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Creating a Venture Ecosystem in Brazil: FINEP's INOVAR Project

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Introduction

In 2011, private equity firms (early stage through buyout) raised a record US$10.13 billion to invest in Latin America. The 27% increase from the prior year's $8.1 billion (also a record) was especially noteworthy given the generally discouraging performance of fund raising efforts in the developed markets that year. Brazil led the region as the target of US$8.1 billion, or 80% of the year's total.[1]

The majority of Brazil-targeted capital went to late stage growth-equity or buyout firms. In 2012, five funds accounting for $7.3 billion (90% of the total) were raised by local or quasi-local firms —Gávea Investimentos (controlled by J.P. Morgan), Vinci Partners, BTG Pactual, and two by Patria Investimentos, which was 40% owned by US-based Blackstone Group. Data on 2011 funds raised for Brazilian early stage opportunities was more difficult to find. ThomsonONE estimated that four firms or funds located in Brazil had raised US$161 million.[2] This figure undoubtedly underestimated the total funds available for investment in Brazilian venture-stage opportunities due to the number of international venture capital firms investing there from global or regional funds. In 2011, such firms as Accel Partners, Redpoint, General Catalyst, and Tiger Global Management had all invested in Brazilian start-ups without a country-specific fund.[3]

After fits and starts in the 1970s, Brazil's private equity[4] industry had begun in earnest in the early 1990s.Later stage investment efforts grew fairly naturally from the country's privatization process in the 1980s and 1990s, but much of that activity was led by firms run and funded by developed market practitioners. The first enduring Brazilian venture capital firm was CRP Companhia de Participacoes (CRP Holding Company), which was founded in 1981 and grew to operate across a host of stages and sectors, but this firm was a rare example. By the mid-1990s, several groups in Brazil became aware of the importance of developing an indigenous venture capital (VC) ecosystem, largely to stimulate the establishment of innovative companies and help them gain access to capital. To achieve those goals, the country needed entrepreneurs who understood how to raise funds and work with equity-owning investment partners; limited partners (LPs) who knew how to evaluate funds and what was involved in such vehicles; and general partners

[1] "PE/VC Firms Raise Historic Record of $10.3 Bln for Latin America in 2011," *Latin American Private Equity and Venture Capital Association Press Release*, March 21, 2012.
[2] Data from ThomsonONE private equity database, accessed April 30, 2012.
[3] "PE/VC Firms Raise Historic Record of $10.3 Bln for Latin America in 2011," *Latin American Private Equity and Venture Capital Association Press Release*, March 21, 2012. In 2012, Redpoint set up a joint-venture in Brazil with BV Capital's eVentures but it invests out of the founding firms' current funds rather than raising dedicated capital.
[4] Please note: "private equity" is used to refer to the entire spectrum of private capital investment, from buyouts through venture and seed capital.

(GPs) who were familiar with selecting and managing companies and managing funds. In addition, an infrastructure had to be developed that included favorable tax regulations, a national private equity practitioners' organization, information sources on the industry and its performance in Brazil and globally, and a method to establish relationships between Brazilian and international private equity actors.

In 2000, the Brazilian government's Agency for Innovation (Financiadora de Estudos e Projectos, or FINEP) with support from the Multilateral Investment Fund (MIF) unveiled a program to address these needs. FINEP had spent a year assessing the obstacles and challenges that confronted technology-based small and medium-sized enterprises (SMEs). The result was the program called INOVAR (Innovation).

In the 12 years since INOVAR's debut, the program has had two iterations (INOVAR I, from 2001-2006, and INOVAR II, from 2007 – 2012) and has been recognized as a role model for government efforts to stimulate a venture capital ecosystem. In many cases, this paper will discuss the two phases as a single entity, largely because the two merged quite naturally. We present here a brief background on private equity in both Latin America and Brazil, and then explore the genesis of INOVAR, the details of the program, and its results. The paper concludes with challenges to be addressed.

History of Private Equity in Latin America

Private equity in Latin America and the Caribbean (LAC) is a relatively recent phenomenon. Data on fundraising for the region only goes to 1993, when US$123 million was raised. Fundraising soared to US$3.7 billion in 1998, only to crash to a low of US$407 million in 2002 in the wake of the collapse of the Argentine economy and the fall of the NASDAQ. After a few years of fundraising below US$1 billion, the industry recovered to reach 2011's peak of US$10.13 billion. Investment followed similar patterns (see **Figure 1** for LAC fundraising and investment.)

Although some of the sectors drawing private equity interest in LAC were similar to those in developed markets—biotech, information technology, and energy—sectors such as travel and retail were also popular. Noted one reporter, "Investors are attracted by the region's growing middle classes, its emerging energy industry…and its huge infrastructure needs."[5] For instance, Denham Capital, a U.S. private equity firm, recently announced that it planned to devote up to 20% of its $3 billion fund to renewable energy and that Brazil would be a "key" market.[6] In late 2011, Darby Private Equity, a long-time investor in Brazil, announced its investments in a bio-energy company and a supplier of engineering solutions to the oil and gas sector.[7] Finally, several investments in consumer

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[5] Joe Leahy, "Latin America at $10.3 billion record for fundraising," *Financial Times*, March 20, 2012, http://www/ft/com/coms/s/0/de722d26-72b0-11e1-ae73-00144feab49a.html, accessed April 10, 2012.
[6] "Denham Earmarks 20% of $3 Bln Fund for Renewable Energy," *LAVCA News*, April 5, 2012, http://lavca.org/2012/04/05/denham -earmarks-20-of-3-bln-fund-for-renewable-energy/ accessed May 2, 2012.
[7] "Darby Makes Two Brazil Infrastructure Investments," *Press Release*, December 14, 2011, posted on www.pehub.com/129140/darby-makes-two-brazil-infrastructure-investments/ accessed May 2, 2012.

sectors such as travel agencies and toy stores (among many others) had been announced. The Carlyle Group acquired 85% of Ri Happy, Brazil's largest toy store chain, in March 2012,[8] while Redpoint and General Catalyst had earlier invested in ViajaNet, an online travel agency.[9]

As in any region, the amount raised by country varied dramatically. The Latin American Venture Capital Association's (LAVCA) scorecard, which ranked the countries in the region based on their attractiveness to private equity investing, rated Chile, Brazil, and Mexico in the top three spots for 2011. Chile's efforts to spark entrepreneurship allowed it to keep the lead it had held for six years. In Brazil, the government's reduction of the financial transactions tax for private equity investors was viewed as promising. In Mexico, regulators were refining the 2009 laws that allowed Mexican pension funds to invest in private equity through "Development Capital Certificates" (CKDs). While still unwieldy, the process of raising CKDs was becoming easier and the vehicles had inspired the creation of a number of new private equity funds in that country.[10] Argentina, once a private equity hotbed, had fallen behind other LAC countries due to economic and political uncertainty. Despite its vibrant entrepreneurial community, the country was in a tie for tenth place in the LAVCA rankings and outranked only the Dominican Republic (see **Figure 2** for 2011 rankings and criteria.)[11]

Brazil first caught the imagination of the world's investment community in 2001when Jim O'Neill from Goldman Sachs coined the acronym "BRIC". By 2012, Cate Ambrose, the president and executive director of the LAVCA, said, "You have by far the deepest pool of fund managers in Brazil and the longest track record of raising and investing multiple funds and returning money to investors."[12] With a population in excess of 190 million, a growing middle class, and a large number of family-owned businesses, the country had much to offer private equity investors. In 2011, Brazil accounted for the highest amount of money dedicated to single-country funds in LAC and since 2009, has been the site of almost half the funds invested in the region.[13]

Private Equity in Brazil

Brazil's performance was even more remarkable when viewed in context. Venture capital had a long but difficult history in the country, dating back to 1974 when Banco Nacional de Desenvolvimento Economico e Social (BNDES) founded three entities to pursue VC

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[8] Evelyn M. Rusli, "Carlyle Buys 85% Stake in Brazil's Largest Toy Retailer," *New York Times DealBook,*, March 2, 2012, http://dealbook.nytimes.com/2012/03/02/carlyle-buys-85-stake-in-brazils-largest-toy-retailer/ , accessed April 20, 2012.
[9] "Brazil's VaijaNet Seals $19 Million," *Press Release*, posted on http://www.pehub. com/106667/brazil%E2%80%99s-viajanet-seals-19m/, accessed May 2, 2012.
[10] LAVCA, *LAVCA 2011 Scorecard: The Private Equity and Venture Capital Environment in Latin America*, (NY, NY: LAVCA) 2011, p. 1-2.
[11] Ibid. p. 1.
[12] Cited in Leahy.
[13] "PE/VC Firms Raise Historic Record of $10.3 Bln for Latin America in 2011," *Latin American Private Equity and Venture Capital Association Press Release*, March 21, 2012 and LAVCA, *2011 LAVCA Industry Data*, 2011, p. 3, 5.

projects. They were short-lived, and subsequent efforts foundered on the country's struggles with hyperinflation and an unsupportive legal framework.[14] The first enduring Brazilian private equity firm was CRP Companhia de Participacoes, which was founded in 1981 and, by 2012, had made 68 investments, exited 41 companies, and had 15 companies in its portfolio.

Between the early 1980s and the mid-1990s, though, two important changes for private equity occurred throughout LAC and especially in Brazil. First, Brazil, along with Argentina and Chile, started to privatize its state-owned industries. State-owned conglomerates in sectors such as insurance, mining, petroleum, and telecommunications were sold off to private investors. Also critical was the move toward democracy in the region. By 1990, Brazil, Argentina, and Chile had all established democratic governments and started reducing barriers to foreign investment.

In Brazil's privatizing, recently democratic environment, the early 1990s saw the stirring of a private equity ecosystem. In 1991, foreign investors received permission to invest in the stock exchange (BOVESPA). Two years later, another early native Brazilian private equity firm, GP Investimentos, was founded and attracted U.S. institutional investors—predominantly banks—through its combination of classic buyout techniques and a local market presence.[15]

Between 1990 and 2000, the Interamerican Development Bank's Multilateral Investment Fund (MIF) and the Inter-American Investment Corporation (IIC) invested in Brazil's domestic private equity funds, along with BNDES. The firms backed by these three institutions became the first vintages of Brazilian funds targeting domestic opportunities.[16]

These operations, however, encountered a number of obstacles. Most notably, while growth equity and buyout investments performed relatively well, VC firms struggled largely due to the small sizes of their funds and the high risk of their portfolios. Those that succeeded quickly moved up-market to larger sized funds and later stage opportunities. In 1999, the Brazilian VC landscape—such as it was—had very few domestic players and very little activity among the early stage investors that typically financed the most innovative companies. Although VC investment funds had been authorized as of March 1994, very few domestic funds had actually been established.[17] This came to the attention of the Brazilian Agency for Innovation, FINEP.

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[14] In 1982, law 2,287 was passed and included incentives to VC such as an income tax exception for capital gains on VC investments. The law was repealed in 1988.

[15] Matthias Baltin and Philipp Bell, "Venture Capital In South America," PhD Dissertation, Wissentschaftliche Hochscule fur Unternehmensfuhrung/Otto Beisheim Graduate School of Management, July 30, 2001, p. 25, http://www.gryphonresources.com/pdf/go/FN01-VentureCapital_SAmerica.pdf, accessed April 3, 2012.

[16] IADB/MIF: "Donors Committee Memo," MIF/AT-837, August 31, 2007: *internal document*, p. 3.

[17] The limited partnership structure is not recognized in Brazil; rather, funds are structured as closed-end partnerships with no more than 35 investors and a 10 year life that can be extended. The legislation designated as CVM 209 is viewed as the critical enabling legislation for VC funds and a majority of funds are organized under it, in part to take advantage of less burdensome taxes.

Founded in 1967 as part of the Ministry of Science and Technology, FINEP financed scientific and technological research and education as well as corporate research and development. The organization, with roughly 500 employees, played a double role in both funding research and helping young companies commercialize innovative technologies. It provided grants to non-profit institutions such as universities and research centers, and lent money to companies. FINEP also administered Science and Technology Sectoral Funds, through which it stimulated innovation efforts among Brazil's manufacturing industries by providing grants, loans, and incentive payments.[18]

Concerned about the scarcity of financing for innovative companies, FINEP studied the environment and identified a number of noteworthy gaps needed to be addressed:[19]

1. There were very few domestic VC fund managers with any significant track record.
2. Local pension funds were unwilling to invest in private equity, particularly venture capital. In 1999, Brazil's private pension funds alone had US$70 billion under management (13.5% of GDP), but very little invested in private equity.[20]
3. There was no national organization for private equity firms to share lessons they had learned or to lobby for regulatory change.
4. There was no effective bridge between investors and SMEs. It was difficult for SMEs to find GPs that might be interested in investing, and when they did so, few GPs had the skills to assess the opportunity. Moreover, few entrepreneurs were comfortable with active, equity-owning investors.
5. The regulatory and legal framework for on-shore VC and later stage investments needed development.
6. Exits from VC investments almost always occurred through strategic or trade sales as the market for Initial Public Offerings (IPOs) was limited. Between 1995 and 1999, Brazil's main stock exchange, BOVESPA, had four IPOs.[21]
7. Few companies regardless of their size, were familiar with private equity as a financing vehicle.

The MIF and FINEP shared an underlying concern that without a healthy early-stage private investment ecosystem, innovation and innovative companies would wither,

[18] FINEP, "The Brazilian Innovation Agency: 2005," *FINEP*, 2005, pp. 2-4, http://www.finep.gov.br/ english/ FINEP_folder_ingles.pdf, accessed April 5, 2012.
[19] FINEP, "Report on the INOVAR Program," *internal document*, April 2012.
[20] Adacir Reis and Leonardo André Paixão, "Private Pensions in Brazil," July 2004, http://www.oecd.org/dataoecd/26/40/42601981.pdf, p, 2, and GDP data from Economist Intelligence Unit, *Country Report: Brazil* , Fourth Quarter 1999, (London: EIU, 1999) accessed April 11, 2012.
[21] Maria Helena Santana, "Securities Exchanges for SMEs: BOVESPA's Novo Mercado and BOVESPA MAIS," slides at the COSRA SME Forum, Miami, FL; May 15, 2006, p. 4, http://georgetownsebi.wikispaces.com/file/view/Securities+Exchanges+for+SMEs.pdf, accessed April 11, 2012

harming Brazil's long-term economic prospects.[22] Noted Susana Garcia-Robles of the MIF:

> Investing in later stage opportunities may make sense from some managers' standpoints, especially if their first fund was too small and didn't deliver a carry to the GP. This phenomenon is not uncommon: fund managers start investing in early stage companies with small funds and then "graduate" to raising larger funds targeting later-stage transactions as they gain recognition in the market. This is worrying, because if experienced managers keep moving to larger opportunities, we must continuously train a group of early-stage GPs. Besides, this evolution does nothing to improve Brazil's capacity for innovation. That's why the MIF wanted to help Brazil create a domestic venture capital industry.[23]

INOVAR

After defining the gaps in the VC ecosystem in 1999, FINEP approached the MIF to help "develop a more comprehensive approach toward the creation of a full-fledged venture capital industry."[24] Patricia Freitas, the current head of the INOVAR program, had joined FINEP from Terra Capital, a South American-focused biodiversity investment fund. She said, "We wanted to collaborate with the MIF for several reasons. They had been active in Brazil for some time, so they knew how things worked. They knew venture capital and could help us develop the critical skills that we would need to convey. And finally, associating with them gave the effort more permanence."

The association with the MIF provided other benefits as well. It gave credibility to the program's goals, which were viewed as ambitious. In addition, the MIF's support meant that INOVAR's staffing, focus, and goals were less likely to change in the wake of future elections, when new governments would arrive with new programs and priorities. Research has shown that government efforts at stimulating venture capital often founder on such changes: it is difficult for politicians to support programs that incur costs during their tenure but may show results only after they move elsewhere. Hence, the support of a supra-national, non-political group like the MIF helped preserve the effort over the time horizon necessary to establish a long-term investment program.

In the INOVAR program, FINEP and the MIF tried to address the gaps that had been identified. To achieve their goal of helping SMEs gain access to capital while

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[22] For more on the importance of venture capital as a tool for creating economic, social, and environmental change, see V. Avril Perez, "Conveying the Role of Venture Capital Investing in Promoting Social, Economic and Environmental Returns," *Report to the Inter-American Development Bank and Multilateral Investment Fund*, January 2012, among others.

[23] By the end of 2010, the Brazilian pension funds had R$565,761 million (US$332.9 billion) under management. (As of December 2010, R$1=US$0.5885, per Oanda.com, historical exchange rates, http://www.oanda.com/currency/historical-rates/ accessed April 10, 2012. Economist Intelligence Unit, "League Tables," *View Wire*, March 28, 2012, http://www.eiu.com/index.asp?layout=ib3 Article&article_id=128918797&country_id=1480000148&pubtypeid=1132462498&industry_id=&category_id=, accessed April 10, 2012. Data is as end of 2010.

[24] Donor Committee memo, p. 3.

encouraging the creation of new VC funds and fund managers in Brazil, the organizers had to address almost all parts of the VC environment simultaneously: entrepreneurs needed to be trained in raising money and what to expect from VC investors; fund managers needed to be trained in raising and managing funds, assessing investment opportunities, and managing portfolio companies; and potential limited partners—particularly the pension funds—had to learn how to do due diligence on funds.

Designing the project took almost two years. "We talked to all the institutions in the market," said Freitas. "Many government programs to stimulate VC miss critical linkages or forget to assess the whole picture.[25] We knew we would need to adjust the program as we went along, but we had to get it mostly right at the start."

Initially, the concept had been to create a government group that would act as a fund-of-funds. "But then we realized the problem," said Freitas. "Who would give money to FINEP to invest in funds at that time?" Complicating the matter was the April 2000 NASDAQ crash and the subsequent dot-com collapse, after which a number of nascent venture-backed high-tech companies in Brazil failed.

The effort focused on both innovation and return. This matched the approach of the MIF, as Garcia-Robles commented, "In some of our past programs, we had had a 'grant-mentality' approach and tried to establish VC funds without a focus on returns. We quickly learned that development is not enough. You need returns as well."

Two other groups joined the project as partners: Sebrae, a public-private partnership that focused on supporting SMEs, and Petros, the pension fund of Brazil's national oil company, Petrobras and the largest such group in the country. Sebrae's involvement with INOVAR was a natural extension of its mission. A public-private partnership, the organization was founded in 1972 with the goal of encouraging SMEs. Unlike FINEP, there was no distinction regarding the enterprise's degree of innovation. The program had a chapter in every state and focused on the dissemination of knowledge to help entrepreneurs found and grow small businesses, particularly those in services and retail, industry, and agribusiness. Some of the chapters had gone beyond knowledge dissemination, though, and invested in VC funds with the MIF before INOVAR's establishment. As a result, the organization was aware of and interested in VC investment.

Petros' interest stemmed from strategic concerns. The head of the operation at the time, aware that his colleagues in the United States had a long history of investing in VC, decided to explore the possibility that INOVAR presented. Although Brazil's short-term annualized interest rates ranged from 15% to 20% at the time and offered a low-risk, high-return investment option, Petros' management was aware that such performance would not endure. One of the most important aspects of the program was that Petros had no obligation to invest in any of the funds—the representative could just learn about the

[25] For more on the challenges of creating public policy to stimulate private equity, see Josh Lerner, *Boulevard of Broken Dreams*, (Princeton NJ: Princeton University Press, 2009).

asset class. Its involvement, however, further legitimized the INOVAR project in the eyes of both LPs and GPs.

In October 2001, FINEP and the MIF signed an agreement launching the INOVAR (Innovation) project. The MIF contributed $1.122 million of the total $3.7 million budget over five years. The balance came from FINEP. The MIF provided intensive training to the INOVAR team to help them understand how to do due diligence and other best practices.

Creating INOVAR

Freitas at the time was head of FINEP's Fund Investment Department and observed the challenge of finding staff for the new project. "We invited FINEP employees to join the project," she recalled:

> No one was interested. Even though we're training people to be venture capitalists, we are not compensated on a VC scale. We don't get carry. We're paid on government pay bands. We finally got people interested by talking up the program and the impact it could have. We wanted committed professionals who would love what they were doing and be willing to work long hours. We now have a staff of about 15-20.

At the start, INOVAR[26] had little money to achieve goals that, as Freitas said, "were ambitious. The MIF thought we might be over-ambitious." The small team started with projects that required little money, such as founding ABVCAP, the Brazilian VC Association and holding the first Venture Forum.

INOVAR I: Components

The group then worked on filling the gaps identified earlier. To disseminate information about the industry and the program, it created a website at www.venturecapital.gov.br/vcn/index.asp. Not only did the website describe VC and the INOVAR program, but it provided information about registration for the project's various components. For some programs, such as the INOVAR Funds Panels and Venture Forums (described later), the website provided a place for applicants to post their preliminary materials for the staff to review.

The other parts of the INOVAR program included[27]:

1. INOVAR Funds Panels –Also called a Technology Investment Facility or the INOVAR Incubator, the program created a structured process that assembled a

[26] FINEP is the agency that sponsored the INOVAR program. INOVAR personnel are FINEP employees and this team is in charge of recommending funds in which FINEP might invest. In general, FINEP refers to the agency while INOVAR refers to the program, but when the two are interlinked, the two names may be used.
[27] MIF, "G-20: SME Finance Stock Taking," *internal MIF memo,* 2008, p. 4.

consortium of investors (the INOVAR Funds Panel) who jointly analyzed and performed due diligence on VC funds. GPs learned how to present their funds and LPs learned how to assess them. Written assessments sent to the GPs provided feedback on their fund proposals, which helped the entire industry evolve.

2. INOVAR Forums – These forums provided education to both entrepreneurs and investors (usually GPs). Promising entrepreneurs received training on fundraising and preparing business plans to present to potential investors, which also received education about the asset class through the program. Segmented according to company stage (seed, venture, or pre-IPO), the companies could interact with potential investors, present their business plans, and if successful, start to negotiate a deal.
3. VC Training programs—These sessions created local capacity by educating local GPs and investors (mainly pension funds) on best practices and due diligence issues.

INOVAR Funds Panels

The INOVAR Funds Panels not only helped GPs and LPs find each other, but trained the two entities on best practices in fund management, design, and assessment. The program operated in a structured process through which FINEP's INOVAR staff issued Calls for Proposals (Calls). Publically announced in an official government newsletter and on the ABVCAP web site, these one-page statements said that FINEP and its partners the MIF, Sebrae, and Petros (initially; later the list of partners grew) wanted to invest in funds targeting innovative small to medium-sized companies. The fund, which had to be a true for-profit VC fund, needed market validation through raising at least 20% of its capital from private investors. The fund focus was purposely left vague. As Freitas explained, "We want to see what's out there and what the market sees as an opportunity." The staff screened the funds and chose the presenters based on their investment strategy. Those funds that passed through this screening were invited to present at the INOVAR Funds Panel.

The panel usually lasted for two or three days[28] and educated both the LPs and GPs. The fund managers presented to investors attending the Call, both INOVAR partners and other LPs who were observers (that is, not financial supporters of INOVAR). Freitas said, "We get the LPs to attend because it's a chance for them to see all the fund managers in the market with no obligation." A fund manager presented for 30 minutes, followed by 30 minutes of questions and answers. The fund manager then left the room and the MIF and FINEP team led the discussion among LPs. The group tried to ensure that both experienced and new LPs attended the session to help the new investors learn how to assess funds. Initially, the MIF staff had trained the FINEP staff and later, the FINEP staff shared their experience with the other investors. "After a few years," Freitas recalled, "*we* started the discussions with the other investors about what to look for— the fee structure, key man clauses, and budgets. Because we were focused on VC funds, the

[28] In 2011, the INOVAR Funds process resulted in a four-day long program as 31 funds presented.

VC industry started using industry best practices. Local GPs and LPs learned from the experience and started adopting the practices in private equity and seed funds as well."

In assessing the opportunity, the group shared their sense of the fund's strengths and weaknesses, along with any doubts. Soon thereafter, the GP received a letter from the INOVAR Partners with the assessment and one of three options:

1. The investor group wanted to do due diligence
2. The investor group did not want to do due diligence
3. The investor group needed more information about certain topics, which were described in detail.

At the first call, four investors—FINEP, Sebrae, Petros, and the MIF—attended and 18 fund managers presented. Said Freitas, "For the first call, some candidates showed up with no real proposal at all. They were rejected and told to refine their strategy. Over time they learned that this was a serious process, and after two to three years, these groups had real proposals as real fund managers." The approach was very technical, largely to respond to the scarcity of track records. For instance, to assess a fund's financial strength, the team examined personal references and the manager's personal finances, along with alignment of interests. INOVAR's philosophy was, "We can have a struggling company but we can't choose the wrong fund managers."

GPs were initially hesitant about the INOVAR Funds Panel process. As the process was implemented and the group's commitment to private equity became obvious, though, a number of advantages appeared. First, the INOVAR Funds Panel process provided tremendous economies of scale to the GPs. In one hour, a GP could address a number of prospective LPs. Later, the LPs could follow up with separate meetings if they wished. The assessment letter that summed up the LPs' concerns also proved to be useful. Freitas recalled, "GPs had been uncertain about what they would do with a letter. They wanted funding, not a letter about their strengths and weaknesses. But then they discovered that the letter helped them refine their strategy and indicated their legitimacy when they approached other LPs."

INOVAR staff also led and managed the due diligence process. "You can say we're the secretariat of the process," Freitas explained. Through due diligence, the potential investors confirmed all the information that was presented at the panel. After negotiating the due diligence agenda with the GPs, the INOVAR team organized the interested LPs. INOVAR did not say whether it would recommend that FINEP invest in the fund and each institution made its own decision. At the end of the process, the INOVAR staff and the other LPs met with the fund manager to present the results. To prevent influencing the other LPs, INOVAR's due diligence reports were descriptive and did not mention the organization's own opinions on the opportunity. (See **Figure 3** for the fund selection process.)

With the exception of the INOVAR partners (initially, FINEP, the MIF, Petros and Sebrae), the group of LPs on the Funds Panel changed with each Call, with a different mix of experienced and new institutions each time so the attendees could learn from one another. Freitas recalled:

> Attracting investors to the INOVAR Funds panels was one of our hardest tasks—at the start, most of our meetings with them were a little tentative. After all, this was in 2000 and 2001 and it wasn't easy to attract investors to high risk investments in technology and innovation after the IT bubble in a market where the annualized short term interest rate averaged between 15% and 20%! But thanks to INOVAR's enriched fund selection process, the pension funds began to participate on the Panel over time. As a result, they were well prepared to invest in private equity when the interest rates started to decline and made returns to alternative assets more competitive.

It is important to note that the INOVAR Fund Panels were not an investment vehicle but a consortium of investors that analyzed funds together but made independent decisions about investing in them. The participation of other LPs enriched the process as they shared concerns and questions. Each LP made its investment decision separately and invested directly in the selected funds. LPs could choose one of two different statuses: INOVAR partners could participate in the structured analysis and due diligence process, had access to INOVAR's courses on private equity and VC, and were part of a continuous and open learning process. "Observers" could only attend the Calls and hear the presentations and the ensuing discussion. INOVAR would run the due diligence process for partners regardless of its intention to invest in the fund on FINEP's behalf; it would not do so for observers. "We'd like the partners to start running their own due diligence processes," said Freitas, "but the time has not come yet; they want to see FINEP's involvement." Either group could invest in any of the funds that presented—or any other funds that it encountered.

Part of INOVAR's goal was to convince Brazil's 366 pension funds to invest in domestic private equity opportunities. Although they were allowed to commit up to 20% of their capital in such assets, lack of familiarity with private equity and its opaque assessment process had made them reluctant to invest. But wooing them was an arduous process. "I visited the big pension funds every month," said Freitas. "It took five years of monthly visits before they finally invested. The GPs started doubting whether the pension funds were really interested."

Further education occurred through international contacts. INOVAR's staff arranged opportunities for Brazilian groups to exchange information with international organizations. Brazilian pension funds visited their counterparts in the U.S. and U.S. pension funds visited Brazil. FINEP/INOVAR also received groups of pension funds in missions organized by the U.S. Department of Commerce. In the early 2000s, Brazilian fund sizes were too small for the large U.S. pension funds to invest in efficiently, but they wanted to be prepared when the economy and the asset class grew.

Venture Forums

The Venture Forums trained entrepreneurs and provided a platform that matched them with GPs. Entrepreneurs were recruited both passively—by responding to a notice on the INOVAR website—and actively, through the efforts of INOVAR staff to find promising innovative start-ups. These two methods usually resulted in roughly 150 registered companies. The INOVAR staff screen the registrants and reduced the pool to 50 companies. This group then appeared before an evaluation board composed of FINEP and market professionals, usually GPs, who selected the final group that would receive business coaching. Along with experience in writing business plans, the program taught them what investors wanted and how to run a start-up, and at the same time assessed the entrepreneur's appetite for pursing high-growth strategies. Upon completion of the training, the companies presented to an assembly of GPs. After the presentations, an interested GP would start to negotiate a term sheet with the company for an investment or an acquisition. When companies that had come through the training program were presented as an opportunity to any of the funds in which FINEP had invested, the staff recused themselves from the assessment to maintain neutrality.

The Forums soon targeted companies at different stages. Venture Forums addressed early stage companies, Pre-IPO (or IPO) Forums targeted later stage companies seeking help in going public, and eventually, Seed Forums focused on the needs of very young companies.

In addition, the MIF, through INOVAR, funded attendance by various Brazilian pension funds and the FINEP staff at the U.S.-based Venture Capital Institute's five-day training programs. Along with the subject matter, the attendees learned about best practices from their colleagues and developed international networks within the private equity industry. To ensure that the attendees took the matter seriously, INOVAR did not pay the entire cost; the attendees' organization assumed part of it.

VC Training

Through the VC Training program, INOVAR further increased the pool of LPs and entrepreneurs who understood venture capital as an asset class. For LPs, the INOVAR program provided training in VC fund assessment and also exposed them to the international market and best practices. Sometimes the trainers were domestic professionals with which INOVAR's staff developed a program.

INOVAR I's Results and INOVAR II

In a 2007 assessment of INOVAR I that requested funding for INOVAR II, the MIF wrote, "The INOVAR project has been executed successfully and has performed according to expectations, which were considered rather ambitious at the time of approval."[29] Moreover, these results had been produced during a period of

[29] MIF Donor Committee Memo, p. 3.

macroeconomic instability, alongside the NASDAQ crash and the Russian and Argentine economic crises.

The INOVAR Funds Panel process had been accepted by all the parties involved.[30] Among the funds that raised part of their early funding through the process were the Stratus Group, Fir Capital, and DGF Investimentos. The Stratus Group presented at the first INOVAR Funds Panel in 2001 and was the first fund that FINEP selected through the INOVAR program. Three of the four INOVAR partners at the time, Sebrae, the MIF, and FINEP, invested in the fund, which produced returns in excess of 2x. Since then, Stratus had become a significant player in Brazil's mid-market, executing growth and buyout transactions and pursuing clean tech and sustainability opportunities.[31] Fir Capital presented at an early INOVAR Funds panel. The firm remained focused on early-stage investments and in 2007, partnered with U.S.-based Draper Fisher Jurvetson in raising a US$40 million fund, which was largely backed by Latin American pension funds.[32] DGF Investimentos, founded in 2001, raised its first fund of R$22 million (US$10 million) from the MIF along with other investors (but not INOVAR). The firm presented its second fund, FIPAC, at the sixth INOVAR Funds Panel in 2006. Even CRP, Brazil's oldest firm, had raised funds through the process. DGF has become a leading growth equity firm targeting SMEs. In addition to funds addressing early stage and growth opportunities, the firm manages a dedicated bio-ethanol investment fund.[33]

The Venture Forums had also been successful. In the first seven years, INOVAR ran two to three forums each year and an average of 40 investors attended each event, generating great awareness. Among the success stories were:

1. Lupatech, a maker of industrial valves. The company took part in one of the first Venture Forums, raised several rounds of capital from groups such as the BNDES and GP Investimentos, made several acquisitions and in 2006, went public on BOVESPA.[34]

2. Microsiga (now TOTVS), a provider of enterprise resource planning software. The company resulted from the merger of three small firms, each of which had attended INOVAR Forums. Microsiga attended the second pre-IPO Forum in 2002 and became the first Latin American information technology company to go public on the BOVESPA Novo Mercado exchange in 2006. The company used the IPO's proceeds to fund its acquisitions of RM Sistemas (a graduate of

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[30] MIF, "G-20: SME Finance Stock Taking," *internal MIF memo,* 2008, p. 4, and MIF Donor Committee Memo, Annex III-INOVAR Track Record.
[31] The Stratus Group website, http://www.stratusbr.com/index.php/2011/english-brazilian-private-equity-firm-stratus-buys-corporate-fleet-company-maestro-for-32m/?lang=en, accessed April 25, 2012. In May 2012, one of Stratus' portfolio companies listed on the Bovespa Mais exchange.
[32] "DFJ-Fir Capital Create Venture Capital Powerhouse in Brazil," *Press Release*, July 15, 2009, http://www.fircapital.com/fircapital/web/conteudo_pti.asp?idioma=0&tipo=12978&conta=45&id=72318, accessed April 25, 2012.
[33] DGF website, http://www.dgf.com.br/index.php/en/company2/whoweare, accessed May 8, 2012.
[34] Lupatech website, http://lupatech.infoinvest.com.br/static/enu/historico.asp?language=enu, accessed April 18, 2012.

> INOVAR's third pre-IPO Forum in 2004) and Datasul, which had attended the first such event in 2002, along with a number of other companies, some of which had been backed by INOVAR-related firms. Eventually, the publicly listed TOTVS acquired Microsiga. [35]

Other noteworthy results included the fact that Brazil's pension funds began investing in the country's VC funds for the first time. In 2005, Petros had announced commitments to five VC funds. INOVAR had also become known as a brand among LAC countries that were trying to adopt aspects of the model to create their own VC ecosystems.

The staff of INOVAR and the MIF, though, wanted to take INOVAR's work further by moving the Brazilian VC industry closer to international standards and helping other LAC countries adopt the model. In addition, they wanted to continue to attract domestic and international institutional investors to Brazil's VC funds and provide training to the VC industry, including the FINEP staff. Dismayed by the continued tendency of VC funds to move into later stage investments, INOVAR II adopted a new goal of stimulating the seed-stage investors and angel funds—although the fact that such evolution was a concern attested to the program's success. In 1999, most funds termed "venture capital" were the size of seed funds, usually less than R$50 million. The budget for this phase was US$5.4 million, and unlike INOVAR I, the MIF and FINEP almost evenly divided the cost.

<u>INOVAR II: Execution</u>

For INOVAR II, the staff used many of the techniques that had proved effective in INOVAR I. Seed Forums, for instance, followed the same general procedure as the Venture Forums but had a thorough screening step in which the INOVAR staff considered the company's amount of innovation, its possible returns, and its market potential. The field of applicants usually fell to 40-50 by the screening stage, and was reduced again to roughly 10 that presented to a panel of GPs, FINEP professionals, and other experts. Freitas commented, "We always ask the markets for help."

Success stories among seed companies included Ningo, a start-up focused on simplifying the process of on-line shopping, and Pixeon, which developed digital imaging solutions for medical diagnosis. Ningo participated in FINEP's business training program before presenting in the 10th Seed Forum in 2011, where it received funding from a group of São Paulo-based angel investors. The investment allowed the company to increase marketing efforts and expand its network of affiliated online stores. Pixeon, founded in 2003 and the recipient of numerous awards for innovation, participated in FINEP's first Seed Forum in late 2007 and received substantial training. In 2011 Intel Capital invested in the company, making its first Latin American healthcare information technology investment.[36]

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[35] TOTVS website, http://www.totvs.com/sobre-a-totvs/nossa-historia, accessed April 18, 2012.
[36] " Intel Capital Invests in Brazilian Healthcare Technology Company Pixeon ," Press Release, December 19, 2011, http://www.intel.com/pressroom/capital/pdfs/Pixeon_Release.pdf

Through INOVAR, FINEP also established a program to encourage Seed Funds distinct from the INOVAR Funds Panels. Initially, the program sought to invest in funds that had raised 40% of their capital from local investors (usually agencies of some sort) and 20% from private investors (usually angels). FINEP would invest up to 40% of the total and would offer a “money-back guarantee” of up to 20% of their commitment to the private investors in case the fund lost money. Although the program did attract some funds, finding local agencies willing to contribute the required 40% was difficult. In addition, as Eduardo Sette Camara, Freitas’ colleague at FINEP, said, “There was too much risk in this structure. There were new companies and new managers along with new LPs investing in small funds where the economics just didn’t add up.”

The program was revised in two ways. First, the requirement for local agency backing was dropped. The “money-back guarantee” on 20% was maintained but private investors had to provide 30% of the total. INOVAR/FINEP[37] would provide up to 70%, but no more than R$35 million (US$20 million). The total fund size had to be at least R$25 million (US$15 million). Secondly, FINEP agreed to reduce its returns and take only invested capital and the hurdle rate (preferred return) on up to 50% of its investment in the fund. This increased the returns for the manager and the other investors. With the new structure, three funds had been founded, with the largest at R$80 million (US$47 million). Sette commented, “In the first model, the largest funds were R$15 million (US$10 million). Now they tend to be in the vicinity of R$50 million (US$30 million).” It was hoped that this program might entice successful funds that had moved away from their VC heritage to reestablish an early stage operation.

The angel network initiative accompanied the Seed Forums. Before a Seed Forum, INOVAR staff held a technical workshop for angel investors only, presenting training on legal and tax issues as well as methods and expectations for angel investing. The first workshop had 70 attendees; the second 75; and a third was in the planning stages. After attending the first workshop, one participant started an umbrella organization for Brazil’s angel groups. In total, five angel networks had been established. Freitas said, “We were asked to cover their administrative costs. That didn’t seem right; it seemed bureaucratic and inconsistent with our goals. So we decided to focus on angel workshops and seed forums—in the workshops the angels start talking to each other and that can really encourage deals.”

Another program begun in INOVAR II was the Inovar Awards, which were intended to promote best practices. The idea dated to 2004, when some rating companies approached Freitas with the suggestion of creating a rating system for Brazilian GPs. “In a market that was still developing as Brazil’s was at the time,” she said, “we were worried about how it could be implemented.” This gave FINEP the idea of developing an award that could increase the reputation and status of GPs and push them to best practices. Launched in 2009, the Inovar award consisted of three categories: Best Governance (on the fund level), Best Team (on the fund level) and Best Deal. The GPs would send their cases to FINEP according to the categories in which they wanted to participate. FINEP and the INOVAR Investors would analyze and vote on the winners. Since 2009, the awards have

[37] Strictly speaking, FINEP supplied the capital as part of the INOVAR program.

been given three times. The program has been fully incorporated into FINEP's Innovation Awards. These have been given every year since 1998, and the winners receive their awards directly from Brazil's president in a national event in Brasilia. In addition to the recognition, the Innovation award winners also receive a cash prize. In 2012, the Inovar Award will use this model.

INOVAR Evolving

At the end of its first decade, INOVAR both reached out and specialized. In keeping with its goal of knowledge dissemination and as part of the MIF's conditions to provide a second technical assistance grant, staff traveled around the country and LAC to spread the INOVAR model. Furthermore, many countries sent their own representatives to Brazil to meet with INOVAR staff. Within Brazil, the group conducted its different forums in the various states. The sessions were held at a center of innovation, usually a neutral institution that could attract the most significant players in the innovation and funding sectors. At the same time, the staff trained the institution's staff in its methodology. This approach transferred skills and provided legitimacy to the new group. "They have the FINEP seal," said Freitas. Increasingly, the program was moving to more remote regions, such as the northeastern regions or Amazonia.

Across LAC, the INOVAR approach had been used as a model for projects in Peru, Colombia, Mexico, Chile, and Argentina. Some of these were funded by the MIF; others were not, but visits to or from FINEP were part of the design.

In Brazil, the program was starting to specialize in the sectors and stages of the companies and funds invited to its Forums. In 2012, FINEP planned to hold a Venture Forum that would target sustainability-focused companies. The entrepreneurial forums were becoming more targeted: one to companies at the pre-IPO stage and others to those from the country's 400+ tech incubators. Fewer than 20% of the companies in FINEP's investment portfolio had been produced by the incubators. Explained Freitas, "We'll invite them to register, screen the proposals and do some training around fundraising. At the end, we'll have them present to the investors and experts. This will provide an opportunity for companies from less effective incubators to learn from those that are more effective."

INOVAR at a Decade

Between its debut in 2001 and the end of 2011, INOVAR had made remarkable strides in addressing the gaps initially identified in Brazil's ecosystem. The INOVAR Funds Panels had executed 12 calls plus 5 calls for seed funds. From the initial four partners, of which one was a pension fund, INOVAR had 17 partners, 11 of which were Brazil's pension funds. The top five pension funds were all partners. More than 220 fund proposals had resulted in over 110 processes of due diligence. FINEP selected 24 funds in which it invested a total of R$416 million (US$250 million). These 24 funds raised a total of U$2 billion from LPs including FINEP, INOVAR investors, and others. Almost half of the total came from 13 local pension funds, not all of which were INOVAR partners. (See **Figure 4** for the funds process over time.)

A significant example of the pension funds that first started investing in VC due to the INOVAR program was Petros, the pension fund for Petrobras. After attending INOVAR Funds panels for almost five years, the organization invested in the asset class for the first time in late 2005. For a substantial period, Petros continued to rely on INOVAR's structure to select funds. Freitas said, "Some of the smaller pension funds and new LPs still rely on our program to select their VC investments. This is a mixed blessing: we are glad to provide the service and glad that they are investing in the funds, but we don't want to be seen as an advisor."

The 36 forums held between 2000 and 2011 (11 seed, 19 venture, and six pre-IPO) had attracted an average of 45 investors and 12 potential investees each. The 19 Venture Forums had resulted in 200 companies being coached and more than 150 investors had participated over the years. More than 56 companies had received roughly US$55 million in seed capital and VC financing; 11 late stage companies had raised US$1.4 billion. In addition to the Seed Forums, the Angel Workshops had attracted an average of 90 people per event, of which roughly half were individual investors.

To date, INOVAR had cost US$13 million in operating costs (US$11 million for INOVAR I and US$2 million for INOVAR II) and facilitated more than US$1 billion invested in private equity (including VC) funds.[38] More than US$2 billion had been invested in companies. Some of the companies backed by funds that FINEP had selected included:

1. ALOG Data Centers do Brasil, one of the leading carrier-neutral data centers in Brazil. The company evolved from the 2007 merger of ALOG and .comDominio, a company funded by Stratus. After the merger, ALOG grew by almost four times, to 400 employees and 1,300 corporate clients in 2011. Stratus exited the company in 2011 through a sale to Equinix, a NASDAQ-listed global data services company, and the private equity firm Riverwood Capital, for $127 million and a return of over 10 times the invested capital.[39] This transaction earned Stratus the INOVAR Award for Best Deal in 2011.

2. Mastersaf Brazil S.A., a provider of customized tax and accounting solutions. In April 2010, the company was funded by DGF Investimentos' FIPAC growth equity fund, which had four INOVAR investors as LPs. During the deal's negotiations, DGF developed a business plan for market consolidation and significant value creation. With operational support from DGF, which acted as Mastersaf's Business Development and M&A Department, the company acquired

[38] These figures are approximate as the investment occurred in reals, rather than dollars, and the exchange rate varied.
[39] "Equinix and Riverwood Capital Acquire 90% of ALOG Data Center," *Press Release*, February 15, 2011, http://lavca.org/2011/02/15/equinix-and-riverwood-capital-to-acquire-90-of-brazil-data-center/, accessed April 26, 2012.

two smaller strategic players. The strategy resulted in average annual estimated revenue growth of 32.6% and 68.0% growth in EBITDA. DGF's divestment in Mastersaf, through its sale to Thomson Reuters in April 2011, was the first of the FIPAC fund and returned almost all of the fund's invested capital in its six portfolio companies.[40]

INOVAR was trying to stay ahead of the market. The program aimed to make the VC industry self-sustaining, and as private entities proved eager to take on projects that INOVAR had initiated, the organization readily transferred them. Responsibility for maintaining the website had been transferred to ABVCAP, which had also started running the Venture Forums. Freitas commented, "We don't want VC to depend on FINEP. This is a natural evolution: the public sector fills a need until the private sector will take over. By shifting responsibility for the forums and the website to ABVCAP, we can focus on aspects of the VC ecosystem that still require support." INOVAR was particularly focused on sustaining the early-stage part of the private equity spectrum to ensure that small innovative companies could access funding and increase their innovation rate.

To expand the range of financing options available to early stage companies, FINEP was examining the possibility of encouraging corporate VC. INOVAR planned to hold forums where the corporations would learn about VC and growth equity. The corporations would then be invited to the forums to see presentations from innovative companies that might be good matches for the corporations, whether as partners, investees, or acquisitions.

Another challenge was exits. FINEP/INOVAR and ABVCAP had been talking with BOVESPA and the financial regulators about creating a more accessible SME market, akin to London's AIM. Noted one observer, "Brazil really needs a few big success stories, when its Skype or its Google emerges. That will be a huge fillip to the aspirations of entrepreneurs."[41] It would also provide encouragement to the country's private equity investors and fund managers.

Brazil's VC ecosystem still had some development ahead of it. For instance, LPs insisted on serving on the investment committees of the funds in which they invested. "It gives them a sense of confidence in the managers," said Freitas. Although FINEP did not have voting power in most of its funds, the agency still had observer rights. Yet how long could the practice continue, especially if the Brazilian LPs wanted to invest in international funds? Another concern involved measurement. In the national accounts, private equity shared the same classification code as real estate and other types of investment funds. This made quantifying and analyzing the industry difficult.

[40] "Thomson Reuters Acquires Mastersaf," *Press Release*, May 17, 2011, http://thomsonreuters.com/content/press_room /tax/440439, accessed April 25, 2012.
[41] J. Mitchell, "Brazil Special Report: VC Awaits a Big Breakthrough," *LatinFinance*, 2008.

The growing move toward regulation, as demonstrated by Europe's Alternative Investment Fund Manager Directive (AIFMD), was another worry. In 2011, ABVCAP and the market regulator, ANBIMA, had promulgated a mandatory self regulation best practices code for the private equity industry, which had met a lukewarm reception. Commented Sette:

> Brazil has a fairly good balance regarding regulatory issues. The major regulations, CVM 391 and 209, create a framework to protect investors and at the same time permit the inclusion of market best practices. The self regulation code for private equity funds was received with restraint by the market because it didn't seem to bring anything new to the industry while creating more mechanisms for supervision and control.

As they considered the future, Freitas and her staff was revisiting the idea of starting a fund of funds. A number of international funds of funds such as Hamilton Lane, Partners Group, and Capital Dynamics had entered Brazil and were increasingly active. Fund of funds targeted not just smaller pension funds but also family offices and insurance companies, entities that were very under-represented in private equity investment. Freitas mused, "We're not sure whether there's really a need for a FINEP fund of funds. Perhaps we should be a co-manager with other investors. Thus far, we've been a facilitator more than an executor. And it would be a fundamental transformation for us. But it may be a good way to get smaller investors participating in the asset class, especially in early stage funds."

Mexico's Fondo de Fondos program offered a model. In 2009, four of the country's development banks-- NAFIN, BANOBRAS, BANCOMEXT and FOCIR--had committed capital to a fund of funds corporation. Since then, the corporation had invested in 38 private equity or VC funds that in turn had financed almost 200 SMEs and special purpose vehicles (SPVs) that focused on Mexico (see **Figure 5** for structure).[42] Freitas commented:

> Our concern is whether we should become an executor instead of a maestro or conductor, which we see as the most important factor of success of the INOVAR approach. We see that INOVAR is still a key program for the development of Seed Funds and our role should be establishing special capabilities to deal with it—we've done that in the recent launch of the Seed Forums and the corporate venture capital programs. We see we have an additional important role in transferring INOVAR's approach to local players in Brazil, as well as the other LAC countries.

INOVAR as Public Policy

Regardless of the lingering questions, FINEP's experience with INOVAR provided a number of lessons. First, the determinants of its success to date included the agency's

[42] See Fondo de Fondos website, http://www.fondodefondos.com.mx/structure.htm?lang=ZW5n, accessed April 18, 2012 for more information.

dual focus on innovation and financial return. It also made use of important relationships with international groups, such as the MIF and LAVCA, and local organizations, such as the stock market regulator and the stock exchange, BOVESPA. It also helped found ABVCAP to increase information exchange among practitioners. Moreover, the group started with low-hanging fruit in terms of demonstrating its effectiveness. Freitas said, “We didn’t start with seed funds in Amazonia. We went to Rio or Sao Paulo to get more exposure.” With a proven platform and results, FINEP could take INOVAR to more remote yet innovative regions that had a local player capable of applying the INOVAR methodology.

In terms of delivering results, the agency applied some simple lessons. First, the group recruited a dedicated team with appropriate (often private sector) backgrounds and used simple models for matching the different groups. In designing programs, the staff sought to create as many positive spin-off effects as possible—such as linking angel workshops with seed forums, or training regional groups to deliver the program at the same time that forums were held in that location. Critically, the team remained true to the project’s goals and focused on achieving its defined results. For instance, the INOVAR team did not stray into interesting but less effective activities, such as investing directly in companies. Finally, the group actively sought to stay ahead of the market by reviewing all private placement memoranda to understand the needs and goals of investors.

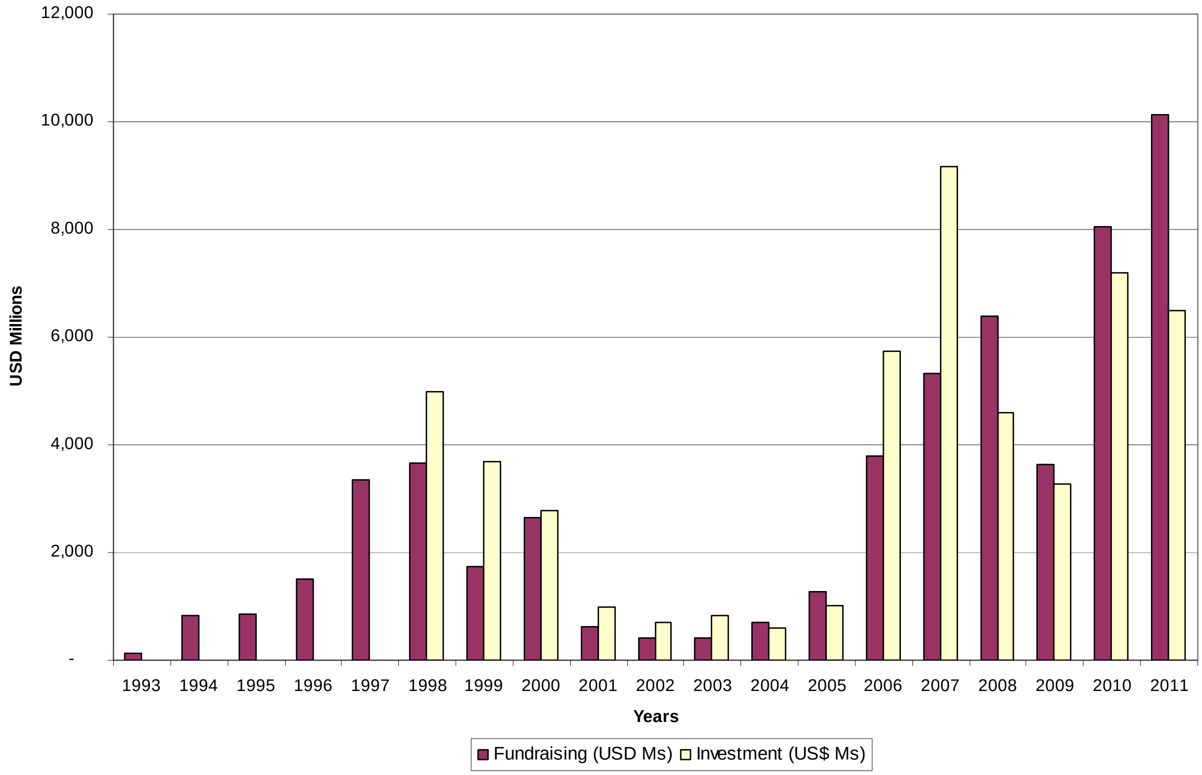
Looking back over the course of the program, Freitas said:

> I think the participation of the pension funds in private equity is INOVAR’s most important result so far. We started with four investors in 2001—FINEP, the MIF/IDB, Sebrae and Petros—of which only one was a pension fund. As of our 12th panel in 2011, there are 17 INOVAR LPs and 13 observers or potential LPs who benefit from and participate in the process. Of the 17 INOVAR LPs, 11 are pension funds and they represent about 10% of Brazil’s GDP (2009/2010) in assets.

A fundamental aspect of INOVAR’s success in attracting pension funds was the program’s focus on educating them about private equity, with no obligation to invest. Without obligation, the pension funds could consider the opportunities on their own merits. As domestic interest rates fell, they could invest in private equity as an alternative asset with which they were already familiar.

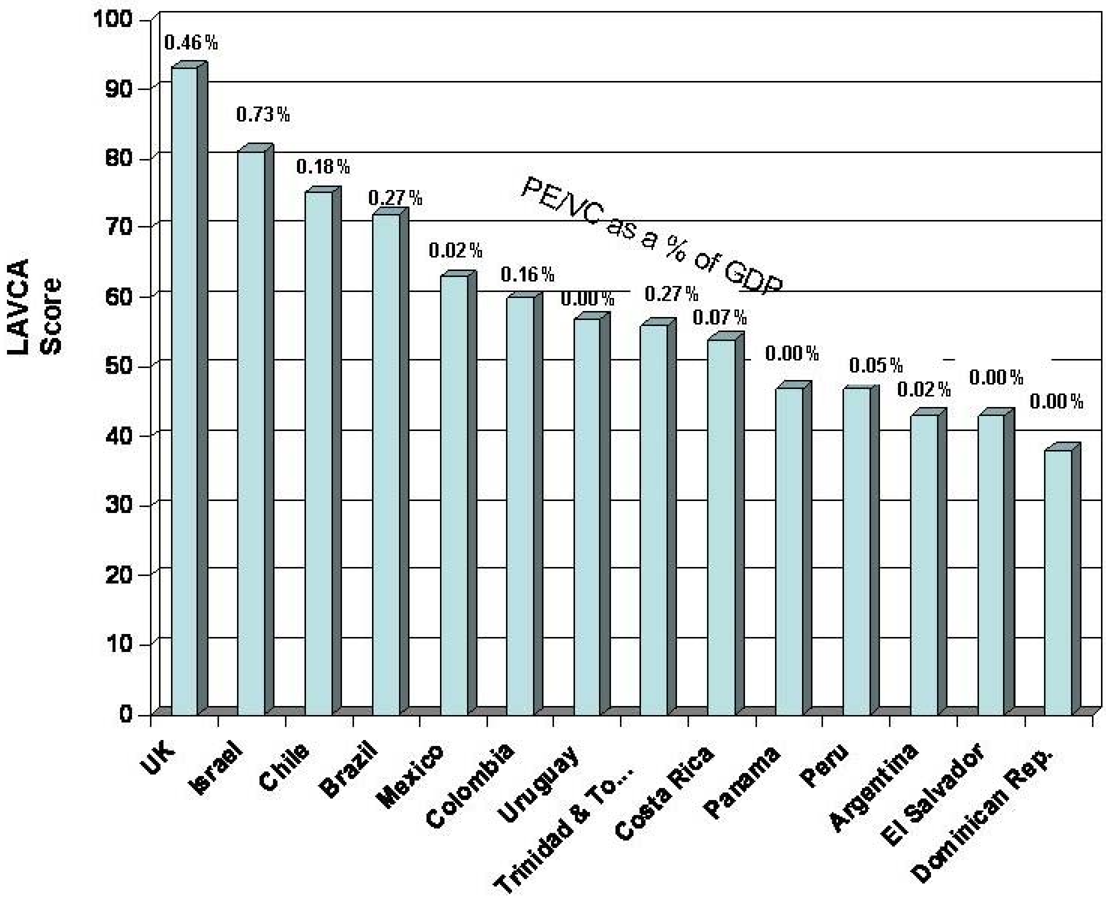
One aspect of INOVAR’s success that is not included in the preceding list is the existence of FINEP. Here was an agency dedicated to supporting science, technology, and innovation. It had its own budget for doing so, although it leveraged funding from such groups as the MIF. The degree to which a country without such an agency can recreate an INOVAR-like program is uncertain, although the efforts by other LAC countries to do just that will provide proof.

Figure 1: Fundraising and Investment in LAC, 1993-2011



Data from LAVCA 2011 Industry Data, pp. 2 and 4. Data prior to 2008 is based on VE-LA reports. Investment data prior to 1998 is missing.

Figure 2a: LAVCA Scorecard Rankings and Criteria



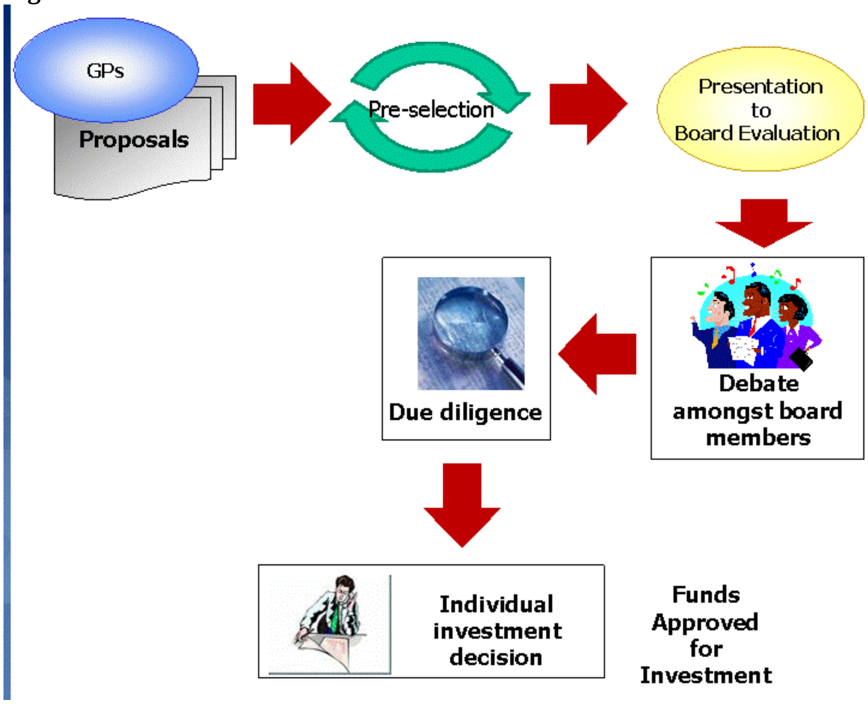
Source: Adapted from LAVCA, *LAVCA 2011 Scorecard: The Private Equity and Venture Capital Environment in Latin America,* (NY, NY: LAVCA), 2011, p. 5.

Figure 2b: LAVCA Scorecard Criteria

- Tax treatment of PE/VC funds and investments
- Protection of minority shareholder rights
- Restrictions on local institutional investors investing in PE/VC
- Protection of intellectual property rights
- Bankruptcy regulation (encompassing bankruptcy procedures/creditor rights/partner liability in cases of bankruptcy)
- Capital market development and feasibility of local exits
- Registration/reserve requirements on inward investments
- Corporate governance requirements
- Strength of the judicial system
- Perceived corruption
- Use of international accounting standards and quality of the local accounting industry
- Entrepreneurship

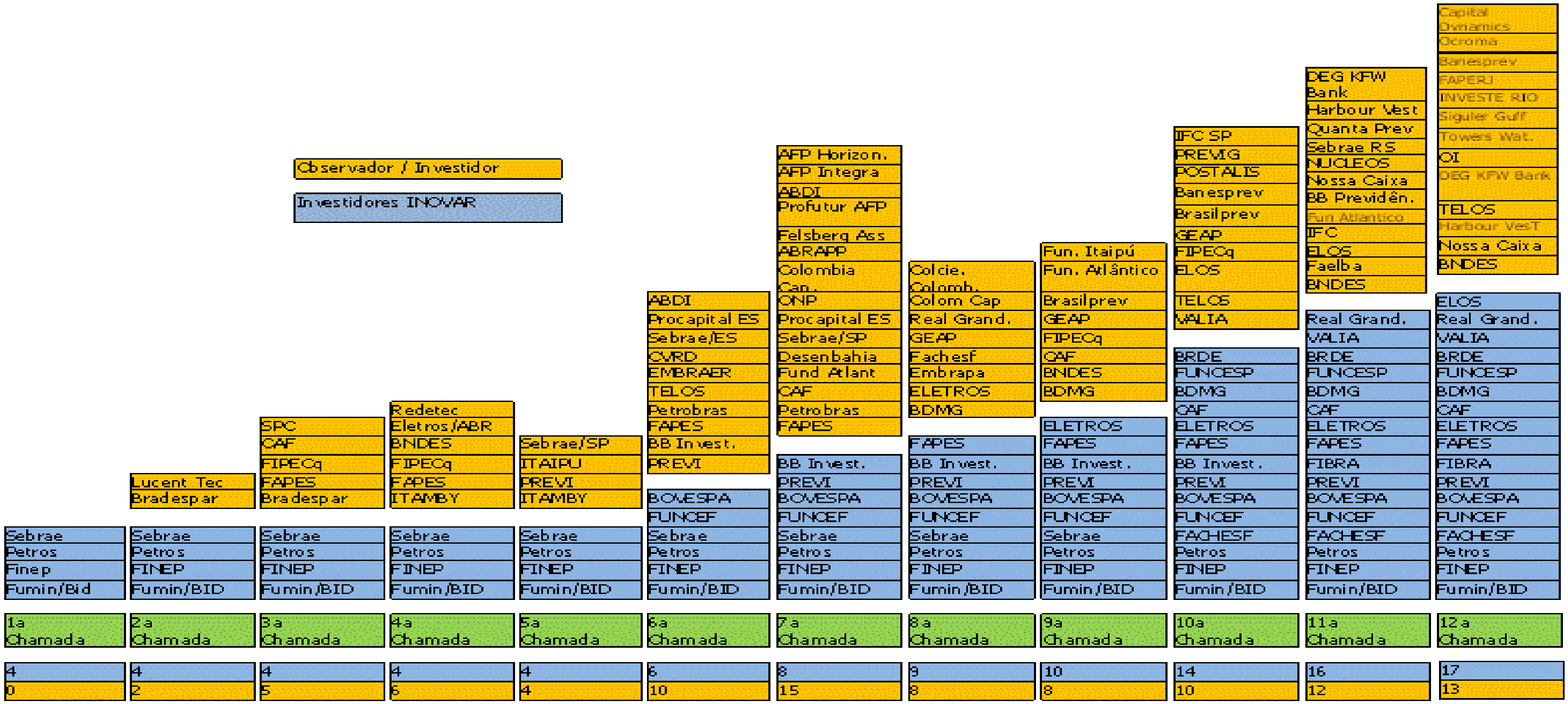
Source: LAVCA, *LAVCA 2011 Scorecard: The Private Equity and Venture Capital Environment in Latin America*, (NY, NY: LAVCA), 2011, p. 3.

Figure 3: Fund Selection Process



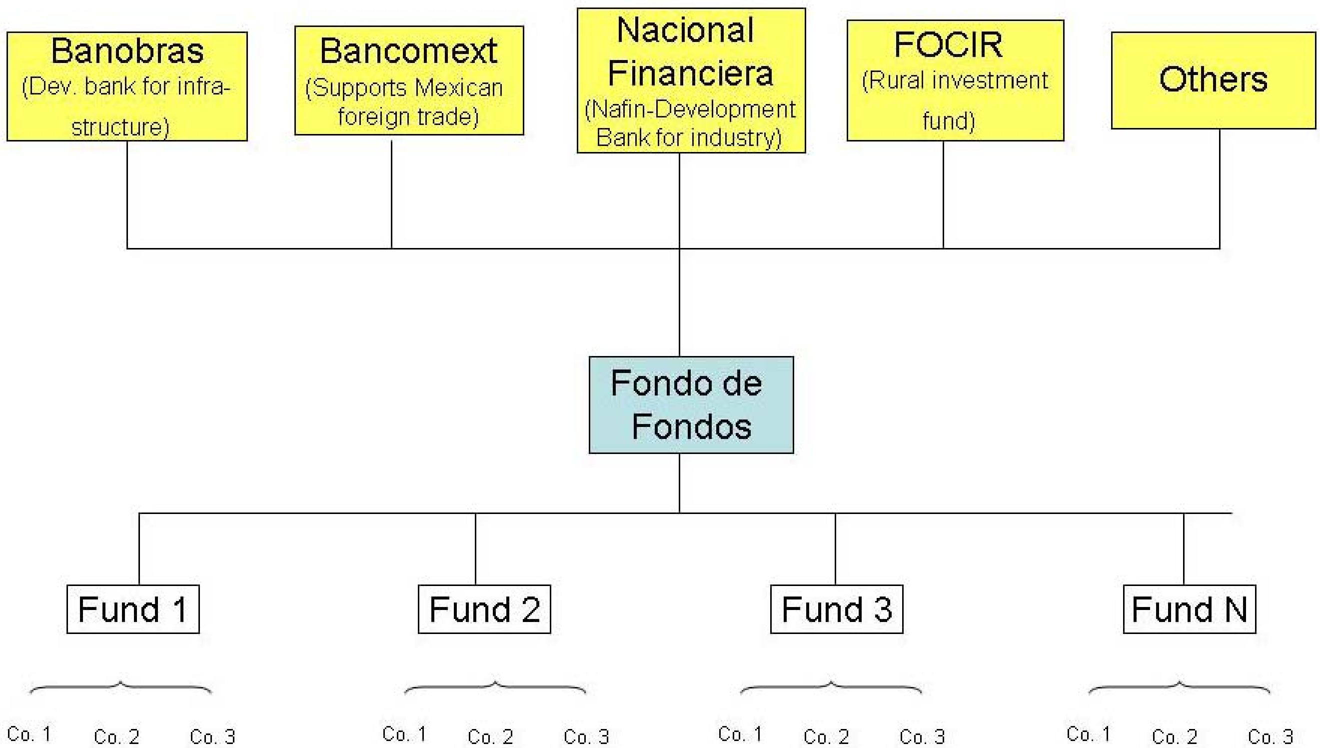
Source: FINEP, *INOVAR Project* slide show, April 2012, p. 19.

Figure 4: INOVAR Funds Panels Over Time



Source: FINEP, *INOVAR Project* slide show, April 2012, p. 22.
Note: Investidores INOVAR are the INOVAR partners; Observadors/Investidors are the investors who are not INOVAR partners.

Figure 5: Structure of NAFIN's Fund of Funds



Source: Adapted from Fondo de Fondos website,
http://www.fondodefondos.com.mx/structure.htm?lang=ZW5n, accessed April 18, 2012.