

China Venture Capitalist Confidence Index

Second Quarter – 2006

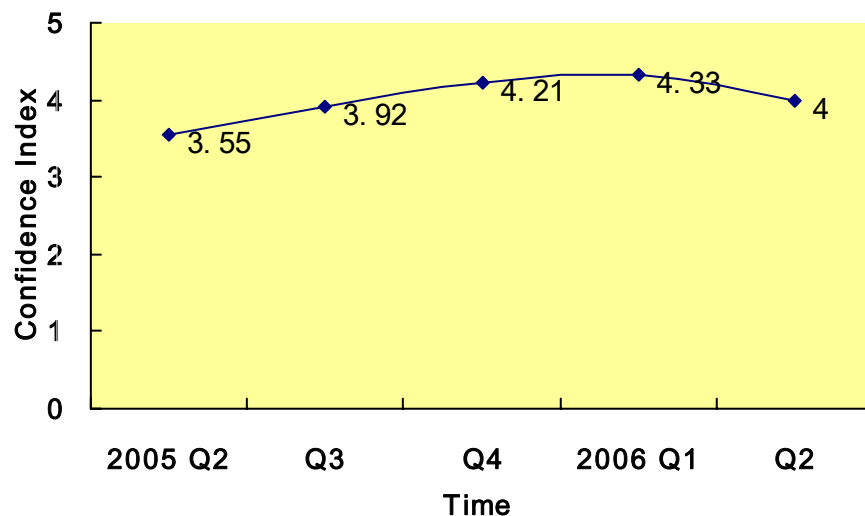
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The quarterly China Venture Capitalist Confidence Index (*Bloomberg ticker symbol: CVCCI*) is based on a survey of mainland China and Hong Kong venture capitalists. Created and authored by Professor Mark Cannice of the University of San Francisco and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

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 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.

Table 1
Trend line of China Venture Capitalists Confidence over recent 5 quarters



The China Venture Capitalist Confidence

Index for the second quarter of 2006, based on an July 2006 survey of 16 mainland China and Hong Kong venture capitalists, came in at 4.0 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 down from last quarter's index of 4.33 on a 5 point scale. (Please see Table 1 for trend data.) While the index reading is based on a modest

sample size of 16 venture capitalists in the China region, we expect that it does shed some light on current and on-going issues in the China venture capital and high-growth venture environment.

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 July survey of 37 San Francisco Bay Area venture capitalists) indicated a reading of 3.89 (also down from the previous quarter's reading of 4.15). Interestingly, the Silicon Valley Index is trending down similarly to the China Index. This might be expected given the increasing integration of venture capital industry between China and California.

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 we provide many of their comments along with our analysis.

Although the confidence index decreased notably from the previous two quarters, there still existed an overall optimistic sense about the high growth venture environment in China among most of the responding venture capitalists. For example, Johannes Schoeter of Victoria Capital Limited cited, "continued high growth, a large number of high growth private companies, and inefficiencies in the (China) economy" for his confidence. While Kevin Chan of SEAVI Advent Holdings holds high confidence (a rating of 5/5) based on his experience in the China market.

Another confident venture capitalist who wished to remain anonymous noted, "continued growth potential in terms of earning & spending." For example, "Human resources, food & beverages production & consumption, and management & quality control are in demand." While yet another anonymous contributor stated, "The ongoing consumer led growth and improving regulatory environment are creating a positive framework for venture investing." Richard Roque of SA Capital Limited was also confident in the high growth environment in China based on the trends he is seeing in the marketplace.

Several respondents noted the continuing influx of VCs into China as a positive indicator. For example, George Li of China Merchants and Fortune Assets Management Ltd, identified "more and more venture capital flow into the (China) region to support the venture business" as a positive sign. Helmut Struss of Siemens Acceleration in Communication also offered an upbeat assessment, stating, "Even though there are many new VCs and funds moving into China and even though there is hype on China's high tech investments, there is also still a huge upside in market potential and growth. This will help to foster the entrepreneurial environment and high tech growth, respectively."

However, caution was also a theme this quarter. Jianhui Zhou of Com Ventures, offered that, "overall economic activities, and the huge domestic market give me confidence; on the other hand, the lack of managerial talent pool, some questionable business practices, and uncertain government/SOE intervention and influence make me cautious." An anonymous contributor added, "(there) will be lots of opportunities, but (I am) seeing lots of companies that are 'me too' ideas. As such, execution will be the key and it is harder to assess the likelihood for success in a market condition where there is a lot of money floating around." Michael Scown of Intel Capital, Asia Pacific, attributed his moderate confidence to the fact that, "Valuations have been rising in China, following a strong run over the past few years. As such, there is potential for the pace of Greater China's VC environment to moderate. This isn't so surprising; business cycles are a natural part of every market. Intel Capital continues to view China as a growth engine for the world economy – we're a long-term investor in China, and our commitment remains firm."

A maturing venture environment was noted by some. Philip Zhai of Shanghai Industrial Holdings Ltd., provided, "The growth of private enterprises in China is reaching a critical stage where successful

models have been repeated and innovation has been driven by intensified competition. As long as the economy is growing the new era of venture investment will not be far.” Additionally, Marvin Lai of ITM Ventures, indicated, “Well, if the question was posted 12 months ago, I suppose our answer would have been in the neighborhood of 3 or below due to foreign brands stiffening the competition in China, and that domestic brands are struggling with their identities and ability to compete; however, today the Chinese brands are actively expanding out of China for survivability, and brands such as Bird, TCL, ZTE, Huawei, etc. are making excellent headways in markets such as Middle East and Africa, which are setting excellent examples for many new Chinese brands to follow. This, in our opinion, shall counter-balance the stiffened competition at home that, in turn, shall increase the future high-growth ventures in greater China.” George Li of China Merchants and Fortune Assets Management Ltd, also confident in the Chinese venture environment, pointed out that, “the economic and legal conditions are improving greatly each year”.

Finally, on **an overall optimistic note**, Max Burger-Calderson of Apax Partners, Ltd., stated, “The drive and energy of the Chinese entrepreneurial community is of a magnitude which overshadows the still very limiting administrative burdens these entrepreneurs are faced with when operating in China.”

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 still positive due to a maturing venture and general business environment, an energetic entrepreneurial community, and the development of stronger Chinese brands for export. Although somewhat lower than the previous two quarters’ readings, the current quarter’s confidence level suggests continued health in high growth entrepreneurial activity and new company formation in the greater China region for the balance of 2006.

Table 2

Participating China based Venture Capitalists in the 2006 2nd Quarter Confidence Index Survey

Chauncey Shey	Soft Bank China Venture Capital
Felix Wong	JAFCO Asia
George Li	China Merchants & Fortune Assets Management Ltd.
Helmut Struss	Siemens Acceleration in Communications
Jamie Paton	3i Asia Pacific PLC
Jianhui Zhou	Com Ventures
Johannes Schoeter	Victoria Capital Limited
Kevin Chan	SEAVI Advent Holdings Ltd.
Marvin Lai	iTM Ventures Inc
Max Burger-Calderon	Apax Partners Ltd
Michael Scown	Intel Capital, Asia Pacific
Patrick Keen	ChinaVest Services Limited
Philip Zhai	Shanghai Industrial Holdings Ltd.
Richard Hsu	Intel Capital, Asia Pacific
Richard Roque	SA Capital Limited
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.

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