

**DEVELOPMENT OF AN INSTITUTIONAL FRAMEWORK TO STIMULATE
VENTURE CAPITAL INVESTMENT IN NEW TECHNOLOGY-BASED
COMPANIES- SUPPORTING THE INOVAR INITIATIVE**

(TC-00-11-04-1-BR)

EXECUTIVE SUMMARY

**EXECUTING
AGENCY:**

Financiadora de Estudos e Projetos (FINEP).

BENEFICIARIES:

Direct beneficiaries of this project would be: 1) the Technology-Based Companies, both start-ups and small and medium emerging companies; 2) research groups developing new products or services in universities and research centers that will become eligible for grants and other forms of structured assistance from FINEP and the partners; 3) venture capital fund managers and angel investors who will benefit from the fund-raising/investment process made easier and more agile for them; and 4) 50 institutional and other qualified investors who, by participating in the different activities of the project, will learn how to better evaluate and monitor their investments.

OBJECTIVES:

The overall objective of the Project is to stimulate the development of new technology-based companies (NTBC) through the establishment of a flourishing venture capital market and to enhance private investment in technology businesses. Specifically, this Project aims to assemble a comprehensive set of market mechanisms for venture capital investment in Brazil, and increase the supply of qualified fund managers. To achieve the proposed objectives, the project would have the following three components: i) development of instruments for information dissemination and enhanced quality deal flows; ii) development of fund managerial capacity in Brazil and institutional strengthening of a newly formed Technology Investment Facility; and iii) training of INOVAR Agents.

DESCRIPTION:

The INOVAR initiative is a comprehensive approach that aims to become the enabling framework that may effectively accelerate venture capital investments in small funds. INOVAR will look at all cross-sectoral issues and develop an institutional infrastructure to encourage venture capital activities and attract private pension fund investments over the longer term. This institutional infrastructure will have two distinctive and interrelated parts: a) the Technology Investment Facility (TIF) and b) a supportive structure for this TIF. The TIF will be the result of a future partnership of MIF –through it's Investment Unit- with local institutions for the creation of future technology funds in Brazil and the supportive structure for the TIF is what

this project aims to develop and strengthen through the components proposed above.

The TIF will be a syndicate of potential public and private investors (MIF, SEBRAE, FINEP, and PETROS – a private pension fund). The objectives of the TIF will be to: i) stimulate the creation of emerging company funds, ii) attract private sector investors and fund managers to the VC industry, iii) continue improving the quality of investments in *fundos emergentes*, and iv) disseminate best practices to private and public Brazilian institutional investors regarding structuring and evaluation of venture capital investment funds. It is important to note that PETROS would be the first private pension fund to enter the syndicate, and that it has already signed a Memorandum of Understanding to work with FINEP in this project, a groundbreaking step that may pull other private pension funds in the same direction. During the course of the Project, each partner has initially agreed to consider directing up to USD 15mm for investments through this Facility. The due diligence process will be done jointly by all TIF partners, but each institution, after completing the due diligence, will take the prospected fund through its internal approval process, leaving the decision up to its Board of Directors.

FINANCING:

Method:	Non-reimbursable – Facility I
MIF:	US\$ 1,122,000
Local counterpart:	<u>US\$ 3,772,600</u>
Total:	US\$ 4,894,600

**EXECUTION
SCHEDULE:**

Execution:	36 months
Disbursement:	42 months

**EXCEPTION TO
BANK POLICIES AND
PROCEDURES:**

None

**SPECIAL
CONTRACTUAL
CONDITIONS:**

Prior to first disbursement, the executing agency will submit the following to the Bank's satisfaction: 1) evidence that the Coordinating Unit is established and operating; 2) a final Plan of Execution for the project with activities, timetables and targets to be met; and 3) the terms of reference for the following consulting services: i) Promotional activities for the Venture Forums; and ii) the Fund Managerial Capacity- Building Training Program.

**ENVIRONMENTAL
AND SOCIAL
IMPACT:**

The project was analyzed by the Committee on Environment and Social Impact (CESI) at its meeting on November 17, 2000. Its recommendations have been included in paragraph 4.9.

I. COUNTRY AND PROJECT ELIGIBILITY

- 1.1 The Federative Republic of Brazil was declared eligible for all Multilateral Investment Fund (MIF) financing modalities by the Donor's Committee at its meeting on February 9, 1995. The proposed project is consistent with the MIF's general purposes and particularly with the Small Enterprise Development Facility because it aims to promote small business competitiveness by means of technological development and to attract the private sector as a source of venture capital.

II. BACKGROUND

Venture Capital in Brazil.

- 2.1 Brazil's venture capital industry is still in the early stages of development. The first venture capital firms emerged in the 1980s replicating those in the United States and were either independent or associated with large business groups. Most of these early venture capital firms failed mainly due to the high inflation of the 1980's and illiquid capital markets. A significant number of these early ventures either disappeared or abandoned their operations and shifted to investments in medium and large-sized firms. The economic climate was therefore a substantial obstacle to the industry's growth.
- 2.2 There is no reliable estimate for the amount of funds currently available for venture capital or private equity investments in Brazil. Industry estimates range from USD 250 mm to USD 2,500 mm. Nevertheless, there are two clear trends. First, the bulk of capital is going to the "com" segment alone, leaving other sectors like the software industry behind. Second, the majority of the funds established have been private equity funds, which target medium to large companies with equity investments generally ranging from USD five to twenty million.
- 2.3 The reality for small, technology-based companies is that either they must count on the support of institutional investors to attract much-needed capital, or they would lose a fine opportunity to embrace the so-called "New Economy" due to the fact that they cannot finance themselves with retained earnings -the most likely alternative for any type of small and medium enterprise (SME) in Brazil. These institutional investors have traditionally been: BNDESPAR -Brazil's most experienced and largest institutional investor of venture capital--, SEBRAE -an independent, private organization affiliated with a national network of organizations providing technical assistance and business consulting services for Brazil's small and medium-sized enterprises--, or FINEP -a state-owned company regulated by private company law, linked to the Ministry of Science and Technology that up to now has provided long-term, reimbursable and non- reimbursable, financing for technology development, corporate management, and pre-investment with a focus on small and medium-sized technology-based companies.
- 2.4 Unfortunately, true seed or venture capital is still hampered by many obstacles, such as: i) lack of information and nascent venture capital culture¹; ii) lack of institutions and

¹ Pension Funds represent a case-in-point of this lack of familiarity with the venture capital industry. Historically averse to invest in riskier venture capital operations due to their legal limitations and unfamiliarity with this industry, and forbidden by law to invest in offshore vehicles, they have been recently allowed to invest a maximum

professionals with expertise in the activity; iii) lack of appropriate and flexible instruments to stimulate seed and start-up investments; iv) absence of permanent channels available to identify high potential businesses and systematically help in the formulation and provision of business plans for investors; v) lack of organized processes in place aiming to attract investors and establish investor connections with entrepreneurs and fund managers; vi) lack of systems in place to undertake fund and fund manager evaluation and assessment with the appropriate levels of reliability and transparency required by investors; and vii) lack of exit possibilities for investors.

- 2.5 In summary, a more supportive and comprehensive approach could be developed, to continuously bring together the players who are willing to participate in this emerging market and who are scattered throughout the national economy.

Attempts at improving the industry:

- 2.6 In 1994, BNDESPAR and the Comissao de Valores Mobiliarios (CVM) created a “*Fundos Mutuos de Investimento em Empresas Emergentes* (FMIEE) framework” through Regulation CVM n. 209 to help develop and regulate the country’s venture capital industry. Under this first design, the new vehicle called “*Fundos Emergentes*” did not have much success. This was due in part to the following reasons: i) the funds were too large and did not favor small investments, ii) the funds were targeting investments nationwide without having an appropriate local infrastructure to identify, monitor and support investees, and iii) the fund managers were usually investment banks with little or no experience in venture capital. Furthermore, some of the funds closed before making any investment and those that had some operational activity produced mediocre results, due to the volatile macroeconomic environment.
- 2.7 Drawing from these lessons, the MIF, in concert with BNDESPAR, developed in late 1998 a strategy to support the venture capital for small technology-related enterprises by focusing on smaller-sized funds with a geographic concentration and managed by skilled financial professionals. The BNDESPAR/MIF’s joint strategy is to steer venture capital investments in the direction of small technology-based companies -not just “.com” companies, and to attract private and local institutional investors --pension funds would be included here-- to this industry. This strategy contemplated the support of several funds. As a result, three funds, RSTEC, SCTEC and MVP Tech have been approved as of September 2000.
- 2.8 Late in 1999, FINEP approached SEBRAE, PETROS and the MIF with a proposal that would address some of these market deficiencies. The proposal is the INOVAR initiative, a comprehensive approach that aims to establish an enabling framework that may effectively accelerate venture capital investments in small funds. INOVAR will look at all cross-sectoral issues and develop an institutional infrastructure to encourage venture capital activities and attract private pension fund investments over the longer term. This institutional infrastructure will have two distinctive and interrelated parts: a) the Technology Investment Facility (TIF) and b) a supportive structure for the TIF. The TIF

of 10% of their assets in venture capital funds. Given that as of March 2000, they reported assets of R\$ 132 billion – approximately USD 74 billion-, their contribution to the venture capital industry could be considerable.

will be the result of a future partnership of MIF -through its Investment Unit- with local institutions for the creation of future technology funds in Brazil. The supportive structure for the TIF is what this project aims to develop in order to resolve some of the obstacles identified above and to allow for the proper functioning of the TIF.

- 2.9 The TIF will be a syndicate of potential public and private investors (MIF, SEBRAE, FINEP, and PETROS – a private pension fund). The objectives of the TIF will be to: i) stimulate the creation of emerging company funds, ii) attract private sector investors and fund managers to the VC industry, iii) continue improving the quality of investments in *fundos emergentes*, and iv) disseminate best practices to private and public Brazilian institutional investors regarding structuring and evaluation of venture capital investment funds. It is important to note that PETROS would be the first private pension fund to enter the syndicate, and that it has already signed a Memorandum of Understanding to work with FINEP in this project, a groundbreaking step that may attract other private pension funds in the same direction. During the course of the Project, each partner has initially agreed to consider directing up to USD 15mm for investments through this Facility. The due diligence process will be done jointly by all TIF partners, but each institution, after completing the due diligence, will take the prospected fund through its internal approval process, leaving the decision up to its Board of Directors.
- 2.10 FINEP, which will be responsible for this operation, has had a long track-record with the Bank since 1965. A total of 11 loans have been granted throughout the years, some with uneven results that are still being evaluated. As it will be mentioned afterwards in this document, FINEP underwent a restructuring of its mission and activities in 1999, that has made FINEP a viable institution for this operation.

III. PROJECT OBJECTIVES AND BASIC COMPONENTS

A. Objectives

- 3.1 The overall objective of the Project is to stimulate the development of new technology-based companies (NTBC) through the establishment of a flourishing venture capital market and to enhance private investment in technology businesses. Specifically, this Project aims to assemble a comprehensive set of market mechanisms for venture capital investment in Brazil, and to increase the supply of qualified fund managers.
- 3.2 To achieve the proposed objectives, the project would have the following three components: (i) development of instruments for information dissemination and enhanced quality deal flows; (ii) development of fund managerial capacity in Brazil and institutional strengthening of a Technology Investment Facility; and (iii) training of INOVAR Agents.

Component I: Development of instruments for information dissemination and enhanced quality deal flows

- 3.3 The objective of this component is to develop an organized “marketplace”, both in *virtual* (Venture Capital Site) and *real* terms (Venture Capital Forums) that will promote and

support new entrepreneurs, their potential projects and attract venture capital investors, *angel* and institutional, enhancing potential business initiatives.

- 3.4 **Venture Capital Site.** This activity involves the development and maintenance of a venture capital Website designed to become a virtual meeting place for entrepreneurs, investors and other players involved in venture capital activities. The Venture Capital Site, registered under the domain name www.venturecapital.com.br, will contain not only news, selected domestic and international texts and publications on venture capital in Brazil and in the world, but also VC statistics in Brazil, such as the volume captured for investment in Brazil, the new investment funds created, venture capital investment in Brazilian companies, etc. The site will make available 200 abstracts and/or articles dealing with venture capital-related themes, as well as 500 links to interrelated websites. This material will be updated on a periodic basis. To facilitate the research, a search engine will be available on the site, which will allow for the selection of information on any subject related to venture capital.
- 3.5 Moreover, the site will also serve as a virtual information exchange venue between investors and entrepreneurs. The companies interested in attracting capital venture will register with the site and thereafter will be exhibited on a virtual display, giving the investors who are seeking investment opportunities the opportunity to research and select companies for closer consideration. The companies registered with the site will receive support for business plan development, thus improving the quality of the product that will be analyzed by the investors. A registration-and-password system also permits that in the future an intermediation fee could be charged on transactions consummated through contacts originated on the site, similar to the US models. The site will also allow formation of e-groups, and a discussion forum for the venture capital community, bringing together investors, fund managers, entrepreneurs, consultants and business academics, who will be able to talk via Internet.
- 3.6 As a result of these innovative features, the site will be able to meet the following objectives: i) disseminating knowledge and understanding as to venture capital concepts and practices; ii) transparently providing information on venture capital operations undertaken in the country; iii) offering a low-cost alternative to enhance the visibility of start-up or emerging Brazilian technology-based companies; iv) increasing market players' awareness of the potential of technology-based businesses; and v) promoting the association of entrepreneurs and investors.
- 3.7 **Venture Forums.** Another initiative that will greatly contribute to increasing the flow of businesses available for venture capital investment and to boosting venture capital activities is the promotion of business rounds. Venture Forums are periodically held events where a group of selected companies presents their business plans for a target audience of investors. After the introductory presentation, interested investors may meet with company representatives in business rounds and gather further information for a more detailed assessment to identify potential partnerships. The objective of the Venture Forums is to bring together, on the one hand, investors seeking opportunities, and, on the other hand, companies seeking partners to capitalize their business.

- 3.8 Thus, the Venture Forums intend to meet the following objectives: i) creating an efficient communication channel between entrepreneur and investor; ii) promoting and supporting the association between entrepreneurs and investors; iii) increasing the efficiency of the market for venture capital; iv) enhancing investor awareness as to the potential of technology-based businesses; and v) enhancing management capabilities of entrepreneurs and executives conducting technology-based small businesses.
- 3.9 The structure behind the Venture Forums is to work on the process of identifying, attracting and selecting investors and companies. Therefore preparatory activities involve: i) providing assistance to investors in assessing business investment opportunities; ii) identifying and selecting projects for participation in the events; and iii) providing training and assistance to entrepreneurs to encourage the establishment of partnerships with investors.
- 3.10 During the three year Project execution period there will be 18 events, where an estimated 200 businesses per event will register, out of which 15 companies per event will be selected, and there will be an estimated 50 investors participating in the Forums every year. The events will be funded by the fees collected from the participating entrepreneurs, investors and general public, corporate sponsors and the project.
- 3.11 To develop these two instruments, a team with expert skills will be hired for the project. Two professional experts will coordinate this team, one specifically for the Venture Site and the other for the Venture Forums (their Terms of Reference can be found in the technical files). To develop and format the Site, a team will be formed consisting of three reporters, one senior editor and three content professionals who will undertake the research as well as select and translate the documents to integrate the Site's collection. It should be pointed out that the editorial line would be defined by FINEP, since its own image is closely associated with the Site. With regard to obtaining statistics on venture capital activities in Brazil, the task will be immensely facilitated by a link to the Web page of the Brazilian Venture Capital Association, which will be hosted on the Venture Capital Site. The responsibility for operating, maintaining and updating all these operating modules in the Venture Capital Site will initially lie with the team hired for its development. As FINEP absorbs the know-how from the team, FINEP will be able to partially take over the Site's operation.
- 3.12 As for the Venture Capital Forums, a Coordinator will work with FINEP staff and hired consultants in the phases of conceiving and preparing the organizational structures for the Forums. They are responsible for: (a) conceiving and formatting the Venture Forum model, including the selection criteria for businesses and investors; (b) preparing the organizational structure of the events; (c) implementing the organizational structure and its operation; (d) organizing and holding the events at a national level; and (e) conceiving and preparing international road-shows for capturing investments.
- 3.13 The project also contemplates hiring a consultant to design and implement a monitoring system for the *matchmaking* done at the Venture Capital Forums. The objective is to follow up on the relationships fostered between entrepreneur and investor at the Forums and capture the different stages of its development, elaborate case studies and present them at future industry forums.

Component II: Development of Fund Managerial Capacity in Brazil and Institutional Strengthening of a Technology Investment Facility

- 3.14 Component II has the general goal of building local professional capacity within the venture capital industry in Brazil, and the more specific goal of providing ways and means to raise the quality of governance of the venture capital industry by promoting the use of best practices among fund managers. As a consequence of this, the level of comfort of both domestic and foreign institutional investors may be improved, in order to attract venture capital in Brazil. This component has been divided into the following sub-components:

Fund Managers Capacity-Building Training Program:

- 3.15 This Capacity-Building Training Program will focus on all aspects of starting a fund and the managerial process of running it, including the preparation and evaluation of a good business plan, how to create a solid pipeline of prospective investee companies for the fund, etc. The Program, targeted at potential and existing local fund managers, will consist of a one-week special course for them to be offered nine times during the life of the Project. Additionally, the fund managers will benefit from the activities offered through the rest of the components of the INOVAR Initiative.
- 3.16 The one-week course will be taught by an organization that will be selected and approved by FINEP, in consultation with the MIF. There are few organizations in the world that have the skills to teach this course, and FINEP has already established some contacts with a few of them. The Project will finance the expenses for the one-week courses almost in their entirety. Participants' fees will absorb the remainder. For the first years, participants' fees will be partially subsidized in order to provide an initial incentive for the fund managers to go through the course and have their business plans evaluated. Afterwards, participants' fees will fully absorb the course costs.
- 3.17 Among the activities that will be offered through the one-week course, fund managers will be offered individual sessions on how to improve their business plans, and at the end of the week, their plans will be evaluated and critiqued by the hired experts running the program.
- 3.18 The Capacity-Building Training Program intends to ensure a steady transfer of know-how to the venture capital managers on the best practices from the international management community. FINEP estimated that approximately 25 fund managers will go through the program during the first year, and that this number will increase in the following two years, as the conditions for venture capital improve in the country. The selection criteria for those attending the Capacity-Building Training Program will be to work in the sectors and with the companies that fit the investment criteria of the TIF members.

Institutional Strengthening of a Technology Investment Facility (TIF)

- 3.19 The TIF is an important aspect of this comprehensive approach to boost venture capital in Brazil, and will aim at the partners working together on the funds' due diligence process,

to accelerate the development of the venture capital industry and the creation of technology-oriented small funds in Brazil.

- 3.20 Each partner will bring to the process its expertise: FINEP, its technology network; SEBRAE, its experience providing technical assistance and business consulting services to SMEs; PETROS, its leadership in being the first private pension fund to enter the syndicate, and, the MIF, its experience and knowledge with regard to international best practices in the due diligence process, the evaluation and structuring of investment funds.
- 3.21 As part of the institutional strengthening of the TIF, the Project will provide financing for: i) salaries of two senior analysts housed at FINEP who will be dedicated to analyzing the business plans and performing the necessary pre-due diligence work on prospective companies; ii) a yearly training seminar for the TIF members (FINEP, SEBRAE, and PETROS) on fund due diligence techniques. (The Project will hire international consultants for the training seminars aimed at the TIF members); and iii) all logistics and speakers' expenses for two Best Practices Seminars to disseminate the results of the TIF's operations. The seminars will be held at the beginning of the second year of operations, and at the end of the third.
- 3.22 Component II will address the needs of: i) financial professionals who are looking into fund management as their next professional career step and who will receive the training; ii) existing fund managers seeking to enhance their professional skills through on-hands training; iii) investors such as FINEP, PETROS, and SEBRAE, that will work along with the MIF on the due diligence process of potential funds for investments, receiving the lessons learned and best practices that the MIF has gathered in its six years of work in the Region, iv) the market, since this training will give a boost to the venture capital industry, by allowing the growth of a deeper, more formal venture capital industry managed by qualified local professionals, and v) all potential investors, whether local or foreign, since the program will provide them with a greater confidence on the professionalization of the fund managers in the country. As a result, more new businesses will have access to start-up and early stage financing as well as the "value-added" advice and guidance usually provided by venture capitalists.

Component III: Training of INOVAR Agents

- 3.23 In order to implement the INOVAR initiative on a national basis, coordinated action by a network of venture capital players is a basic requirement. As a result, the INOVAR Network was created to coordinate all the relevant actors in the technology and business development scenario in Brazil with the objective of increasing the creation of new technology businesses and improving the quality of deal flow for the venture capital market.
- 3.24 The INOVAR Network is coordinated by FINEP and the institutions that compose it are: SEBRAE, CNPq, ANPROTEC, SOFTEX, IEL-CNI, IEL state level institutions, and more recently the state level foundations for research support, the university research centers and their support foundations. Technology promotion networks and the Intellectual Property Support Network also cooperate with the Project as a whole and with the organization of this action in particular. The INOVAR Network is organized in

Nucleus, one per State, encompassing the regional arms of each partner national institution and the main local institutions. The individuals appointed by each institution to participate in the INOVAR Network are called *INOVAR Agents*.

- 3.25 One of the main goals of the INOVAR Agent is to help pave the way for scientific research to be commercialized into high potential businesses, to be prepared to screen the main knowledge production centers with the aim of detecting among them projects with high potential of resulting in innovative products or services and helping design and provide tailor-made technical assistance to these projects. The INOVAR Agents should be able to: a) disseminate the INOVAR initiative throughout the Country; b) identify prospective new companies and new business opportunities for the INOVAR initiative; c) provide direction to the companies on how to prepare or improve their business plans; and d) support the operation of the Venture Capital Website and the Venture Forums.
- 3.26 In order to accomplish this, training of these agents is necessary. The Project will support FINEP in this task through activities that will include: i) establishing selection criteria for the potential INOVAR Agents; ii) designing and providing training sessions for potential INOVAR Agents; iii) building and implementing a network of agents and participating institutions, iv) designing and implementing monitoring mechanisms to follow up on the Agents' effectiveness; and v) designing and implementing a certification mechanism. The Project will hire local consultants for these activities. With this component, an estimated 200 INOVAR Agents are expected to be trained and monitored, and an active network will be established throughout the country.

IV. EXECUTING AGENCY AND MECHANISMS, PROJECT READINESS AND DIRECT BENEFICIARIES

- 4.1 **Executing Agency:** The Executing Agency will be the *Financiadora de Estudos e Projetos* (FINEP). FINEP is a state-owned company regulated by private company law, founded in 1967 and linked to the Ministry of Science and Technology. FINEP applies resources through long-term financing, reimbursable –including venture capital investment–, or non-reimbursable, with the purpose of strengthening technological and scientific development in the country, and to enhance its competitiveness.
- 4.2 As a financial institution, FINEP assigns resources on repayment terms to be invested in and finance the business sector; it supports projects in the fields of technology development, corporate management, environmental projects, education for enhancing competitiveness and pre-investment, with a special focus on small- and medium-sized technology-based companies.
- 4.3 It also provides support to universities, research centers and non-profit institutions, acting as manager and agency for government funds and programs. FINEP started in 1965 as a fund, linked to the *Banco Nacional de Desenvolvimento Econômico (BNDE)*, but directly managed by the *Ministro Extraordinário do Planejamento e Coordenação*. Its objective then was to provide resources to finance public and private companies, and governments in the elaboration of studies and projects. In July 1967, the Fund became the *Financiadora de Estudos e Projetos (FINEP)*, with the task to raise the national technological standards.

- 4.4 Two years later, in July 1969, the *Fundo Nacional de Desenvolvimento Científico e Tecnológico (FNDCT)* was created, in order to foster and structure research activities in Brazil. FINEP was chosen to act as its Secretariat. Initially constituted as a fund for pre-investment activities, FINEP became the government's instrument to strengthen and train local enterprises.
- 4.5 In 1975, FINEP promoted an intense effort, matching supply and demand in technology, and creating a network of universities, businesses and consultants. The 80s were particularly hard for the country, and FINEP was not an exception during the crisis. Lack of significant projects and of resources on the part of the enterprises, forced FINEP to find a new framework for action. The 90s bring changes in the country and the models in place up to then. FINEP underwent a profound restructuring in 1999 after a Government evaluation, making the necessary changes to address past institutional pitfalls. A new industrial and foreign trade policy forged a new role for FINEP, that became a Federal Agency for Innovation, with a leadership role in the search for technological innovation, essential to ensure the local enterprises' competitiveness in an increasing globalized world.
- 4.6 FINEP is now positioned to call upon all the players in the venture capital industry, and try to affect change through this project². FINEP has the ability to act simultaneously with two critical segments of the innovation process: private companies and research institutions, and this allows FINEP to have an integrated vision of the process.
- 4.7 **Execution Mechanism:** Day to day implementation will be managed by a Coordinating Unit (CU) set up by FINEP, and based at FINEP's headquarters in Rio de Janeiro. The CU will be headed by the Project Director, and will be responsible for setting up the program and for its administrative management and ongoing relationship with the Bank for technical, operational, accounting and contractual issues. Due to the national scope of the Project, the CU will also be responsible for all relations with FINEP's regional partners to ensure the proper execution of the Project.
- 4.8 **Reports:** FINEP, through the CU, is responsible for the monitoring and preparation of semi-annual project reports. Each progress report must document the activities accomplished during the six-month period, with emphasis on the achievement of results and impact of the project. FINEP and the Country Office in Brazil will agree on the content and structure of the progress report prior to their presentation. In addition, the CU will prepare work plans and disbursement timetables for the following six-month period. The progress reports must be presented to the Bank within 60 days of the end of the semester. Within the three months of the conclusion of the project's execution, the Bank will present to the MIF the Project Conclusion Report.
- 4.9 **Beneficiaries:** Beneficiaries of this project would be: 1) the *Technology-Based Companies (TBC)* both *start-ups and small and medium emerging companies*. With six

² As way of example, Mr. Thomas Tosta De Sa, a former Chairman of the CVM who in 1994 regulated the *fundos emergentes* with the creation of the Instruction CVM 209, has accepted to be a member of the *Conselho Consultivo* of the INOVAR Initiative; and the Central Bank President, Arminio Fraga, has been a speaker at the first Venture Forum. FINEP is also a member of the newly formed *Associação Brasileira de Capital de Risco (ABCR)*, which started in July 2000.

venture forums a year raising funds for 15 TBCs each, if we consider a 50% program success rate, the Project may reach up to 135 companies, if the goal of 15 companies selected per venture forum is reached in every event; 2) *Venture Capital fund managers* and *angel investors* who will benefit from the fund-raising/investment process made easier and more agile for them; 3) *50 institutional and other qualified investors* who, by participating in the venture forums will learn how to better evaluate and monitor their investments; and 4) *research groups* developing new products or services in universities and research centers that will become eligible for grants and other forms of structured aide from FINEP and the partners through the website.

- 4.10 **Project readiness:** The Project design, its budget, activities and Logical Framework with the proper indicators was devised jointly by FINEP and the IDB Project Team. The terms of reference for the consultants have been drafted as well as the operating manual.
- 4.11 **Environmental and social impact:** Training in environmental and social issues will play an important place in the training provided to current and potential fund managers. The MIF will also highlight the importance of these issues when passing onto the TIF members the lessons learned with respect to due diligence, structuring, and supervision of funds.

V. COSTS AND FINANCING

- 5.1 The project's total estimated cost is USD 4,894,600, to be funded by a MIF grant of USD 1,122,000 and a local counterpart contribution of USD 3,772,600. Table I shows the project budget breakdown information for the proposed activities.

Table I
Consolidated budget by component

Budget Category (in USD)	MIF	Local counterpart	Total
Component I: Development of instruments for information dissemination and enhanced quality deal flows	210,000	2,586,000	2,796,000
a. Venture Capital Website	0	675,000	
b. Venture Forums	210,000	1,911,000	
Component II: Development of fund managerial capacity in the region and institutional strengthening of a newly formed Technology Investment Facility	862,000	886,600	1,748,600
Component III: Training and certification of INOVAR Agents	0	300,000	300,000
Evaluation and external audits	50,000	0	50,000
Total	1,122,000	3,772,600	4,894,600

- 5.2 The MIF contribution would be allocated to finance the total cost of the Fund Managers Capacity Building Training program, the training of the TIF members, the two Best Practices seminars, and the evaluations and external audits; and would partially finance the monitoring of the venture forums and two analysts' salaries. The local counterpart (FINEP) would finance the total cost of the training and certification of INOVAR agents

and the website, and would partially finance the venture forums and the rest of the TIF operational expenses, including other salaries not covered by the MIF. It is important to note that the local counterpart (FINEP) is also absorbing as its contribution to the project, the salaries of some of the FINEP staff now dedicated exclusively to the INOVAR project, as well as the offices used by them, and other miscellaneous office expenses, and these are not shown in the above budget.

- 5.3 **Procurement of goods and services:** FINEP will be responsible for procuring the goods and services necessary for the project in accordance with the Bank's procurement rules, procedures and policies and with the MIF's eligibility criteria for contracting.
- 5.4 **Execution and disbursement period:** The execution period for this project will be 36 months from the signing of the Agreement, with a disbursement period of 42 months from the same date. Once the conditions prior to the first disbursement have been met, a maximum of 5% of MIF resources may be advanced to establish a Revolving Fund to facilitate project execution. The resources may be replenished upon documented justification of the use of such resources.
- 5.5 **Accounting and Audits:** FINEP will be responsible for: a) establishing and maintaining accounting and financial controls and adequate internal auditing, as well as a system which will provide detailed records of the source and utilization of the program's funding, including i) identification of amounts and sources of funds, ii) information on the program's expenditures, distinguishing between those paid out of MIF resources and those covered by funding from other sources, and iii) the details required to identify the goods procured and the services contracted for; b) opening separate bank accounts for administration of the MIF contribution and the local counterpart funding; c) processing of requests for disbursements and the respective substantiation of expenditures in accordance with the Bank's disbursement procedures; and d) preparing and submitting to the Bank the final, audited financial statements on the program, and the semiannual reports on the revolving fund. The Executing Agency must present the final audited financial statements to the Bank within a period of 90 days from the last disbursement date. The Bank must previously accept the audit firm and the external audit costs will be financed by the MIF contribution.
- 5.6 **Sustainability:** For the Venture Capital Site: a) a fee structure plan as a result of the match-making process, b) corporate sponsors and c) a possible privatization option for the site itself. As for the Venture Capital Forums, the sources of income from businesses and investors and from corporate sponsors is expected to cover total costs by the end of the Project. In October 2000, FINEP organized its first Venture Forum and all indicates that this projection will be attainable. With respect to the Fund Managerial Capacity Program, FINEP is confident that market recognition from investors and fund managers will be developed during the first three years of the project, due to the quality of the due diligence process and the managerial training offered. Therefore, FINEP projects that this component will later be financially supported by the beneficiaries themselves, i.e., a) fund managers who will pay for the managerial training in its entirety, which will still be offered by consultant firms and training institutions acquainted with the INOVAR project and the TIF's goals to improve the investment process, but no longer under FINEP's supervision; and b) institutional investors who will pay for the information they receive

on fund managers and will be asked to share the expenses involved in a professional cooperative due diligence process. As for the Training of INOVAR Agents, a fee structure will be implemented during the project.

VI. PROJECT JUSTIFICATION AND RISKS

A. Justification

- 6.1 This project will: i) disseminate information and culture on venture capital in Brazil; ii) encourage a higher qualification of professionals dedicated to assessing new businesses in high-tech industries; iii) enhance quality deal flows; iv) promote higher professional standards and provide advisory services for Brazilian entrepreneurs; v) create virtual and physical forums to promote convergence of knowledge-intensive enterprises presenting good investment opportunities with investors; vi) develop an institutional system that would favor the establishment and the growth of venture capital funds; vii) enhance private investor attractiveness to venture capital investment; and viii) encourage the development of access markets to benefit small companies.

B. Risks

- 6.2 The project team considers INOVAR a very innovative initiative, appropriate to the MIF's mandate to act as a catalytic factor to accelerate private sector development in the region. Given its nature, INOVAR entails several risks, that the team views as within the MIF's risk tolerance. Mainly, these risks are the following:
- 6.3 In spite of the Internet boom and what it has done to the venture capital scenario in Brazil, still, local fund managers are scarce in the country, so there may not be enough fund managers to go through the process. Mitigant: The project intends to promote new managers while helping the current ones start their funds. Currently, there are people who are leaving their jobs to become entrepreneurs. These could be trained to become fund managers if the fund structure is in place. The executing agency and its other partners, as well as the project team are confident that this comprehensive approach is what it's needed to firm up the venture capital industry in Brazil.
- 6.4 The project assumes that changes in the regulatory environment for *fundos emergentes* can be pushed through with the momentum that the INOVAR initiative will create in the market. But up to this point, there has been a lack of coordination between Government and private initiatives, and the INOVAR coalition of partners may fail to reach the CVM, one of the most important actors, which can effect the much needed regulatory changes. Mitigant: FINEP has been very active promoting the INOVAR project among CVM authorities, and some have already attended the first Venture Forums that FINEP organized late last year. The press has written many articles promoting the INOVAR aims, helping to create a more favorable environment for venture capital. The project team believes that FINEP, with MIF's help, will have the necessary leadership to call upon all actors involved in key areas of the government where changes in the regulations that are not propitious to venture capital can be achieved.

- 6.5 Since SEBRAE has strong links with the government, and FINEP is a government organization, there is a risk of the Project becoming politicized. Mitigant: The selection of the companies participating in the Forums that will be chosen to receive support has been left up to the industry experts, and the final approval of the funds that pass the TIF's joint due diligence process will be sent back to each organization's Board of Directors. Since there is no obligation that all the TIF partners have to invest in the same project, it is up to each institution to decide on the worthiness of the proposed fund for approval.

VII. EVALUATION

- 7.1 Through the consultancy services of third-party specialists contracted by the Bank, the project will have a mid-term evaluation 12 months after the first disbursement and an impact evaluation three months after the project is completed. The evaluations should be guided by the Plan of Execution and by the indicators established in the logical framework presented in Annex I.
- 7.2 The mid-term evaluation will measure: i) with regard to the Website: quality of information presented, how many visits the site received, how many of those visits resulted in registrations to the site, quality and quantity of the virtual discussion forums; ii) with regard to the Venture Forums: how many companies were pre-selected and, out of those, how many were selected, number of business plans prospected and selected, number of companies monitored, and how the matchmaking process worked to produce new entrepreneur-investor partnerships; iii) with regard to the development of fund managerial capacity and institutional strengthening of the Technology Investment Facility: the number of current and potential fund managers who attended the management programs, the number of business plans reviewed by the facility, and the number of investments closed or in an advanced stage, that were promoted through the facility; and iv) with regard to the training of INOVAR Agents: the number of training sessions offered, the number of agents trained up to the mid-term evaluation, their outreach in different regions of the country, and a progress report on the implementation of the network. The final impact evaluation will measure these same indicators through the three-year period of the project, as well as the sustainability of this effort after these first three years.

VIII. EXCEPTION TO POLICIES AND PROCEDURES

- 8.1 No exceptions to Bank policies are anticipated.

IX. SPECIAL CONTRACTUAL CONDITIONS

- 9.1 Prior to the first disbursement, the executing agency will submit the following to the Bank's satisfaction: 1) evidence that the Coordinating Unit is established and operating; 2) a final Plan of Execution for the project with timetables and targets to be met; and 3) the terms of reference for the following consulting services: i) Promotional activities for the Venture Forums; and ii) the Fund Managerial Capacity-Building Training Program.

LOGICAL FRAMEWORK

Brazil: INOVAR Project

(TC-000-11-04-1-BR)

OBJECTIVES	INDICATORS	VERIFICATION METHODS	PREMISES
development of new technology based (NTBC) through the establishment of a venture capital market and to enhance investment in technology businesses.	<u>In three years:</u> the program will develop: <ul style="list-style-type: none"> 135 companies 	Final Evaluation	
mechanism for VC investment in Brazil	<u>After the implementation of the project:</u> <ul style="list-style-type: none"> 15 investments made through the TIF 	Final Evaluation Mid-term Evaluation	The legal and regulatory framework keeps improving. Pension funds are attracted to these instruments.
<p>Information for Information Dissemination and Quality Deal Flow developed.</p> <p>Managerial Capacity developed and institutional strengthening of the Technology Investment Facility achieved.</p> <p>INOVAR Agents trained and certified.</p>	<ul style="list-style-type: none"> 18 Venture Forums 270 companies pre-selected and 150 investors selected for matchmaking 1,000 companies registered in the website 25 Fund Managers per year trained 15 Fund Managers per year under due diligence 200 INOVAR Agents trained and certified 200 INOVAR Agents monitored 	Semi-annual Project Reports Semi-annual Monitoring Reports	Given the current VC scenario due to the Internet boom, there are enough fund managers to participate in the project

<p>ents for Information Dissemination and Quality Deal Flow</p> <p>and implement improvements to the Venture Capital Website</p> <p>content development</p> <p>n and implement an assistance program companies selected for the Venture</p> <p>ent operational logistics</p> <p>and implement a monitoring system for ure Forum</p> <p>and implement promotional campaigns</p> <p>anagerial Capacity developed and strengthening of the Technology facility achieved.</p>	<p>Improvements to the current Venture Capital Website designed and implemented during 3 years: USD 80,000 per year</p> <p>Website content developed during 3 years: USD 145,000 per year</p> <p>Assistance program for companies established and developed during 3 years: USD 256,000 per year</p> <p>Operational logistics implemented throughout the 3 years: USD 306,000 per year</p> <p>Monitoring system designed in the first three months and implemented throughout the project: USD 60,000 per year</p> <p>Promotional campaigns designed and implemented during the 3 years: USD 85,000 per year</p>	<p>Semi-annual Project Reports</p> <p>Semi-annual Monitoring Reports</p>	<p>There is an institutional coord among FINEP and its partner: agree to fully participate in th</p>
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and implement the Fund Managerial gram	Program designed during the first semester and implemented throughout the project: USD 120,000 per year	Semi-annual Project Reports Semi-annual Monitoring Reports	
and implement training courses for strengthening of TIF members	Training courses designed during the first semester and implemented throughout the project: USD 50,000 per year		
Plans Screen Methodology	Methodology in place and implemented throughout the year: USD 84,000 per year		
tion of Best Practices Seminars	Best Practices Seminars offered in year 2 and 3: USD 50,000 per event		
rational expenses	TIF in operations: USD 886,600 for the 3 years (FINEP in full charge of this)		
and Certification of INOVAR Agents			
and implement training sessions for INOVAR agents	Training sessions designed in the first semester and implemented throughout the 3 years: USD 70,000 per year		
n and activate a Network of INOVAR	INOVAR Agents Network established throughout the 3 years: USD 30,000 per year		

PROPOSED RESOLUTION

BRAZIL. NONREIMBURSABLE TECHNICAL COOPERATION PROGRAM FOR
THE DEVELOPMENT OF AN INSTITUTIONAL FRAMEWORK TO STIMULATE
VENTURE CAPITAL INVESTMENT IN NEW TECHNOLOGY BASED COMPANIES -
SUPPORTING THE INOVAR INITIATIVE

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, on behalf of the Multilateral Investment Fund, to enter into such agreement(s) as may be necessary with the company "Financiadora de Estudos e Projetos" (FINEP) and to adopt such other measures as may be pertinent for the execution of the plan of operations incorporated in the donors memorandum referred to in Document MIF/AT-_____ with respect to a technical cooperation for the development of an institutional framework to stimulate venture capital investment in new technology based companies - supporting the Inovar initiative.
2. That up to the amount of one million one hundred and twenty two dollars of the United States of America (US\$1,122,000) or its equivalent in other convertible currencies, is authorized for the purpose of this resolution, chargeable to the Technical Cooperation Facility) of the Multilateral Investment Fund.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.