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News Release

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U.S. Venture Capital Industry Expected to Shrink While Emerging Markets Grow: Deloitte, National Venture Capital Association Study

Challenged IPO Market and Unfavorable Political Climate in U.S. Dampens Historical Strength Despite Vibrant Entrepreneurial Culture

NEW YORK, July 14, 2010 — Venture capitalists in the United States widely expect their industry to contract while those in emerging markets, including China, India and Brazil, expect to see their ecosystem expand over the next five years, according to the 2010 Global Venture Capital Survey by Deloitte and the National Venture Capital Association.

According to the survey results, more than 90 percent of U.S. survey respondents expect the number of venture firms to decrease between now and 2015, while a majority of venture capitalists in China, India and Brazil anticipate adding more venture firms in their country during the same time frame. Venture capitalists in Europe and Canada also expect an industry contraction in their respective countries though to a lesser extent than in the U.S.

The 2010 Global Venture Capital survey, which measured the opinions of more than 500 venture capitalists worldwide, also examined the factors contributing to each country's outlook. The U.S. respondents feel the industry has suffered from a weak IPO market and unfavorable tax and regulatory policies. More than half the U.S. respondents also believe that limited partners will be less inclined to invest in U.S. venture capital funds in the next five years. Despite the challenges, U.S. venture investors remain optimistic regarding the quality of the opportunities in the U.S., with most predicting a stable or improving environment for valuations and deal flow.

"Traditionally strong markets like the U.S. and Europe will continue to be important hubs despite consolidation in the number of venture firms," said Mark Jensen, partner, Deloitte & Touche LLP and national managing partner for venture capital services. "However, the stage has now been set for emerging markets like China, India and Brazil to rise as drivers of innovation as they are increasingly becoming more competitive with the traditional markets."

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Mark Heesen, president of the National Venture Capital Association said, “This year’s survey results underscore the importance of market and political environments to the future of global venture capital ecosystems. It comes as no surprise that optimism abounds in geographies where venture investment is well supported by sound public policies, stable capital markets and entrepreneurial energy. Yet, it is ironic that the more optimistic environments are now outside the United States.”

Venture Growth Predicted in Emerging Markets; Consolidation Expected in U.S. and Europe

Sixty-two percent of all respondents globally expect the number of venture firms in their country to decline in the next five years. This figure is driven largely by the United States where 92 percent of U.S. venture capitalists expect the number of venture capital firms to decline, followed by France (83 percent), Israel (80 percent) and the United Kingdom (70 percent). Conversely, 99 percent of respondents in China expect the number of venture capital firms to increase in their country, followed by Brazil (97 percent) and India (85 percent). The predicted amount of venture capital available for investment in the next five years followed similar trends by country.

Limited Partner Interests Expected to Shift Geographically

Venture capitalists’ forecasts for limited partner contributions are consistent with their predictions for industry growth or contraction. In the United States, 56 percent of respondents believe that limited partners will be less inclined to invest in U.S. venture capital. These predictions are shared by venture capitalists in Europe with France (89 percent), the United Kingdom (61 percent) and Germany (44 percent) all predicting less limited partner interest. This sentiment is shared by venture capitalists in Israel with 50 percent of respondents forecasting declines. Yet, venture capitalists in Brazil (92 percent), China (91 percent) and India (76 percent) all believe limited partners will be more inclined to invest in their respective countries.

Increases in Cross Border Venture Investing Slow Down, Will Plateau

Overall, only 34 percent of all respondents indicated that they expect to increase their investment activity outside their own country, suggesting that cross border investing activity has reached a plateau for the time being. The countries with the most interest in cross border investing include: France (56 percent), Israel (50 percent) and the United Kingdom (49 percent). Countries indicating the least interest in outside investing were Brazil (19 percent), India (15 percent) and China (11 percent).

“The Asian markets, in particular, are abundant in entrepreneurial spirit, energy and a dedication from both the private and public sectors to push the economic growth pendulum as far as possible,” said Trevor Loy, general partner of Flywheel Ventures. "The continued rapid growth of emerging markets is also creating a new source of customer revenue, investment capital, job creation, and shareholder liquidity for U.S. based technology start-ups, particularly those leveraging America's deep research and development (R&D) resources to address critical infrastructure needs in energy, water, materials and communications.”

Challenges Abound, Notable in the U.S.

Factors cited most often for an unfavorable investment climate in the U.S. were difficulty in achieving successful exits (88 percent); unfavorable tax policies (59 percent) and unstable regulatory environment (53 percent). The prevalence of these challenges represents a stark contrast to responses five years ago when the survey posed a similar line of questions. At that time, these factors were barely on the radar for

U.S. investors as contributing to an unfavorable investment environment in their country. Despite the obstacles recognized this year, 48 percent of U.S. venture capitalists cited both a strong R&D climate supported by the government and an improving entrepreneurial environment as factors that worked in favor of a stronger venture investment climate.

"Within the past several years, the United States government has supported the venture capital ecosystem in the areas of innovation by committing more federal funds to basic research and development, but has fallen considerably short in other important areas," said Heesen. "The uncertainty and potential impact around many of the policies that have been discussed in Congress in recent months has contributed to an investment climate that is viewed as increasingly unfavorable by a majority of the venture capital industry. This course must change if we wish to remain competitive with other nations over the long term."

Top challenges varied in countries around the globe with the exit market being cited the most in the United Kingdom (80 percent), Canada (75 percent), India (71 percent) and Israel (70 percent). Eighty-one percent of respondents in Brazil cited unfavorable tax policies as being a hindrance. An unstable regulatory environment was the most common factor cited by respondents in France (72 percent) and China (62 percent).

"The challenges for a U.S. venture firm trying to do business in Europe include the current weakness in the euro-zone economy, language and cultural differences, and the tendency towards inflexible employment regulations," said Bruce Evans, managing director of Summit Partners. "On top of this, U.S. firms have to fund their European expansion from their own profits, and the proposed U.S. tax changes to carried interest--and the taxation of equity interests in fund managers more generally — would serve as an impediment to U.S. venture funds' growth aspirations."

"Yet, opportunities remain as well," Evans continued. "The psychological make-up of successful, driven entrepreneurs in Europe mirrors what we have found in the U.S. In addition, the globalization of technology markets means that successful products are as likely to be developed in Europe as elsewhere. Finally, the days of missionary selling of venture capital in Europe are over, and today there is a broad understanding of our type of financing."

Entrepreneurial Opportunity Remains

In the United States, venture capital respondents are of split opinion regarding valuations over the next five years with 32 percent expecting increases, 34 percent expecting decreases and 34 percent expecting valuations to hold steady. Valuation expectations are the most optimistic in India and China where 68 and 62 percent of the venture capitalists in those countries believe valuations will increase over the next five years. Only 10 percent of venture capitalist respondents in Israel and 6 percent of respondents in France see valuations increasing in their respective countries.

Despite concerns over contracting industries in the U.S. and Europe, 57 percent of all respondents believe the quantity of deal flow will increase over the next five years and 56 percent expect the quality to improve as well. This forecast is particularly strong in respondents from China, Brazil and India.

"We have seen signs of venture capital industry contraction since the dotcom bust, and the liquidity crisis continues to exacerbate an unfavorable investment climate. Mature geographies obviously will not grow as fast as those that are emerging, but there is endless opportunity ahead, both in the U.S. and abroad, for those countries willing to embrace it," concludes Jensen.

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About NVCA
The National Venture Capital Association (NVCA) represents approximately 460 venture capital firms in the United States. NVCA's mission is to foster greater understanding of the importance of venture capital to the U.S. economy and support entrepreneurial activity and innovation. According to a 2009 Global Insight study, venture-backed companies accounted for 12.1 million jobs and $2.9 trillion in revenue in the United States in 2008. The NVCA represents the public policy interests of the venture capital community, strives to maintain high professional standards, provides reliable industry data, sponsors professional development and facilitates interaction among its members. For more information about the NVCA, please visit www.nvca.org.

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