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**The Role of Law and Public-Private Collaboration in Promoting
Innovative Firms in Brazil:
the case of the BNDES and the “Criatec Fund”^a**

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Abstract: This paper presents the result of a qualitative empirical research about the “Criatec Fund”, a venture capital fund, privately managed and directed to innovative firms, that was created in 2007 by the Brazilian Development Bank (BNDES). The paper discusses the role of law in the implementation of the Criatec Fund in three different legal dimensions: structural, regulatory and contractual. Based on interviews, this paper tries to test some hypothesis previously formulated by some scholars that studied new financial policies created by the BNDES. This study explains the institutional arrangements of this seed capital policy and the role of flexible legal instruments in the execution of this peculiar type of public-private partnership. It also poses some questions to the “law and development agenda” based on some insights from the economic sociology of law.

Keywords: State activism, venture capital, development bank, institutions, public-private partnership.

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1 Introduction

This paper presents the results of a qualitative empirical research about the public-private partnership in the promotion of innovative firms in Brazil through venture capital. In this research I analyze how the “Criatec Fund” – the biggest seed capital fund in the country – was created by the Brazilian Development Bank (BNDES) in 2007 and what legal instruments were developed in order to select a private partner and decentralize the selection of start-ups throughout different regions of Brazil. I do not discuss the economic result of this venture capital fund. I am interested in its institutional arrangement and the debate about the role of law in public policies.²

Based on interviews with social actors directly involved with the “Criatec Fund”, this paper discusses the role of law in the execution of this public venture capital fund in three dimensions: structural, regulatory and contractual. I rely on the literature on the “new law and development” to formulate three hypotheses about the legal dimension of this venture capital policy. The first hypothesis, which I call *Trubek’s hypothesis*, says that new flexible instruments are responsible for a new type of public-private partnership in Brazil. These instruments coordinate a complex interaction between the public and private sector. The second hypothesis, which I call *Schapiro’s hypothesis*, points out that the regulatory norms created by the Brazilian Securities Commission (*Comissão de Valores Mobiliários*) in the 1990s helped the consolidation of a national venture capital industry induced by the BNDES. In one word, the regulation helped the creation of funds like the Criatec. The third hypothesis, which I call *Matto’s hypothesis*, suggests that flexible private contracts (shareholders agreements) are being used by the public financial institutions to structure these funds. This indicates that traditionally private contracts are an important element of the Criatec Fund.

The qualitative research tried to test these hypotheses about the role of law – public law, regulations and contracts – in the promotion of innovative firms through venture capital, which is a specific type of financial instrument. Some hypotheses were fully confirmed and others partially. The results, however, are valid only for this specific case. It is impossible to construct a general theory about the role of law and public-private partnership based on this small empirical research about the Criatec Fund. However, it is possible to argue that the Criatec Fund is a legally constructed public policy based on the decentralization and the

² Considering that the Brazilian Development Bank is a state-owned company that has social goals I assume that financial policies are also public policies. For a general account about the study of public policies and policy analysis, see Frey (2000). For a general discussion about the legal dimension of public policies, see Coutinho (2013).

partnership between the state and the private sector. It is also a public policy that recognizes the cognitive limitations of the public and private actors and sets forth a cooperation scheme based on flexible frameworks.³ In this sense, it might be interesting to analyze how this partnership really occurs (what is the institutional arrangement of this venture capital policy) and what legal instruments were used to connect the BNDES, the private firms responsible for the management of the public fund and the investee innovative firms.

Considering that this is not a complete study case about the Criatec Fund,⁴ the results must be analyzed with some caution. I did not interview the representatives of the investee firms (36 firms were invested by the Criatec Fund) and did not examine the relationship between the fund's manager and the regional consultants (seven regional consultants were hired by the Criatec Fund). The qualitative research was limited to a small number of professionals involved with the fund. However, I believe that this qualitative data is enough to understand how this venture capital fund operates and to discuss the legal dimension of the Criatec Fund in three perspectives: (i) the structural, (ii) the regulatory and (iii) the contractual. The structural dimension focuses on the formal governance structure created by the Bank to operate the fund in cooperation with the private sector. The regulatory dimension is related to the "rules of the game" created by the regulatory agency concerning the venture capital funds. The contractual dimension focuses on the formal exchange instruments (contracts) used by the Bank and the private managers and their role in the definition of obligations, construction of trust and mitigation of risks.

I take the case of the Criatec Fund to discuss the functions of law and review some basic assumptions of the literature of the new law and development (COUTINHO; MATTOS, 2008; SCHAPIRO, 2009; TRUBEK, 2010; TRUBEK; COUTINHO; SCHAPIRO, 2013). Instead of discussing how law can promote economic development in abstract terms, I chose to study one specific financial policy designed to foster innovation and small firms in Brazil. Concerning the debate about law and development, my main claim is that legal scholars should study not only the formal institutional arrangements of different development strategies, but they should understand how different actors create trust, build social networks and cooperate in risky activities. It seems that, at least in the venture capital industry, trust and relationship are just as important as rules and formal contracts. "Law and development" scholarship should not ignore the social dimension of economy and the process of "trust building" and "problem-solving" in the execution of public policies. The case of the Criatec

³ This approach, known as "experimentalist governance", is based on Sabel & Simon (2011).

⁴ The complexity of study cases in social sciences is discussed by Yin (2000).

Fund shows that law (statutes, regulation, contracts) matters, but there is something else in play.

Following Richard Swedberg's advice, sociology of law could learn from the economic sociology. Legal scholars could produce "careful empirical studies on the role that law and regulations play in the economic sphere, drawing primarily on an analysis that highlights not only social relations but also interests" (2003, p. 2). Law and development could view the economic relations as "an aspect of the social"⁵. In this sense, we could move beyond the analysis of formal institutional arrangements.

Following this introduction, this paper has four parts. The first part is dedicated to the theoretical background of the research and the debate about the legal consequences of a new state activism in Brazil. In this part I formulate the problem of this research. In the second part, I explain the research methods and explain which social actors were selected to the qualitative empirical research. In the third part, I discuss the main results of the study case about the Criatec Fund. I also analyze the structural, the regulatory and the contractual dimension of this venture capital policy created by the Brazilian Development Bank. In the last part there is a brief conclusion.

2 A new form of state activism? Theoretical background of the research

2.1 Financing innovation: building a venture capital industry

Public policies focused on innovation, technology and entrepreneurship have become priorities in Brazil (DE NEGRI; KUBOTA, 2008; ALMEIDA, 2009; ARBIX, 2010). Since 2004, the government has announced three industrial policies aimed at innovative firms and has developed different strategies to support entrepreneurship. Some of those strategies involves the creation of technological universities all over the country,⁶ the regulation of

⁵ Roger Cotterrel proposes that the social should be seen as "networks of community", which are dominated by economic relations – that is, instrumental relations centered on common or convergent projects focused on profit making or mutual material welfare: "in this approach, the economic appears as an aspect of the social. As such, it has regulatory conditions and requirements that reflect not only the particular characteristics of economic relations but also their situations as part of networks of community that may be held together by a variety of bonds (for example, shared values, allegiances or customary practices, as well as by a convergence of economic interests). Sociology of law should concern itself with the interplay of different types of social relations in communal networks, focusing on the regulatory issues these present" (COTTERRELL, 2013, p. 51).

⁶ See Law 11.892/2008.

partnerships between universities and private companies,⁷ the creation of firm incubators inside universities,⁸ tax subsidies for IT firms,⁹ tax subsidies for companies that hire researchers and invest in R&D,¹⁰ a different tributary regime for small firms,¹¹ and the partnership with the private sector in order to disseminate entrepreneurship values and support the creation of start-ups.¹²

Beside all these policies created by legal instruments, the Brazilian government also developed new financial mechanisms to capitalize small firms that lack tangible assets.¹³ These mechanisms consist of venture capital funds,¹⁴ risk-based equity investments in early stage companies operating in fast changing environments (COOK, 2011, p. 1). Based on the assumption that “venture capital have a strong positive impact on innovation” (KORTUM; LERNER, 2000, p. 675), Brazilian public companies and the private sector are trying to generate an endogenous venture capital industry,¹⁵ based on high-quality universities, incubators, entrepreneurs, venture capital firms, investors, audit firms, lawyers, investment banks and foreign investors.

In Brazil, there were failed experiences in the promotion of venture capital in the past (SCHAPIRO, 2009, p. 220-235; LEAMON; LERNER, 2012, p. 3-7). A few venture capital firms emerged during the 1980s and the regulation of this financial vehicle was developed in the 1990s.¹⁶ After the privatization programs and the macroeconomic reforms – financial stability and inflation control –, some funds were created by the private sector and the venture capital industry finally began to emerge. However, there were no funds directed to innovative early-stage firms. The private sector considered it too risky in comparison with other investment strategies.¹⁷ The “seed capital”¹⁸ – venture capital focused on early-stage firms

⁷ See Law 10.973/2004.

⁸ See GUIMARÃES; AZAMBUJA, 2010.

⁹ See Law 11.077/2004.

¹⁰ See Law 11.196/2005.

¹¹ See Complementary Law 123/2006.

¹² On the role of the private organization Sebrae (*Serviço Brasileiro de Apoio às Micro e Pequenas Empresas*), the different programs created by this institution (*Desafio Sebrae*, *Programa Jovem Empreendedor*, etc) and the “entrepreneurship discourse”, see COSTA et al., 2012.

¹³ Or companies that do not have cash flow to pay interest on debt or dividends on equity.

¹⁴ The venture capital was created in the United States and is a special type of private equity. While venture capital is channeled to start-up enterprises, private equity is linked to more mature corporations that are restructuring consolidating or expanding their businesses.

¹⁵ Venture capital can be defined as a kind of financial investment made by specialized venture capital organizations “in high-growth, high-risk, often high-technology firms that need capital to finance product development or growth and must, by the nature of their business, obtain this capital largely in the form of equity rather than debt” (BLACK; GILSON, 1998, p. 245).

¹⁶ See CVM Instruction 209/1994. *Comissão de Valores Mobiliários* (CVM) is the Brazilian Securities Commission, responsible for the regulation of the capital market. It was created by Law 6.385/1976.

¹⁷ One must have in mind that Brazil has high interest rates due to its historically high level of inflation. Before the macroeconomic stability, it was safer to invest in public debt securities (with high interest rates) rather than

with intangible assets – was and still is a gap in the capital market.¹⁹ Brazil faced one problem concerning innovative small firms: how to finance them without a “market-based”²⁰ financial system?

The government has been trying to solve this puzzle through the Brazilian Development Bank (BNDES) and the Brazilian Agency of Innovation (FINEP). In the early 2000’s, these companies created venture capital funds directed to innovative start-ups in close collaboration with the private sector. Despite being created by public companies, these close-end funds are managed by venture capital firms that emerged in the private sector, responsible for the start-ups’ business assistance and the compliance with the rules imposed by the Brazilian Securities Commission.²¹

One might wonder why governments would want to promote venture capital funds. The answer lies in the challenges facing many start-ups, which often require substantial capital:

A firm’s founder may not have sufficient funds to finance projects alone, and therefore must seek outside financing. Entrepreneurial firms that are characterized by significant intangible assets, expect years of negative earnings, and have uncertain prospects are unlikely to receive bank loans or other debt financing. Venture capital – independently managed, dedicated pools of capital that focus on equity or equity-linked investments in privately held, high-growth companies – can help alleviate these problems (LERNER, 2009, p. 6-7).

In Brazil, the development of indirect equity vehicles – public pools of capital managed by specialized private firms and directed to innovative small firms – must be seen as part of a larger economic agenda focused on innovation, entrepreneurship and competitiveness (COUTINHO; FERRAZ, 1994). Venture capital funds are part of a set of Schumpeterian public policies which are part of the “post-Fordist” capitalism (JESSOP,

venture capital funds. According to OECD, “low-interest rates make equity valuable and reward growth; investing in venture capital is less attractive when interest rates are high” (1996, p. 10).

¹⁸ The literature defines several stages of venture-capital investing: seed investment (entrepreneur that does not have a product), start-up investment (product development, prototype testing), first stage (early development), second stage (expansion), third stage (profitable but cash poor), fourth stage (rapid growth toward liquidity point), bridge stage (mezzanine investment), and liquidity stage (cash-out or exit). *See* SAHLMAN, 1990, p. 479-480.

¹⁹ For a complete understanding of the Brazilian private equity and venture capital industry, *see* ABDI, 2011.

²⁰ On the classic distinction between “capital market-based” financial system (USA), “credit-based” financial system with government administered prices (France) and “credit-based” system dominated by financial institutions (Germany), *see* ZYSMAN, 1983. On the difficulties of the banking system to finance emerging firms and the Brazilian scenario, *see* MOREIRA; PUGA, 2000.

²¹ This is not a Brazilian phenomenon, but rather a global one: “The perceived importance of developing the knowledge based and high-tech sectors has led to a large number of governmental programs that subsidize these sectors through direct government venture capital funds and tax policy” (CUMMING, 2007, p. 196).

2002). These financial policies – directed to emerging companies and the constant process of “creative destruction” – forge a new type of alliance between the public and private sector.²²

In the next section I will discuss how the Brazilian Development Bank forged this alliance and which legal instruments were used to allocate public resources through this risk-based capitalist activity. Just like South Korea,²³ Brazil is trying to use a state-owned bank to stimulate the creation of a private venture capital industry. This process involves new institutional arrangements and a peculiar kind of public-private collaboration. The funds are public, but they are managed by private actors. The objective of the policy is to induce the development of venture capital managers and innovative firms. It also aims at building trust in the “venture capital ecosystem”, supported by the state.²⁴

2.2 Public-Private Partnership: experimentalism and new legal tools

The development of public venture capital funds managed by private companies has called the attention of some legal scholars in Brazil (COUTINHO; MATTOS, 2008; MATTOS, 2008). They suggest that a broad concept of public-private partnership between the state and private firms is emerging. Paulo Mattos (2008) noted that these venture capital funds represent a new type of the state intervention in the economy. He believes that the key aspect of the new type of state intervention appearing in Brazil is the risk-sharing between the state and the private sector. However, the novelty about it is not only the risk-sharing, but “the use of new mechanisms, legally institutionalized by the state, to share risk with the private sector in order to promote new investments in innovation and to develop private equity, as well as venture and seed capital markets in Brazil, especially in the case of small and mid-sized companies” (MATTOS, 2008, p. 8). To him, the state acts *as a risk taker* and manages legal instruments that are generally used by private actors.

²² For a discussion about the “new developmentalism” and the relationship between public and private bureaucracies, see ZANATTA, 2012.

²³ On South Korea venture capital industry, see OECD, 1996.

²⁴ In a famous study about the structure of capital markets (banks versus stock markets) written in 1998, Bernard Black and Ronald Gilson noted that Germany faced many challenges in order to develop a venture capital system: “A strong venture capital market thus reflect an equilibrium of a number of interdependent factors, only one of which is the presence of a stock market. For example, Germany today faces a chicken and egg problem: a venture capital market requires a stock market, but a stock market requires a supply of entrepreneurs and deals which, in turn, require a venture capital market. In addition, German entrepreneurs who care about future control of their company must trust venture capitalists to return control to them some years hence and must further trust that the stock market window will be open when they are ready to go public. The institutional design issue is how to simultaneously create both a set of mutually dependent institutions and the trust that these institutions will work as expected when called upon” (BLACK; GILSON, 1998, p. 273).

The study conducted by Paulo Mattos shows that one of the major players in this new scenario is the company *BNDES Participações S.A.* (BNDESPar), BNDES's investment arm. BNDESPar aims to develop the private venture and seed capital market. In order to do so, BNDESPar had the initiative to create funds with specific investment strategies, defining the profile of innovative target firms in certain industries or regions of Brazil. These funds, however, are not managed by the BNDESPar. The state relies on private firms that have the expertise in this area. Mattos explains that BNDESPar selects a private investment manager launching a public call for proposals, then “the investment manager is selected by BNDESPar taking into consideration his or her proposal to meet the investment strategy of the BNDESPar fund and the management cost of the fund” (MATTOS, 2008, p. 10). The state defines the social desired strategy (promotion of high-tech innovative firms), but the fund is managed by private actors. The reason is that venture capital involves not only buying a company's asset (financial investment). It also involves business and legal assistance, accounting support, expansion of the firm's social networks through the manager of the fund and continuous communication between the investee and the venture capitalist.

Mario Schapiro, who also studied the new tools developed by the BNDES to promote innovation (SCHAPIRO, 2009), believes that innovation financing contains elements of a “new state activism” that are very different from the “old developmentalist” view. Instead of the top-down financial operations, the Bank has developed financial products based on the partnership with the private sector in order to promote innovation.

Concerning the tools developed for this new mission, they have represented a break in the Bank's paradigm (used to financing large enterprises with physical assets); it relies on flexible legal structures that, formally or informally, favor a financial relationship subject to trajectory revisions and adaptations. Ultimately, instead of the top-down and pre-defined financial operations, designed to meet economic planning requirements, the financing of innovation has been based on alliances and public-private partnerships between the private companies and the public Bank. This is the case of joint operations established between BNDES and capital market investment groups, which come together to form venture capital private funds (SCHAPIRO, 2012, p. 1).

Paulo Mattos and Mario Schapiro try to prove their points with examples of venture capital funds created by the BNDESPar that are managed by private companies. They both agree that the “Criatec Fund” – the biggest public seed capital fund in the country – is the best example of this new form of state activism, heavily dependent on the private sector because of the complexity and the peculiarity of venture capital funds focused on seed companies

(innovative early-stage start-ups that demand intense business assistance). The Criatec Fund shows that public companies are developing new legal tools to collaborate with the private sector, especially in the venture capital market.

2.3 What do we know about the Criatec Fund and the instrumental role of law?

The “Criatec Fund”²⁵ is a seed capital fund that has the aim to capitalize innovative start-up companies and to give them management support in order to help the development of their business. This fund has called the attention of legal scholars because of its experimentalist institutional design and its “public-private partnership” character (SCHAPIRO, 2009; SCHAPIRO, 2011). Legal sociologists noted that it epitomizes the replacement of BNDES’s “traditional form of fixed obligation loan agreements with a variety of flexible devices that support collaboration and experimentation” (TRUBEK, 2013, p. 8).

The Criatec Fund was created in 2007 in partnership with another public bank – *Banco do Nordeste do Brasil* (BNB) – to capitalize 50 seed companies (with no more than R\$ 6 million of annual income) in different regions of Brazil.²⁶ In order to select innovative start-up companies all around the country, the creators (BNDES and BNB) defined that the manager, selected through the public call, would have to hire six “regional consultants”, responsible for the “hands-on” business assistance to the early-stage investees. These and others obligations – designed to reduce risks – were defined in the “joint ownership agreement”²⁷ signed between the investors (public companies) and the managers of the fund (private firms). This contract defines the governance of the venture capital fund and details the rights and responsibilities of venture capital firm and investors (LITVAK, 2009, p. 163).

Despite the interest of some Brazilian legal scholars about these new financial vehicles created by the state – like the pioneer Criatec Fund –, there are no empirical legal studies that investigate how the relationship between public and private actors really occurs in the execution of a venture capital fund, and if the legal instruments have a significant role to play.

²⁵ The formal name of the condominium (fund) is *Fundo Mútuo de Investimento em Empresas Emergentes Criatec* (FMIEE Criatec).

²⁶ The regions are Southeast (Rio de Janeiro, Campinas and Belo Horizonte), Northeast (Recife, Fortaleza and Belém) and South (Florianópolis).

²⁷ In Brazil, venture capital funds are not created through a “limited partnership agreement” like in the United States (SAHLMAN, 1990) and they can use diverse legal structures (holdings or joint ownership). The Brazilian Securities Commission established legal forms for venture capital funds (FIP/FMIEE) that can be used. According to Carvalho (2012, p. 8), from 2004 to 2009 the proportion of investment funds structured as FIP or FMIEE increased from 33% to 42%. In the opposite direction, funds structured as holding decreases from 20% to 13%.

The literature describes the legal structure of the investment fund and which governance rules are adopted by the bank. However, the field lacks qualitative empirical research. This study tries to advance the knowledge about the legal dimension of this financial policy.

3 Research method and hypotheses

3.1 Questions and basic concepts

In this research I try to answer three questions concerning the Criatec Fund: (i) *What is the institutional design of this venture capital fund?*; (ii) *How did the collaboration process between the public and private sector occur in the selection of the investee companies?*; (iii) *What was the “role of law” in the implementation of the Criatec Fund?*

In order to answer these questions some concepts are needed. By *institutional design* I mean the process of creation of the venture capital fund through institutional means (purposive creation of norms) and how the state managed to distribute functions between different actors.²⁸ This question is based on the hypothesis formulated by Diogo Coutinho that legal instruments can create an institutional arrangement that is adequate for the coordination of social action (instruments that can legally connect and coordinate actors, policies and sectors). In this sense, I am interested in the structural perspective of the Criatec Fund and the definition of “who does what” (COUTINHO, 2011, p. 16). It is true that this perspective could be called functional, because it is focused on the functions of law.²⁹ However, I do not use the expression “structural” in the positivist tradition (the structure of legal norms).³⁰ I am interested in the structure of specific institutional arrangements.

By *role of law* I mean two specific legal and normative dimensions: the regulatory and the contractual. The *regulatory role of law* means the role played by legal rules imposed by the Brazilian Securities Commission (federal agency), responsible for the regulation of the capital market. The *contractual role of law* means the role played by different private contracts used in this venture capital fund. There are contracts signed by the investors and the managers of the fund in order to constitute a condominium (“joint ownership agreement”) and

²⁸ There are many uses for “institutional design” in the sociology of law. Philippe Nonet and Philip Selznick, in their classic work about “repressive law”, “autonomous law” and “responsive law”, explained that “institutional design” is a common feature of a legal system that is supportive of overriding societal policies and purposes (NONET; SELZNICK, 1978).

²⁹ As posed by Bobbio (2007) in his “sociological turn”.

³⁰ The main scholar in this tradition in the 20th century was Hans Kelsen.

contracts signed by the condominium and the investees in order to assure corporate governance rules (“shareholders’ agreement”). Beyond the contracts themselves, there is the “contract law”³¹ – a set of rules and norms concerning the capacity of individuals to formalize exchanges and protect them with the judicial system.

3.2 The qualitative approach: some details about the interviews

In order to answer the questions above, the research was divided in two phases. The first consisted of documental and legal analysis.³² The second consisted of semi-structured interviews with three actors that were considered relevant to provide information that would help in the formulation of answers to the questions previously described. The format of “semi-structured interviews” – that consist of questions previously formulated by the researcher and other questions that can be made during the conversation with the interviewee – was chosen because it made the interviews more dynamic and allowed new topics during the conversation.

The interviews were conducted between December 2012 and February 2013. The conversation time (length) varied between 60 and 90 minutes. All interviews were recorded and transcribed. All social actors were previously informed about the academic nature of the interviews. In the chart below I explain the role of each person interviewed.

³¹ Luciano Timm explains the difference between the “liberal model” and the “social model” of contract regulation in Brazil: “From continental European law, Brazilian lawmakers transplanted the idea of contractual *dirigisme* by the state, thus broadening the scope for government intervention in the realm of the parties’ will by having in place mandatory rules that cannot be excluded or changed by the parties. In this new regulatory paradigm (typically a phenomenon of ‘publicisation’ of private law through distributive or social welfare laws), the assumption of the liberal model of contractual relationships – based on the principle that freedom and formal equality of individuals would ascertain the balance and justice in private relationships whatever their economic and social status might be – was undermined. Hence, there was an understanding that the need arose for protection of the weaker party in the relationship with the goal of establishing a substantive, or positive, balance. This became known as the social or collectivist model of contract regulation, it being the offspring of socialist and collectivist influences. It sum, it is clear more than ever that in Brazil it is not always that the terms of the contract that will govern the relationship of the parties” (TIMM, 2011, p. 86-87).

³² Some data were collected through CVM’s website, like the “joint ownership agreement” (*regulamento do FMIEE Criatec*).

Chart 1. Interviewed actors involved with the Criatec Fund

Name	Affiliation	Date	Role
Leandro Benzecry	Spalding Advocacia (<i>Fund's Manager Law Firm</i>)	December 2012	Law firm hired by the fund to elaborate all the contracts between the fund and the start-up companies
Gustavo Junqueira	Inseed Investments/Instituto Inovação (<i>Fund's Manager</i>)	January, 2013	Founder of the Inseed Investment, responsible the selection of companies and the “hands-on” entrepreneurial support
Marcio Spata	BNDES (<i>Fund's Main Investor</i>)	February, 2013	Manager of the Venture Capital Area of BNDES, responsible for the supervision of the Criatec Fund

Considering that (i) the Criatec Fund was created by the BNDES, that (ii) it was managed by a special consortium of two companies (*Antera Gestão de Recursos* and *Inseed Investments*) and that (iii) one single law firm was responsible for all legal transactions between the fund and the start-up companies invested by the Criatec Fund, I believe that this sample is representative.³³ I was able to collect data from different actors performing different roles. This data supports the argument of this paper. I recognize that the interviews are insufficient for a sociological thesis about this venture capital fund. However, when I began this research I had a smaller ambitious. I wanted to know if the legal instruments matter. The interviews helped me to understand what roles law played.

3.3 Research hypotheses

Social researches usually have hypotheses. Hypotheses can be defined as provisory answers to research problems. In this research, I was able to formulate three hypotheses based on the literature about “law and new developmental state” (TRUBEK; SANTOS, 2006; COUTINHO; MATTOS, 2008; MATTOS, 2008; SCHAPIRO, 2009; TRUBEK, 2010).³⁴ The first is that *the Criatec Fund shows an extremely collaborative form of public-private*

³³ One thing must be clear. This is not a complete study case about the Criatec Fund. I did not interview the entrepreneurs and the regional consultants. But, considering the I am focused on the structural, regulatory and contractual legal dimensions, these interviews can help to understand what flexible legal instruments were developed by the BNDESPar, how the regulation interfered in the execution of the fund and what kind of contracts were signed between the fund and the invested companies.

³⁴ A debate about the “law and new developmental state” project and the “new law and development movement” was made in another paper. See ZANATTA, 2011.

partnership institutionalized by flexible legal instruments. I will try to show that this hypothesis was confirmed by the perceptions of the social actors about the relationship between the state and the private sector and the use of private contracts (“joint ownership agreement”) that are flexible and revisable. I will call this the *Trubek’s hypothesis*, considering that David Trubek has defended this point of view some years ago.³⁵

The second hypothesis is that the *regulatory law facilitated the creation and execution of the Criatec Fund*. I will call this the *Schapiro’s hypothesis* because Mario Schapiro believes that the BNDES helped to shape the CVM’s rules, which allowed room for experimentation in the venture capital market.³⁶ I do agree with Schapiro – I believe that the Criatec Fund was possible because there were capital market rules created by the CVM –, but I will try to show that the regulatory law disturbed the execution of the seed capital policy. In the case of the Criatec Fund, the CVM did not allow the co-management of the fund, which created a small problem for the private managers. In my opinion, this hypothesis was partially confirmed.

The third hypothesis is that *legal instruments (private contracts) play a major role in the execution of the Criatec Fund*. I will call this the *Mattos’s hypothesis*, considering that Paulo Mattos published some articles defending the idea that private contracts (like shareholder’s agreement with corporate governance clauses) are important to the execution of these public venture capital funds.³⁷ I intend to demonstrate that this hypothesis was partially confirmed. The interviewees recognized that the “shareholders’ agreements” are important to define the relationship between the innovative firms and the venture capitalists. But they also showed that, in the selection of start-ups, the *close relationship and the negotiation were more important than the legal instruments*, like “shareholder’s agreements” and others. This is something reinforced by the literature on “economic sociology”. Economic activities are socially embedded. Cooperation is highly dependent on social networks, trust and social capital.

In the next part, I discuss the research results and how these hypotheses were tested through the case of the Criatec Fund.

³⁵ See TRUBEK, 2010, 2013; TRUBEK; COUTINHO; SCHAPIRO, 2013.

³⁶ See SCHAPIRO, 2009, 2012.

³⁷ See MATTOS, 2008.

4 Main Findings

4.1 Criatec Fund: Institutional design and execution

The Criatec Fund is the result of a unique experimentation conducted by the BNDES.³⁸ This experimentation in the venture capital area, however, did not come out of the blue. It is the adaptation of previously venture capital funds that the BNDESPar invested in the last 15 years. BNDESPar helped to create several VC funds directed to start-ups, like *RSTec* (1999), *SCTec* (2001), *SPTec* (2002), *Nordeste I* (2002) and *MVP-TechFund* (2003). But these funds had some problems. They were too regional, too small (R\$ 15 million) and based only on information technology (IT) firms. Because of their size, duration (10 years), and the small amount of money involved, these public funds had difficulties to “hold” the private managers.

These venture capital funds produced some positive externalities. 41 companies were supported and 63 million were invested by the BNDESPar. According to Marcio Spata, manager of the venture capital department of the Brazilian National Bank, these funds are the roots of the Criatec Fund. The Criatec Fund tried to fix the problems of these regional funds through a different strategy: instead of many regional funds, the idea was to create a big national fund, managed nationally, but also decentralized with the support of regional consultants.

These regional funds had some externalities. We had a lot of technology-based innovation, we induced entrepreneurship (brought this business to the market), we invested R\$ 63 million in 41 companies. But the main benefit was the learning curve, because the Criatec came from here. The Criatec Fund was created as one investment fund and not seven regional funds. Being just one venture capital fund, we avoided duplicity of expenses, such as CVM costs, audit costs, lawyers cost, because today I have one fund and not seven.³⁹

The Criatec Fund was created in 2007 by the BNDES, based on its previous experience with venture capital funds and the emerging “venture capital environment” in Brazil. The “Brazilian Venture Capital and Private Equity Association” was formed in 2000 and many start-up incubators were being created. For the bank, it was possible to publish a

³⁸ See CHEROBIM et al., 2011.

³⁹ Marcio Spata, interview made in February 2013.

“public call for proposal”⁴⁰ and create a national seed capital fund, managed by a private partner.

In 2007, a public call for proposal was published on-line by the Brazilian National Bank⁴¹ and determined some basic characteristics of the Criatec Fund: (i) the investors would be BNDESPar (80%) and BNB (20%); (ii) investee companies should be start-ups with less than R\$ 6 million in annual sales, (iii) the national manager should hire six regional consultants; and (iv) the investment fund should be registered as a FMIEE,⁴² following CVM Instruction 209/1994.

The organization chart below shows the institutional design of the Criatec Fund as described in the public call for proposal published in 2007 by the BNDES.

The public call for proposal was published in August 2007. The selection of the national manager lasted two months. On October 23rd 2007, the joint ownership agreement was registered at the Brazilian Securities Commission. The national manager selected by the

⁴⁰ In Brazilian administrative law, a public call for proposal means *edital público*.

⁴¹ These public calls are published on the bank's website: <<http://www.bndes.gov.br/>>.

⁴² FMIEE stands for *Fundo Mútuo de Investimento em Empresas Emergentes*.

Brazilian Development Bank was the private firm *Antera Gestão de Recursos S.A.*⁴³ This firm was created by Robert Binder, former president of the ABVCAP,⁴⁴ who had expertise in the capital market. However, considering that the Criatec Fund demanded intense business assistance for start-ups, a partnership was made between *Antera Gestão de Recursos S.A.*, based on Rio de Janeiro, and an accelerator firm called *Instituto Inovação*, based on Belo Horizonte – that later became the firm *Inseed Investment*.

According to Leandro Benzecry, from *Spalding Advocacia* (law firm hired by the national manager), the firm was planning to constitute a seed capital fund in Brazil. When the public call for proposal was published, *Antera* sought to form a partnership with another company focused on innovation and start-ups.

When the public call was announced, it was almost made a readjustment and product suitability as a response to the public call. The public call demanded capillarity, from the national perspective. *Antera* was a regional company based in Rio. Then we sought a partnership with the *Instituto Inovação*, which had worked the concept of seed capital, but had little contact with the financial capital market. They were more focused on the support of small business and on identifying business opportunities for start-ups. Anyway, a consortium was made – they use the term consortium, but I do not like it, because from the legal perspective it was never a consortium –, but it created a joint action to submit a project meeting the requirements of the public call of the BNDES, which ended up being selected.⁴⁵

The national administration of the Criatec Fund, indeed, was formed by a private partnership between two companies: *Antera Gestão de Recursos S.A.* and *Instituto Inovação*. According to Gustavo Junqueira, CEO of the *Instituto Inovação*, the company started in 2002 and focused on start-up incubation. By the time the Criatec public call was published, the firm had already decided to become a venture capital firm. However, they were not registered at the Brazilian Securities Commission. It happened that the Criatec Fund demanded not only venture capital expertise, but also “hands-on” assistance to start-ups. The partnership between these two private companies was made during the public call. This is explained by Junqueira:

First we submitted together the material demanded by the public call. This material had nothing signed between the parties. We considered the call and the idea was that we could arrange a consortium or that the *Instituto Inovação* could create its own fund management firm registered at CVM.

⁴³ The national manager must be registered at the Brazilian Securities Commission. According to the CVM Instruction 209/1994, Article 6: “The administration of the fund lies on the person or entity authorized by the Brazilian Securities Commission to exercise the activity of portfolio management of securities”.

⁴⁴ Brazilian Venture Capital and Private Equity Association, created in 2000.

⁴⁵ Leandro Benzecry, interview made in December 2012.

That was the idea. We became partner of the *Antera* – the *Instituto Inovação* got a percentage of *Antera*'s shares – and we made a joint operating agreement (operating partnership). Until the joint operating agreement, we had not formalized the partnership. By the time of the due diligence, the BNDES demanded some kind of formalization and then we made a partnership agreement – I do not know exactly the formal name of the contract – while we finished the entry of the *Instituto Inovação* in *Antera*. This took one or two years. Then we realized that the best way for the *Antera* and for the *Instituto Inovação* was to move on as two separate companies. The way we formalized this relationship was through the joint operating agreement.⁴⁶

After the arrangement of the joint operating agreement between *Antera* and *Instituto Inovação*, it began the process of selection of the innovative firms throughout the country. In this part, the legal instrument that created the Criatec Fund – the *joint ownership agreement (fund statute)* registered at the Brazilian Securities Commission – had a major role. This agreement defined the function of different actors (national manager, financial institution, regional manager) and created a deliberative instance called “Investment Committee”⁴⁷.

Some elements of the agreement were imposed by the Brazilian law and others were freely created by the BNDES. The normative instruction created by the Brazilian Securities Commission (Instruction 209/1994) demands information about the financial institution responsible for the transaction of quotes, the investment policy adopted by the national manager and the competence of the General Assembly of Shareholders. However, the regulatory norm does not say a word about the “Investment Committee”. This institutional arrangement was freely chosen by the BNDES to create a kind of “public-private collaboration” between the private national managers and the bank.

The implementation of the Criatec Fund was only possible through an extremely detailed division of functions in the fund statute (*joint ownership agreement*). Considering that the BNDES is part of the Brazilian state, this shows a cooperative rationality between private actors and the public sector that is institutionalized by contracts – a phenomenon that the French professor Jacques Chevallier calls *la contractualisation de la production normative* (CHEVALLIER, 2009, p. 160-182), a flexible form of normative production based on the negotiation with the private sector and the definition of cooperation through

⁴⁶ Gustavo Junqueira, interview made in January 2013.

⁴⁷ In Brazilian law, this deliberative institution inside the investment fund is called *comitê de investimento*. It was created by the BNDES in the 1990's to reduce the operational risks and adopted by the Brazilian Securities Commission in the CVM Instruction 391/2003.

contracts.⁴⁸ In the case of the Criatec Fund, the division of functions is clear in the contract that created the venture capital fund.

Table 1. Division of functions by the joint ownership agreement (*FMIEE Criatec*)

<i>Actors</i>	<i>Functions and responsibilities</i>
1. Financial institution (BNY Mellon)	(i) Keep updated records of shareholders, (ii) receive dividends, (iii) exercise or sell rights to subscribe for shares, (iv) maintain under custody in a financial institution authorized by the CVM the securities that integrate the fund, (v) pay for market expenses of the fund;
2. National manager (Antera/Inseed)	(i) prospect target companies, (ii) select companies in which to invest and direct to the approval by the investment committee, (iii) sign with the target company a pre-investment contract before the approval by the investment committee, (iv) determine exit strategies, (v) evaluate companies according to the target market and its characteristics, (vi) analyze the companies' management (entrepreneurs and their staff) and business model, (vii) define the need to contract companies specialized in the analysis of corporate law, intellectual property, tax and labor of the target companies, (viii) monitor the performance of the investee companies e decide on the time of divestment. (ix) hire the regional consultants in 6 different regions.
3. Investment Committee (BNDESPar/BNB/Antera/Inseed)	(i) deliberate about situations involving conflicts of interest, (ii) hire the independent auditor of the fund, (iii) approve the fund's investments and divestments, (iv) approve the selection of the regional consultants, (v) approve the calls for payment of subscribed shares, (vi) decide on expenses above R\$ 10.000,00 in due diligence, (vii) deliberate about the replacement of the Director or any of the analysts that integrate the manager's team, (viii) deliberate about ending the contracts with the regional consultants
4. General Assembly of Shareholder (BNDESPar/BNB)	(i) examine the fund's account and deliberate about the financial statements presented by the financial institution, (ii) modify the statute of the fund, (iii) approve the substitution of the administrator, (iv) approve the merger of the fund, (v) approve the issuance of new shares, (vi) approve changes in the rate of remuneration of the manager, (vii) extend for five years the fund's duration.

This institutional arrangement was very important to the fund's implementation in 2007. Each organization (*BNY Mellon*, *BNDESPar*, *Banco do Nordeste*, *Antera*, *Inseed*) had specific functions, described in the statute. There were two deliberative organs (IC/GAS) and a formal governance structure that privileged the communication between the fund's managers and the investors.⁴⁹

After this process of institutional design, it began the phase of selection of innovative firms by the regional consultants and the national manager. This process began on the

⁴⁸ This phenomenon has been noted by Faria (2008). In the United States, a similar debate was made by the "new governance" scholars. Efforts to describe the "new governance" suggest that it is an approach that is normative but not legally binding, it is designed to form norms through bottom up processes not by top-down legislation, it uses open-ended rather than precise legal rules, and it is flexible and revisable rather than fixed. *See* LOBEL, 2004; TRUBEK; TRUBEK, 2006, 2010.

⁴⁹ For a discussion about the role of the investment committees (IC), *see* CARVALHO et al., 2012.

internet.⁵⁰ The selection process consisted of six steps: (i) filling an internet-based formulary, describing the investment opportunity with emphasis on merit, (ii) personal conversation with the Criatec's regional team (diligence), (iii) conclusion of the business and investment plan, (iv) selection by the Criatec's national manager, (v) negotiation of the firm's legal structure and due diligence, (v) approval by the Criatec's investment committee.

1.847 early-stage companies applied for the Criatec Fund between 2007 and 2011. By the end of the selection phase, 36 companies (2%) were approved both by the national manager and the investment committee.⁵¹ 31% of the selected companies were in the "proof-of-concept" phase,⁵² which shows that the Criatec Fund really invested in seed companies.⁵³

The investment in these 36 selected innovative start-ups only occurred after a long process of negotiation between the fund's managers and the entrepreneurs. In order to coordinate and harmonize the selection in different regions of the country, the national manager (*Antera/Inseed*) created a "seed capital manual" that was distributed to the regional consultants. This manual contained the rules about the fund's intervention in the selected companies and the corporate governance mechanisms that the fund would use. During this process, the national manager hired one law firm (*Spalding Advocacia*) that became responsible for writing the legal part of the "seed capital manual" and doing the due diligences on the selected seed companies. Leandro Belzecry, responsible for the legal aspects of the Criatec Fund, explained that the law firm decentralized this task. They looked for regional legal partners that could also assist the selected companies:

All contracts passed by Spalding. So we centralized the legal part and we had almost a whole team for the Criatec. The due diligence involved questions like the transformation of the investee company, since many were limited and needed to become a joint stock company. We made a "letter of intentions" and asked for preliminary documents. Then the due diligence processes initiated. But we had a particularity. We did not want to embrace all due diligences. I think we did three or four in Rio and other location that we could not identify a partner. We thought that it was a good thing to find a legal regional partner that could also be a legal adviser to the day-to-day business of the start-ups. We thought that it would be convenient not to mix the legal counseling of the fund and the legal counseling of the day-to-day

⁵⁰ See <<http://fundocriatec.com.br/index.php>>.

⁵¹ The regional distribution is: Pará (1), Ceará (4), Pernambuco (5), Minas Gerais (8), Rio de Janeiro (5), São Paulo (8), Santa Catarina (5).

⁵² The "proof-of-concept" phase is the earliest stage in a private firm evolution (the entrepreneurs only have the idea). Venture capital funds generally invest in companies that already tested the products that they intend to sell.

⁵³ I will not discuss the types of companies selected and if they are succeeding economically. I am not interested in the economic result of the fund. This research focuses on the institutional design and the many roles of law.

business of the selected companies, because at some point that could generate a conflict.⁵⁴

This initial phase involved an intense relationship between the national manager of the fund and the regional consultants selected by the investment committee. In the beginning, the national manager – the partnership between *Antera* and *Instituto Inovação* – had to train the regional consultants. In the following years, the regional consultants became partners of the national manager and a more horizontal approach overcame the previous “top-down” coordination. Gustavo Junqueira, from *Inseed Investment* (former *Instituto Inovação*) described the transformation in details:

In the beginning it was a formal training based on a manual, an operational manual and training. Now, after five years, it is something different. We take decisions together, always seeking alignment. It is no longer “one teaches the other”. It is “one executes and shares with the other”, to see if the other has a different opinion, or wants to propose an adjustment. It is not a training anymore. In the beginning it was, but now is a joint management. We only make the supervision and the quality control.⁵⁵

As shown above, the Criatec Fund had a detailed institutional design that permitted the coordination of different organizations and actors. This is one important function of law. In the execution of the fund, the national manager decentralized the legal and business assistance through regional consultants. The fact that the national manager was a partnership between two different companies also helped the Criatec Fund. One company, *Antera Gestão de Recursos*, was focused on the compliance and the relationship with the investment committee and the financial institution (*BNY Mellon*). The other, *Instituto Inovação*, was focused on the acceleration of the selected start-ups and the relationship with the regional consultants.

After this description about the creation of the fund, I will discuss the legal dimension of the Criatec Fund in three perspectives (structural, regulatory and contractual). These legal dimensions are linked to different hypothesis concerning this venture capital fund.

⁵⁴ Leandro Benzecry, interview made in December 2012.

⁵⁵ Gustavo Junqueira, interview made in January 2013.

4.2 Trubek's hypothesis: flexible instruments and public-private partnership

The legal sociologist David Trubek has argued that one of the main features of the law in the “new developmental state” is the use of flexible instruments to foster innovation and public-private partnership (TRUBEK, 2010). In this part, I discuss if the Criatec Fund shows an extremely collaborative form of public-private partnership institutionalized by flexible legal instruments.

The research concerning the role of public companies in the venture capital industry shows that the BNDES has developed many instruments to support innovative firms and foster this risk modality of financial investment in Brazil. In the case of the Criatec fund, the main flexible instrument is the joint ownership agreement that regulates the investment fund according to the CVM Instruction 209/1994.⁵⁶ This legal instrument coordinates the relationship between many organizations and entities, like the investors (*BNDES Participações S.A.* and *Banco do Nordeste do Brasil*), the financial institution hired by the fund (*BNY Mellon Serviços Financeiros DTVM S.A.*), the national manager (*Antera Gestão de Recursos S.A.*), the national supervisor (*Instituto Inovação*) and the regional consultants.

This legal instrument is flexible because the public companies that created this venture capital fund can modify its rules through the General Assembly of Shareholders (GAS), the main deliberative organ inside the condominium. The Article 14 of Criatec Fund's statute determines that the GAS – formed by representatives of the BNDESPar and the BNB – can modify the statute in the annual meeting and can also substitute the financial institution or the national manager.⁵⁷

The public-private collaboration is a strong characteristic of this legal instrument. The statute creates an institution called Investment Committee (IC), a technical deliberative instance formed by representatives of the public sector (BNDESPar) and the private one (national manager).⁵⁸ The IC has the formal competence to deliberate about the approval of

⁵⁶ In the United States, this contract is generally the “limited partnership agreement”. In Brazil, the prevailing institutional form is the condominium (joint ownership of financial resources).

⁵⁷ However, the GAS did not make any substantial modification of the statute since 2007.

⁵⁸ According to the Article 13 of the fund statute, the IC is formed by 6 members. One is nominated by the national manager, two members are nominated by the BNDESPar, one member is nominated by the BNB and two members are elected by all the members. However, each vote of the members indicated by the BNDESPar is equivalent to two votes. In this logic, the BNDESPar is responsible for half the power of the deliberative instance. It results that is not possible to decide anything without the consent of the representatives of the BNDESPar.

investments suggested by the national manager,⁵⁹ the approval of the regional consultants and to solve conflicts of interest that may appear between 2007 and 2017.

In the case of the Criatec Fund, the public-private partnership is institutionalized through a “formal governance structure” inside the fund statute. The legal instrument not only imposes enforceable obligations, but crafts a “structure that establishes a framework for iterative collaboration” (GILSON; SABEL; SCOTT, 2011, p. 6). The public-private collaboration is possible through a formal governance arrangement.

This continuous collaboration is extremely important considering the conditions of uncertainty and risk that involves the seed capital. As noted by Ronald Gilson, Charles Sabel and Robert Scott, in scenarios of uncertainty, legal instruments can “create governance processes that support iterative joint effort through low-powered enforcement techniques that specify only the commitment to collaborate”. One important component of this formal governance arrangement is a “commitment to an ongoing mutual exchange of information designed to determine if a project is feasible, and if so, how best to implement the parties’ joint objectives” (GILSON; SABEL; SCOTT, 2011, p. 9).

The difference about the Criatec Fund is that the partnership between public and private firms is not formed to produce industrial goods, but to finance innovative firms through equity. However, the ongoing mutual exchange of information is extremely necessary. The investors need to know if the company selected by the regional consultant has the potential to grow and become an innovative firm in the market. Communicational processes between the regional consultants, the national manager and the IC are essential. The committee relies on the information produced by several actors. There is a whole chain of communication (start-ups → regional consultants → national manager → investment committee). This partnership helps not only the state but also the private companies.

The interviews revealed that the BNDES was not a “passive shareholder”. At least in the opinion of the fund manager, there was an intense exchange of information in the meetings of the investment committee. In these meetings, both sides had the opportunity to learn. In fact, sometimes the BNDES is considered to be a “coach” to the national managers:

BNDES is much more than a shareholder. It is not a passive shareholder. The investment committee of Criatec, where the BNDES has the majority of the votes, takes the investment and divestment decisions. In this sense, the state has a great influence to say what makes sense and what does not,

⁵⁹ The innovative firms are first selected by the regional consultant. Then they are approved by the national manager. Then they are approved by the Investment Committee (formed by the investors and the managers).

because we will not lose much time in an opportunity that later will not be approved. Every month the *Inseed* sends to the BNDES the EBITDA of all portfolio companies and gives an “update”, a “rating” of all relevant facts of the month. With this level of monitoring, the shareholders – both the BNB and the BNDES – have a relevant role of defining the agenda. So we go and say “this and that are happening”. Considering that they have a great experience of dozens of other funds, they can get things really fast. “Well, you are reporting here many cases of financial problems. What is the manager’s profile? How much are you paying for the CFO?”. So, they can call our attention, which bring our focus to some points and this has an influence in our day-to-day operation. [...] So, in short, they are very important as drivers and they have a very active role. Considering their experience with other funds and even in direct operations, they act as a “coach” for the fund managers. I am happy to have them as shareholders. It even gives greater security for us to be going in the right path or not.⁶⁰

It seems that in the Criatec Fund there is no “top-down” relationship between the BNDES and the private managers, considering that the investor (state) depends on the professional expertise provided by the private firms. There is a *formal* horizontal partnership mediated by flexible instruments that foster a collaborative process of governance, based on constant meetings and information exchange. It is not possible to measure this collaboration in the *substantial* perspective (if the suggestions made by the private sector are really adopted by the state-owned banks). But it seems reasonable to conclude that there are formal instruments that allow this collaborative process.

I believe that all these evidences (legal documents and interviews) confirm the *Trubek’s hypothesis*, at least in the formal perspective. In the case of the Criatec Fund, flexible instruments were managed by the state in order to promote a collaborative environment with the private sector. The legal instrument that created the fund not only coordinated different social actors (defining “who does what”), but also created a formal governance structure based on the exchange of information between the public and private sector for decision-making. In the structural perspective, law played an important role.⁶¹ Now it is time to see if law was important in the regulatory perspective and in the contractual perspective.

⁶⁰ Gustavo Junqueira, interview made in January 2013.

⁶¹ In this sense, law can be seen as a formal institution, that is, humanly devised constraint that structure human interaction. (NORTH, 1990; MANTZAVINOS; NORTH; SHARIQ, 2003)

4.3 Schapiro's Hypothesis: regulation and the co-management problem

The legal scholar Mario Schapiro has produced many interesting studies about the innovation financing and the legal aspects of the venture capital industry in Brazil (SCHAPIRO, 2010, 2012). He believes that the Brazilian venture capital market is path dependent, based on the institutional heritage of the financial arrangement. This “institutional heritage” is characterized by the articulation of three regulatory instances, the auto-regulation, the indirect regulation and the direct activity of the public financial agents.⁶² Schapiro believes that the venture capital market regulation made by the Brazilian Securities Commission – which he calls “indirect regulation” – helped to consolidate the seed capital:

In addition to the self-regulation promoted by the agents of the market in the late 1990s and early 2000s, another institutional factor played in favor of the creation of a venture capital market in the country: the regulation indirectly promoted by the normative instructions issued by the Brazilian Securities Commission (CVM). This new regulatory set contributed to the establishment of legal and financial vehicles and governance rules favorable to the strengthening of a capital market and, in particular, a venture capital market (SCHAPIRO, 2012, p. 24)

It is true that the regulation is important. The Criatec Fund was based on the CVM Instruction 209/1994 (*Fundo Mútuo de Investimento em Empresas Emergentes*). This normative instruction provided legal certainty for the market, because it defined rights and duties for the different players in venture capital funds. The private sector knew that it was safe to create venture capital funds following the CVM legal structure. The regulation imposed by the federal agency, in this sense, provided an institutional environment that allowed new financial vehicles directed to innovative firms. According to Schapiro (2009), it is interesting to notice that the BNDES experimentalism in the venture capital in the early 1990's forced the CVM to regulate the sector. Through this “indirect regulation”, the CVM stimulated the creation of new public and private equity funds.

The creation of the Criatec Fund by the BNDES, however, was blocked by the very regulation that fostered the Brazilian venture capital industry. What happened is that the management of the Criatec Fund was supposed to be conducted by two companies: *Antera Gestão de Recursos S.A.* and *Instituto Inovação*. However, in 2007 there were two problems:

⁶² The auto-regulation is made by the stock market agents, like *Bovespa*. The indirect regulation is made by the Brazilian Securities Commission (*Comissão de Valores Mobiliários*). Finally, the direct activity of public financial agents is conducted by the BNDES (SCHAPIRO, 2012, p. 20-21).

(i) *Instituto Inovação* was not registered at the CVM as an official fund manager,⁶³ and (ii) the Brazilian Securities Commission did not accept a fund co-management. The regulatory agency defined that only one company could act as “manager”. The reason was that this would be safer for the investors. They would know who was responsible for the management of the fund. Allowing a “co-management” would be dangerous, because it would be harder to define the responsibilities of each manager.

This rule imposed by the Brazilian Securities Commission turned out to be a small problem for the private companies that were selected by the BNDES to manage the Criatec Fund. Gustavo Junqueira explained that there was an “institutional blockage” that did not allow a co-management. The result was that the Rio-based company, *Antera*, was considered the manager and the *Instituto Inovação* was hired by the fund as a “national supervisor”.

After the public call it was a consortium of two equal parts. We set up the consortium because the *Instituto Inovação* had an operational experience (identifying and accelerating technology-based companies) and the *Antera* was registered at the CVM and had a good “compliance” experience. The companies were complementary, each one with its own skills. When we had to put it in the fund statute, by the time of the due diligence, we found that the consortium could not manage the fund because it was not regulated by the CVM. So the *Antera* had to stay as a national manager and the *Instituto Inovação* as a national supervisor. In the statute of the fund the powers were disproportionate. That was one of things that provoked questions like “well, should we keep the consortium?”, “do we have to merge the companies?”, “is it better to move on separately?”. In this period, the *Instituto Inovação* created its own venture capital firm, the *Inseed Investment*, that was approved by the CVM and had the right to manage third-party resources. We made a private joint operating contract to manage the fund. Later on, the shareholders asked us to put the content of this contract in the statute of the fund, declaring that there is a co-management. Now this is possible.⁶⁴

The “co-management rule” only changed after the constitution of the Criatec Fund. In 2008, a private bank (*Banco Opportunity S.A.*) appealed against a decision of the CVM that did not allow the co-management of a specific investment fund.⁶⁵ The regulatory agency, however, reconsidered its own position and recognized that there was no rule forbidding the co-management of investment funds.⁶⁶ The Brazilian Securities Commission changed its

⁶³ See CVM Instruction 306/1999, Article 7.

⁶⁴ Gustavo Junqueira, interview made in January 2013.

⁶⁵ CVM, *Recurso Contra Decisão da Superintendência de Relações com Investidores, Banco Opportunity S.A., Proc. RJ2008/12466*.

⁶⁶ The lawyers of the private bank (*Banco Opportunity*) recalled the Brazilian Federal Constitution to sustain the “legality principle”. According to the decision: “The appellant held that, under the penalty of hurting the principle of legality secured by the Article 5, II, of the Federal Constitution, the CVM could not prohibit certain

normative orientation and allowed the co-management.⁶⁷ However, this “case law development” inside the CVM only happened in 2008. In 2007, when the Criatec Fund was created, the co-management of the fund was not allowed.

Obviously, this institutional blockage was a minor issue. It did not hinder the implementation of the fund. However, this example shows that the regulatory law created a small obstacle to the execution of the Criatec Fund. A seed capital fund like Criatec needed not only the financial expertise (capital market), but also a start-up acceleration expertise (“hands-on” business assistance). The fund would have a more accurate statute with the co-management approach.

It is clear that this co-management problem was a small problem solved in 2008 by the case law development of the CVM. This “institutional blockage” does not underestimate the role of the regulatory law provided by the “indirect regulation” (SCHAPIRO, 2011). The normative instructions created by the CVM strengthened the venture capital industry in Brazil.⁶⁸ This helped the BNDES in the promotion of the seed capital through the Criatec Fund.

4.4 Matto’s Hypothesis: contracts as “instruments of last resort”

Paulo Mattos was one of the first legal scholars that described how the Brazilian National Bank was managing legal instruments – especially private contracts – for risk sharing with the private sector in order to promote innovation (MATTOS, 2008). Mattos noticed that the BNDES had created several venture capital funds and had developed contractual instruments to reduce risks and monitor the investee companies. According to Mattos, the main instrument available for this governance control was the “shareholders’ agreement” (or stockholder agreement), a special type of contract in the corporate law.⁶⁹

practices that could not find expressed legal prohibition. Accordingly, the appellant stressed that the CVM, as a regulation agency, in order to require that the investment fund had only one manager, should expressly prohibit the existence of more than one manager as a service provider. Otherwise, it would be acting arbitrarily and exceeding the duties devolving upon the agency”. *CVM, Proc. RJ2008/12466*.

⁶⁷ The co-management of an investment fund is now permitted. But a specific contract must be made (joint operating agreement), the investors must be informed and the statute must specify the role of each manager.

⁶⁸ According to the report **Brazil VC Ecosystem Study**, published by the MIT Sloan Management School in 2013, “The Brazilian venture capital ecosystem is still nascent. Conventional VC has emerged over the past 5 years with accelerated activity in the last 24 months. The past two years have seen a significant increase of investors and LP interest in Brazil, with multiple high-profile international firms entering the market and the formation of several dedicated domestic funds” (2013, p. 13).

⁶⁹ Article 118 of Law 6.404/1976: “Shareholder agreements regulating the purchase and sale of shares, preference to acquire shares, the exercise of voting rights, or the exercise of control must be observed by the corporation when filed in its head office”.

Mattos formulated the hypothesis that public credit institutions are using flexible private contracts (credit contracts, shareholders and fund investors agreements) to bind private companies to industrial policy's investments and corporate governance objectives.⁷⁰ In this final part of the paper I want to discuss *how important are these flexible private contracts*. Based on the interviews, I will try to show that these contracts are significant, but the communication process and the trust building with the entrepreneurs are more important than the legal instrument (considered an "instrument of last resort").

As argued in this paper, the Criatec Fund is based on risk. It is a type of venture capital directed to early-stage companies. Some may fail, some may succeed.⁷¹ Obviously, the investor is interested in reducing his risks. In the case of the Criatec Fund, the risk was reduced by many forms: (i) there was a competitive selection process (1.847 applied and 36 was selected); (ii) the selection was conducted by a private firm specialized in start-up acceleration, and (iii) there was a decentralized mechanism of monitoring the investments through the regional consultants. However, this could not eliminate the risk of failure.

Scholars like Sahlman (1990) agree that the stock-purchase agreement is the basic document that governs the relationship between the venture-capital firm and the venture. In order to reduce the investment risk, this contract may have clauses about the amount and timing, form of the investment (purchases of convertible preferred stock), puts and calls,⁷² go-along rights,⁷³ preemptive rights, information rights (regular transmission of information, including financial statements and budgets) and the board's structure (representation on the company's board of directors).

These contractual instruments are important to the Criatec Fund. In the statute, in the Article that deals with the investment policy, there is a clear rule about the use of shareholders' agreement in order to influence the economic strategies of the investee companies:

⁷⁰ This was also noted by Trubek (2010, p. 32): "In its venture capital operations the Bank employs a number of tools to give it flexibility and ensure that it can participate actively in the management of the company. In return for its investment, the Bank receives convertible debentures or preferred stock that can be converted into common stock. The most important tool is the Stockholder agreement".

⁷¹ A venture capitalist does not expect that all investee companies are going to succeed. However, an exponential growth of one company of the portfolio compensates the failure of many small firms.

⁷² See SAHLMAN, 1990, p. 504: "Agreements typically give the venture capitalists the right to put the security by calling for redemption of the preferred stock".

⁷³ See SAHLMAN, 1990, p. 505: "Many agreements specify that the venture capitalists can sell shares after conversion at the same time and on the same terms as the key employees".

Article 8, Paragraph 6: The fund will participate in the decision making process of the investee companies with effective influence in defining its policy strategy through at least one of the following mechanisms: (i) appointment of a member to participate in the company's board of directors, (ii) holding shares that integrate the block of control of the company, (iii) celebration of the shareholders' agreement, (iv) adoption of procedures to ensure the effective influence of the fund in the definition of strategy policies and management of the company.⁷⁴

The shareholders' agreement is a typical "relational contract". This concept was developed by Ian MacNeil in the late 1970's.⁷⁵ According to MacNeil, all contracts are characterized by permitting and encouraging participation in exchange, promoting reciprocity, reinforcing role patterns appropriate to the various particular kinds of contracts, providing limited freedom for exercise of choice, effectuating planning, and harmonizing internal and external matrixes of particular contracts. The relational contracts, however, have two particular norms: (i) harmonizing conflict within the internal matrix of relation, including especially, discrete and presentiated behaviour with nondiscrete and nonpresentiated behaviour; and (ii) preservation of the relation (MACNEIL, 1978, p. 895).

It is easy to see that the private contract signed between the investee company and the venture capital fund (Criatec) is a relational contract. It is a long-term contract expected to last 10 years or less. It involves relations rather than discrete transactions. It transfers powers to the venture capitalist and forces a co-management of the investee company between the entrepreneurs and the fund's manager. Without this contract, the investment would be too risky. So, it would be logical to conclude that the law – or the relational contracts – plays a major role in the Criatec Fund.

The interviews, however, revealed that the shareholders' agreements were not so important when compared to the negotiation process and the relationship between the managers and the entrepreneurs. Following a thesis argued by two Asian scholars, it seems that "although the use of contracts is prevalent in every investment deal, they remain an instrument of last resort, when all else in the relationship fails" (LIM; CU, 2012, p. 578).

The case of the Criatec Fund shows that the decentralization through the regional managers helped the implementation of the public venture capital policy. In order to mitigate the risks of the investment, the BNDES demanded contracts that would create special rights for the investors, like "veto powers" to a representative of the Criatec Fund. But it was hard for the national managers to explain to the entrepreneurs that the investment was accompanied

⁷⁴ Criatec's statute, available at <www.cvm.gov.br>.

⁷⁵ In Brazil, MacNeil's theory has been adopted by Macedo Junior (2007).

with several corporate governance rules. Gustavo Junqueira explained that the shareholders' agreements provoked some discomfort. But there was a "pedagogical process" in which the regional consultants had to explain that the venture capital involved not only money, but also responsibilities:

We had to show to the entrepreneur that he is an executive partner who manages a direct impact of his will in the business. The Criatec fund is a partner that can influence, but cannot run the business. The implementation of the strategies always depends on the entrepreneur, especially in these seed companies where the company is practically the head of the entrepreneur. There was a nuisance about the disproportionality of power that the Criatec required to put some money in the company and all the extra powers given to the fund. That was a problem, but in these 36 investments we managed to show that this extra responsibility comes along with the money. With the acceleration opportunity, comes governance. With opportunity, comes responsibility.⁷⁶

The head of the venture capital department of the BNDES, Marcio Spata, also said that the negotiation processes were far more important than the contracts themselves. Indeed, the Bank used typical private contracts (MATTOS, 2008). But the BNDES relied on the social network of national managers, regional managers, university consultants and lawyers to negotiate and create trust. In Spata's opinion, the Criatec Fund is a successful venture capital policy not because of the legal instruments (private contracts) created by the Bank, but because of the communication and negotiation process between the fund and the investees.

It is great to have the best fund statute of the world, the best shareholders agreement of the world, the best legal team in the world. Not to be used. What matters is the relationship. If you use legal arguments to arbitrate anything with your partner, something will go wrong. "Do not enter in the paper", is what we always say in Criatec. Do not let it go to the legal documents. If you let it go, then it is going to end in the Judiciary. So the first thing is relationship. We have to be very good in the relationship with the firms. To go inside a company and to remove one Director, to put him as "Innovation Director", or to elected the Board's President, this involves relationship. It is obvious that it is very important to have contracts and legal documents. It is important. It is good. But it is good in the sense that I negotiate everything before. You need to negotiate. The good thing about the contract is that it will contain everything that you negotiated before. Everybody will see how things are going to be in the future. But they will not use the contract.⁷⁷

⁷⁶ Gustavo Junqueira, interview made in January 2013.

⁷⁷ Marcio Spata, interview made in February 2013.

This finding is different from other socio-legal researches about “non-contractual relations in business” (MACAULAY, 1963). In a classical study about business transactions in the automobile sector, Stewart Macaulay found that contract law did not matter at all. Despite the existence of formal contracts, businessmen relied on trust, relational spaces and informal communication. This is not the case here. In the Criatec Fund, different types of contracts are used (pre-investment contracts, shareholders’ agreement) and they are considered important by everyone. However, the “contractual dimension” is less important than the “relational dimension”.

The “success of the Criatec Fund”⁷⁸ is related to (i) an intense negotiation process conducted by the regional consultants and supervised by the national manager, (ii) a pedagogical process in which a “legal manual” was elaborated by the national manager and explained to the entrepreneurs, (iii) a process of continued exchange of information between the entrepreneurs and the fund’s manager about business strategies, innovation and market competition, and (iv) the definition of a co-management structure in the investee companies (with the participation of representatives indicated by the fund in the investee’s board of directors).

It seems that the Brazilian scholars pay too much attention on the legal instruments when, in fact, the relationship between the social actors and the complex process of building trust in order to perform risky economic activities also matter. Regulation and private contracts are important to the execution of this public venture capital policy. But it seems that what is more important is the communication process between social actors and the way they interact and construct “social capital”⁷⁹. So far, this relational dimension has been neglected by the majority of the legal scholars.

⁷⁸ It is too early to discuss if the policy is a success or a failure. The “exit phase” is going to happen in the next years (2012-2017). However, considering that the BNDES announced the “Criatec II” (2012) and the “Criatec III” (2013) – two new versions of this seed capital fund –, it seems reasonable to conclude that the government believes this is a right policy.

⁷⁹ I did not discuss, in this paper, the concept of “social capital”. The term is used here in the way proposed by James Coleman: “social capital comes about through changes in the relations among persons that facilitate action. If physical capital is wholly tangible, being embodied in observable material form, and human capital is less tangible yet, for it exists in the *relations* among persons. Just as physical capital and human capital facilitate productive activity, social capital does as well. For example, a group within which there is extensive trustworthiness and extensive trust is able to accomplish much more than a comparable group without trustworthiness and trust” (COLEMAN, 1988, p. 100-101).

4.5 Venture capital policy and the many roles of Law

The empirical analysis of the Criatec Fund as a financial policy illuminates the understanding about the relationship between the law and the economy. As described in this paper, law played many roles in the creation and execution of this venture capital policy. It is clear that the Criatec Fund is not simply the “product” of legal instruments. It is the result of many experiences of the BNDES in the capital market – which were thought and developed by many economists and employees of this huge state-owned bank.

It is important to understand that the Brazilian Development Bank operates in order to accomplish developmental goals. The Brazilian society has declared its fundamental objectives.⁸⁰ As postulated in the Constitution, the economic order, founded on the appreciation of the value of human work and on free enterprise, is intended to ensure everyone a life with dignity, in accordance with the dictates of social justice, with due regard for the principles of “national sovereignty, private property, the social function of property, free competition, consumer protection, environment protection, reduction of regional and social differences, pursuit of full employment, and preferential treatment for small enterprises organized under Brazilian laws and having their head-office and management in Brazil”⁸¹.

The Constitution sets forth objectives and goals, such as the promotion of scientific development and technological expertise.⁸² But normative texts are not enough. The whole developmental agenda depends on public policies, including financial ones. This is the case of the promotion of innovative small firms in Brazil. It depends on innovations inside the national financial system, considering that the traditional banking model is not adequate to finance risk-based entrepreneurship.

The Criatec Fund is unique because it is the synthesis of many venture capital policies created by the BNDES in the 2000s. It is decentralized, based on the coordination of two different national managers and seven regional managers that constantly keep in touch with the 36 investee companies. It has a flexible legal structure that allows the revision of the “rules of the game”. It is regulated by a federal agency, which provides legal certainty for the private actors in the market. It is based on negotiation and contracts between the managers and the investee companies.

⁸⁰ Federal Constitution, Article 3: “The fundamental objectives of the Federative Republic of Brazil are: I - to build a free, just and solidary society; II - to guarantee national development; III - to eradicate poverty and substandard living conditions and to reduce social and regional inequalities; IV - to promote the well-being of all, without prejudice as to origin, race, sex, colour, age and any other forms of discrimination”.

⁸¹ See Federal Constitution, Article 170.

⁸² See Federal Constitution, Article 218.

This venture capital policy has many legal dimensions. It is possible to identify a structural, a regulatory and a contractual perspective. These are the roles of law studied in this paper.

Chart 3. Legal dimensions of the Criatec Fund

Legal dimension	Roles of law	Case of the Criatec Fund
Structural	Defines the institutional arrangement of the public policy (who does what), connecting actors and organizations	Joint ownership agreement (defines the role of the investors, the national managers, the financial institution responsible for the quotes and the investees).
Regulatory	Defines the general rules of the game, calibrate expectations and provides institutional stability	CVM Instruction 209/1994 (defines the rules for the creation of venture capital funds)
Contractual	Defines the duties and obligations of the contracting parties, reinforcing the negotiation process and the mitigation of risk through trust building	Shareholders agreements (signed between the fund and the investee after a long negotiation process)

Through this analytical scheme it might be easier to understand what law can do.⁸³ However, legal scholars should not overestimate the role of legal instruments such as private contracts. As argued before, these formal institutions are important but they are not the main guide for social interaction. “Economic sociology” suggests that we should also understand the “embeddedness” of economic activity, the role of social networks and how trust supports cooperation. This powerful insight – provided by sociologists that studied the venture capital industry (FREEMAN, 2005; FERRARY; GRANOVETTER, 2009) – seems to be neglected by legal scholars.

⁸³ Diogo Coutinho provides another analytical perspective to understand the roles of law in developing countries. Coutinho (2013) thinks that we can see law as an objective, law as a tool, law as an institutional arrangement and law a kind of “demands vocalizer” (creation of institutional spaces for political participation and deliberation).

5 Conclusion

The Criatec Fund is a public financial policy based on the collaboration with the private sector. Because of the complexity of its economic activity – the promotion of venture capital and innovative small firms –, it is highly dependent on the private sector, which possesses the expertise, the knowledge and the networks that facilitate its performance.

It is clear that, in the Criatec Fund, some flexible legal instruments were developed to establish a formal structure of information exchange between different social actors and organizations. In this paper I tried to show that this seed capital fund involves a unique public-private partnership. It seems that there is a horizontal relationship between the state (BNDES) and the private sector (venture capital firms selected by the public bank to manage the fund and incubate innovative small firms). It was not possible to analyze the relationship between the national manager and the regional consultants, but it seems reasonable to conclude that there is a horizontal public-private partnership at least in the formal dimension.

The research showed that law plays different functional roles in this venture capital policy. The first functional dimension is the structural. The statute of the Criatec Fund (joint ownership agreement) defines functions and responsibilities of the national manager, the investment committee and the general assembly of shareholders. The statute coordinates the role of each organization in the execution of this risky financial instrument. The second dimension is the regulatory. The Brazilian Securities Commission was influenced by the experimentalism of the BNDES and regulated the sector through normative instructions. The regulation was crucial to the development of the Brazilian venture capital industry, even though there was an “institutional blockage” concerning the co-management of venture capital funds.

The research also analyzed the role of law in the contractual dimension. According to the interviewees, the shareholders’ agreements are important because they create governance rules for the investee and reduce risks for the venture capitalists (public banks). However, it seems that what really matters is the relationship between the venture capital firm and the investee. Contracts are seen as instruments of last resort. A close relationship with low information asymmetry is the best way to reduce risks.

In the case of the Criatec Fund, the national manager created a “legal manual” for the regional consultants. This “corporate governance training” was important for the negotiation process between the investees and the regional consultants. They explained which rules would

be in the shareholder's agreement. This was important to create trustworthiness – something that is rarely studied by legal scholars.

The fast changes occurring in Brazil demand more empirical studies in order to understand how the country is influenced by the globalization process and how institutions are being shaped for the promotion of innovation and entrepreneurship. These new forms of public-private partnership – like public venture capital funds managed by the private sector – may be gradually becoming the emerging pattern of public policy in the country. This shows that legal scholars should pay attention not only to the structural, the regulatory and the contractual dimension of public policies based on the public-private collaboration. It is also important to understand how social actors interact, how they create enough trustworthiness to perform risky activities and if the law – in its multiple forms – affects the coordination of these actors. The case of the Criatec Fund may point to this direction.

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