

# *Venture Business Support in Latin America by the IDB-MIF*

Roundtable “ Innovating and Increasing Venture Capital and  
Business: Lessons from Asia and Latin America”

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# MIF- A Unique Development Instrument

- Established in 1993 as a special mechanism to assist countries of LAC bridge the gap between the theory and the realities of transitioning to a global market economy, focused on growth through private sector development
- MIF is the major source of technical assistance grants for micro and small business development in LAC
- Designed to stimulate innovative approaches to development and extend beyond existing international and bilateral assistance instruments
- Within the IDB Private Sector Group, MIF has a catalytic role and the highest appetite for risk



## A Unique Development Instrument

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- Focused on innovation and learning
- Entrepreneurship is core to our activities
- Reaching out to involve new communities, we work always with local counterpart agencies
- Advancing regional approaches
- Responding quickly to new needs
- Total MIF capitalization is USD 1,800 mm after second replenishment (March 2007) Our resources have been primarily directed to less developed countries, Japan one of the major contributors to the MIF along with the US



# Project Characteristics

- Small, targeted interventions that play a catalytic role
- Innovation – approaches must be new
- Sustainable and with Demonstration effect – projects should offer potential to be replicated, MIF is a laboratory for new ideas, we test and replicate the best ones, we focus on sharing lessons learned
- Sustainability – credible plan to continue
- Partnership – risk sharing
- Additionality – MIF resources must be critical to the outcome and the most appropriate choice to fund an initiative



# Innovation

- MIF utilizes both grant and investment mechanisms to promote private sector development and entrepreneurship
- Acts with both the private sector and the governments
- MIF investment program's goal is to take measured risks that the market is not yet taking and to finance innovative projects that will provide information to the markets, in order to promote future participation by other financing sources. MIF will test it, others will take these ideas to scale
- Before we invest, we can help better the environment with our grants

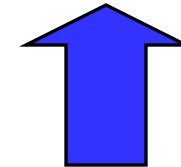


Non-reimbursable grants  
65 to 75%  
Of total MIF funding



MIF Operations Unit

Financial Instruments  
25 to 35%  
Of total MIF funding



MIF Access to Finance  
Unit



## **Instruments offered by the Multilateral Investment Fund (MIF)**

### *Non-Reimbursable Technical Assistance:*

Chanelled through the clusters and lines of activity, and a few other non-related projects (ie, support of VC and microfinance institutions, projects to develop capital markets and VC industry)

### *Reimbursable Instruments:*

Loans, Lines of Credit, Credit enhancement, bonds, Subordinated loans

Lender of last resort and emergency lending

Direct Equity Investments in microfinance institutions, banks, insurance companies, leasing companies and mortgage companies

Direct Equity Investments in Seed and Venture Capital funds



## New Project Preparation Methods

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### ➤ *Lines of Activity*

- Useful tool where exists great similarity in design needs (latest one is a line for banks that want to diversify into SME lending)

### ➤ *Project Clusters*

- Projects developed, supported and evaluated as a group
- Particularly useful to introduce and test innovative development approaches



# Lines of Activity

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- *Strengthening Financial Institutions for Microenterprise*
- *Infrastructure Concession Agreements*
- *Reform in the Infrastructure Sector (C&D countries)*
- *Strengthening Airport Security*
- *MIF/IFAD partnership facility for rural private sector development*
- *Promoting Small Enterprise Financing through Financial institutions*



## MIF Project Clusters

- *Quality Management Standards*
- *Cleaner Production and Environmental Management*
- *Clean Energy Markets*
- *Remittances as a Development Tool*
- *Accounting and Auditing Standards*
- *Reducing Regulatory Burdens on Small Business*
- *Facilitation of Trade and Investment*
- *Small Business Networks and Supply Chains*
- *Information and Communication Technologies for SMEs*
- *Corporate Social Responsibility*
- *Property Rights*
- *Sustainable Tourism*
- *Public-Private Partnerships*
- *Housing Markets*
- ***Promotion of Dynamic Ventures***



## Cluster to Promote Dynamic Ventures

- This cluster funds: 1) with TA, the formation of an eco system conducive to supporting dynamic venture businesses, and 2) with a reimbursable component (loan or equity), the creation of a fund in which CAF and angel investors also invest, purpose is to fund venture businesses
- So far, the program has approved projects in Chile, Bolivia, Costa Rica, Uruguay, Argentina, and Paraguay
- Next countries: Dominican Republic, Panama, Guatemala, and Nicaragua.
- Goal is to target smaller economies, test the ground for entrepreneurial development and begin to set the stage for a VC industry



## MIF Access to Finance Unit

- *Our mandate is to support companies in the range between start-ups to companies with up to 100 employees, that can have from zero to a maximum of USD 5 mm in annual sales or assets at the time of our intervention*
- *We stimulate the development of these microfinance institutions, dynamic ventures, and small businesses, by providing loans, quasi-equity and equity to financial institutions and funds specialized in financing them*
- *We act through financial intermediaries*



- **MIF is the leading investor in creating new formal venture capital vehicles for small business in the region**
  - 53 seed (6) and VC (47) funds since 1996. Approximately 37 active as of today.
  - Over 255 companies financed, over 9,950 jobs supported, companies account for USD 450 million in sales to date. More than 500 entrepreneurs supported through MIF funds; about one quarter of these companies are start ups.
  
- **Funds target small business and start-ups that otherwise cannot access long-term venture capital**



## Snapshot-Venture Capital Activities in LAC

In LAC, the VC story begins in the mid to late 80s, with Brazil leading the industry, and Argentina and Mexico being also attractive destinations

The growth of these early funds was funded largely by local government agencies like BNDES (Brazil) and NAFIN (Mexico) along with the MIF (since 1996)

Internet boom and bust changed the industry's landscape for almost a decade: the bubble to bust cycle followed US crash, it showed cracks in the industry in LAC as

- Performance very poor as US style practices not entirely transferable;
- Inadequate legal and regulatory structures
- Less mature entrepreneurial culture
- Lack of depth in fund manager industry in the region
- Lack of jurisprudence and disclosure issues a challenge



## Snapshot-Venture Capital Activities in LAC

After 2003, re-building from the ashes; in 2006 and 2007: entering another, more mature and sustainable boom in some countries.

Numbers speak: Fund raising over USD3.6 bn in 1998, following to USD 407 MM in 2002 reaching a gradual recovery to pre crisis levels with USD3.2 billion in 2006, and by mid 2007 USD 1.5 billion. (VE-LA Mid-Year report 2007)

To a large extent, VC is still a nascent industry in the Region, but a few countries are showing signs of a more mature industry



More than 10 years ago, MIF set out to promote equity  
as a development tool by:

1. Growing promising companies
2. Attracting private capital for SMEs
3. Promoting technology
4. Encouraging development of local fund management experience
5. Promoting good governance among funds and companies invested
6. Providing hands-on assistance to business ventures
7. Promoting a culture of investing among entrepreneurs
8. Asking for rates of return in line with market expectations
9. Working on developing the capital markets, to improve exit possibilities



## MIF Venture Capital Program

- MIF portfolio includes state, country, or regional funds; specialized (technology, tourism, environmental) or general SME funds;
- We work through funds: we do not invest directly in companies but exclusively in specialized venture capital funds led by (preferably) local teams;
- We seek to transfer our know-how to other potential private and public sector investors, attracting them to the industry;



- Through technical assistance programs, we work with the entrepreneurs to position their companies;
- We work with government agencies in the improvement of the regulatory environment for the industry;
- We support local professional management teams, and, when not available in a country, we support the creation of these teams with training and technical assistance programs done with government agencies and VC associations;



- We seek positive financial and socioeconomic returns;
- We encourage best market practices, and expect our funds to operate in line with them;
- We try to facilitate increased levels of private investment and participation on equal terms: we make our investments on a pari passu basis when possible; and
- We play a catalytic role: we always take minority positions. Our mandate is fulfilled if the private sector takes over after us, and we can move to other areas still untested by the private sector, to have a demonstration and catalytic effect



## MIF's Value Added in the Development of VC

- Has injected capital in 53 seed and VC funds in the LAC region;
- Has supported the development of new, local fund management companies, helping them acquire fund management skills according to international standards; this is expertise that they passed onto the entrepreneurs of the fund's investee companies
- Those skills have been transferred to the companies in which the funds have invested (i.e., corporate governance);
- Has worked with the public and the private sector on regulatory changes to make the LAC markets more attractive to international and local private sector investors (i.e., shareholders' rights).



## MIF's Value Added in the Development of VC II

- Has transferred its know-how in due diligence to other investors, creating a pool of knowledge in the region, and shortening the learning curve for this industry;
- Has developed a network of fund managers;
- Has fostered encounters of entrepreneurs among countries and supported MIT, Endeavor and other initiatives to train entrepreneurs on how to present their ventures to potential investors;
- MIF financing is counter cyclical: we do not leave the region in spite of volatility, rather, we work harder to convince other investors to stay in the region;



## MIF's Value Added in the Development of VC III

- Through our grant activities, we support other areas which are important for the development of the VC industry (i.e., INOVAR Program in Brazil was replicated in Peru and Colombia, angel networks, regulatory studies, technology upgrades in the stock market, venture funds with UK and US angels, etc.);
- We disseminate our lessons learned through seminars, website, tool kits and best practices manuals (now working on a guide for angel investing and seed funds);
- In spite of being a development organization, we inject financial discipline in all our projects, knowing that the best demonstration effect for sustainable development is that projects be... sustainable!



## Some Lessons Learned re VC/PE in General

1. International capital can easily retrench, as demonstrated in the last crises, path to profitability has not been easy
2. Technology transfer has occurred
3. There is an emerging core of local investment fund managers
4. There is an increasing awareness on corporate governance issues
5. Hands-on assistance is not enough to go around, SMEs are always in need of more rounds of financing
6. Culture of investing still not widespread, but improving in some countries; we need to find “serial entrepreneurs”
7. Rates of return: too early to tell, many funds are just finishing their investment period
8. Exits: the Region is beginning to show some attractive exits



## Some Lessons Learned re Issues Faced by LAC Entrepreneurs

### Competition

How to position themselves in the developed markets?

How to be noticed?

How to inspire confidence in the developed markets that LAC companies can be innovative and competitive?

### Challenges

Slow business formation processes,

fiscal structure not conducive for new businesses,

credit not available,

intellectual property issues,

FDA or other type of certification approvals ...



## Despite all problems, an industry is being shaped

- Some limited sophisticated investors entering the market with their eyes wide open
- Valuations are reasonable, laboratory and bubble phase are over. Poised for normal, cautious evolution of the industry
- Growth expectations more conservative, use of cash flow oriented debt instruments and expect debt-like returns for modest growth companies and under developed markets
- Collaboration within the industry; domestic and regional associations being formed (MIF support for LAVCA, AmexCap, ABVCAP, INOVAR I and II, Programa Invertir, and Colombia Capital)
- Serial entrepreneurs are being found by VCs, successful exits are happening (MercadoLibre, Akwan, City express Hotels, CheckForte, SONDA, etc)



... and there are good news...

- Lessons have been learned; local experienced fund managers in place
- Governments have made many changes – SAPI law in Mexico; Novo Mercado in Brazil; Ley de Carteras Colectivas in Colombia
- Strong industry associations are being organized
- Consolidation/acquisitions



## What Role for the Government?

- VC in Latin America is still in its infancy, need for governments to promote the industry through technical assistance grants and innovative programs, working with multilaterals and the private sector
- The generation of the conditions for the development of a VC industry is measured in decades, as the international experience demonstrates; governments should take a long term approach and develop a vision to be continued independently from political parties changing
- The governments and the Multilateral institutions are the only institutions that can remain consistently involved in vc/pe funding throughout crises



## What role for the Government?

- The international experience indicates that the development of the VC/PE industry require not only patient investors, savvy managers, a large pool of entrepreneurial talent, BUT a predictable economic environment, good information sources, an appropriate tax and legal system, and active capital markets to allow for exits: how to achieve this should be studied by the different government agencies to include in their strategic plans
- The VC industry also requires clustering and critical mass, supported by the appropriate infrastructure. To gain size there is the need of a large base of entrepreneurs, scientists and skilled personnel, assisted by a network of service providers. This process requires a significant financial commitment by public and quasi-public institutions



- Of all exit possibilities, a booming stock market supports the highest valuations and generates visible success stories, the government needs to support capital markets development working with the private sector (Novo Mercado, Bolsa Junior, etc.)
- Tax and regulatory legislation governing investment vehicles is often overly restrictive, and lacking specific legislation to deal with the VC/PE industry. Additionally, other obstacles to entrepreneurship and doing business exist: time and money required to set up a business, compliance costs, administrative procedures, etc.
- Funding for technology-based companies is worth continued support if it is part of a cluster of activities with strong domestic stakeholders, like in Brazil and Chile
- The cluster of activities, funds, regulatory changes, and institutional development achieved in Brazil is a model worth strengthening and showcasing in Latin America. It shows a consistent and coherent strategy where both VC entrepreneurs and public or semi-public institutions have become important stakeholders



- Pension funds' investment in VC is key to development of the industry; government should look at how to pension funds regulation on asset allocations
- Study all the fiscal and regulatory issues that can improve the environment for international investors to come to the country
- Improve all business process to register companies, patent registration issues, disclosure issues, etc



## Example of collaboration between the government, MIF and the private sector in Brazil: Best Practice: INOVAR Project with FINEP



## MIF Strategy for the Future

1. long term financing, entrepreneurial development
2. working with all our partners to find areas of overlap with local and international private sector interests
3. Continuing to work with the public and private sectors to improve the business environment, including legal platforms, accounting practices, tax incentives, governance standards, and fund oversight mechanisms
4. Providing training and disseminating lessons learned through seminars, toolkits, networking with the players on the ground
5. Continuing to promote the evolution of the industry through programs like INOVAR (Brazil), Programa Invertir (Peru), and Colombia Capital (Colombia) Now beginning to work in Argentina.
6. Raising the bar for our fund managers: to have a demonstration effect for the VC industry, they have to pick winners!



## MIF Strategy for the Future-Other Actions

8. Support v/c associations in creation of scorecards/lobbying efforts/best practice case studies-work through LAVCA
9. Work with “clubs” of investors to generate new funds in Brazil, Peru, Colombia (In Brazil, 50% of new funds associated with MIF/FINEP activities)
10. Lobby to enable domestic investment vehicles.( Grant to Amexcap)



## Considerations

- Hope for the future is regional integration, but there are deep political and philosophical/cultural differences among the countries that need to be taken into account
- Integration with developed countries a must
- Competitiveness, investment climate for business must improve
- Investment in training, education, and technology is critical
- Governments should promote a culture of entrepreneurship from the early stages of education
- Our fund managers are eager to forge partnerships between their investees and overseas companies, governments and multilaterals have to work together on supporting these initiatives



## To read more on these topics...

*“Angel Investing in Latin America ”* by the Darden School, University of Virginia, in collaboration with USA and Latin American experts

Also, go to [www.iadb.org](http://www.iadb.org), click on MIF, MIF Topics, Micro, Small and Medium Enterprise Financing, and on the right side see Key Documents:

- *“Managing SMEs funds in Latin America and the Caribbean”* (report on best practices, available only in English),
- *“Manual de Mejores Prácticas para Nuevos Gerentes de Fondos de Capital de Riesgo”* (available only in Spanish)

