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A renowned Brazilian sociologist once commented that if Bill Gates had started his company in Brazil he would be selling counterfeit DVDs on the streets, and Steven Jobs would be peddling knick-knacks in Rio's hippie fair. His words illustrate the environment that Brazilian entrepreneurs face and the difficulties Brazil has to address to fully utilize its talent, intellectual capital and entrepreneurship in order to create successful investment case studies.

A country develops through innovation and productivity gains. Venture capital funds acts as catalysts helping to transform entrepreneurs' ideas and innovations into successful corporations." It is known that despite all the problems, corporations have enriched the societies that embraced them." (For more information please refer to: *The Company - A Short History of a Revolutionary Idea* – John Micklethwait & Adrian Wooldridge).

This short article is a brief assessment of the Venture Capital industry and the creation of new innovative companies in Brazil. It is based on observations and the author's experience running both seed capital and venture capital funds in Brazil.

Brazil produces over 57,000 Science PhDs per year. According to Unesco, Brazil ranks 9<sup>th</sup> in the world (1.7%) in terms of its number of researchers. Their participation in the quantity of papers published in well known scientific magazines grew from 1.35% of world total in 2000 to 2.63% in 2008. This is admirable progress. But in terms of registered patents, the numbers are still dismal. As the research approaches its practical use, from papers to patent to transformation into products, why is it that Brazil falls behind so drastically? What are the obstacles to transforming a large number of entrepreneurs and their ideas into companies operating inside a culture where new ventures thrive?

We can identify three major obstacles facing Brazil's entrepreneurs.

The first is the country's corporate ecosystem: Brazil is ranked 129<sup>th</sup> in the 2010 edition of the World Bank Publication *Doing Business*. Even with the flaws that exist in any methodology the eventual "right" rank would be one that shows how difficult it is to set up a company (and, indeed, to create value at an existing company).

The second is mistaken cultural attitudes towards risk/failure. In any capitalist society risk is always related to reward, and statistics show that a large percentage of new companies fail. However, there seems to be a stigma attached to failure, which tarnishes the unsuccessful entrepreneur as an outcast in Brazilian society.

Perhaps this explains the third factor which is the large number of talented, bright young students that prefer steady jobs in the civil service. To avoid the risk of failure, job security tends to be highly valued. "Unfortunately, there is still no wide understanding among the public of the benefits that can fairly be credited to capitalism and why these benefits have costs"(Uncertainty bedevils the best system by Edmund Phelps Financial Times April 15, 2009). This misunderstanding certainly applies to Brazil.

But with all these problems, or in spite of them, it seems that Brazil is finding a way to create successful companies while developing some degree of innovation.

Embrapa and Embraer are two cases in point. The former has been the genesis of most R&D development in agro business with its most successful example being the production of alcohol from sugar cane, developing an efficient biofuel industry. The latter was the result of the establishment of a major engineering school (ITA) which produced the engineers who set up the company. With its privatization, leading managerial techniques were implemented, helping turn Embraer into the world's third largest airplane manufacturer.

The development of the private equity industry in Brazil is another example that hopefully will lead to the growth of the venture capital sector. The first Brazilian P.E. funds were formed in the early 90s. That harvest matured 5 -6 years later at an inopportune moment. Macro problems and the non existence of capital markets hindered the transformation in liquidity, monetization, of the wealth created in several investments.

With the development and coming of age of Brazil's capital markets at the beginning of 2003 all this has changed. Since then, for example, there have been over 110 IPOs, several from companies backed by PE funds. In this new environment Totus (Software), Natura (cosmetics), Lupatech (Oil&Gas) , Submarino(Internet) and Bematech(Hardware/Software) are a few examples of companies that tapped the market, providing liquidity to their founders and/or PE backers. In other words value had been created and liquidity for this value creation was provided by the market. This is a distinct contrast to the past alternative of selling the company, often at low multiples, to a multinational.

And what about the VC (early and growth capital) industry? Where does it stand in Brazil now? With the backing of local institutional investors, mainly pension funds and Finep (Financiadora de Estudos e Projetos) approximately 50 funds have been created over the last 6 years. Many of them have been targeting specific sectors such as, Biotech, nanotechnology, IT, Oil & Gas and Logistics. The first wave of investments in early stage VC was focused on internet related projects. This wave as well as the more recent "vintage" encountered similar problems to those faced by the pioneers of PE - with an additional difficulty: as these are typically smaller companies, the exit door is even more limited than for PE investments. It is often the case that there has been value creation, but the challenge is to provide liquidity to unlock this value.

The way forward is clear: the development and maturation of Brazil's capital markets will trickle down, providing dynamism and new financing alternatives to these companies, thus accelerating the creation of value and liquidity.

To close, some words of wisdom by the famous Portuguese poet Fernando Pessoa that may well apply to the vast number of Brazilian Venture capitalists:

Pedras no caminho?

Guardo todas, um dia vou construir um castelo...

Stones in my path?

I keep them all, for one day I shall build a castle....

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Espirito Santo Venture and JBI are co-investors in Superbac a leading Biotech company in Brazil