

San Jose VentureVitality Report

Innovation Leads the Way in Capital of Silicon Valley

Developed by



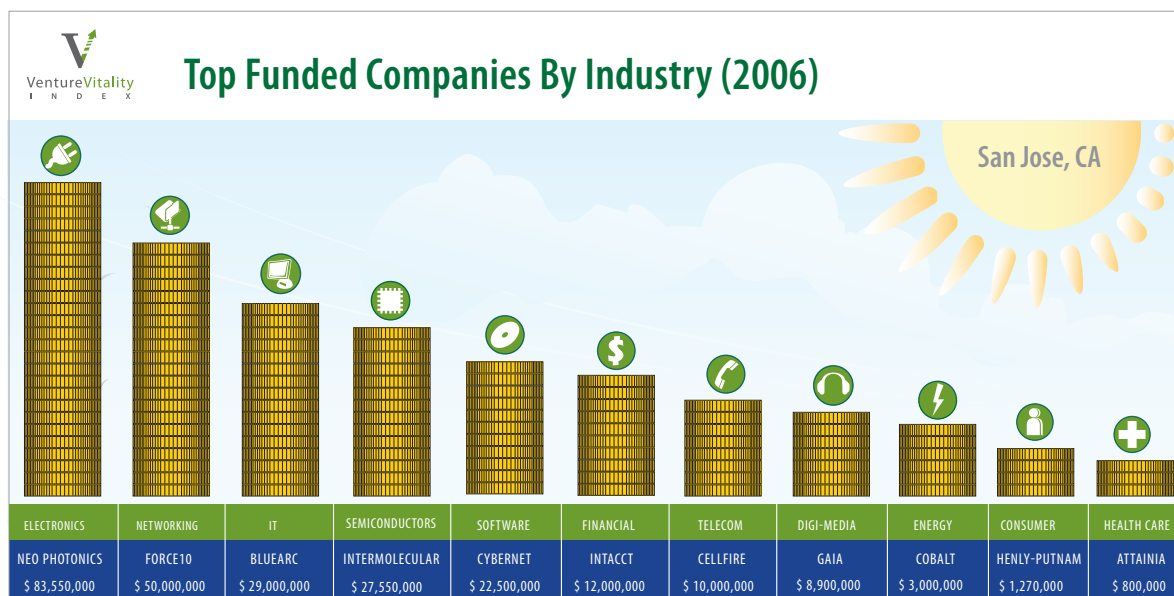
INNOVATION LEADS THE WAY IN SAN JOSE

Technology innovation and venture financing have contributed mightily to job creation and economic growth throughout much of the United States, but nowhere more so than in Silicon Valley. Of the region's top 15 private sector employers, 14 are technology innovation companies, many of which were started with the help of venture capital. For San Jose, Silicon Valley's only major city, innovation and venture-funded business development also play a critical economic role. Cisco Systems, by far the city's largest private sector employer with more than 13,000 local employees, was founded in 1984 with the help of venture capital. Indeed, the City of San Jose's own belief in the economic power of innovation mixed with venture financing recently led the city to form its own joint venture for innovation-based financing. In December of 2006, San Jose became the nation's first city to partner with an investment management company, Pacific Community Ventures, to operate a strategic equity investment fund to support growth and expansion of small, innovative businesses.

The San Jose VentureVitality Index is developed with data and insight from VentureDeal, a leading provider of information and analysis on the venture capital industry. It provides a new metro perspective on the state of venture funding in San Jose, including a look at the

forces and factors impacting innovation-based financing there, as well as some of the unique advantages the city has in attracting and growing venture-funded companies.

The total value of VC financing in San Jose was up 27.4 percent in 2006.



Like venture capital throughout Silicon Valley and the nation as a whole, financing increased in 2006. The total dollar amount of VC financing was up 27.4 percent in the City of San Jose, compared with a 12 percent increase nationwide and 15 percent throughout Silicon Valley. San Jose was home to 64 companies, across a wide range of technology sectors, which received a total disclosed funding of \$616.4 million in 2006. By comparison, 57 San Jose companies received \$483.6 million in 2005.

Level of VC Financing

NATIONWIDE:

2006

2005

\$25.5 billion +12% vs. 2005

\$22.7 billion

3,400 deals +10% vs. 2005

3,090 deals

SILICON VALLEY:

2006

2005

\$9.2 billion +15% vs. 2005

\$8 billion

1,100 deals +14% vs. 2005

960 deals

SAN JOSE:

2006

2005

\$616.4 million +27% vs. 2005

\$483.6 million

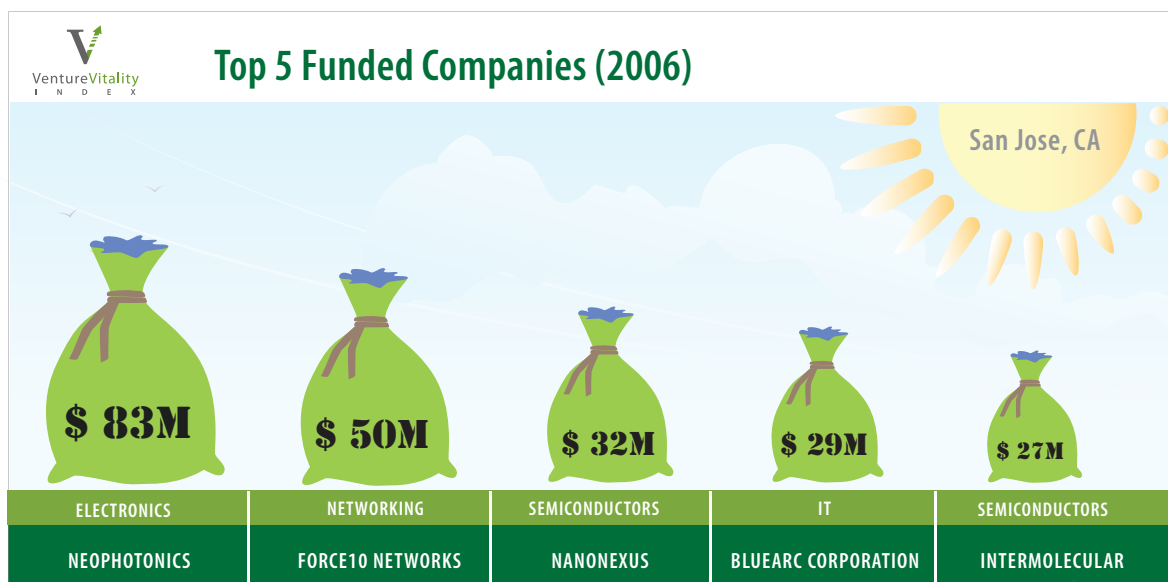
64 deals +12% vs. 2005

57 deals

Technology innovation and venture financing in San Jose is spread across a wide range of sectors. The top three sectors represented by these financings were software (25 companies received \$184 million), semiconductors (12 companies received \$97 million) and networking (8 companies received \$104 million). However, health care services, consumer technology, biotechnology, IT services and infrastructure, clean technology, digital media, and

Each \$1 million in venture financing directly creates an estimated 7.5 high-paying jobs, plus another 16.5 indirect jobs through a multiplier effect.

financial services are all represented. In terms of the stage of companies participating in 2006 financings, 25 were later stage companies, 21 were expansion stage, 13 were early stage, and five were start-ups.



The increase in VC funding has significant short-term and long-term implications for San Jose in terms of jobs, economic growth, development and taxes. According to estimates by the Illinois Venture Capital Association, approximately 75 percent of venture funds are spent on salaries. One million dollars in venture financing on average accounts for 7.5 high-paying direct jobs, plus an additional 16.5 indirect jobs resulting from a multiplier effect. More importantly, of course, venture capital backed companies often grow to become much larger contributors to the local economy, as represented by the large number of major private sector employers in Silicon Valley that started with the help of venture funding. Venture capital backed companies employed more than 10 million American workers, including 2.5 million Californians, and generated more than \$1.8 trillion in sales, in 2003, according to the analyst firm, Global Insight, Inc.

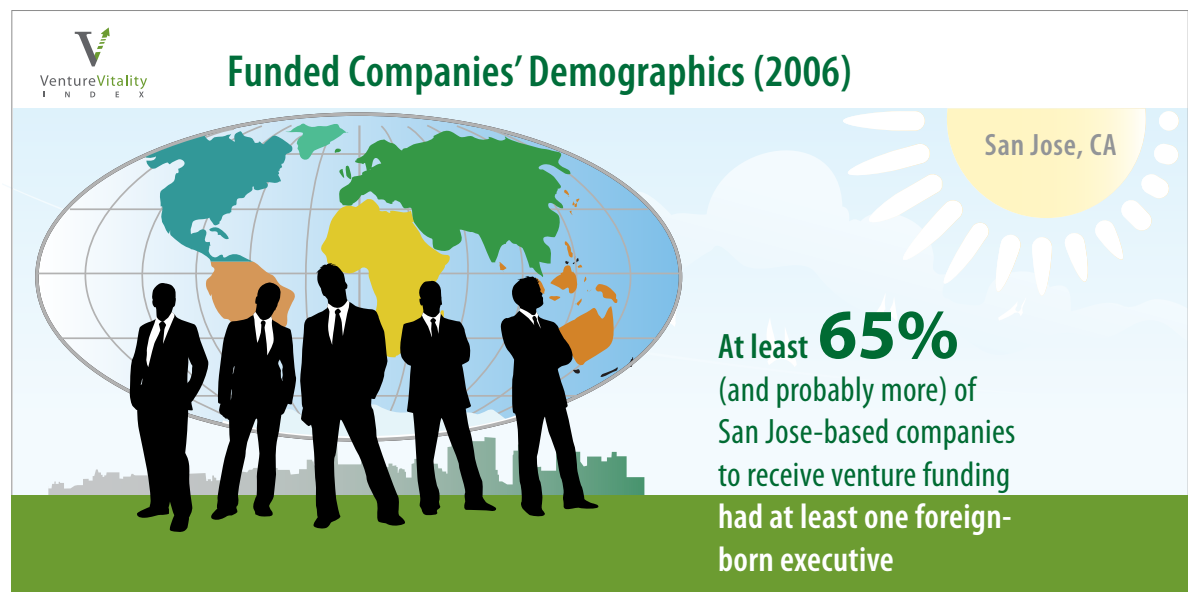
UNIQUE ASPECTS OF SAN JOSE'S ECONOMY

As the nation's 10th largest city and metropolitan hub of Silicon Valley, San Jose has a variety of important advantages for innovation-based venture companies. While technology innovation and business development are now clearly a global phenomenon, Silicon Valley remains perhaps the leading global incubator. Indeed, 36 percent of all venture capital activity in the United States took place in Silicon Valley in 2006. The region's world-renowned critical mass in technology innovation companies, venture capital firms, related services, and skilled professionals continues to help develop and attract entrepreneurs, financing and talent to the region.

For San Jose specifically, the close proximity of major technology giants in semiconductors, networking, Web 2.0 and other sectors are a catalyst for many new business starts. The world's largest semiconductor company, Intel, is headquartered next-door in Santa Clara, and the world's largest network equipment company, Cisco, is headquartered in San Jose.

At least 65 percent, and probably more, of the San Jose-based companies to receive venture funding had a least one foreign-born executive.

Other well-known technology companies headquartered in San Jose include such heavyweights as eBay and Adobe Systems. These companies attract numerous smaller companies into their orbit to provide outsourced innovation. Additionally, they serve as breeding grounds to 'spin-out' talented managers to start the next generation of great innovation companies.



Immigrant entrepreneurs are also a major force in San Jose's innovation milieu. Fully 20 percent of all the H1-B Visas, or work permits, issued in the United States in 2006 were in Silicon Valley. San Jose itself is arguably the most internationally diverse major city in America. It has the third-highest percentage of foreign-born residents (38%), behind only Miami (58%) and Los Angeles (40%). However, the diversity of this immigrant population is much wider. The breakdown of its immigrant population is: Mexico (23%), Vietnam (13.9%), China (13.8%), India (11.4%), other Asian countries (20.7%), Europe (8.8%), other countries (8.5%). Over 100 languages and dialects are spoken in Santa Clara County.

Recent studies have demonstrated the profound impact of immigrant entrepreneurs and foreign-born talent on the U.S. economy, particularly in the technology sector. Of engineering & technology companies started in Silicon Valley between 1995 and 2005, 52.4 percent had at least one founder who was foreign-born. Those percentages are 25.3 percent for the U.S. as a whole and 38.8 percent for all of California. Likewise, foreign nationals were named as inventors or co-inventors in 24.2 percent of international patent applications filed in the U.S., according to the World Intellectual Property Organization. This does not include foreign-born immigrants who became U.S. citizens. By comparison, this percentage was only 7.3 percent as recently as 1998. By 2000, 53 percent of Silicon Valley's science and engineering workforce was foreign-born.

The critical importance of foreign-born entrepreneurs is highly evident among the companies funded in San Jose in 2006. A survey of those companies shows that a minimum of 65 percent, and probably more, have at least one, and typically more than one, foreign-born executive on the management team. This prevalence of immigrant founders and executives cuts across almost all industry sectors.

San Jose itself operates a range of programs and initiatives to support global integration and immigrant assimilation. For example, one of its most successful incubator initiatives is the US Market Access Center. Founded in 1995 as the International Business Incubator, the center specializes in cost-effective US market entry for small to mid-sized, high-growth technology and life science companies planning to expand their reach to the United States. The center has graduated 68 companies since it was founded.

The City of San Jose, in fact, has dedicated significant expertise and resources to developing a fertile environment for fostering entrepreneurship and innovation. The city's core economic development strategy is focused much more on new business formation and growth of existing companies than on attracting large corporations from outside of the city, according to Paul Krutko, Chief Development Officer, City of San Jose. San Jose is home to the largest new business incubator program in the nation. The City has helped develop and operate a variety of successful incubators and business clusters, as well as a unique investment fund, designed to support technology innovation and new business starts. In addition

to the US Market Access Center, these efforts include the Software Business Cluster, the Environmental Business Cluster, the San Jose BioCenter, and, most recently, the Catalyst Fund, the first investment fund co-funded and operated by a U.S. city.

To be sure, the city and region have their share of challenges when it comes to continued leadership in the global innovation economy: The growing competitiveness and critical mass of other innovation centers in the U.S. and worldwide, the area's high housing and land development prices, and continued off-shoring of business functions are among them. However, employee salaries in San Jose and the region are considerably higher than most other innovation centers, enabled by the fact that productivity by workers is approximately twice the national average.

In addition, San Jose is also at the forefront of a major refresh in urban planning to accommodate the next-generation needs of Silicon Valley, including the need for more affordable housing and higher density office and commercial space. For example, the city has laid the groundwork for a new type of development in key industrial areas of the city; these new areas will combine high-rise office space and higher density housing, along with entertainment and retail businesses and improved transportation. A key example is the North San Jose Vision 2030 plan, calling for an additional 26.7 million square feet of office space and up to 32,000 new homes.

Downtown development and vitalization is progressing: a leading software company, BEA Systems, has just announced it is moving its headquarters downtown, joining companies like Adobe, in anticipation of the continued rise of a vibrant urban center that can attract top talent and companies. In addition, high-rise home production is underway. Seven high-rises are currently under construction or are actively seeking a development permit, representing a total of 1,747 new downtown residences. Five more high-rise projects are in the early stage of planning. With a citywide office vacancy rate of approximately 11.5 percent, the city still has ample affordably priced office space (available at 1997 rates) to support growth.

SUMMARY CONCLUSION

The VentureVitality of the City of San Jose appears to be on the upswing, providing positive impetus for future job growth, economic development and transformation. While strongest in software, networking and semiconductors, venture funding of San Jose-based companies, incorporates a wide range of technology sectors. The city is leveraging its position as Silicon Valley's major metropolitan hub to create an environment that fosters and attracts new business starts, innovation and global talent – key ingredients in an innovation-based economy. At the same time, city officials are taking a leadership role in addressing some of the major challenges that San Jose and all of Silicon Valley face, if the region is to remain one the world's most vibrant innovation centers.