

BRAZILIAN VENTURES AND INTELLECTUAL PROPERTY

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ABSTRACT: This article provides an overview of the Brazilian venture capital market and explains the importance of an appropriate use of the intellectual property system as a powerful tool for competition, stability and mitigation of risks on capital investments. It alerts also to the fact that, while several legal measures have already been adopted to promote the venture capital market in Brazil, a more developed culture of intellectual property must be spread over the Brazilian investment agenda.

Important modifications are taking place in the structures required for the consolidation of a venture capital market in Brazil. While investments in small companies are still not the result of a fruitful symbiosis between technology and market, we must not forget that various factors are contributing to endow Brazil with suitable instruments to promote the venture capital market, essential to speed up the economic and social development of the Country.

Studies conducted by the Brazilian Association of Venture Capital and Thomson Venture Economics, with support from FINEP and the Getúlio Vargas Foundation, have concluded that around US\$ 91 Million were invested in the Brazilian venture capital market in the first half of 2002. Most of these funds were invested in companies that were already beyond the start-up phase. Investing in such companies offers lower risks to investors than investing seed money into start-up companies.

These are shy numbers, still, and reflect an international trend of retraction in venture capital investments witnessed over the last two years. For a country producing over six thousand PhDs a year and occupying the 17th place in terms of the number of articles published in scientific journals worldwide (numbers that are comparable to Canada and Italy), such a great gap between knowledge produced inside Universities and its practical application, on a commercial scale, capable of attracting the attention of venture capital investors, is not justified.

The number of Brazilian patent applications filed per year in the US (100) is not very encouraging either, and reflects certain lack of perception of the necessity and the

utility of promoting the protection of intellectual creations, which contributes, to a large extent, to the relatively slow evolution of the Brazilian venture capital market.

Effectively, the economic value of a patent, a trademark, software, a domain name, must be very carefully weighed in the analysis of which companies deserve to receive venture capital investments. Exclusive rights offered by the intellectual property system are often the main asset from which a small technology-based company can benefit. The appropriate use of the intellectual property system may contribute to bring high rates of return on capital, which is crucial in order to attract venture capital investors.

Although these exclusive rights are not limitless rights, as they are socially and economically balanced, one cannot deny that they are absolute rights, in the sense that they are included in a legal relationship between the right-holders and society, requiring respect for the rights attributed to the right-holder. In addition, the protection granted by intellectual property rights should not only be considered locally. All member countries of the various conventions that constitute the intellectual property system must have in place mechanisms for the protection of intellectual property rights for the creations of nationals and foreigners alike.

It can be argued that the **intellectual property system stabilizes the market**, eliminating an original failure that would allow anyone to use other people's creations, taking advantage of the natural non-appropriability that characterizes intangible goods.

What occurs is that while the intangibility of such assets is a tool for earning higher profits from them, it also enables others to reproduce limitlessly the intellectual creations of innovators, taking over the clientele and the profits that legitimately would belong to the owner of the intellectual creation. In order to prevent the dispersion of this injustice, of dismal economic and social consequences, and to stimulate the innovation process, law comes to create exclusive rights, and, thus, to stabilize the market.

It is precisely this **concept of stability that must be opposed to the idea of risk**. The more effective the protection, the bigger the potential of any technology to bring to the owner of the respective rights the domination of a market, to generate a competitive advantage over competitors (e.g. by taking over their clientele), to

transcend the state-of-the-art leading to the appropriation of the results of economic and intellectual efforts, to impose a technological barrier, and, as a result, the less risky will be the financial bid launched by the investor.

Thus, the venture capital investor should not restrict himself to the analysis of the corporate structure of the target company, to the identification of its possible taxation or labor liabilities, to auditing its financial performance. It must also, and even more carefully, be concerned with valuating the intangible assets of the target company.

This depends, to a large extent, on the accomplishment of a previous due diligence procedure that contemplates the examination of legal transactions involving intellectual property, the inquiry into alleged ownership of intellectual creations (e.g., consulting patents databases), checking practices adopted for the use of intangible property owned by third parties, the analysis of the strategy for protection of trade secrets, among many other issues of extreme relevance for the most accurate delimitation possible of the risks involved in the operation.

Important measures have already been adopted to strengthen the Brazilian venture capital market, aiming at making it more active, and, therefore, stable. The improvement of the corporations law, with the goal to promote cooperation among shareholders as a central element and to raise the protection of minority shareholders; the creation of various state instruments for fostering innovation and the development of technology-based companies (including the use of government funds directed towards the most diverse sectors of the Brazilian economy); the implementation of a new market for the listing of companies implementing good practices on corporate governance; the regulation of mutual funds for investment in small enterprises; all these are actions to be understood within such specific context. But it has to be understood, however, that the **aspired stability will not come without a greater concern about intellectual property strategies of Brazilian companies.**

Some years ago, an advanced industrial property law was introduced in the Brazilian legal system. A little time later, new laws on copyright and intellectual property protection for software were adopted. The approval of the so-called "Innovation's Law" is awaited with great anxiety, considering that it is expected to promote a closer

relationship between science and technology, and to clear the way that leads academia to the entrepreneurial world.

Our legal landmarks, therefore, are very close to maturity as regards the stimulation of the innovation process and to the protection of creations of the human genius. What remains to spread over to the venture capital market, in general, is a more sharpened perception of the importance of intellectual property as a factor of stabilization, mitigation of risk and determination of success for small technology-based companies.

Sensitive to this necessity, FINEP, the Brazilian Federal Agency for Fostering Innovation, has recently created internal rules stipulating the acceptance of intellectual property rights as guaranties in financing contracts with variable return (resembling investments, but without shareholding). By this means, it seeks to guarantee the return of funds in case of breach of contract, to smoothen the access to venture capital for those companies which do not have tangible goods to offer as guaranties and, over all, to deepen the analysis, in such financial contracts, of intangible assets protection strategies adopted by the financed companies, as an instrument of competition and consolidation of markets.

It is a pioneering initiative, that will certainly bring good fruits and on which experience we intend to bring further contributions for the dissemination of an intellectual property culture within the Brazilian venture capital market, and, as a natural consequence, for the strengthening of the national innovation system.