

**DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK  
MULTILATERAL INVESTMENT FUND  
NOT FOR PUBLIC USE**

**BRAZIL**

**VENTURE FUND FOR RETURNING ENTREPRENEURS**

**(TC-00-04-00-2)**

**DONORS MEMORANDUM**

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#### **BASIC SOCIOECONOMIC DATA**

The basic socioeconomic data for Brazil available on the Internet at the following address:

**English:**

**[www.iadb.org/int/sta/english/brptnet/brptframe\\_eng.htm](http://www.iadb.org/int/sta/english/brptnet/brptframe_eng.htm)**

**Spanish:**

**[www.iadb.org/int/sta/spanish/brptnet/brptframe\\_eng.htm](http://www.iadb.org/int/sta/spanish/brptnet/brptframe_eng.htm)**

**INFORMATION AVAILABLE IN THE FILES OF MIF**

**PREPARATION:**

1. Annex I. Detailed biographies of the fund management team
2. Annex II. Environment review guidelines
3. Annex III. Detailed market study of *dekassegui*
4. Annex IV. Description of potential investment profile
5. Annex V. Budget of management company
6. Annex VI. Financial projections

**EXECUTION:**

7. Annex VII. Draft Fund Document (*Regulamento*)

## **ABBREVIATIONS**

<b>BANESPA</b>	<b>Banco do Estado de São Paulo</b>
<b>BAS</b>	<b>Banco América do Sul</b>
<b>BCI</b>	<b>Banca Commerciale Italiana</b>
<b>BNDESPAR</b>	<b>Banco Nacional de Desenvolvimento Econômico e Social Participação S.A.</b>
<b>BSI</b>	<b>Banco Sudameris de Investimento</b>
<b>CVM</b>	<b>Comissão de Valores Mobiliários</b>
<b>DESA</b>	<b>Dekassegui Sociedad Anônima</b>
<b>EP</b>	<b>Empresa de Participação</b>
<b>FAR</b>	<b>Banco Fator Administração de Recursos</b>
<b>FMIEE</b>	<b>Fundo Mútuo de Investimento em Empresas Emergentes</b>
<b>IDB</b>	<b>Inter-American Development Bank</b>
<b>IIC</b>	<b>Inter-American Investment Corporation</b>
<b>IRR</b>	<b>Internal Rate of Return</b>
<b>MIF</b>	<b>Multilateral Investment Fund</b>
<b>R\$</b>	<b>Brazilian Real</b>
<b>SA</b>	<b>Sociedad Anônima</b>
<b>SAM</b>	<b>Sudameris Asset Management</b>
<b>SEBRAE</b>	<b>Serviço de Apoio às Micro e Pequenas Empresas</b>

## Abstract

A US\$10-12 million equity investment fund will be established as a *Fundo Mutuo de Investimento em Empresas Emergentes* regulated by the Comissão de Valores Mobiliarios, in which MIF will play the role of an anchor investor by investing US\$5 million. SEBRAE (Serviço de Apoio às Micro e Pequenas Empresas) and Banco Sudameris Brasil are committed to investing US\$3.3 million and US\$1.7 million respectively in the Fund.

The objective of the Project is to promote entrepreneurial activities by those Brazilian temporary workers overseas who desire to start businesses upon their return to Brazil. The Fund will provide primarily early-stage financing for such returning entrepreneurs and to assist them, through capital provision, in structuring their new business ideas and converting them into viable businesses.

The Fund is open to all the returning entrepreneurs who have emigrated temporarily overseas and would like to return to Brazil to start up businesses. Initially, a special emphasis will be made to those returning Brazilians who have worked in Japan, as Japanese-descendant Brazilians are a close-knit society, thus making it easier to identify potential projects.

Brazilian temporary workers in Japan commonly known as *dekassegui*-a Japanese term which means to leave to make money are prepared and motivated to start new businesses, using their earned “bootstrap” money and experiences and/or networks established while working in Japan. Due to lack of enough seed capital for start-up or small-size business development, however, it is very difficult to follow through on their plans. The Fund will try to actively raise additional capital from the community of beneficiaries- particularly from cohesive groups of Japanese descendant Brazilians who wish to make investment in this vehicle. This will help tap into the regularly transferred accounts from Japan to Brazil, and direct a small portion of their savings to more productive uses.

Banco Sudameris Brasil is the sponsor of the proposed Project. Banco Sudameris Brasil, owned by the group of Banco Commerciale Italiana, is one of the oldest and leading commercial banks in Latin America, and is active in the investment banking area. Its investment bank arm, Banco Sudameris de Investimento, will be the fund management company. Banco Sudameris Brasil recently acquired Banco América do Sul, a bank founded by Japanese immigrants more than 60 years ago to serve the Japanese-descendants communities.

The Project would serve developmental purposes such as: 1) promotion of small business and job creation; 2) channeling of existing savings into productive uses; and 3) development of entrepreneurship of returning expatriates.

## VENTURE FUND FOR RETURNING ENTREPRENEURS

(TC-00-04-002)

## EXECUTIVE SUMMARY

**Executing agency:** A fund to be established as a *Fundo Mútuo de Investimento em Empresas Emergentes* ("FMIEE") regulated by the Comissão de Valores Mobiliários ("CVM") n. 209.

**Objectives**

The objective of the Project is to promote entrepreneurial activities by those Brazilian temporary workers overseas who have the appropriate background and desire to start businesses upon their return to Brazil. The Project would serve three primary purposes: 1) it would encourage the development of small businesses; 2) it would channel existing savings into productive uses; and 3) it would support primarily returning *dekassegui* (a Japanese term which means to leave to make money) in starting new businesses. In addition, it will promote job creation, entrepreneurship and a socially responsible investment culture.

**Amount and Source:**

Modality:	Equity	III-B Facility
MIF:	US\$	5,000,000
SEBRAE:		3,300,000
Banco Sudameris Brasil:		1,700,000
Other private investors:		<u>2,000,000</u>
<b>TOTAL</b>	<b>US\$</b>	<b>12,000,000</b>
<b>Fund Life:</b>		<b>10 years</b>

**Description:**

Brazilian temporary workers are prepared and motivated to start new businesses, using their earned "bootstrap" money and experiences and/or networks established while working overseas. Due to lack of sufficient seed capital for start-up or small-size business development, however, it is very difficult to follow through on their plans. The Project consists of establishing a fund to provide early-stage financing for returning entrepreneurs and to assist them, through seed capital provision, in structuring their new business ideas and developing viable business plans. The US\$ 12 million fund ("the Fund") will require an equity investment of US\$ 5 million from MIF, matched by Serviço de Apoio às Micro e Pequenas Empresas (SEBRAE) and Banco Sudameris Brasil. The Fund will also tap into *dekassegui* savings through the inclusion of *dekassegui* investment groups as co-investors in the Fund. The Fund's life will be 10 years.

The Project is open to all entrepreneurs who have temporarily emigrated to other countries and would like to return to Brazil to start up businesses. Initially, a special emphasis will be placed on identifying Brazilian *dekassegui* who have worked in Japan. Brazilian temporary workers in Japan are primarily Japanese-descendants (*nikkey*)- the children and grandchildren of the Japanese who immigrated to Brazil as early as 1908. The Japanese Brazilian community is a close-knit one, and quite well-organized with regard to business support groups. Therefore, it is an ideal initial target for an investment fund focusing on returning entrepreneurs, as the Fund will be able to use existing business support groups to identify potential deals.

**Management:**

The Fund will be managed by Banco Sudameris de Investimento (BSI), an investment banking arm of Banco Sudameris Brasil, S.A., which is controlled by Banca Commerciale Italiana (BCI), a well-respected European bank that views Latin America as an important region. BSI will hire an experienced venture capital fund manager through Sudameris Asset Management (SAM), a division of BSI. SAM will be responsible for the structuring of investment deals, and the governing and exiting from portfolio companies, while BSI will provide back-office support to SAM.

In 1998, Banco Sudameris Brasil acquired Banco Amércia do Sul (BAS), a bank founded by Japanese-descendent Brazilians which had operated in Brazil for over 60 years. BAS has been considered as a bank serving the *nikkey* community since the first Japanese immigrants settled in Brazil. This acquisition cemented Banco Sudameris Brasil's interest in the *dekassegui* community as a client base and strategically positioned it to reach this target population effectively.

**Environment and Social Impact:**

The Project was reviewed and approved by the Environment and Social Impact Committee (CESI) at its meeting on March 30, 2001 (TRG 13-01).

**Contractual Conditions**

The Project will require authorization by CVM to establish a FMIEE. Prior to the first disbursement, MIF will obtain a legal opinion on the validity and enforceability of the Fund documents. MIF will acquire the Fund's quotas up to the lesser of US\$5 million (subscription of quotas will be made in local currency) or 50% of the Fund's aggregate capital commitment. Disbursement of the MIF funding will be contingent upon matching funds on a *pari-passu* basis by the other investors including US\$1.7 million from the private sector (see 4.15 and 4.16).

**Exceptions to Bank policy:**

None.



## **I. COUNTRY AND PROJECT ELIGIBILITY**

- 1.1 On February 9, 1995, the MIF Donors Committee declared Brazil eligible to receive financing from the Multilateral Investment Fund under all modalities available. The proposed project ("the Project") is fully consistent with the purpose of the MIF to stimulate small enterprise, and with the criteria for the Small Enterprise Investment Fund (Facility III-B). The Project is also compatible with the current strategy, particularly because the MIF resources: 1) open opportunities for entrepreneurs by providing risk capital and management skills; and 2) supply vital market access to expand start-up and/or small businesses. The Project will enhance the productivity of the private sector, thus accelerating economic growth.

## **II. BACKGROUND**

### **A. Brazilian temporary workers in Japan (*Dekassegui*) and annual remittance**

- 2.1 Due in large part to recent economic downturns, many Brazilians have emigrated, if only temporarily, in order to earn more elsewhere. A significant number of these have moved to Japan to work. According to Japan's Justice Ministry there are 224,300 Brazilians living and working in Japan as of January 2000. They are the third largest group of Brazilian expatriates after the United States and Paraguay. Such a great number of Brazilian temporary workers was made possible because of the Japanese Government's granting temporary workers visas for three years extendable to five years. As with most of the migrants, the *dekassegui* – a Japanese term which means to leave to make money – moved to improve their economic lot.
- 2.2 The Brazilian *dekassegui* phenomenon started at the end of the 1980s, after a period of slow growth in Brazil. Then with the deteriorating Japanese economy, many *dekassegui* returned to Brazil. However, in 1999, following the devaluation of the Real, a new cycle started as the Japanese economy again picked up steam. Ads asking for *nisei* and *sansei* (second and third generation Japanese) to work in Japan for salaries ranging on average from US\$3,000 to US\$3,500 are once again common in Japanese newspapers published in Brazil. *Dekassegui* almost invariably middle-class, and frequently college graduates, are often overqualified. However, the salaries are the great attraction of working in Japan. Even considering the higher cost of living in Japan, many *dekassegui* can save much more than they could back home.
- 2.3 Most Brazilian migrants in Japan are temporary workers and intend on returning to Brazil, while some become successful and settle in Japan. In general, though, the average time that the *dekassegui* stay in Japan is three to five years. As the temporary workers save money, they send it back home or buy consumables.

Overall annual remittances amount to approximately \$1.5 billion.<sup>1/</sup> Of the remittances, the majority goes to consumables, while some is saved for homes or new businesses. On average, it is estimated that *dekassegui* save \$50,000-\$70,000 while working abroad for an average of three years (their savings rate is very high, equaling approximately 40% of disposable income).

- 2.4 Many returning *dekassegui* are actively engaged in starting new businesses or expanding their existing small businesses. Some of them receive support from their relatives and friends, as their own saved resources are not enough. They usually form small groups of association of mutual help. The objective of such groups is to share the members' experience in Japan and develop solidarity among members through an exchange of information on market development. One example, Grupo Okinawa of São Paulo City represents a successful case of such a group. The group was founded 10 years ago by young entrepreneurs as an "informal brotherhood" to help each other to overcome the difficulties involved in running small firms. Currently the group is composed of 99 members; most of them are former-*dekassegui* and each one owns a small, but financially sustainable business of electronic parts, hardware, or construction materials. Members of the group have recently opened a "super" housing improvement/hardware store and have plans to open another, but need more capital as well as financial advisory services.
- 2.5 There are dozens of joint efforts by similar groups of *dekassegui* in other locations. One, for example, has formed a holding company to incubate new businesses (to take equity in exchange for advisory services), while another has formed a cooperative to export medical herbs and flowers. Another group has started a for-profit industrial condominium to house foreign investments in a Silicon Valley-like setting of São José dos Campos. These initiatives have been made possible thanks to the extensive networking of the Japanese-origin communities with regard to production, industrialization, transport and marketing.

## **B. Small Businesses in Brazil**

- 2.6 Brazilian small businesses provide employment, flexibility in the face of a changing market, innovation, and a basis for economic growth. However, they have difficulty accessing the necessary financing to start up operations. The financial system is still suffering from an "inflation hangover" and the capital markets have not yet adjusted to a longer-term mentality. Also the banking sector is still undergoing reform as a result of market liberalization and competition from abroad. Privatization is active and foreign players are setting up their own ventures and acquiring banks. Many of these new participants bring with them the benefits of technology and other capabilities new to the market. Nevertheless,

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<sup>1/</sup> Banco do Brasil has recently announced that it will place in the Japanese market US\$350 million securitized paper backed by remittances early 2001. This demonstrates that the flow of remittances is reliable and steady, and constitutes a critical mass.

despite the progress observed in financial intermediation, the financial market does not see small businesses as a target with interesting advantages.

- 2.7 There are entrenched problems related to high transaction costs and the risk associated with lenders to small businesses who have difficulty in presenting the collateral required. The number of companies ready to enter the public equity markets is limited, due in part to a predominance of family controlled corporations that cannot make the institutional jump involved in meeting listing and reporting requirements. Small businesses are faced with problems related to the costs of "formalization" that make them reluctant to seek access to the capital markets. Until long-term funds are available, the small businesses must be supported by risk capital which, in addition to capital, provides direct and long-term assistance through the investors' participation in management decisions.

### III. SPONSOR

- 3.1 The Project is sponsored by Banco Sudameris Brasil, S.A. Banco Sudameris, in existence for over 90 years, is the 12<sup>th</sup> largest Brazilian private sector bank by equity, and one of the top 30 largest financial institutions in Latin America in terms of total assets. Banco Sudameris, by the end of 2000, had 6,800 employees, held US\$ 5.9 billion in assets, had 890,000 customers and 492 points of service, and reached the overseas market through 123 operating units. Banco Sudameris, though quoted publicly, is controlled by Banca Commerciale Italiana (BCI) which generates 25% of its international transactions in Latin America.
- 3.2 Banco Sudameris has been traditionally strong in lending to mid-sized markets, but took a strategic move in 1998, when it acquired Banco América do Sul (BAS). BAS, created in 1940 by Japanese immigrants, was headquartered in São Paulo to serve the Japanese immigrants to Brazil and their colony that needed financing to start and run particularly agricultural businesses. In 1951, BAS opened up to other Brazilian public investors, and started expanding its business beyond the Japanese-descendant Brazilian (*nikkey*) communities. It kept, however, the traditional customers' strong loyalty and showed consistently its strength in doing business with Japanese corporations, including Fuji Bank of Japan which made a substantial equity investment in BAS in 1954.
- 3.3 Despite strategic goals to expand globally, and to increase retail banking in its existing markets, Banco Sudameris, as a foreign-capital owned bank in Brazil, was prohibited from growing organically. It could only grow through the acquisition of local banks. In BAS, a mid-size commercial bank with a broad customer base, Banco Sudameris found a target of opportunity. In 1998, Sudameris acquired BAS and restructured and integrated its 139 branches. Sudameris currently holds 271 branches mainly in the State of São Paulo and south-east of Brazil and is allowed to increase this number to 500. Banco Sudameris has 10 subsidiaries involved in leasing, securities, investment banking and credit cards, and has a stake in an insurance-pension company.

- 3.4 Banco Sudameris has spent the last two years absorbing its acquisition, integrating all of the BAS operations into Banco Sudameris Brasil's structure and name. As part of its strategic plan, Sudameris retained the key personnel of BAS to serve the Japanese descendant Brazilian communities. Furthermore, Banco Sudameris established a *Dekassegui Platform* comprising 6 former BAS employees and offering a special window to provide financial advice to returning *dekassegui*, particularly with regard to starting a new business, taking advantage of the BAS employees' established customer relations. In Japan, Banco Sudameris, through BCI, holds more than 40,000 accounts of *dekassegui* and quasi-permanent residents, and is seeking aggressively to capture more *dekassegui* clients by offering convenient remittance services. The amount of the accounts corresponds to 25% of the overall amount of the accounts held by all the *dekassegui* community.<sup>2/</sup> BCI has kept the BAS name of its representative office in Japan to address inquiries of *dekassegui* communities.
- 3.5 Banco Sudameris is committed to exploring new markets, including venture capital. Recognizing the new opportunities offered by the *Novo Mercado (the New Market)*, a newly created segment of Bovespa (São Paulo Stock Exchange)<sup>3/</sup>. Sudameris views private equity management as a rapidly growing sector. Even though the Fund's target market involves a high level of risk, Sudameris is interested in using this opportunity to enhance business transactions within its existing niche market of the Japanese Brazilian community, and at the same time to strengthen its knowledge of venture capital management. Furthermore, targeting the former BAS customers with this new line of business will further integrate the former BAS operations. Having a significant financial stake of US\$1.7 million in the proposed Fund, Sudameris is clearly committed to pursuing private equity investment as a business.

#### IV. THE PROJECT

##### A. Project's Objectives

- 4.1 The objective of the Project is to promote entrepreneurial activities by those Brazilian temporary workers overseas who have the appropriate background and desire to start businesses upon their return to Brazil. The Project also intends to create a mechanism to tap into the *dekassegui* savings, and direct a small portion of the funds to productive uses.

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<sup>2/</sup> Banco do Brasil, the largest financial institution of Latin America, currently captures around US\$600-800 million of these remittances from Japan, about half of the market share, followed by BCI and Banespa (Banco do Estado de São Paulo).

<sup>3/</sup> On December 11, 2000, Bovespa officially launched Novo Mercado (the New Market) and a new Corporate Governance Rating System, which will be a strong improvement in the market's ability to objectively measure the premium investors are willing to play for good corporate governance.

- 4.2 The Project is open to all entrepreneurs who have temporarily emigrated to other countries and would like to return to Brazil to start up businesses. Initially, a special emphasis will be placed on identifying Brazilian *dekassegui* who have worked in Japan. Brazilian temporary workers in Japan are primarily Japanese-descendants (*nikkey*)—the children and grandchildren of the Japanese who immigrated to Brazil as early as 1908. The Japanese Brazilian community is a close-knit one, and quite well-organized with regard to business support groups. Therefore, it is an ideal initial target for an investment fund focusing on returning entrepreneurs, as the Fund will be able to use existing business support groups to identify potential deals. Furthermore, the sponsor of the Project has an established relationship with the Japanese Brazilian community which will further facilitate the identification and analysis of potential investments.
- 4.3 Brazilian temporary workers are prepared and motivated to start new businesses, using their earned "bootstrap" money and experiences and/or networks established while working in Japan and other countries. Due to the lack of sufficient capital for start-up or small-size business development, however, they have been unable to follow through on their plans. The target *dekassegui* savings to be directed into the Fund are those of Brazilian workers in Japan and returned *dekassegui* from Japan (see Section C for more detail).
- 4.4 The Project would serve three specific purposes: 1) it would encourage the development of small businesses; 2) it would channel existing savings into productive uses; and 3) it would support returning entrepreneurs in starting new businesses. In addition, it will promote job creation, entrepreneurship and a socially responsible investment culture. In order to achieve those goals, the Project consists of an equity investment of US\$5 million by MIF in a US\$12 million fund ("the Fund") that in turn invests in new and/or small companies.

## **B. Structure of the Fund**

- 4.5 *Legal Structure.* The Fund is to be established as a *Fundo Mútuo de Investimento em Empresas Emergentes* ("FMIEE") regulated by the Comissão de Valores Mobiliários ("CVM") n. 209. The Fund will primarily invest in start up and early stage companies in Brazil. The Fund's liquidation is scheduled 10 years after commencement of operations and will allow for one 2-year extension for the sole purpose of liquidation. By law, FMIEEs must be onshore funds. They are governed by their by-laws, or "*Regulamento*", that follows CVM n. 209 rather than a standard shareholders agreement and management contract.
- 4.6 The Fund will seek to acquire minority holdings that are of sufficient import to each firm to enable it to influence, via board membership, the activities of the firm concerned, and to give local management technical guidance. The Fund will additionally provide expertise and advice to the investee companies by means of board participation and lessons of experience from other markets.

- 4.7 The Fund's investment period is four years following the first closing date, and individual investments will have about five year terms. Exit strategies will include put options, private equity sales to third party investors, and initial public offerings on the local securities exchange when appropriate and feasible. The Fund will invest in approximately 15 start-ups/small businesses over its 10-year life

### C. Partnership with *Dekassegui* Support Initiatives

- 4.8 The minimum committed capital of the Fund is R\$20 million (approximately US\$10 million)<sup>4/</sup>; this will be covered by three primary investors – MIF, Serviço de Apoio às Micro e Pequenas Empresas(SEBRAE), and Banco Sudameris Brasil.

MIF:		5,000,000
SEBRAE:		3,300,000
Banco Sudameris Brasil:		1,700,000
Other private investors:		<u>2,000,000</u>
TOTAL	US\$	12,000,000

However, immediately after the initial capital is raised, the Fund will start working with three “investment holding companies” sponsored by Japanese Brazilian groups and individuals. These “holding companies” are constituted as “Empresas de Participações” (EP). The EP is a concept developed by a division of SEBRAE, which has coordinated the creation of a type of Sociedad Anônima (SA) that in a sense democratizes the capital participation of small-scale investors. Typically, in an EP, each investor is not allowed to own more than 5% of its capital and has one vote regardless of the invested amount. The rules with regard to capital holdings vary, however, based on the decision of the EP's General Assembly.

- 4.9 Three EPs that may be potential co-investors in the Fund, either individually or under one joint EP, are EP-Nikkey Vale Participações S.A., Dekassegui Sociedad Anônima (DESA), and Nippo-Brasil. EP-Nikkey Vale Participações S.A, a holding company constituted in late 2000 as a legal corporation in São José dos Campos, has raised US\$300,000 from 190 shareholders, more than 60% of whom have experiences in working as *dekassegui* in Japan. The idea behind Nikkey Vale was to provide a financing vehicle for *dekassegui* upon their return, as the Japanese Brazilian community has identified a crucial need for long-term capital, in addition to technical advice and information. Each shareholder has invested US\$500-US\$2000, and the objective of Nikkey Vale is to make equity investments in businesses launched by returning *dekassegui*. Dekassegui Sociedad Anônima or DESA, another EP created in 1998 by 140 shareholders and based in Curitiba of the state of Paraná, has a similar objective and has also raised about US\$300,000. Both EPs have made small investments, but, as they are not well-equipped to identify, structure and analyze business ideas on their own, seem to

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<sup>4/</sup> The exchange rate used throughout the document is R\$ 2/USD, as it has been fluctuating between R\$ 1.97-2.11/USD during the first half of March 2001.

welcome the opportunity to invest in a managed Fund which has the same investment targets as they do.

- 4.10 In addition, there is an initiative to create another EP, known as Nippo-Brasil; this EP intends to raise capital not only from the *ex-dekassegui* or the Japanese Brazilian community in Brazil, but also from *dekassegui* residing in Japan. It aims ambitiously at raising US\$1,000,000 from 1000-2000 *dekassegui* residing in Japan.
- 4.11 There is a growing consensus that these efforts which share the same common objective should be consolidated. In October 2000, under the SEBRAE's coordination, the Brazilian Association of *Dekassegui* was created to serve as an instrument to exchange business information and eventually to unite these similar initiatives such as Associação de Apoio ao Dekassegui (Curitiba) and Centro de Atendimento ao Dekassegui (São José dos Campos).
- 4.12 The proposed Fund invites these private investment initiatives to invest in the Fund, as it considers it important for the beneficiary community to share in its own financial stake. As was mentioned above, the *nikkey* community is currently scrutinizing the idea of creating a new, consolidated EP, which, once established, will seek to offer shares to Brazilian temporary and quasi-permanent workers in Japan. Moreover, SEBRAE has a plan to open up an office in Japan to promote this idea. The Fund anticipates raising US\$2 million (US\$1,000,000 from Brazil and US\$1,000,000 from Japan) before the expected closing date of June 2001, through the issuance of the Fund's shares or "quotas" to the EP which will consolidate Nikkey Vale, DESA and Nippo-Brasil. Thus, the Fund's closing goal is US\$12 million including the amount tapped from these private investors, and the Fund also will consider raising additional private capital over a period of 12 months after it becomes operational. Nevertheless, MIF, SEBRAE and Banco Sudameris have agreed to partner with a smaller investor if this amount cannot be raised, or no other investor is available.
- 4.13 Banca Commerciale Italiana (BCI) through its branch in Tokyo can assist in marketing the Fund (and indirectly the new EP) to its *dekassegui* and quasi-permanent Brazilian clients. Given that annual remittances from Japan to Brazil amount to approximately US\$1.5 billion and that Banca Commerciale Italiana currently captures US\$350 million of these remittances, it is clear that BCI has access to potential investors who could, through the new EP, invest in the Fund.

#### **D. MIF's role.**

- 4.14 Despite Banco Sudameris' its strategic interest in the venture capital market and the advantageous position it holds with the already carved target market niche, it should be noted that the Project represents the first venture capital fund to be sponsored by Banco Sudameris. As the anchor investor, MIF will play a key role in mitigating the perceived risk in this emerging industry of private equity, and

making it easier for the conservative bank to commit a significant financial stake. The Project will also have a demonstration effect, as MIF's presence will provide comfort in joining such new initiatives to a cohesive group of returning expatriates.

#### **E. Terms of MIF Investment**

- 4.15 MIF will acquire the FMIEE's "quotas" up to the lesser of the US\$5 million or 50% of the Fund's aggregate capital commitment. The minimum capital commitment is R\$20 million (approximately US\$10 million). Disbursement of the MIF funding will be contingent upon matching funds on a *pari-passu* basis by the other investors: SEBRAE (US\$3.3 million) and Banco Sudameris Brasil (US\$1.7 million). Even if the Fund fails to raise funds from *dekassegui* and quasi-permanent Brazilian residents in Japan, MIF is committed to investing up to the referenced amount until fully invested. However, co-investment of at least US\$1.7 million from the private sector is a condition for MIF to participate in the Fund. Once operational, the Fund will try to raise additional private capital over a period of 12 months.
- 4.16 Prior to the first disbursement, a legal opinion on the validity and enforceability of the Fund documents (*Regulamento* and subscription agreement) will be tendered by a local counsel acceptable to the IDB, CVM must have authorized the establishment of the Fund and its operation, and independent auditors will be hired to undertake the auditing of the Fund's financial statements. Other general disbursement conditions include that there is no material change that can undermine the fulfillment of the *Regulamento* by the Fund Manager, and that draw-downs for investments will be pro rata and previously approved by the Investment Committee.

#### **F. Investment Policy**

- 4.17 Investee companies will be mainly start-ups that have been founded, primarily if not entirely, or financially supported by returning *dekassegui* and those Brazilian temporary workers who spent at least one year overseas. As mentioned, the Fund will target primarily returning Brazilian entrepreneurs from Japan, but does not exclude those Brazilians who have temporarily emigrated to countries other than Japan to work, who would like to return to Brazil to start up businesses. In addition to this basic selection criteria, eligible companies (new or existing) will be Brazilian entrepreneur-owned, and have annual revenues of no more than R\$10 million (approximately US\$5 million) and less than 100 employees. At least 75% of the Fund's investment should be in those companies that meet the MIF eligibility criteria, although CVM n. 209 defines a small emerging enterprise as one with net annual sales of less than R\$60 million (approximately US\$30 million). Moreover, the Fund's unique strategy includes early-stage companies, so



that at least 33% of the Fund's portfolio will be those companies whose annual revenues are no more than R\$1.2 million (approximately US\$600,000).

- 4.18 Investee companies will have sound business plans and strong management teams. The Fund aims to identify start-up companies that have adequate foresight and competent management to be able to achieve above-average results and growth by providing them with the early stage financing and technical expertise necessary to ensure their successful beginning operations and to position them for sustainable growth. As appropriate, when investing in target companies, the Fund will use hybrid financial instruments (quasi-equity) that provide current income with upside potential, are backed by pledged collateral, and offer alternative exit paths.
- 4.19 Each investment size by the Fund will be between US\$200,000 and US\$1,000,000, with an average investment of US\$600,000, for stakes of 25% to 49% in general. No single company will receive an investment or more than US\$1,000,000. No more than 30% of the Fund capital should be invested in one industry. Industry focuses will include communications, e-business, and media, as well as more traditional industries such as agriculture, civil construction, steel, auto parts, etc. However, the Fund will target export-potential and technology-based firms, as the Fund demands a superior risk-adjusted rate of return. The Fund will seek to achieve medium to long-term capital appreciation of its portfolio investments; however, it may also invest up to 7.5 % of the total value of the Fund in securities offering high current yield in order to maintain a measure of liquidity to finance seed capital investments (see 5.2). The Fund will reinvest any earnings any proceeds from equity sales for the first four years, following which excess earnings will be distributed as capital redemption and dividends.

## V. SPECIAL FEATURE OF THE FUND

- 5.1 **Development Fund Model for Early-Stage Financing.** As venture capital is still new to the Brazilian market, and the objective of this project is to promote entrepreneurial activities by returning *dekassegui*, the Fund will not follow a conventional venture capital fund model, but rather will act more as a development fund. Although the primary focus will be on providing early-stage financing, rather than relying on a few outstanding winners, the Fund will attempt to support a greater number of "medium return" deals that are more likely to have even performances and fewer write-offs. In a very few cases, the Fund may provide second-stage financing to *dekassegui*-run small businesses.<sup>5/</sup>

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<sup>5/</sup> **Seed financing** is a relatively small amount of capital provided to an entrepreneur to prove a concept and to qualify for start-up capital. This may involve product development and market research as well as building a management team and elaborating a business plan, if the initial steps are successful. **Start-up financing** is provided to companies completing product development and initial marketing. Companies may be in the process of organizing or they may already be in business for one year or less, but have not sold their product commercially. Usually such firms will have made market studies, assembled the key management, and are ready to do business. **First-stage financing** is provided to companies that have expended their initial capital (often in market testing a prototype), and require funds to initiate full-scale

- 5.2 **Seed Capital Financing.** In keeping with the notion of the Fund being a development fund, rather than a straightforward venture capital fund, the Fund will not only provide start-up and first-stage (and in some cases second-stage) financing, but it in certain cases will also provide seed capital through financial instruments allowed by the CVM. This capital would finance initial market research, product development and business plan refinement. The amount allotted to seed capital will be limited up to a cumulative total of US\$750,000. Up to US\$50,000 would be invested in each of approximately 15 promising but very early stage entrepreneurial companies. To facilitate this financing, the Fund will be allowed to invest in liquid instruments and use their proceeds for seed capital. The seed capital investments would be made at the rate of approximately four per year over the first four years of the Fund. It is expected that these companies would have great potential but would otherwise be at too early a stage of development for standard investments by the Fund. However, it is important to note that the target market is not one that can be addressed by micro-credit.
- 5.3 The target companies for seed capital investment might be in the process of developing a prototype of a product or demonstrating a technique with market potential but not have proven the commercial viability of the venture. Subject to CVM approval, the seed capital might be provided as a zero-interest loan with no claim for the principal in case of default and repayment would be made monthly at a rate equaling a small percentage of revenues. The companies receiving such financing are likely to be candidates for start-up or first-stage investment from the Fund at a later date. In cases where the Fund in fact invests in the company at a later date, to the extent possible, the Fund manager may attempt to recoup some of the “lost interest and principal” from the seed financing loan through receiving equity or quasi-equity shares equal to an agreed-upon value of forsaken interest.
- 5.4 Seed capital financing will greatly assist entrepreneurs in structuring their new business ideas and refining viable business plans. This feature of seed financing by the Fund will be advertised through the same channels used to market to the *dekassegui*; BCI, which currently captures 25% of all remittances from Japan annually, will distribute to the *dekassegui* fliers and application materials for the Fund’s seed capital and venture capital components, in collaboration with SEBRAE’s supporting programs.
- 5.5 Where appropriate, “hands-on” assistance will be provided to the management of these companies, through a structured program of small group sessions arranged with one or more technical assistance providers such as SEBRAE. SEBRAE has recently started various support programs for new business starters. SEBRAE subsidizes initial training for selected entrepreneurs, including basic advice on

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manufacturing and sales. **Second-stage financing** is working capital for the initial expansion of a company that is producing and shipping, and has growing accounts receivable and inventories.

how to draft business plans. However, more professional consultation on elaboration of business plans is needed. The proposed seed financing will be used for hiring specialized consultants to advise on needed technical studies and specific business plan elaboration. Meanwhile SEBRAE will provide, on a continuous basis, general support and augmentation of entrepreneurship through training programs.

- 5.6 **Start-Up, First-Stage and Limited Second Stage Financing.** For the start-up and first stage financing investments, the Fund will rely on financial instruments that provide capital appreciation and/or cumulative return. It is unlikely that there will be current return in most early stage investments, since the company's cash flow (if any) will most often be dedicated toward funding future growth of the business. However, the investment structure may provide for a cumulative dividend on a convertible preferred stock, which will become part of the "liquidation preference" upon sale or redemption. This has the effect of providing a minimum rate of return to the Fund on a priority basis before the common stock held by the entrepreneur and others will receive anything. For second-stage financings, where the company's projected cash flow is strong enough to provide some sort of current return, the structure may include a "current pay" dividend on preferred stock or current interest payments on a debt instrument. Even in these cases, however, the principal financial objective of the Fund will be capital appreciation of the equity securities associated with the investment.
- 5.7 Likely investment structures include: (a) convertible preferred stock, which is convertible into common stock at the option of the Fund, or perhaps, mandatorily upon the occurrence of certain events (public offering, takeover, etc.); (b) a convertible note, which provides for conversion of the principal amount of the note into common stock at the option of the Fund, or perhaps, mandatorily upon the occurrence of certain events; (c) stock purchase warrants, issued in conjunction with promissory notes, giving the Fund the right to purchase common stock at a fixed price at some future date.

## **VI. GOVERNANCE AND MANAGEMENT**

### **A. Shareholders' Assembly and Investment Committee**

- 6.1 The Fund will be governed by the Shareholders' Assembly in accordance with Brazilian regulation CVM n.209. The Shareholders' Assembly will be responsible for setting policy matters, appointing the Fund Manager, establishing the annual budget and approving the selection criteria and investment approval process. The Shareholders' Assembly will be composed of the shareholders' representatives, whose voting power will be proportional to their shares of the capital. The Shareholders Assembly selects the members of the Investment Committee which provides oversight, reviews and approves investment proposals recommended by the Manager and ensures that all projects meet the investment criteria.

- 6.2 The selection and pre-approval of individual investments (which must conform to the investment criteria discussed) will be determined by the Fund Manager, which will subsequently recommend investments to the Investment Committee for final approval. The Investment Committee will comprise four members representing investors whose investment is superior to US\$1.5 million as well as the Fund Manager -- one from MIF, one from SEBRAE, one from Banco Sudameris, and one from the Fund Manager -- and decisions will be made by unanimous vote. Occasionally, the Investment Committee will invite an external consultant who has a sound knowledge of the *dekassegui* and Japanese descendent Brazilian community to participate in meetings.

## **B. Management**

- 6.3 The Fund will be managed by the São Paulo-based Banco Sudameris de Investimento (BSI), one of the leading investment banks in Brazil, through its asset management group, Sudameris Asset Management (SAM), the Fund Manager. The majority of BSI's shares are owned by Banco Sudameris Brasil. BSI has 25 years experience in local and international capital markets and is the leader of the mutual fund and portfolio market in Brazil with over US\$4.3 billion assets under management. BSI, whose return on equity in 2000 was 20%, has strong expertise in providing specialized financial services, including securities brokerage and M&A activities in domestic and international financial markets, in addition to project finance and business advisory services. BSI has been managing 45 traded securities funds; of this total, 80% has been in fixed income and 20% in equity funds. BSI has tripled its assets under management since 1997, achieving today a 2.5% share of the whole Brazilian investment fund market.
- 6.4 SAM will be greatly supported by BSI's research and market risk departments, specialized in technical, fundamental, and corporate analysis, in addition to macroeconomic research. BSI's research department covers 90% of the total market capitalization of the Brazilian Stock Market (Bovespa), and over the last year, it was recognized by the IBMEC-Brazilian Capital Markets Institutes as the best research arm of the country in terms of its effectiveness of buy/sell advisory services over the achieved returns. BSI will also provide other back-office support to the Fund Manager including legal and custodian services.
- 6.5 BSI is expected to hire Mr. Sidney Chameh as the principal manager of the Fund. It will hire one analyst experienced in venture capital with business expertise in order to facilitate access to the information needed to assess the potential investee/start-up companies among *dekassegui*. (See Annex I for the detailed biographies). It will also hire one assistant and one analyst trainee. Mr. Chameh has been the key officer for the private equity group at Banco Fator Administração de Recursos Ltda. ("FAR"). FAR, an asset management subsidiary of Banco Fator S.A., has R\$1 billion (US\$500 million) under management. The volume of transactions amounted to US\$4.6 billion in 1999. Their clients include

200 institutional investor-pension funds, equity funds, banks and foreign investors.

- 6.6 In 1997, Mr. Chameh started managing a US\$18 million private equity fund sponsored by Banco Nacional de Desenvolvimento Econômico e Social Participação (BNDESPAR), as one of the few private equity capital funds (FMIEE) in Santa Catarina regulated by the Comissão de Valores Mobiliários (CVM). Mr. Chameh was responsible for the structuring of investment deals, governance of and exiting from portfolio companies. The fund quickly invested a total of US\$17 million for 11 investments in growing businesses with an average investment amount of US\$1.5 million. The percentage stake in the portfolio companies varied from 17% to 52%, with most of the holdings hovering around 30%. In 2000, Mr. Chameh successfully divested two investments with outstanding returns: 220% and 540% annualized internal rate of return (“IRR”) respectively. Since the proposed Fund presents the first venture capital fund to be managed by BSI, Key-Person provisions should be added to the Fund Document where replacing “key persons”, including Mr. Chameh, is subject to approval by the Shareholders’ Assembly in a supermajority vote.

### **C. Expenses, Distribution and Management Incentives**

- 6.7 The Fund will pay the Fund Manager to cover operating costs an annual management fee of 3.0% of the total committed capital during the first four years of the investment period. For the remaining years, the Fund Manager will receive a 3% fee based on invested capital. The costs will include wages, benefits, office equipment, communications and travel associated with the search and analysis of potential deals and the subsequent monitoring of the investments. The management fee will be charged to the Fund and be annually reviewed by the Shareholders’ Assembly. The Fund Manager will also receive a performance incentive tied to the Fund’s realized gains -25% on profits above 7% cumulative compound preferred return (hurdle rate) to the “quota” holders. Up to 1.0 % of the total capitalization for the first 12 months are additionally allowed for organizational expenses that include marketing costs of the Fund.
- 6.8 The distribution cascade for the return of capital and capital gains to be realized by the Fund is in the following order of priority: (1) 100% of capital to the investors; (2) preferred return of 7% p.a. to the investors; (3) 75% of capital gains to the investors; and (4) 25% of capital gains to the Fund Manager.
- 6.9 *Incremental Due Diligence.* The Fund will operate under investment guidelines that call for due diligence procedures typical of private equity funds. However, the due diligence costs associated with the large number of small deals processed by a development fund will likely be higher than the due diligence costs incurred by standard venture capital funds. For example, in general, it is expected that most of the target *dekassegui* companies will have prepared sound business plans, but in some cases, the Fund Manager may want to have the target firm undertake an

additional due diligence (technical, legal, accounting, etc.). Naturally, the incremental due diligence would be pursued only for a limited number of highly promising deals (particularly out of the pool of companies that received seed capital financing) that, for lack of funds or experience, did not provide all of the information needed by the Fund manager to make a decision. To compensate for some of these extra efforts for start-up or early-stage financing, the performance incentive portion for the Fund Manager is set higher than the standard 20%.

#### **D. Conflicts of Interest**

- 6.10 There is a risk that BSI, being a subsidiary of Banco Sudameris, may also engage in activities for the purpose of benefiting its own group or its existing commercial banking activities. On the other hand, co-investment opportunities may arise from time to time for related parties or for other clients of the Fund Manager. The investors and the Fund Manager must disclose their investments. Whenever such opportunities are presented to the Fund for its consideration, co-investment by such entities will occur only (i) with prior notice to the Investment Committee and (ii) on terms no more favorable to BSI or the clients of the Fund Manager than those applicable to the Fund. This item will be written in either a Side Letter or *Regulamento*.
- 6.11 The Fund Manager and their affiliates may sponsor and participate in investment vehicles and other ventures in addition to the Fund. However, the Fund Manager will not sponsor any other investment fund with a primary investment focus similar to that of the Fund until either (i) the Fund has been invested or committed to invest at least 80% of aggregate capital commitments as specified by CVM n. 209, or (ii) the Fund's Investment Committee has authorized the Fund Manager to proceed with another such fund.

#### **E. Environmental and Social Impact (CESI)**

- 6.12 The Fund will invest only in companies that are in compliance with Brazilian labor and environmental regulations. The Fund Manager will adhere to operating criteria that include environmental and social standards approved by the IDB (Annex II provides a draft of the Bank's environmental guidelines for MIF financial intermediary operations). The staff will be expected to participate in environmental training courses jointly sponsored by the IIC and the MIF. The Project was reviewed and approved by the Committee on Environment and Social Impact (CESI) at its meeting on March 30, 2001 (TRG 13-01).

#### **F. Supervision, Monitoring and Evaluation**

- 6.13 The Fund's investment audits will track the companies' performance against their projected plans. Despite the fact that the audit may focus on financial aspects of the investments, it will always be scrupulous in assuring that all of the risks are

covered. When possible, the supervision report will include market research, the status of results from previous years' operations, an analysis of environment and social impact and identification of the expected exit paths. On a quarterly basis, the Fund will issue unaudited financial statements and a valuation review of the portfolio; every six months the Fund will issue summaries on each portfolio company. Annually, the Fund will issue audited financial statements certified by a recognized accounting firm, and a report describing the portfolio status. Over the life of the Fund, the Fund Manager will occasionally produce impact assessments of the Fund's investment strategy. For example, it may analyze the effect of the Fund's targeting returning entrepreneurs, a cohesive, well-networked group, on the general development of entrepreneurship in Brazil.

## VII. THE MARKET

- 7.1 *Macro-economy.* In the early 1990s, Brazil introduced important reforms in liberalization of external trade and in developing a framework for privatization. It underwent a major change in economic regime with the introduction of the Real Plan, resulting in a sharp reduction of inflation. This package of measures permitted a resumption of growth, reduction in poverty, and a significant increase in private capital. Moreover, because of labor market flexibility, stabilization was not accompanied by as large an increase in unemployment as might have been expected. To the recent crisis of Asia and Russia, the government responded by adopting a floating exchange regime. Banks and corporations were conservative in managing their exposure caused by the devaluation, and the exchange rate volatility has been mild. During the past decade, the government has intensified its efforts at fiscal adjustment. Today, Brazil's macroeconomic momentum could not be more supportive for migrating local resources from fixed income to equities. Pre-conditions for growth, including sound economic incentives, policies and regulatory framework, have been established, and it is expected that GDP growth will remain strong in 2001. As real interest rates drop to levels unseen in more than a decade and the economy expands at a strong pace, there is strong potential in the equity market, a dynamic engine of sustainable long-term growth.<sup>6/</sup>
- 7.2 *Dekassegui.* An estimated amount of 300,000 Brazilians living in Brazil have experience in working temporarily in Japan, in addition to about 220,000 Brazilians currently working in Japan. In very broad terms, the *dekassegui* can be categorized in one of two ways: (a) 70% have gone to Japan to look for jobs with higher salaries and are hoping to save money to repay debt; and (b) 30% are young with college degrees or entrepreneurial experience and are interested in obtaining hands-on experience which they can apply to their own businesses when they return to Brazil. The latter is a promising market for the proposed Fund. Approximately 60% of the returning *dekassegui* are residents of the state of São Paulo, followed by 25% from Paraná and 5% from Mato Grosso do Sul and Pará. According to a market study based on interviews with approximately 100

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<sup>6/</sup> Merrill Lynch Global Securities Research & Economic Group, *Strategy Insight*, December 2001.

returning *dekassegui*, the types of business they are interested in starting include agribusiness, e-commerce, export/import business, retail and hardware/construction materials. (Detailed market study is available as Annex III)

- 7.3 The following is an indicative pipeline of projects in which the Fund could invest (more information on the potential projects is available in Annex IV).

Location	Description	Amount
São Paulo	Measurement sensors of inventory levels (solids and liquids) and measurement devices for flow control (gas and liquid)	\$500,000
São Paulo	A home improvement “super” retail store	\$400,000
Santa Catarina	Plastic packaging materials for cosmetics.	\$900,000
São Paulo	Wireless technology	\$600,000
São Paulo	On line forum for parents focusing on education and raising of child	\$400,000
Mato Grosso do Sul	Flower and medicinal herb production	\$300,000
Mato Grosso do Sul	Organic vegetable production	\$250,000
Paraná	Day spa to offer a package of beauty an anti-stress products and services to women and men.	\$500,000

## VIII. FINANCING PLAN AND FINANCIAL PROJECTIONS

- 8.1 The following table is a summary of the Fund’s financing plan. A Among other investors considered so far, there are three potential private corporations comprising of ex-*dekassegui* shareholders (see 4.12).
- 8.2 The Fund is expected to generate 10-15% as an annualized rate of return for investors upon its liquidation, assuming a 20% failure rate. Since equity investment in startups needs a longer holding period, dividend payments during the operating life will be limited. MIF funding is contingent on commitments, and disbursement will be made only on a matching basis with other investors and contributors (see Annex V and VI for detailed budget and financial projections).

US\$	Minimum Capital	Closing Goal
Equity Investment		
IDB/MIF	5,000,000	5,000,000
SEBRAE	3,300,000	3,000,000
Banco Sudameris	1,700,000	1,700,000
Other private investors (EP)		2,000,000
Total	10,000,000	12,000,000



## IX. BENEFITS AND RISKS

### A. Benefits

- 9.1 **Channel savings:** It is estimated that Brazilian temporary workers in Japan send over \$1.5 billion back to Brazil per year. The majority of this is used for consumables rather than for productive uses. Of that which is saved to start businesses, the amounts saved are often not sufficient to successfully start up and sustain an enterprise. Creating a fund that would tap into the savings and would invest in start-up small businesses will strengthen the Brazilian economy by applying a productive use multiplier to the original savings.
- 9.2 ***Small business development:*** Although the equity financing the Fund provides helps firms grow, an important part of the value-added and development impact of venture capital funds is the expertise in strategic/financial planning, marketing and accessing financing that they bring to their investee firms. A private equity fund is one of the few viable approaches to mobilizing capital to help entrepreneurs start and expand smaller business, a sector that is in need of such technical input.
- 9.3 ***Supporting entrepreneurs and job creation:*** Many Brazilian temporary workers abroad are saving money to start businesses of their own upon their return to Brazil. However, generally speaking, the amounts they save are not sufficient to support the start up of a new venture. By targeting start-up companies, the Fund would support these returning workers. Furthermore, by supporting the expansion of small companies, the Project will contribute to job creation within those enterprises as well as within up-stream supplier companies.
- 9.4 ***Demonstration effect:*** The Project's focus will significantly emphasize start-up companies, a niche under-served by the few equity capital investment funds already established in the region. The Fund's investments are intended to be models not only for successful venture financing, but also for channeling savings to productive use. If it proves successful in Brazil, similar funds could be established elsewhere in Latin America.
- 9.5 ***Capital markets development:*** The Fund's exit strategies will include sales to third party investors who otherwise would not target this market. This will open financing possibilities to other small enterprises and will improve market efficiency. A strong equity market is key to reaching the goal of raising domestic savings to promote long-term economic growth. In appropriate cases, initial public offerings will be used as the exit strategy, thereby contributing to the widening and deepening of local capital markets, and encouraging the process of capital formation and promoting the creation of investment instruments.
- 9.6 ***Compatibility with existing MIF projects:*** This project will not compete with existing MIF projects such as Biominas, RsTEC, ScTEC and MVC funds. These

are oriented toward specific sectors (biotechnology, technology-based and Internet businesses) and it is not expected that there will be overlap among the funds.

## **B. Risks**

- 9.7 *Marketing risk:* Marketing the Fund's shares to the *dekassegui*-sponsored investment holding companies (EPs) may be more difficult than anticipated, because many Brazilians are wary of long-term investments, no matter what the potential return. The Fund is designed to be viable even without such funds.
- 9.8 *Currency and business risk:* The Fund's investments will be equity or equity-like, and denominated in Brazil's local currency. The investment value may be affected by currency fluctuations as the Fund does not expect to hedge the currency exposure. This risk should be mitigated by rigorous selection of portfolio companies with inflation adjusted pricing or dollar cash flows. As individual investment terms are expected to be seven years, short-term currency fluctuations should not affect the value of the returns. The Fund will primarily target start-up companies, which are subject to high operating, management and financial risks. Through technical assistance implemented by SEBRAE, entrepreneurial skills should be enhanced and the Fund's seed capital financing should be effectively utilized to improve business feasibility.
- 9.9 *Exit risk:* The Fund's investments in the targeted companies are subject to less liquidity and greater risks than those inherent in publicly, actively traded securities. Even if the Fund is able to exit by selling securities in the local stock market, the securities market is smaller, less liquid and more volatile than the major, developed securities markets. The limited liquidity of the securities market and of the types of companies in which the Fund proposes to invest, may adversely affect the Fund's ability to acquire or dispose of securities at the price and time it wishes to do so. However, the Fund Manager has a track record in exiting investments through third-party sales and management buy-backs. Their business contacts will be instrumental in supporting the Fund's exit from their investments. Moreover, the Bovespa's new framework for *Novo Mercado* with listing requirements more favorable for minority shareholders is expected to add more liquidity.
- 9.10 *Deal flow risk:* The number of projects in the Fund's target deal size range may be fewer than anticipated, which could pressure the Fund to make lower-quality investments and produce lower-than-expected returns, involving a high degree of uncertainty. However, the proposed Manager has already identified a growing pipeline of potential investments, and business incubators with which the Fund Manager has a good relationship provide a ready pipeline of businesses. One of the advantages of Banco Sudameris extensive network of referral sources is that they can introduce companies to support services provided by local and

international enterprises while using those enterprises as informal marketing agents. The *Dekasegui Platform* of Banco Sudameris can be used as a source of generating deals which are risky due to a lack of collateral, but promising, and thus appropriate for the proposed Fund. The client base from the acquired Banco América do Sul provides a reliable database of potential deals as well.