

## vFinance Entrepreneurial Confidence Index (VECI)

**First Quarter 2005**  
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### Executive Summary

Entrepreneurial confidence declined 7.6% in the first quarter of 2005 versus the previous quarter to stand at its lowest level in a year. However, in the first quarter of 2005, the vFinance Entrepreneurial Confidence Index (VECI) was 5.2% above the level of a year ago. Although the VECI has been essentially flat for the past year, it remains at a very high level suggesting that the overall level of interest in starting a new business remains high.

The current level of the VECI indicates that the number of individuals interested in obtaining funding for a new business has remained high for the past year. Data released by the Government over the past few months suggests that the number of businesses actually started has begun to increase and these businesses are employing more people. In the third quarter of 2004 (latest available data) the number of newly created establishments which added new employees increased to its highest level since the third quarter of 2000. Prior to the third quarter of 2003, while the VECI was rising, the number of new establishments hiring people had been falling, suggesting that there was a gap between the desire to start a business (the rising VECI) and the actual number of businesses started. However the 7.9% increase in new establishments hiring since then suggests that this innovation gap, the difference between the upward trend in the VECI and the declining trend in new businesses has begun to narrow. The strong performance of the economy over the past two years has increased confidence of entrepreneurs and investors alike, resulting in more business start ups and contributing to the healthy increase in employment since August 2003.



Other important findings include:

- **Energy** has attracted growing interest over the past year, reflecting the high price of oil. The number of individuals expressing a desire to start a business in the **oil and gas exploration and production** sub-sector reached a record high in the first quarter as the price of oil rose to record levels.
- **Financial services** saw a significant increase in interest with large gains in the **investment banking and brokerage** and **mortgage banking** sub-sectors. Although equity markets have been weak this year, low interest rates, particularly mortgage rates and increasing merger activity appear to be attracting entrepreneurs.
- Led by sharp increases in interest in **trucking** and **logistics** the **transportation** sector was the highest rated major industry sector. As the distribution of goods becomes an increasingly important area of emphasis for corporations, **transportation** is likely to remain a high interest sector in the coming year.

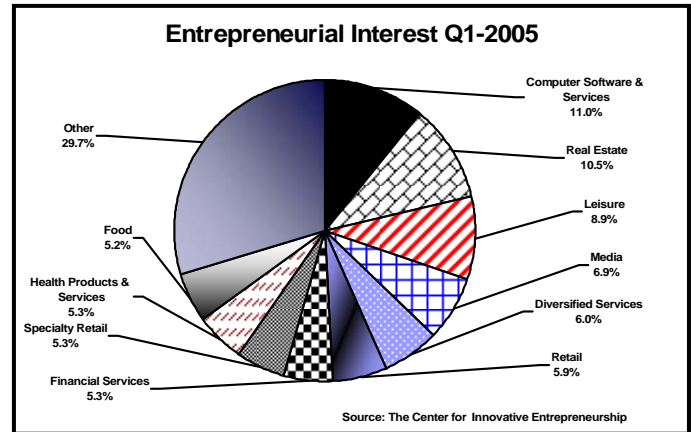
These sectors and sub-sectors experienced large changes in interest, representing early indications that investors should monitor.

Q1/2005	Rising	Declining
<b>Sectors</b>	<ul style="list-style-type: none"> <li>• Transportation</li> <li>• Leisure</li> <li>• Financial Services</li> <li>• Computer Hardware</li> </ul>	<ul style="list-style-type: none"> <li>• Banking</li> <li>• Automotive &amp; Transport Equipment</li> <li>• Drugs</li> </ul>
<b>Sub-Sectors</b>	<ul style="list-style-type: none"> <li>• Restaurants</li> <li>• Trucking</li> <li>• Real Estate Development</li> <li>• Internet &amp; Intranet Software &amp; Services</li> </ul>	<ul style="list-style-type: none"> <li>• Entertainment &amp; Games Software</li> <li>• Auto Manufacturing</li> <li>• Concrete &amp; Cement</li> <li>• Music Production and Publishing</li> </ul>

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**Response Shares**

Although the **computer software and services** sector continued to attract the largest number of responses in the first quarter survey (11.0% of all responses), its share of all responses fell to the lowest level since we began in the third quarter of 2001. Much of the decline in interest in software has been replaced by **real estate**, which remained second in interest level with 10.5% of all responses, up from 10.3% in the fourth quarter and 9.9% a year ago. **Leisure** (8.9%) and **media** (6.9%) were in the third and fourth spots as they have been since the second quarter of 2004. Interest in starting a **retail** business is also very high among the entrepreneurs who come to the web site. In the first quarter, interest in **retail** and **specialty retail** taken together accounted for 11.3% of all responses, almost identical to the 11.2% level in the fourth quarter.



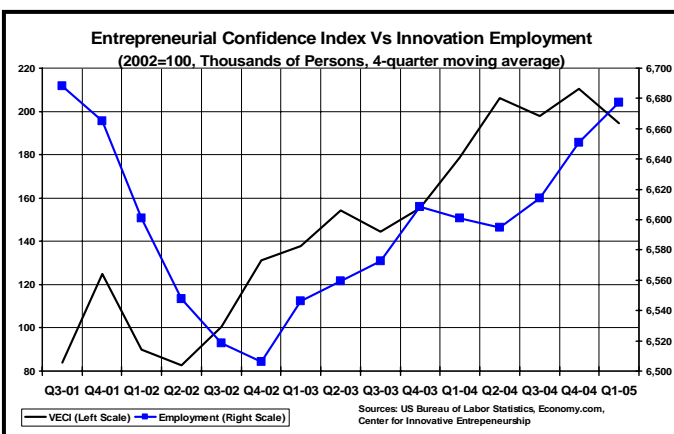
The VECI monitors 28 major sectors and 289 sub-sectors

The biggest shifts between the fourth quarter of 2004 and the first quarter were in **leisure** and **media**. Interest in starting a business in the **leisure** sector jumped from 8.3% to 8.9%, the second largest increase of any sector. The biggest reason for the increase was a sharp jump in interest in starting **restaurants**. In the **media** sector, interest dropped from 7.3% of all responses to 6.9% largely because of a steep drop in interest in **music production** one of the hottest segments of the **media** sector.

Response share is not the same as VECI ranking. Response share is the individual sector's share of all responses; the VECI ranking includes measures of the growth or decline in interest over time, and therefore gives an indication of rising or falling interest as well as the overall level of interest at any given time.

**The VECI and The Economy: The Innovation Economy Turns Mixed**

The first quarter saw a mixed performance for the innovation economy, the dynamic core of the economy where new ideas become new businesses, creating opportunity, wealth and jobs. Several indicators of innovation activity moved in opposite directions in the first quarter. On the financial side of the economy, investment in new start ups by venture capital firms declined sharply, from 776 in the fourth quarter of 2004 to 674 in the first quarter. In addition, initial public offerings of stock were down by nearly 50%, from 82 to 43 (although they were up slightly from a year ago). But employment in innovation occupations is rising. In the first quarter, innovation employment, on a moving average basis was at its highest level since the third quarter of 2001 (see chart). Innovation employment appears to track the VECI with a lag, which suggests that the increase in innovation employment may slow in the second half of 2005.



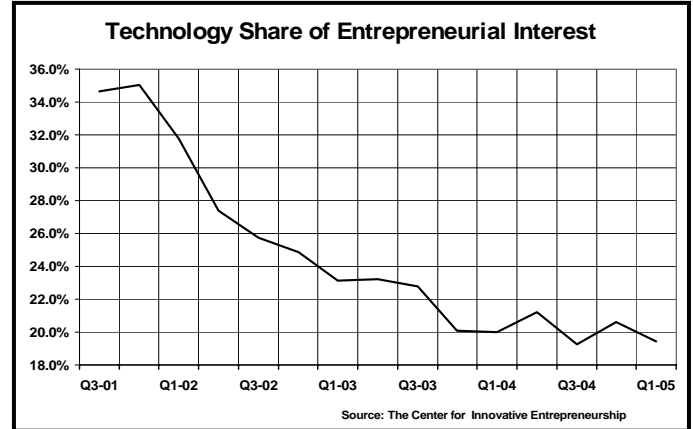
These trends suggest that confidence in new business start ups may be faltering. Investment in these businesses remains at low ebb, at least from the venture capital community, while employment in the occupations that tend to

create new innovation may not continue growing at the recent strong pace. Another indicator suggesting faltering confidence is the National Federation of Independent Business Small Business Optimism Index declined by 2.5% in the first quarter to its lowest reading since the third quarter of 2003.

Overall, the VECI and other indicators suggest that the innovation economy was flat in the first quarter, a far cry from the growth of the previous year.

## VECI Trends: Technology continues to decline.

When the first VECI survey was taken in the third quarter of 2001, the technology/internet/NASDAQ bubble was deflating. But technology was far and away the dominant interest of the entrepreneurs who came to the vFinance web site seeking funding. Of the 289 sub-sectors tracked in the VECI survey, 63 are technology related, everything from software to biotechnology to alternative energy. In 2001 and early 2002, these technology industries accounted for more than one third (35%) of all inquiries at the web site. But as the Internet bubble deflated and the stock market dropped, so did interest in starting a technology business. In the first quarter of 2005, the percentage of all entrepreneurs coming to the web site and seeking funding in a technology-related industry fell to 19.4%. The biggest decline was in the **computer software and services** (down 9.4 percentage points since the second half of 2001) and within that sector the **internet and intranet software and services** sub-sector showed the largest decline(-3.2 percentage points). The only technology related sub-sector to record a significant increase in interest between the end of 2001 and early 2005 was **alternative energy** where interest is up about 28% from the level at the end of 2001.

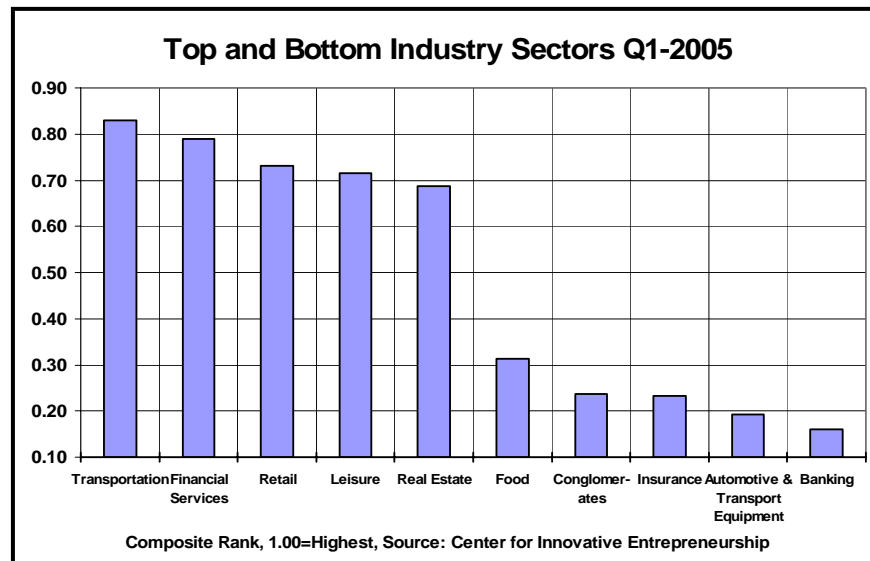


The decline in interest in technology has been replaced by a surge in interest in **real estate** and to a lesser extent a climb in interest in **retail, leisure and media**. The shift in interest reflects entrepreneurs changing perceptions about the general economy. The performance of the economy since the end of 2001 has been dominated by consumers, with a booming housing sector and increasing spending on entertainment and leisure activities.

The shift away from technology also reflects differences in financial markets where the NASDAQ market remains well below the levels of late 2000 while other sectors of the equity market have made more meaningful recoveries (As of mid-May 2005, the S&P 500 was 22% below its 2000 peak while the NASDAQ was down 60% from the 2000 high). The better-performing sectors of the market are attracting greater interest on the part of entrepreneurs who are seeking to profit where the opportunity is, and right now, according to equity markets, it is not in technology.

## Major Industry Sectors

vFinance ranks the 28 major industry sectors that our respondents are asked to identify by both size and growth. The rankings are from a low of 0.00 to a high of 1.00. A highly ranked industry sector shows a combination of a high level of interest and rapid growth in interest. This composite rank provides an insight into where entrepreneurs are focusing their efforts and can provide investors and policy makers with valuable information on prospective future economic and market trends.



There were some surprises in the first quarter rankings as rapid increases in interest in the **transportation** and **financial services** sectors caused them to jump to the top of the rankings. It is these surprises, the sudden shifts in interest and ranking among sectors that are of the most potential interest to investors since they may represent a new or emerging shift in the economy, presenting profit potential.

- ✓ Within the **transportation** sector, the largest reason for the increase in interest was a sharp climb in the number of inquiries by individuals seeking funding for a business in the **trucking** sub-sector. In the first quarter, this sub-sector saw an all-time high in number of inquiries and its share of all inquiries. Other sub-sectors that saw a significant increase in interest were **logistics** and **shipping**. The significant increase in the **transportation** sector even in the face of sharply rising energy prices underscores the increasing importance of logistics to corporations as they seek to manage inventories ever more efficiently.
- ✓ The sharp increase in interest in **financial services** was also a surprise considering the volatile environment for equities and other assets. The increase in interest was concentrated in the investment segment of this sector with **investment banking** and **brokerage** showing strong increases in interest. In addition, the **mortgage banking** sub-sector saw a substantial increase in interest reflecting the boom in residential real estate.
- ✓ **Retail** saw a significant increase in entrepreneurial interest after two quarters of declines. The major reason for the increase was a jump in interest in **convenience stores and gas stations** where the number on entrepreneurs seeking funding rose to an all time high. Clearly, the increase in gasoline prices has played a role here, attracting entrepreneurs seeking to profit in the delivery of gasoline to consumers.
- ✓ The **leisure** sector was also ranked highly due to sharp increases in interest in starting businesses in the **restaurants** and **miscellaneous entertainment** sub-sectors.

The lowest ranked major sectors were **banking** (0.161), **automotive & transportation equipment** (0.192), and **insurance** (0.232). The biggest surprise in the low-ranked sectors is **automotive and transport equipment** which had been one of the stronger sectors in 2004. But it has seen interest fall sharply in the latest two quarters, particularly for the **auto manufacturers** sub-sector. It is likely that the recent well publicized financial and operating troubles of the major auto manufacturers contributed to this decline. **Banking** has never generated a high level of interest and in the first quarter the number of entrepreneurs seeking funding for a business in this sector fell to the lowest level since the third quarter on 2001.

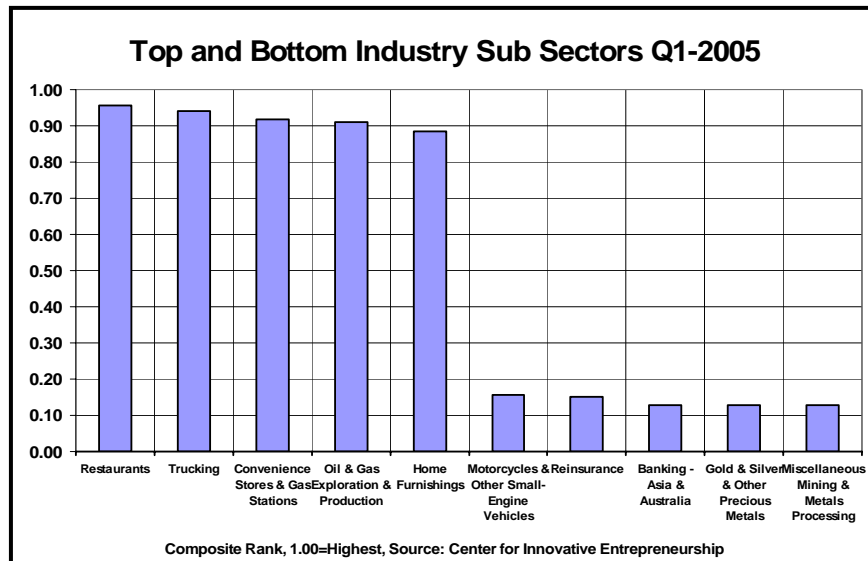
The following table shows the top ten major industry sectors for each of the past three quarters.

Major Industry Sector	Q3-04	Major Industry Sector	Q4-04	Major Industry Sector	Q1-05
Real Estate	0.8393	Computer Software & Services	0.6875	Transportation	0.8304
Retail	0.8348	Drugs	0.6563	Financial Services	0.7902
Transportation	0.7500	Consumer Products - Non-Durables	0.6339	Retail	0.7321
Automotive & Transport Equipment	0.7277	Telecommunications	0.6205	Leisure	0.7143
Manufacturing	0.7098	Media	0.5982	Real Estate	0.6875
Media	0.7098	Banking	0.5848	Computer Hardware	0.6473
Financial Services	0.7054	Financial Services	0.5804	Chemicals	0.6429
Energy	0.6786	Leisure	0.5714	Materials & Construction	0.5714
Health Products & Services	0.6652	Real Estate	0.5268	Aerospace & Defense	0.5670
Metals & Mining	0.6607	Automotive & Transport Equipment	0.5223	Consumer Products - Durables	0.5625

- ✓ The biggest surprise in the first quarter is the **chemicals** sector showing up at number seven. This marks the first time that this sector has been among the top 10. It is largely a result of an increase in interest in **agricultural chemicals**. The high ranking in the first quarter appears to be a fluke and we would need to see another high ranking in the second quarter before exploring this sector more closely.
- ✓ **Real estate** remains hot. It was in the top 10 for the fifth consecutive quarter. Economic data continue to support this sector with sales of new and existing homes reaching record almost monthly. Within **real estate** the highest ranked sub-sector was **real estate development** which had the second highest level of interest among all sub-sectors.
- ✓ **Computer hardware** was ranked sixth in the first quarter largely because of a sharp increase in entrepreneurs seeking funding in **networking and communications devices**. This sub-sector saw the highest level of interest in nearly a year and recorded a sharp increase from both the preceding quarter and the same quarter a year ago. Other sub-sectors showing healthy increases were **miscellaneous computer-based systems** and **diversified computer products**.

## Industry Sub-Sectors

Of the 289 industry sub-sectors tracked by vFinance, 152 saw the number of entrepreneurs expressing interest increase while 125 saw declining interest in the first quarter compared to the fourth quarter and 12 remained unchanged. This was a substantial improvement from the fourth quarter when only 81 sub-sectors experienced increases in interest.



- ✓ For the second consecutive quarter **oil and gas exploration** was one of the top ranked sub-sectors. The number of entrepreneurs seeking to obtain funding for a business in this sub-sector surged again. In the third quarter of 2004 **oil and gas exploration** was ranked number 101 out of 289 in the number of inquiries, By the first quarter of 2005, it was ranked number 27. The surge in energy prices and the perception that they will remain high for the foreseeable future is attracting an increasing number of entrepreneurs into this sub-sector.
- ✓ **Restaurants** recorded the largest increase in interest of any sub-sector in the first quarter, and were ranked number one in terms of growth across several categories. The total number of entrepreneurs seeking funds for a business in this sub-sector reached the second highest level ever recorded. Healthy growth in consumer spending at eating and drinking places has probably helped stimulated this interest. Over the past two years, retail sales at restaurants and bars has increased more than 17%, compared with 14% for all retail sales.
- ✓ The lowest ranked sub-sectors are those that have little constituency within the US, such as **Asian banking**. In addition, industries that require large initial investments such as mining are among the lowest ranked sub-sectors.

The movement in rankings from one quarter to the next is shown in the following table. Because of the large number of sub-sectors, there tends to be significant movement between quarters.

Major Sector	Sub-Sector	Q3-04	Major Sector	Sub-Sector	Q4-04	Major Sector	Sub-Sector	Q1-05
Retail	Discount & Variety Retailing	0.9381	Computer Software & Services	Entertainment & Games Software	0.9468	Leisure	Restaurants	0.9572
Automotive & Transport Equipment	Auto Parts	0.9144	Energy	Oil & Gas Exploration & Production	0.9187	Transportation	Trucking	0.9399
Financial Services	Investment Banking & Brokerage	0.8512	Financial Services	Miscellaneous Financial Services	0.9048	Retail	Convenience Stores & Gas Stations	0.9170
Real Estate	REIT - Residential	0.8495	Drugs	Biotechnology - Research	0.8815	Energy	Oil & Gas Exploration & Production	0.9096
Real Estate	Miscellaneous Real Estate Services	0.8304	Materials & Construction	Concrete & Cement	0.8707	Consumer Products - Durables	Home Furnishings	0.8858
Transportation	Trucking	0.8240	Electronics & Miscellaneous Technology	Scientific & Technical Instruments	0.8521	Financial Services	Investment Banking & Brokerage	0.8806
Real Estate	REIT - Hotel/Motel	0.8205	Specialty Retail	Miscellaneous Wholesale	0.8218	Transportation	Logistics & Other Transportation Services	0.8776
Financial Services	Investment Firms	0.8192	Specialty Retail	Auto Dealers & Distributors	0.8188	Health Products & Services	Medical Practice Management & Services	0.8754
Metals & Mining	Gold & Silver & Other Precious Metals	0.8175	Diversified Services	Management Consulting Services	0.8157	Financial Services	Investment Firms	0.8733
Retail	Clothing	0.8075	Media	Television Production	0.8058	Aerospace & Defense	Aerospace/Defense - Products	0.8720

- ✓ Two trends that jump out from this data are the sharp increase in interest in the **trucking** and **logistics** sub-sectors, and the strength of financial services, which saw two sub-sectors among the top 10. Significantly, the **trucking** sub-sector is among the top 10 for the second time in the past three quarters. This suggests that there is an underlying demand for this type of service in the general economy. We believe this trend reflects among other things, the growing use of the Internet as a purchasing tool. As companies have moved rapidly to e-commerce, the economy has moved more to a national distribution system with the resulting higher demand for both trucking and logistics services.
- ✓ Care must be given when interpreting these data. The trends in the general economy tend to be reflected in the movement of entrepreneurial interest, hence the strength in oil and gas. But this may reflect more popularity than represent an investment opportunity. Nonetheless, some nuggets for investors can appear within this data. Where we look is at the surprises. Which industries or sub-sectors are rising when everything says they shouldn't be? These sub-sectors deserve more scrutiny by investors as the rising interest may indicate a new trend emerging in the industry. This quarter, the sector that jumps out is **transportation** which appears to be in the early stages of a prolonged period of healthy growth driven by fundamental economic shifts. This is the kind of trend that may present opportunities for investors and should be more closely researched.

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