The University of San Francisco
Silicon Valley Venture Capitalist Confidence Index

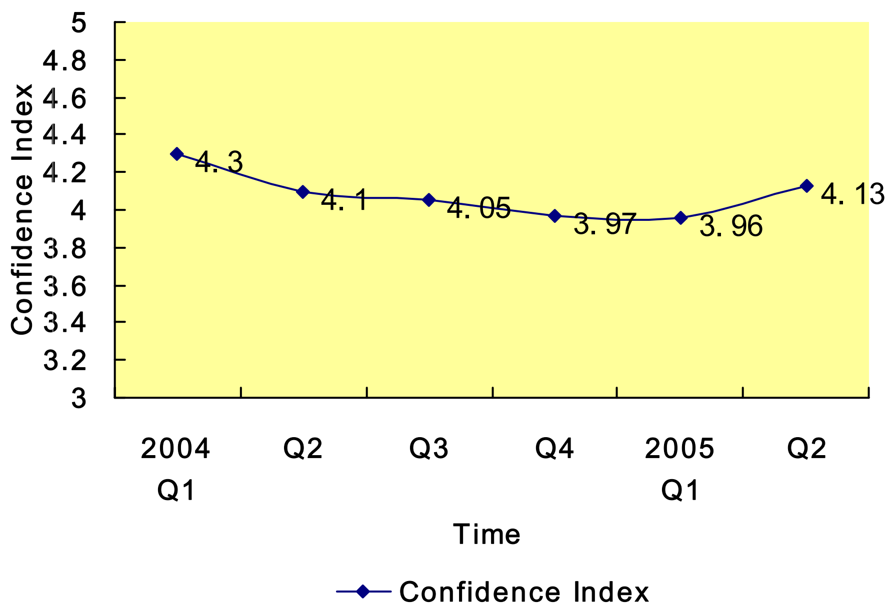
Second Quarter – 2005
(Release date – July 26 – 2005)

The *Quarterly University of San Francisco Silicon Valley Venture Capitalist Confidence Index* is based on a survey of San Francisco Bay Area/Silicon Valley venture capitalists. Created and authored by Professor Mark Cannice and Professor Roger Chen of the University of San Francisco School of Business and Management, the USF Index *(Bloomberg ticker: USFSVVCI)* measures and reports the opinions of professional venture capitalists in their estimation of the high-growth venture entrepreneurial environment in the San Francisco Bay Area over the next 6 - 18 months.

In publishing a recurring confidence index of professional venture capital investors, the USF Entrepreneurship Program intends to provide an on-going leading indicator of investment in new high growth businesses in the San Francisco Bay Area. We expect that this forward looking indicator of Bay Area new venture investment and high growth entrepreneurial activity will also act as a fair proxy for new venture investment across the U.S., as the San Francisco Bay Area is the largest source of venture capital in the nation.

The USF Silicon Valley Venture Capitalist Confidence Index for the second quarter of 2005, based on a July 2005 survey of 40 San Francisco Bay Area venture capitalists, came in at 4.13 on a 5 point scale (with 5 indicating high confidence and 1 indicating low confidence), and suggests a very healthy level of Bay Area venture financings and entrepreneurial activity in the coming months. The 2nd Quarter Index Level rose significantly from the previous quarter's level of 3.96 on a 5 point scale, and is the highest level of venture confidence seen during the last year.

Table 1
Trend line of Venture Capitalists Confidence over recent 6 quarters



We see a clear turning point in venture capitalists' confidence to the upside from what was a modest downtrend during the last four quarters. This spike in confidence appears to be based on significant new fund raising at a number of venture capital firms as well as the flow of those funds into new ventures. This additional flow of funds is also leading to higher valuations of new ventures. Other factors that are positively affecting confidence include corporate IT spending and opportunities in the energy and international sector.

The increase in confidence in the 2nd quarter of 2005 over the1st quarter is further borne out upon examining the responses of 20 of the venture capitalists who participated in both quarters' surveys. When comparing their current responses to their responses for the previous quarter, of the 20 repeat respondents, 5 reported an increase in confidence; 14 reported the same level of confidence, and one reported lower confidence for this quarter from the previous quarter. The absolute overall rating of the sample of respondents along with the relative rating of the 20 repeating respondents signifies a clear up trend in confidence.

All of the Index respondents' names and firms are listed in Table 2, save those who wished to remain anonymous. Many 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.

Strong Confidence in the high growth venture environment was the general theme. For example, Ann Winblad indicated that, "Hummer Winblad Venture Partners invests exclusively in new software opportunities. We are currently in a strong innovation cycle for software on both the enterprise and consumer fronts. In the last 16 months we have funded a dozen new software startups, 10 in the Bay area." Also confident, Venky Ganesan, Globespan Capital Partners, commented, "We have turned the curve and the road is clear. The legacy issues caused by the Internet bubble have been mostly cleared; enterprises have gone from "shell shock" mode to "normal business" mode where they are willing to make capital investments to improve productivity..." Echoing this sentiment, Bart Schachter of Blueprint Ventures asserted, "We are exiting the tech depression and preparing for another 10 year cycle." Similarly, Peter Wolken of Capital Valley Ventures observes a "better environment than there has been for the past four plus years." Cautious optimism was offered by Sanford Miller of 3I who shared, "I am relatively optimistic about the venture environment over the next year. Young companies are seeing meaningful customer traction, even some in the areas that have been most difficult -- enterprise and telco infrastructure."

This high level of broad confidence seemed to emanate from several distinct factors.

Venture fund raising and venture investing are strong. Dave Epstein of Crosslink Capital confirmed, that "Lots of $$ were recently raised. Anxious VC's want to put it to work. Merger mania continues..." Joe Mandato of De Novo Ventures concurred, "There are large volumes of available money given recent fund-raising by a number of firms. There seems to be more and higher quality opportunities". Further, Kurt Keilhacker of TechFund Capital, confirmed, "The investment environment continues to strengthen and a number of promising new companies are being financed." And Robert Marshall of Selby Venture Partners commented that, "The venture environment continues to improve. New funds have successfully raised money and early stage activity is healthy." Richard Yen of Blueprint Ventures added, "There has been significant VC funding activity over the last quarter, in particular with follow-on fundraisings. The fundraising timeline is becoming contracted, which is good news for entrepreneurs since they are spending less time raising money and more time building their companies." Bob Ackerman with Allegis Capital indicated his high rating was ".. based on the large number of funds raising money this year. All of those firms will be in the market with fresh cash. This historically has resulted in a larger number of companies being started and funded." Finally, Mike Rocke of Rocke Capital Ventures summed, "There are some new Bay Area funds starting up, which is an indication of positive momentum in the startup area."

Concurrently, entrepreneurial talent is abundant. Fred Dotzler of DeNovo Ventures pointed to the "availability of capital and the availability of founding teams seeking capital," while Kirk B. Westbrook of International Venture Fund added, "The immediate availability of both capital and experienced talent already present in the Bay Area, coupled with a culturally supportive environment of risk taking continues to provide the area with a differentiator that facilitates emerging endeavors." Striking a similar chord, Jeb Miller of ComVentures sees "optimism based on a strong pool of entrepreneurial and technical talent combined with an ample supply of venture capital funds." But he suggests that, "enthusiasm is tempered by limited lucrative exit alternatives and relative labor cost and real estate disadvantages in the Bay Area." Meanwhile, Jim Marshall, Selby Venture Partners, finds "The environment is improving and there's a ton of new innovation happening. Entrepreneurs are taking risks again and venture firms are funding new ideas again."

Higher valuations were observed by some respondents. Brendan Richardson of Vision Capital noted, "continuing enthusiasm on the part of investors to fund deals and increasing valuations. Particular segments of interest seem to be environmental (clean technology), energy and semiconductors." Similarly, David DeRuff of East Peak Advisors added, "...M&A and venture activity is accelerating as well. In two recent M&A projects, we have seen substantial competition between multiple bidders and significant sales price improvements."

A maturing technology paradigm was offered as another positive factor. Robert Troy of Geneva Venture Partners, provided a comprehensive analysis, stating, "We have entered a high-tech maturity cycle prone to large deployment of technology. The key word is to spread for accessing the mass market. More and more, creative entrepreneurs come to the Bay Area to launch their new ventures and our deal flow is better and better. These entrepreneurs not only bring technological innovations taking advantages of the new trends in mobility, bandwidth, voice and video over IP, customer electronic, embedded systems and regulations, but also new business models absolutely required to succeed in this cycle. They certainly find a very receptive environment eager to finance great ideas as reflected by the rebound in venture capital, up to the point of being, sometimes, excessively competitive. Silicon Valley is moving up the value chain and I believe this is the best which can happen. We still need to go through the re-balancing between what must be done in the expensive Bay Area and what could be done elsewhere; this is still a work in progress and a challenge for entrepreneurs and their executive teams."

Other supporting factors also buoyed confidence.

Increase in technology spending
For example, Igor Sill of Geneva Venture Partners observed, "increased purchasing expenditures of technology by Fortune 500 companies" while Deepak Kamra of Canaan Partners noted "strong growth and increasing customer traction in certain technology related markets - e.g. internet and telecomm."

A bullish energy sector
Bryant Tong of Nth Power "..continues to see much activity both in new business plans and new venture firms investing in the energy technology space. More money into this sector brings better management teams and in certain cases, better venture partners to syndicate with. On the other hand, more money sometimes brings over inflated pricing. Careful and knowledgeable investing is critical in this sector. Knowing the history of certain energy sectors, and knowing what has worked and what hasn’t is helpful in avoiding those same mistakes today." And, Arno Penzias of NEA expressed high optimism

due to ".. opportunities for new companies aimed at blended US-overseas operations and marketing--as well as for differentiated approaches to energy generation, storage and distribution technologies."

Growing opportunities in the international sector
Randolph L. Tom of Dynasty Capital Services confimed, "I have high confidence in the future of the high-growth venture entrepreneurial environment in the SF Bay Area. Dynasty has observed a tremendous surge in interest in mid-market companies seeking all sorts of liquidity opportunities. We see a large opportunity in Asian companies being able to partner with U.S. firms, particularly venture capitalists whose portfolios are in need of China exposure or Asian relationships. The acquisition of public companies indicates a need for China to deploy its foreign reserves, which means there should be active M&A activity for large public companies as well as pre-public entities to be purchased."

And strength in medical technologies
Jan Barker of MedVenture Associates, offered that, "Healthcare remains an interesting and diversified area for investors to find lucrative opportunities for success."

Still, a pragmatic outlook was maintained by some. Steve Dow of Sevin Rosen Funds communicated, *"*Given that our investment pace has been reasonably constant for 24 years, I guess I would have to pick "3" – not too hot, not too cold. A successful investment, when initially made at the seed or Series A stage, has typically taken 5-7 years to get liquid – we are not smart enough to know the future that far in advance, so investing more or less aggressively based on the environment today makes no sense to us."

And Concerns were voiced by others. David Pidwell of Alloy Ventures indicated "The state of the financial economy....interest rates, unemployment levels, fuel costs, the Iraq war, and the risk of inflation all add up to an unstable environment for venture spending." Further, Graham Burnette, SBV Venture Partners, said "High deficits in the US budget are likely to slow the economy and result in a decreasing stock market. This will probably depress venture activity." While Dag Syrrist of Vision Capital was "more optimistic about consumer driven end use vs corporate buying of product and services companies typically backed by venture funds and less optimistic about company formation in the Bay Area given very high local cost structure – directly and indirectly – in locating companies in the region vs other parts of the US or Europe." An anonymous contributor stated, ".. Other entrepreneurial 'hubs' are being formed elsewhere that are capable of advancing innovation in a more cost effective manner."

In sum, however, the sentiment was strongly positive and noticeably better than the previous three quarters. A distinct shift from the cautious optimism of the previous quarters to widely shared high confidence in the high growth venture environment appears to be taking hold now. This shift appears to be primarily driven by increases in venture fund raising and the willingness to deploy these funds to promising new ventures. The uptick of the relative index level and the broadly positive comments from the venture capitalists surveyed indicate an increasingly upbeat sentiment for venture capital investment in the coming months, and bode well for *strong health in entrepreneurial activity and new company formation in the San Francisco Bay Area for the balance of 2005.*

Table 2

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

Andy Donner	Great Spirit Ventures
Ann Winblad	HummerWinblad
Arno Penzias	New Enterprise Associates

Bart Schachter	Blueprint Ventures
Bob Marshall	Selby Venture Partners
Brendan Richardson	Vision Capital
Bryant Tong	Nth Power
Chester Wang	Acorn Campus
D. Kirk B. Westbrook	International Venture Fund
Dag Syrrist	Vision Capital
David DeRuff	East Peak Advisors
David Epstein	Crosslink Capital
David Haselwood	Burrill & Company
David Pidwell	Alloy Ventures
Deepak Kamra	Canaan Partners
Dixon Doll	Doll Capital Management
Fred Dotzler	De Novo Ventures
Graham Burnette	SBV Venture Partners
Guy Kawasaki	Garage Technology Ventures
Igor Sill	Geneva Venture Partners
Jan Barker	MedVenture Associates
Jeb Miller	ComVentures
Jim Marshall	Selby Venture Partners
Joe Mandato	De Novo Ventures
Kurt Keilhacker	Techfund Capital
Mike Rocke	Rocke Capital Ventures
Peter Wolken	Capital Valley Ventures
Raj Atluru	Draper Fisher Jurvetson
Randolph L. Tom	Dynasty Capital Services
Richard Yen	Blueprint Ventures
Robert R. Ackerman, Jr.	Allegis Capital
Robert Troy	Geneva Venture Partners
Sanford Miller	3i Group
Sergi Martorell	3i Group
Shomit Ghose	Onset Ventures
Steve Dow	Sevin Rosen Funds
Steve Harrick	Institutional Venture Partners
Tom Fountain	Mayfield
Venky Ganesan	Globespan Capital Partners
Anonymous	Skyline Ventures

Please see the report for the previous quarter at: http://www.usfca.edu/sobam/nvc/cindex_1_2005.htm.

Look for the 3rd Quarter 2005 USF Silicon Valley Venture Capitalist Confidence Index in October 2005. Venture capitalists who wish to participate in next quarter's Index survey or become involved with the 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.

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*The authors wish to thank the participating venture capitalists who generously provided their expert analysis and commentary. We also wish to thank Ling Ding (USF MBA 2006), our research assistant, who provided essential and extensive support in our survey effort as well as Grace Tan (USF MBA 2007) for copy editing our manuscript.