

## vFinance Entrepreneurial Confidence Index (VECI)

Second Quarter 2006

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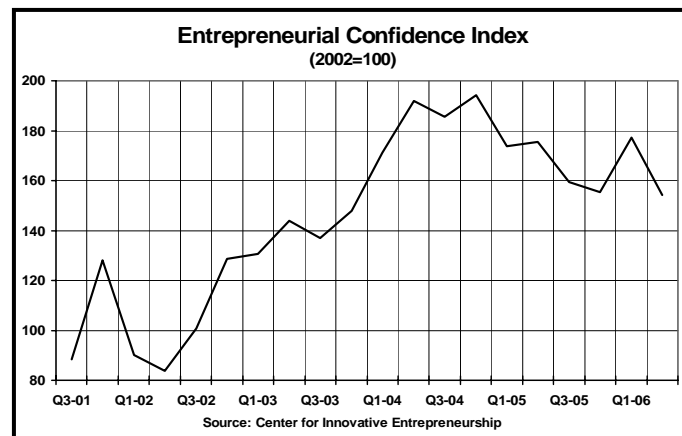
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### Executive Summary

Entrepreneurial confidence declined 12.9% in the second quarter of 2006 versus the previous quarter to stand at its lowest level in two and a half years. This marked the fourth decline in the past six quarters in the vFinance Entrepreneurial Confidence Index (VECI) putting the index 12.1% below the level of a year ago. Since reaching a peak in the fourth quarter of 2004, the VECI has drifted lower, with its current reading 20.5% below that peak reading.

The VECI estimates the level of confidence in the entrepreneurial community by measuring the number of entrepreneurs coming to the web site [www.vfinance.com](http://www.vfinance.com) and seeking capital for their business. It covers 289 industry sub sectors in 28 major industry sectors and is adjusted for factors such as the growth of the Internet. It represents the only current indicator in the world of the entrepreneurial community's perceptions about their business climate.



The performance of the VECI over the past four years: a strong surge in 2002 and 2003 followed by a plateau and subsequent drift downward; is similar to that seen in the US economy. US gross domestic product (GDP) grew very strongly in 2002 and 2003 with year-on-year growth peaking at nearly 5.0% in the first quarter of 2004. Since then GDP growth has trended gradually lower, similar to the performance of the VECI. This correlation suggests that economic growth gives entrepreneurs the confidence to strike out on their own and the confidence that financial support for their efforts is available in a favorable economic climate.

Even though the VECI has drifted lower over the past year and a half, it still remains at a high level suggesting a healthy level of optimism among entrepreneurs. Recently, this optimism has been matched within the investment community as evidenced by the strongest levels of VC funding in five years. The increase in VC funding has narrowed the **Innovation Gap** between the desire to obtain funding and actual funding over the past year, a finding which suggests that more businesses are being formed; creating the jobs that will support future economic growth.

Other important findings include:

- **Transportation** has continued to show remarkable strength in the face of rising energy costs, accounting for 3.9% of all entrepreneurs seeking capital in the second quarter, the highest share ever for this sector. The strongest growth has been in the **trucking** and **logistics** industries, reflecting the rapid growth of foreign trade and the increasing need ship goods over long distances as corporations seek to take advantage of low cost producers no matter where they are located.

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

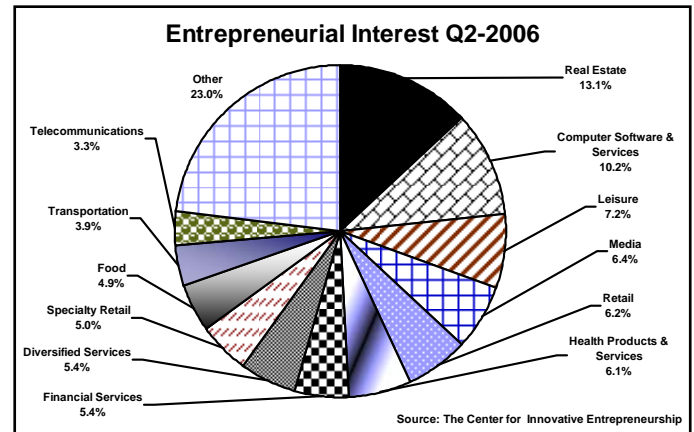
Q2/2006	Rising	Declining
<b>Sectors</b>	<ul style="list-style-type: none"> <li>• Transportation</li> <li>• Real Estate</li> <li>• Retail</li> <li>• Health Products and Services</li> </ul>	<ul style="list-style-type: none"> <li>• Diversified Services</li> <li>• Food</li> <li>• Computer Hardware</li> </ul>
<b>Sub-Sectors</b>	<ul style="list-style-type: none"> <li>• Restaurants</li> <li>• Property Investment and management</li> <li>• Asset Management</li> <li>• Internet &amp; Intranet Software &amp; Services</li> </ul>	<ul style="list-style-type: none"> <li>• Miscellaneous Food Products</li> <li>• Personal Computers</li> <li>• Sporting Activities</li> <li>• Miscellaneous Specialty Retail</li> </ul>

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## Response Shares

The sector generating the greatest number of inquiries in the second quarter was **real estate**, which accounted for 13.1% of all entrepreneurs seeking financing at vfinance.com. Since the third quarter of 2005, real estate has taken over the top spot from **computer software and services**, the dominant sector since the VEI was first calculated in September 2001. **Leisure** and **media** remain the third and fourth most popular sectors among entrepreneurs seeking capital although both have seen their share of all entrepreneurs decline over the past four quarters.

The declining interest in software, leisure and media has been offset by increases in **retail**, **transportation** and **health products and services**. In each of these sectors one industry is showing particular strength. As noted above, the **logistics** industry is showing much greater interest from entrepreneurs seeking to profit from the growth in demand for transportation services from US manufacturers, wholesalers and retailers. Within the retail sector, there has been a sharp increase in interest in the **clothing** and **shoe** retail stores and in health products and services, **home health care** has seen a sharp increase in interest over the past year.

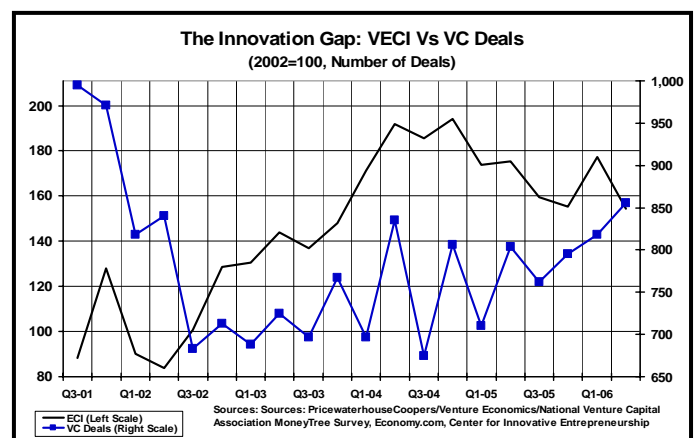


The VEI monitors 28 major sectors and 289 sub-sectors

Response share is not the same as VEI ranking. Response share is the individual sector's share of all responses; the VEI 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.

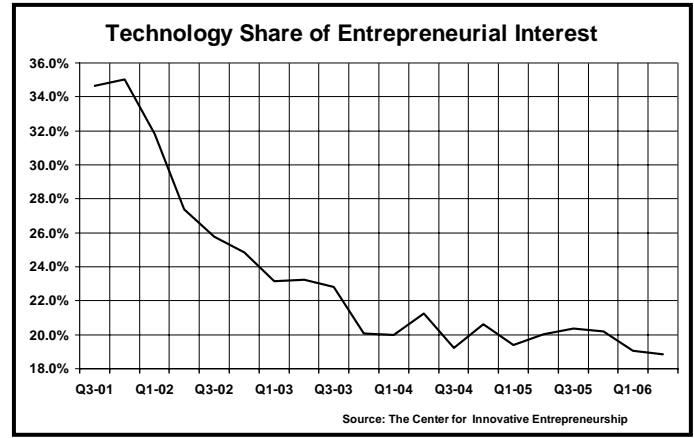
## The VEI and The Economy: The Innovation Gap Narrows

The Innovation Gap, the contrast between high levels of entrepreneurial confidence as measured in the VEI and low levels of investment as measured by the number of deals funded by the venture capital community has narrowed considerably over the past year. A wide innovation gap suggests that entrepreneurs seeking financing are not getting funded at levels that will generate the high levels of business formation consistent with stronger economic growth. In the second quarter of 2006, even as the VEI was declining for the third time in the past four quarters the number of deals funded by venture capital firms increased to its highest level since the fourth quarter of 2001. The number of deals funded has been erratic, but basically flat since the end of 2003, however, starting in the third quarter of 2005, it has increased in three consecutive quarters, the first time there have been three consecutive increases since 1999. This data is encouraging for future economic growth. Although the VEI has declined from its 2004 peak, it is still far above the levels of four years ago, and now the level of funding activity is rising steadily. This suggests that the economy is creating the new businesses needed to support employment and income growth in the future.



## VECI Trends: Technology continues to decline.

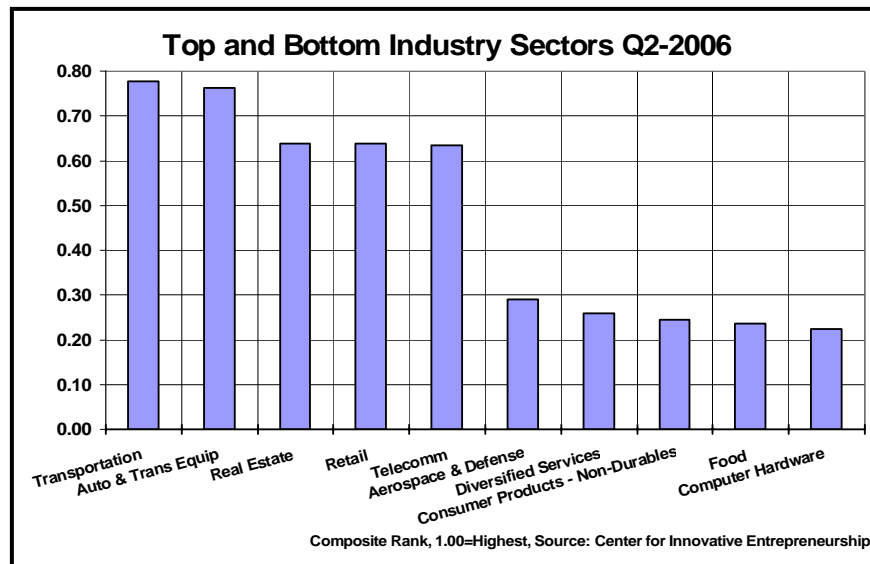
Interest in technology businesses continued to decline over the past year, with the percentage of entrepreneurs seeking capital for a business in one of the 64 sub sectors classified as technology related, falling to the lowest level since we began aggregating this data in 2001. As of Q2-2006, 18.9% of all entrepreneurs coming to vfinance.com were seeking funding for a business in a technology industry; this is roughly half the share that technology garnered when the VECI was first calculated in 2001. In place of technology, the sector that has seen the largest increase in interest has been **real estate** followed by the two retail sectors, **retail** and **specialty retail**. Together, retail and specialty retail account for 11.2% of all entrepreneurs seeking capital, up from an average of 7.6% in the first year that the VECI was calculated. The biggest decline within technology has been in the share of entrepreneurs seeking capital to start a business in the **Internet and Intranet software and services industry**, which accounted for 5.1% of all entrepreneurs seeking capital in 2001 and now accounts for about 2.9%. Other technology sub sectors showing large declines in interest include: **educational software, information technology consulting services** and **telecommunications switching and transmission equipment**.



The shift away from technology partly reflects differences in the performance of financial markets, mainly NASDAQ. The NASDAQ is the market which is most closely identified with technology companies and where many of the initial public offerings (IPO) from the late 1990s were issued. But the NASDAQ market is more than 50% below its level of early 2000, making it less attractive to entrepreneurs seeking to profit from their business via an IPO. Better-performing sectors of the market and the economy tend to attract 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 Sectors

vFinance ranks the 28 major 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.



The second quarter rankings were notable for the unexpected strength of the **transportation** and **automobile and transportation equipment** sectors. In an economic environment of rising oil and gasoline prices, it is a difficult time to be in these two sectors. Yet, entrepreneurs seeking capital for both of these sectors increased their share of all sectors and showed sharp share gains over the past year indicating entrepreneurs are seeking opportunity in these businesses.

- ✓ Within the **transportation** sector, the sub sectors that have shown the strongest performance were **trucking** and **logistics and other transportation services**. Both saw their share of all entrepreneurs rise to a record high in the second quarter. This increase in the face of sharp increases in costs for the transportation sector indicates the growing importance of the flow of goods through the economy as rising imports and high volumes of freight traffic attract the attention of business owners and those starting new businesses. In the fourth quarter of 2005, the volume of freight shipped by truck reached a record high before backing off slightly in the first half of 2006.
- ✓ The biggest surprise is the growth in interest in the **automotive and transportation equipment** sector. The struggles of the auto and parts industry have been widely documented over the past six months, yet the number of entrepreneurs seeking funding for a business in the **auto parts** and **trucks** sub sectors both increased in the quarter. Perhaps these entrepreneurs are seeking to profit from the troubles of the auto industry by introducing new products or processes at a time when the industry is in distress.
- ✓ **Real estate** was a top ranked sector as not only was the total level of interest at record levels, but it has shown significant growth over the past year. This is also somewhat surprising as mortgage rates rose to the highest level in four years, and home sales fell during the first half of the year. Nevertheless, entrepreneurs continue to flock to this sector seeking to profit from the still strong, if not sizzling, housing industry.
- ✓ Another surprise in the top sectors was **telecommunications**, led by strength in the **internet service provider** sub sector. Telecommunications was one of the biggest casualties of the collapse of the internet bubble, and its revival

suggests that entrepreneurs are still seeing opportunity in this rapidly growing sector even if it did not live up to inflated expectations in the late 1990s.

The lowest ranked sectors were **computer hardware** (0.223), **food** (0.236), and **consumer non-durable goods** (0.246). The biggest surprise in the low-ranked sectors is **diversified services** which has historically attracted a large number of entrepreneurs seeking to start consulting businesses.

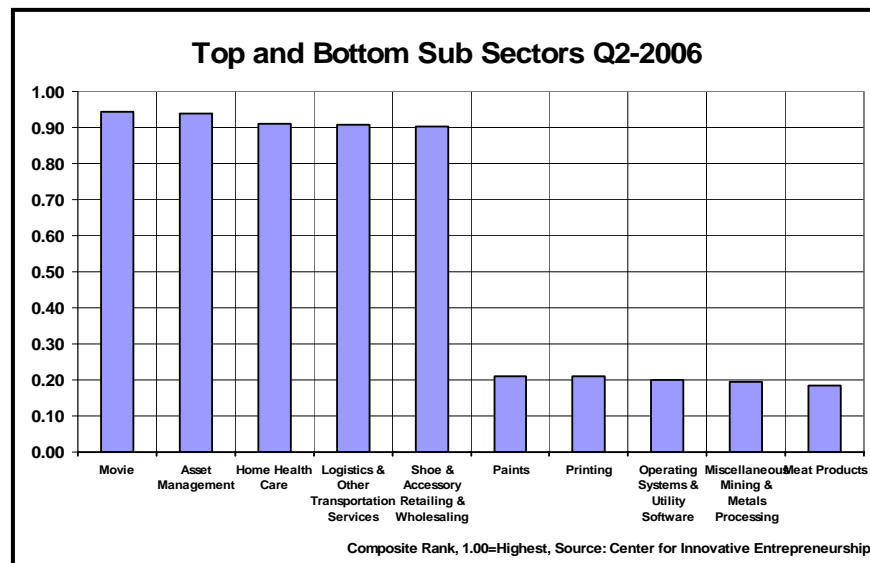
The following table shows the top ten major industry sectors for each of the past three quarters.

Major Sector	Q4-05	Major Sector	Q1-06	Major Sector	Q2-06
Retail	0.8482	Food	0.8527	Transportation	0.7768
Financial Services	0.7991	Real Estate	0.7857	Automotive & Transport Equipment	0.7634
Diversified Services	0.6875	Drugs	0.7188	Real Estate	0.6384
Real Estate	0.6830	Energy	0.7143	Retail	0.6384
Computer Hardware	0.6696	Specialty Retail	0.6295	Telecommunications	0.6339
Electronics & Miscellaneous Technology	0.6696	Manufacturing	0.6250	Health Products & Services	0.6295
Transportation	0.6250	Aerospace & Defense	0.6205	Insurance	0.6161
Insurance	0.6027	Media	0.6071	Banking	0.5893
Chemicals	0.5938	Conglomerates	0.5848	Energy	0.5893
Health Products & Services	0.5446	Health Products & Services	0.5848	Metals & Mining	0.5714

- ✓ In the second quarter there were some surprises in the rankings, among them the high rankings for **insurance** and **banking**. These are two sectors that have historically generated little interest among entrepreneurs. In the second quarter, they accounted for a total of less than 2% of all entrepreneurs seeking capital, but both saw increases in interest in the quarter and their share of all entrepreneurs. Within insurance, the **property and casualty** as well as **accident and health** sub sectors were strong, while in banking rising interest in the northeast US and in the Middle East were evident.
- ✓ **Energy** was in the top 10 for the second consecutive quarter as rising prices for oil; gasoline and natural gas are generating more interest in both **petroleum distribution** and in **oil and gas exploration and development**. These are segments of the industry that entrepreneurs can enter without the huge capital required for major development. **Alternative energy** remains a sub sector of interest among entrepreneurs.
- ✓ **Real estate** continues to attract strong interest, particularly the sub sectors related to developing and managing property. .

## Sub-Sectors

Of the 289 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.



- ✓ Interest in the **movie** sub sector was at its highest share in the history of the VEI in the second quarter and jumped sharply from the levels of the first quarter and a year ago, propelling this industry to the top industry ranking. This may be a result of increasing activity in Internet video, where web sites such as YouTube are among the fastest growing on the Internet.
- ✓ **Transportation** generated some of the strongest results in the first half of the year with **logistics and other transportation services** generating the fourth highest ranking. In the second quarter, this sector saw its share of entrepreneurs seeking capital rise to a record high since the VEI was first calculated.
- ✓ Several **food** sub sectors saw very low levels of interest and sharp declines. **Meat products** and **sugar and confectionary** were both ranked in the bottom 10 sub sectors in the second quarter and showed substantial drops in the number of entrepreneurs seeking capital. It appears that as diet fads have faded from public awareness, the desire to start businesses in the food sector has declined.

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.

Sector	Sub-Sector	Q4-05	Sector	Sub-Sector	Q1-06	Sector	Sub-Sector	Q2-06
Financial Services	Mortgage Banking & Related Services	0.96237	Food	Diversified Foods - Other	0.935121	Media	Movie	0.944637
Health Products & Services	Medical Instruments & Supplies	0.923875	Drugs	Biotechnology - Research	0.914792	Financial Services	Asset Management	0.938149
Financial Services	Consumer Loans	0.913495	Automotive & Transport Equipment	Auto Manufacturers	0.911765	Health Products & Services	Home Health Care	0.90917
Computer Software & Services	Diversified Software	0.911765	Food	Miscellaneous Food Products	0.907439	Transportation	Logistics & Other Transportation Services	0.907007
Retail	Department Stores	0.87846	Aerospace & Defense	Aerospace/Defense - Major Diversified	0.876298	Retail	Shoe & Accessory Retailing & Wholesaling	0.903547
Automotive & Transport Equipment	Trucks	0.875433	Food	Sugar & Confectionery	0.860727	Real Estate	REIT - Hotel/Motel	0.895761
Specialty Retail	Music	0.868512	Energy	Oil & Gas Services	0.856401	Health Products & Services	Hospitals	0.868512
Retail	Discount & Variety Retailing	0.861592	Telecommunications	Wireless	0.853806	Telecommunications	Internet & Online Service Providers	0.863754
Real Estate	Residential Construction	0.858997	Manufacturing	Construction	0.852509	Transportation	Trucking	0.838668
Diversified Services	Photocopying & Graphic Design	0.853806	Food	Canned & Frozen Foods	0.849481	Automotive & Transport Equipment	Recreational Vehicles	0.838235

- ✓ The large number of industries covered in the VEI tends to generate significant shifts in the growth and level of interest from one quarter to the next. In the latest quarter, the only clear trend, as we have emphasized in this report has been the emergence of significant interest in transportation services as entrepreneurs seek to profit from rising demand for all kinds of services that make it easier for wholesalers, retailers and manufacturer to obtain goods from anywhere and ship them to anywhere.
- ✓ 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 real estate. But this may reflect more popularity than represent an investment opportunity. Nonetheless, some nuggets for investors can appear within this data. What we are looking for is 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, no particular sector emerges as meeting these criteria, although the retail sector does spark our interest because consumer spending growth is slowing, and it does not appear to be a good time to be getting in to retail. This sector may deserve more scrutiny by investors to determine if there are new trends that entrepreneurs are seeking to tap in to.

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