

China Venture Capitalist Confidence Index™

(Bloomberg ticker symbol: CVCCI)

First Quarter – 2008

(Release date: May 12, 2008)

Mark V. Cannice, Ph.D.

Ling Ding

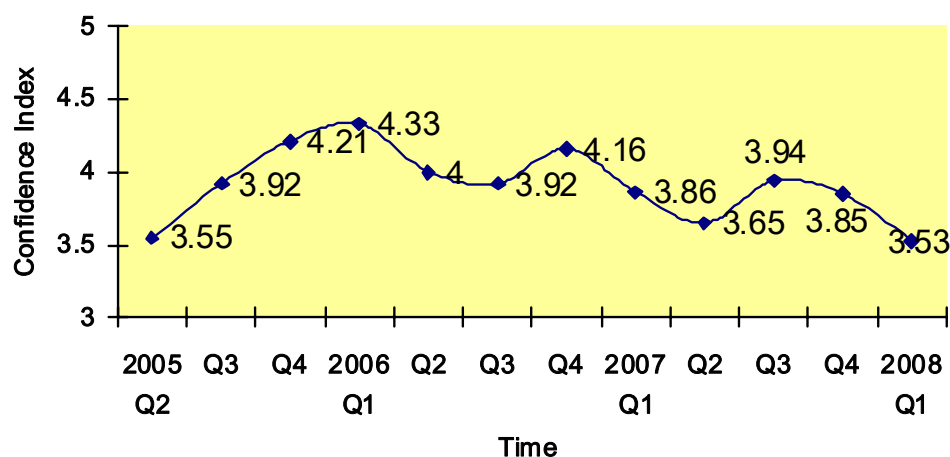
The quarterly *China Venture Capitalist Confidence Index* (Bloomberg ticker symbol: CVCCI) is based on a survey of Mainland China and Hong Kong venture capitalists. The China VC Index measures and reports the opinions of China-based professional venture capitalists in their estimation of the high-growth 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.¹

The China Venture Capitalist Confidence Index for the first quarter of 2008, based on an April 2008 survey of 15 Mainland China and Hong Kong venture capitalists, registered **3.53 on a 5 point scale** (with 5

Graph 1

Trend line of China Venture Capitalists Confidence over recent 12 quarters



¹ 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.

indicating high confidence and 1 indicating low confidence). This quarter's reading fell from last quarter's index of 3.85, suggesting a declining trend of China based venture capitalist confidence in the future high-growth entrepreneurial environment in China. Please see Graph 1 for trend data.

This report's commentary and index reading are based on a sample of fifteen venture capitalists in the China region. 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 decline in the 1st quarter index reading reflects China venture capitalists' growing concerns over China's slowing economic growth and stock market fluctuations. For example, a seasoned observer with ChinaVest Services noted that while the amount of deals has remained unchanged, they are proceeding slower than in past quarters due to PRC issues. However, he noted that the continued decline of the stock markets in PRC may 'force' entrepreneurs to focus on VC/PE firms as sources of capital rather than assuming that the stock market is the road to immediate riches. Another venture capitalist who wished to remain anonymous predicted "uncertain public market performance in the next 6 to 18 months." Uncertain public markets, of course, tend to make venture-backed exits more difficult.

Increasing inflation and the U.S. sub-prime crisis also affected venture capitalists' confidence. While expecting a commodity price correction in Q4, Jessica Mak of Electra Partners Asia Limited anticipates that "2008 will still be a difficult year." Also focusing on inflation, Marvin Lai of iTM Ventures, stated that "the soaring costs of raw material in China and overall surge in fuel prices led to a drop of the China business prosperity index from 143.6 to 136.2 (out of 200) in the first quarter of this year, which is the lowest confidence level since 2006 third quarter. This situation might persist due to the extent of the U.S. sub-prime issue that is yet to reveal its impact to the world's capital market." Finally, Alan Song of Soft Bank China Venture Capital also noted inflation as a key issue affecting the VC industry along with the economic slow down. Another respondent observed that "pace of exits has slowed, as on-going inflation slows down China's high economic growth."

Despite the rising caution many VCs pinned their hopes on overall strong economic growth, a stable society, and improving capital markets. One anonymous participant declared that "growth overall is still robust, which in turn fuels the entrepreneurial spirit." In addition, Anne Jiang of Shenzhen Capital Group Co. Ltd expressed her confidence by noting the Chinese economy is maintaining rapid if slightly slower growth, especially in the private sector. She also noted that China's stable society will benefit the Greater China Region. Finally, Ms. Jiang argued that China's leaders will apply the lessons of the U.S. sub-prime mortgage crisis and, as a result, take a more steady policy path. In sum, Ms. Jiang believes the China entrepreneurial environment may be at a turning point and expects a better capital market going forward.

The pending establishment of China's 'Growth Enterprise Market' buoyed confidence as it would provide an additional exit channel for venture-backed firms. Although some venture capitalists are concerned about the current stock market, which is an important exit alternative, Max Burger-Calderon of Apax Partners Ltd believed that "public market corrections are normally an indicator that it is a good moment to invest in private companies." Tony Luh of DFJ Dragon Fund China pointed out that "we are

seeing more innovation in China than ever and we believe the capital markets in China are just beginning to flourish.” Anne Jiang of Shenzhen Capital Group emphasized that the establishment of China’s second security exchange board will improve the entrepreneurial environment and speed high-tech industry development.² Alan Song of Soft Bank China Venture Capital agreed with Ms. Jiang on this point, noting that the launch of China's Growth Enterprise Market may boost the VC industry.

Based on the preceding observations, we find that although China’s venture capitalists’ confidence has been negatively impacted by slowing economic growth, increasing inflation, and a volatile stock market swings; a maturing and expanding capital market and burgeoning entrepreneurial enthusiasm provide cause for enduring confidence. It does appear that the Chinese government is making notable strides in securing a more stable capital market; these efforts are likely to foster a better investment environment for China’s venture firms. Again, the launch of China's Growth Enterprise Market should provide VCs with an additional exit channel in Mainland China, helping them to realize their investment return. Further, the establishment of the GEM sends a strong signal of governmental support and leadership in the continued development of China’s technology and innovative capacity while recognizing the vital role that local and foreign venture firms play in this process.

Thus, a generally sound and vibrant high-growth entrepreneurial environment coupled with pending additional venture capital investment exit alternatives suggest continued health in high-growth entrepreneurial activity and new company formation in the greater China region. Data from Zero2Ipo supports this notion. They report that for the 1st quarter of 2008, venture capital fund raising and investment showed a steady increase compared to 1st quarter of 2007. And the number of VC funding deals soared by 73% from 67 deals to 116³. To sum, we expect that after some turbulence in mid 2008, an increasingly strong and sophisticated high-growth entrepreneurial environment will be evident by 2009.

² <http://baike.baidu.com/view/96367.htm>, 创业板的概念及特点. The Chinese government has been preparing to launch the ‘Growth Enterprise Market’ (GEM) for nearly 10 years. The GEM is focused on providing a vital capital market for technology growth enterprises, along with other functions. As such, the GEM is intended to help nurture the continued development of a vibrant technology industry in China by providing an alternative source of financing for technology enterprises as well as an exit opportunity for venture-backed firms.

³ <http://www.zero2ipo.com.cn/2008/4/10/20084105623.html>, 2008 年一季度VC募资投资显著增长 PE投资放稳, Zero2IPO China Venture Capital Report Q4 2007

Table 1
Participating China based Venture Capitalists in the
2008 1st Quarter Confidence Index Survey

Alan Song	Soft Bank China Venture Capital
Anne Jiang	Shenzhen Capital Group Co. Ltd
Cadol Cheung	Intel Capital, Asia Pacific
ChinaVest Services	ChinaVest Services
Harry Man	WI Harper Group
Jessica Mak	Electra Partners Asia Limited
Marc Wang	WI Harper Group
Marvin Lai	iTM Ventures Inc.
Max Burger-Calderon	Apax Partners Ltd
Raymond Gu	JAFCO Investment (Hong Kong) Ltd.
Steven Lin	CLSA Capital Partners
Tony Luh	DFJ Dragon Fund China
Anonymous	Anonymous
Anonymous	Anonymous
Anonymous	Anonymous

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 2009) for his survey and technology support. Please see the reports for the previous quarters at: 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. 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.

Copyright © 2005 – 2008: Mark V. Cannice, Ph.D. All rights reserved.