycamore Ventures noted that, "China is coming up with more new regulations and new taxes for foreign investors. And Taiwan is still under heavy political uncertainty until later part of May 2008." Similarly, a seasoned observer with ChinaVest Services pointed out that "The environment in the PRC is clouded by the government's attempts to clamp down on the existing bubble while not upsetting the financial applecart, a very difficult balance, and by the government's belief that the VC/PE industry in PRC should be led by local firms - not foreign firms." In addition, excessive valuations continue to worry investors, as an anonymous VC observed "ample opportunities in a relatively immature market at sometimes unrealistic valuations". Harry Man of WI Harper Group concurred, noting "I dropped my rating from 4 to 3 this quarter as I feel the market is getting increasingly competitive with more funds in town (international and local). Fierce competition is driving valuations higher and it is getting increasingly difficult to get good deals."

**Furthermore, some VCs worry about the macro economic environment in China and worldwide, including the US economic slowdown.** For example, Jessica Mak of Electra Partners Asia expressed her concerns over a "challenging operation environment." In particular she pointed to a "tightening monetary policy, more efficient tax collection, new labor laws, high inflation, a high talent turnover rate, and infrastructure underdevelopment in interior regions of China." Ms. Mak also expressed concern over international economic issues such as the strengthening RMB and related high currency risk while limited hedging tools existed, as well as slowing US consumption and uncertain European spending power that could put pressure on Chinese exporters. And Tony Luh of DFJ Dragon Fund China stated the "Chinese Yuan's appreciation may accelerate as U. S. economy continues to sink deeper and the strength of the dollar further weakens. This, coupled with the Olympics, may increase chances for inflation in China." Moreover, Laurence Ip of CLSA Capital Partners asserted that, "Growth will slow with excessive control from the six ministries on foreign investment. Large and small houses are slow to set up onshore funds, as there are no clear available structures." Mr. Ip further concluded that, "As such, we do not foresee the same kind of growth as in the past from 2003 to 2007."

**While caution has increased, Chinese VCs still hold an overall optimistic view on the future high growth venture environment in China.** For example, Laurence Ip of CLSA Capital Partners mentioned, "China remains a hotbed for private equity." Although more governmental restrictions on business led to concerns among VCs, Jessica Mak of Electra Partners Asia believes that those new regulations will benefit

the Chinese market in the long run and stimulate innovative projects and more investments in those high-tech projects. In terms of RMB appreciation, she expects that Chinese importers may benefit from the stronger RMB. Additionally, S C Mak of Asset Managers (Asia) Company Ltd, showed strong confidence on the outlook of the Chinese market based on “continued high economic growth and thriving entrepreneurship in China.” Max Burger-Calderon of Apax Partners Ltd agreed with Mr. Mak, stating “While I think we will also see downward pressure on stock prices in China in 2008, the general outlook continues to be very positive.” An anonymous VC further pointed out that “Opportunities exist for continuation of the country’s development in tech, retail, and services while putting certain controls in foreign direct investments to avoid an overheating market.” And Tony Luh of DFJ Dragon Fund China shared “My confidence is a solid 4 although there may be bumps on the road along the way...” He continued “China continues to grow at an exceptional pace with gap between the have and the have-nots widening. However, the government is trying hard to balance the growth so rural and poorer areas may also benefit from government's stimulus plans.” Finally, Yuan Fang of WI Harper noted that “The success stories in the past few years are inspiring more and more people to start their own businesses, while government regulation, legislation structure and general infrastructure have become much better than before.”

**Table 1**

**Participating China based Venture Capitalists in the  
2007 4<sup>th</sup> Quarter Confidence Index Survey**

Alan Song	Soft Bank China Venture Capital
Alicia Eastman	Asia Pacific Capital Group
ChinaVest Services	ChinaVest Services
Harry Man	WI Harper Group
Jessica Mak	Electra Partners Asia Limited
Laurence Ip	CLSA Capital Partners
Mathew Lam	SEAVI Advent Ocean Private Equity
Max Burger-Calderon	Apax Partners Ltd
Michael Scown	Intel Capital, Asia Pacific
Raymond Gu	JAFCO Investment (Hong Kong) Ltd.
SC Mak	Asset Managers (Asia) Company Ltd
Stephen Chiao	Sycamore Ventures
Steven Lin	CLSA Capital Partners
Tony Luh	DFJ DragonFund China
Vincent Lui	KLM Capital Management Ltd.
Yuan Fang	WI Harper Group
Anonymous	Anonymous
Anonymous	Anonymous
Anonymous	Anonymous

Based on the above observations we find that while new governmental regulations are bringing pressure on entrepreneurs and their financial backers in China, they may benefit start-ups and VC investors in the long run. Even though the economic slow-down in the U.S. may hamper China's fast growing economy, Chinese domestic demand remains strong and could further support China's high-growth venture environment. Plus, concern over financial market performance in Europe and U.S. may lead more investors to pour additional capital into Chinese market and further support the entrepreneurial activities in China. In addition, VCs' caution over excessive valuations could lead to a more rational investment climate and minimize inflated new venture pricing. Thus, with strong economic growth and a growing cadre of experienced entrepreneurs, China remains an attractive place with high investment return to VCs. According to Zero2Ipo 2007 report<sup>2</sup>, VC fund raising and investments soared in 2007. An impressive 58 new VC funds established with a total amount of \$5.5 billion in 2007, compared to 39 new funds with \$4 billion in 2006. At the same time, \$3.2 billion flew into 440 deals in 2007 while 324 deals closed with a total of \$1.8 billion of investment in 2006. This growth trend in the high growth entrepreneurial environment appears likely to continue in the near term albeit at a moderating pace.

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 has also been a Visiting Associate Professor with Peking University's Beijing International MBA Program (2005) and the Hong Kong University of Science and Technology School of Business (2005 - 2007). Ling Ding is a partner with MCLD Venture Resources and holds an MBA from the University of San Francisco (2006). The authors wish to thank the participating venture capitalists who generously provided their expert analysis and commentary as well as Tomosue Den (USF MBA candidate) for his survey support. Please see the reports for the previous quarters at: [www.EntrepreneurshipProgram.org](http://www.EntrepreneurshipProgram.org) under the publications tab. Venture capitalists who wish to participate in next quarter's Index survey are asked to contact Professor Mark Cannice at [Cannice@usfca.edu](mailto:Cannice@usfca.edu). 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 full names and titles of the authors.

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<sup>2</sup> <http://www.zero2ipo.com.cn/2008/1/18/20081184754.html> Zero2IPO China Venture Capital Report Q4 2007