

# China Venture Capitalist Confidence Index™

(Bloomberg ticker symbol: CVCCI)

## First Quarter – 2010

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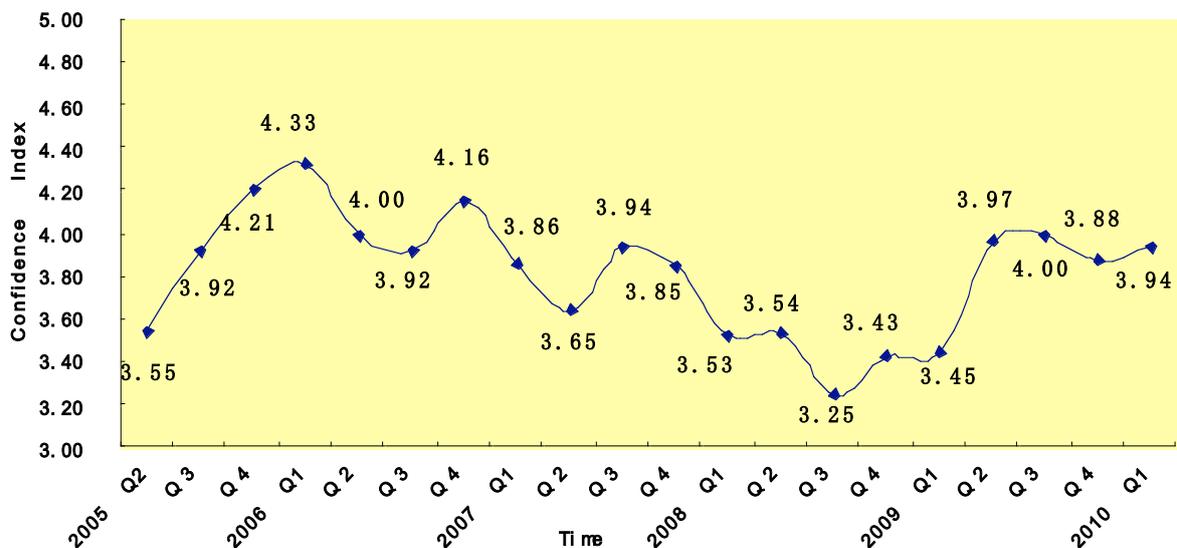
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The quarterly *China Venture Capitalist Confidence Index™* (Bloomberg ticker symbol: CVCCI) is based on an on-going survey of Mainland China and Hong Kong venture capitalists. The China VC Index measures and reports the opinions of China-based professional 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 essential perspective and an on-going leading indicator of 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 capital flows, we aim to provide actionable insight for all market participants.

The China Venture Capitalist Confidence Index for the first quarter of 2010, based on an April 2010 survey of 16 Mainland China and Hong Kong venture capitalists, registered **3.94 on a 5-point scale** (with 5 indicating high confidence and 1 indicating low confidence). This quarter's reading increased slightly from the 2009 Q4 level. The index readings of the past four quarters have confirmed that China VC confidence has settled into a comfortably optimistic range after China emerged strongly from the global financial crisis in 2009. Please see Graph 1 for trend data.

Graph 1

Trend line of China Venture Capitalists Confidence over recent 20 quarters



**Confidence among venture capitalists in China has remained buoyant over the last year.** Rapid economic growth, a growing pool of experienced entrepreneurial talent, and government support of the venture industry have provided support to the Chinese venture entrepreneurial environment. A close look at the confidence trend line in Graph 1 reveals that the four readings of 2008 are all below 3.55 (preceding and concurrent with the worst of the global financial crisis) whereas the recent four readings are above 3.90. This positive stabilization in confidence in recent quarters appears linked to the rebound in the Chinese economy and IPO activities of VC/PE backed startups in China. According to Zero2IPO, 39 VC/PE-funded startups raised \$6.844 billion through IPO in the first quarter of 2010. This number dwarfed the two IPOs in first quarter of 2009 and the ten IPOs in first quarter of 2008<sup>1</sup>. The maintenance of stable financial markets after the global financial crisis and the resulting IPO opportunities for Chinese venture-backed firms should help maintain VC confidence and financing opportunities for entrepreneurs in the coming quarters. In the following, we provide many of the comments of the participating venture capitalist respondents along with our analysis. The Index respondents' names and firms for this report are listed in Table 1, save those who wished to remain anonymous.

**Most venture capitalists that responded to the Q1 survey held an overall optimistic outlook on the China entrepreneurial environment. Some attributed their optimism to continuing government support.** For example, Lucas Wang of WI Harper Group attributed his confidence in part to "...the government's strong role in business promotion." Another venture capitalist, who wished to remain anonymous, also stressed the government's effort to improve the entrepreneurial environment, stating that the "Chinese government or related entities (are) establishing VC or PE arms with a large amount of capital available for domestic investment." In fact, Chinese government supported funds constituted 19.02% of venture capital in China in 2009<sup>2</sup>. This type of official support for the emerging venture industry in China is bound to buoy confidence by increasing liquidity and investable capital as well as providing an explicit government endorsement for the acceleration of venture investing.

**The general economic and operating environment in China also bolstered the venture industry.** Rampant economic growth and stable public financial markets provide a rich context for the venture industry. For instance, one China based venture capitalist who wished to remain anonymous stated that "the outlook for both fundraising and investment activity in the venture and growth space in China is positive. Investors around the globe continue to find alternatives ...to diversify capital, and the economic growth in China is particularly attractive." He added "For fund managers themselves, the environment is likely to become more competitive. For entrepreneurs and business owners looking for development / expansion capital, it should be a very welcoming environment."

**The maturing of local entrepreneurial talent also adds to the attractiveness of investing in Chinese startups with the resultant increase in VC confidence.** David Zhang of Matrix Partners China pointed out that "there are simply more entrepreneurs to choose from and high-tech remains a key focus for us. Chinese people have always been very entrepreneurial and now play an important

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<sup>1</sup> <http://www.chinavcpe.com/news/cn/policy/2010-04-14/32ae3e52d2e768c7.html> 72只创投基金平均获8.7倍回报, by证券时报, 4/14/2010

<sup>2</sup> <http://www.cvcvi.com/forum/news/newscenter1.asp?id=11849> 研究报告:人民币基金开始在国内占据主流地位, Source: 新华网, 2/3/2010

role in China's continued growth. Yes we are very positive (about) China's venture environment." A VC respondent who wished to remain anonymous also noted the "increased breadth and depth of managers." This trend in growth in entrepreneurial talent, coupled with "... realized returns provide for cautious optimism for the near future."

**Despite positive signs in the China venture capital industry some venture investors are concerned about uncertainty in future investment restrictions and the lack of consistent regulation from Beijing and local governments.** One anonymous venture capitalist admitted that "significant risks remain for investing into China." Another participating VC extended this point of view, stating that "In many high-tech industries there is still a lot of uncertainty about legal restrictions with different government offices announcing conflicting regulations." He added that "Offshore investment is also still uncertain due to restrictions on foreign ownership in certain sectors and mandated contractual structures with local partners rather than direct investment. A new structure has been announced which seems to be an improvement, though it is untested."

**In summary, while the regulatory environment in China remains a concern, strong economic growth, ongoing government support, and maturing entrepreneurial talent make investment in China's enterprises attractive to many venture capitalists.** China's first quarter GDP grew by 11.9%.<sup>3</sup> This strong economic growth supports venture capitalists' confidence and encourages further portfolio investments. Although worry continues on the sustainability of its rampant economic growth, high investment returns make China venture capital funds an attractive investment alternative<sup>4</sup>. But will these returns attract excess capital that chases limited quality projects?

Despite some macro economic and industry specific risks, we believe that the growth in the cadre of high-tech Chinese entrepreneurs is the key factor to watch. This growing population of experienced high-tech entrepreneurs along with the growth of supporting sectors such as incubator services that are being established to help support entrepreneurial talent development point to an emerging stage in Chinese innovation. Clearly, experienced entrepreneurial talent is a necessary condition for a vibrant venture industry. Silicon Valley has been blessed with a history of innovative entrepreneurial talent and this aspect of the Valley has helped it maintain its edge in developing world-class high-growth firms. As China's venture capitalists develop and leverage the experience of its own entrepreneurial talent, they come a step closer to replicating the success enjoyed by their colleagues across the Pacific.

To conclude, government support of the venture industry, rapid economic growth and a well functioning capital market, coupled with a growing pool of experienced entrepreneurial talent point to the maturing of the Chinese venture entrepreneurial environment and its contribution to broader Chinese economic growth through its ability to deliver disruptive solutions to an increasing number of industries across the globe.

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<sup>3</sup> [http://www.cs.com.cn/xwzx/03/201004/t20100414\\_2394729.htm](http://www.cs.com.cn/xwzx/03/201004/t20100414_2394729.htm) 据悉中国2010年第一季度GDP年增约11.9%

<sup>4</sup> <http://www.chinavcpe.com/news/cn/policy/2010-04-14/32ae3e52d2e768c7.html> 72只创投基金平均获8.7倍回报, by证券时报, 4/14/2010

**Table 1**

**Participating China-based Venture Capitalists in the 2010 1<sup>st</sup> Quarter Confidence Index Survey**

<b>Participant</b>	<b>Company</b>
Alan Song	Soft Bank China Venture Capital
Alicia Eastman	Asia Pacific Capital
David Lam	WI Harper Group
David Zhang	Matrix Partners China
Jixun Foo	GGV Capital
Johannes Schoeter	Victoria Capital Limited
Lucas Wang	WI Harper Group
Marvin Lai	iTM Ventures
Michael Scown	Intel Capital, Asia Pacific
Patrick Keen	China Vest
Raymond Gu	JAFCO Asia
Sebastiaan van den Berg	HarbourVest Partners (Asia) Ltd.
Anonymous	Anonymous

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