

***Venture Capital at the MIF:  
Empowering SMEs and entrepreneurs  
in Latin America and the Caribbean***

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## More than 17 years ago, the MIF set out to promote equity as a development tool by:

1. Supporting promising companies through specific programs
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. Promoting a culture of investing among entrepreneurs
7. Asking for rates of return in line with market expectations
8. Working on developing the capital markets, to improve exit possibilities

*•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 dynamic ventures and small businesses, by providing loans, quasi-equity and equity through seed and venture capital fund managers specialized in these segments of the private equity industry*

*•We do not invest directly in companies*

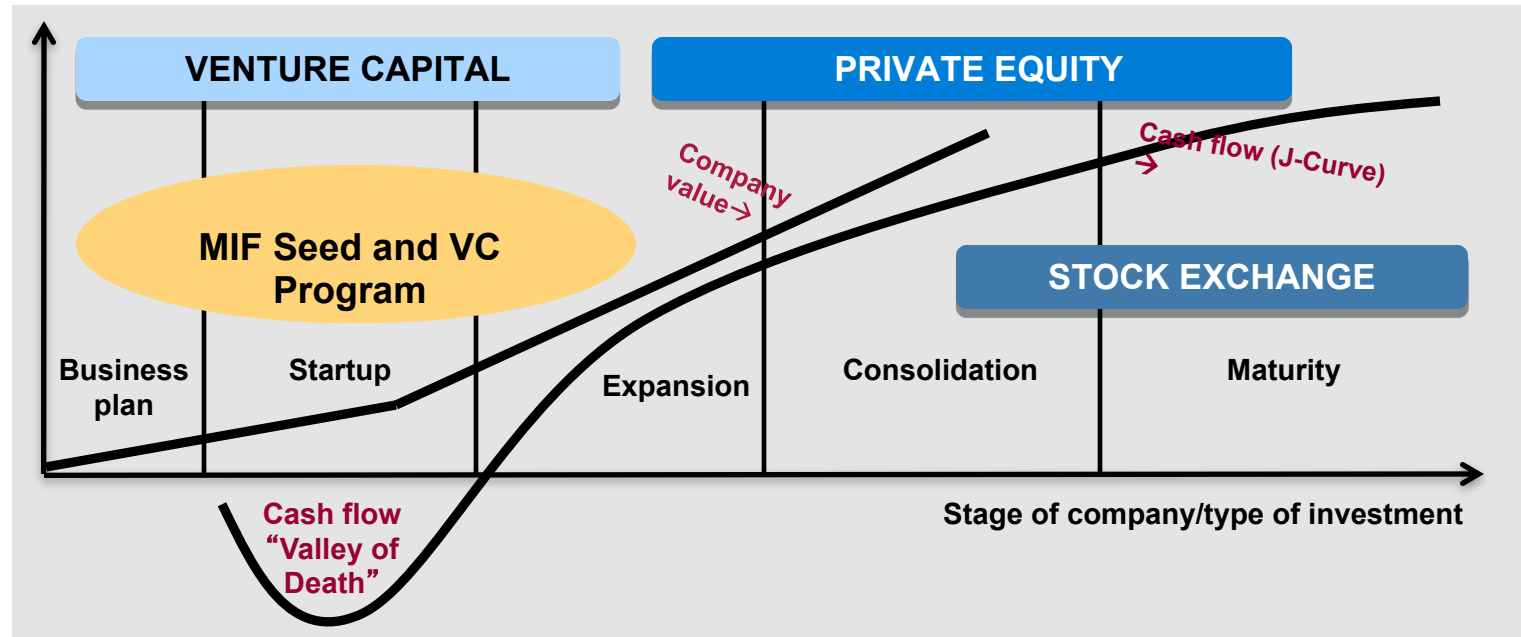
# Venture Capital Transforms

- **Finance** - offering new ways to finance entrepreneurs' ideas and companies through equity, quasi-equity and convertible loans
- **Growth** - Job creation, rising incomes and resulting GDP growth contribute to poverty alleviation
- **Skills and Capacity** - VC fund managers improve SME management, operations, corporate governance, auditing and finance practices
- **Partnerships** - VC fund managers are long-term, hands-on investors who work in partnership with entrepreneurs
- **Development** - VC stimulates sustainable development of the private sector and the knowledge economy
- **Markets** - VC develops markets by turning entrepreneurs' ideas into useful products and services



# How VC Investment Works

- **Long-term** - typical fund life is about 10 years
- **Hands-on** - fund managers work in partnership with entrepreneurs to make SMEs grow
- **J-Curve pattern of returns** - funds present a negative IRR (return) in the first years while a fund makes investments, but the returns improve as fund starts exiting from investments



# Status of VC Ecosystems in LAC

## MOST DEVELOPED VC ECOSYSTEMS

Brazil, Chile, Colombia, Mexico

- Strong government support for entrepreneurship and VC
- Acceptable legal, tax and regulatory frameworks in place; relative good corporate governance standards
- Pension funds are investing
- Local capital markets still developing but strategic exits possible
- Most promising VC and entrepreneurial ecosystems
- Angel groups and accelerators starting
- Fund managers with track records, mostly on growth and PE side
- PE most developed in Brazil and Colombia. Early stage VC, seed and angel investing still underdeveloped.
- Still room for improvement

## MOVING TOWARD CONDUCIVE BUSINESS AND/OR REGULATORY ENVIRONMENT

Peru, Uruguay, Argentina, Panama, Costa Rica, Jamaica

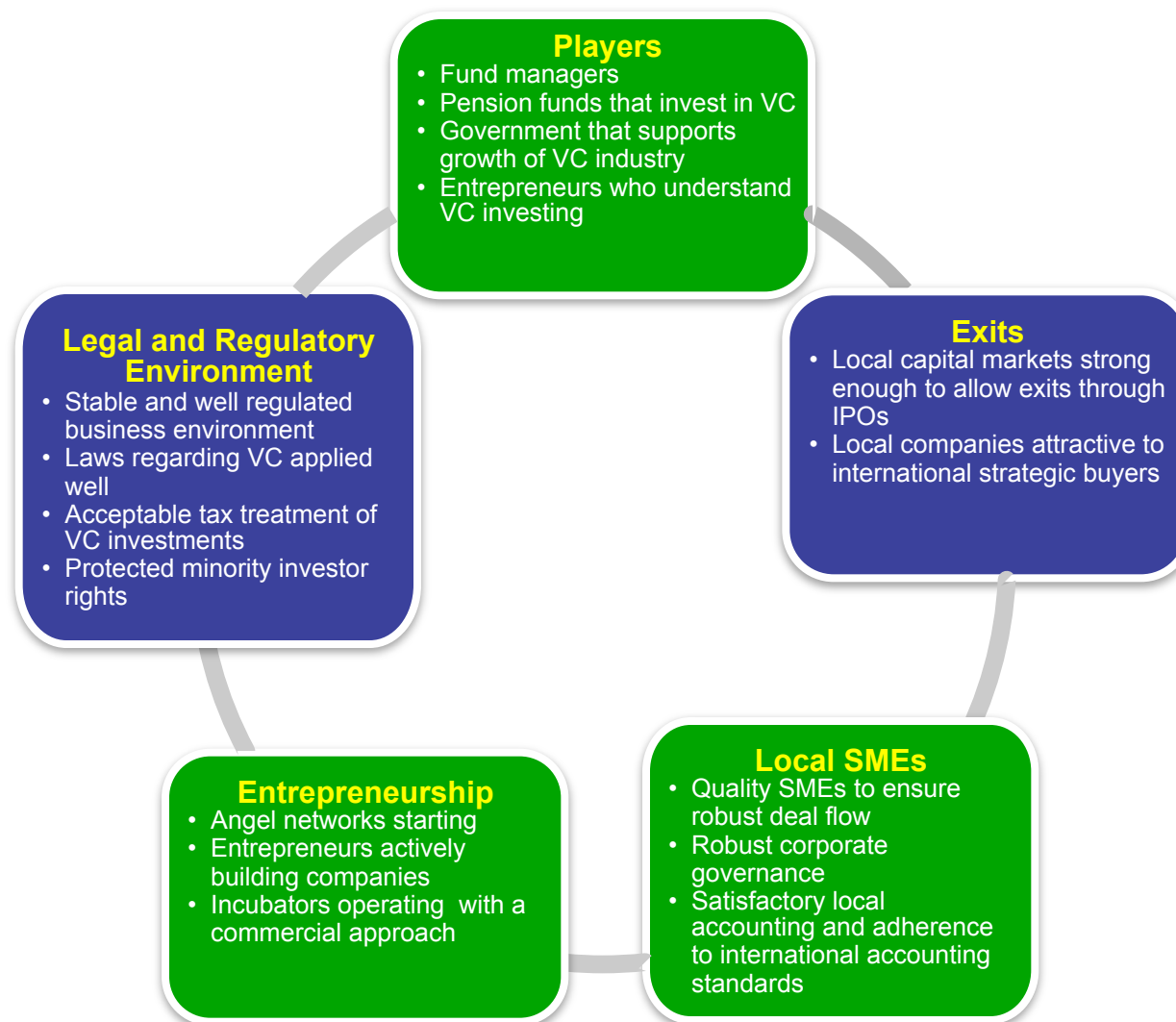
- Not all have organized government support to VC
- Some government actions not investor-friendly, VC laws need to be improved or put in place (e.g. Argentina, Mexico)
- Tax treatment of VC investments needs improvement
- Corporate governance and accounting standards receiving attention
- Pension funds do not invest or are not permitted to invest in VC (except Peru)
- Exit options are limited
- Entrepreneurship is flourishing and ecosystems are beginning to develop
- Angel groups starting, incubators and accelerators are commercializing
- Funds with track record in PE only; few or none in VC

## CURRENTLY DO NOT HAVE CONDUCIVE BUSINESS AND/OR REGULATORY ENVIRONMENT

Barbados, Bahamas, Suriname, Trinidad & Tobago, Bolivia, Paraguay, Belize, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Ecuador, Guyana, Venezuela

- Government does not provide organized support to VC industry
- No local laws for VC investing, so only offshore funds are possible
- Early stages of corporate governance awareness; ambiguous quality of accounting standards
- Weak ecosystems
- Minority shareholder protection rights are ambiguous
- Pension funds not investing in VC
- Exit options are limited
- Business environment at times challenging
- Low levels of entrepreneurship
- Angel groups and incubators starting in a few countries
- DFIs and foreign PE regional funds are the main investors
- Scarcity of capable local VC fund managers
- Difficult to generate adequate deal flow due to size of markets
- VC and seed investing not well-known

# Elements of a Conducive Venture Capital Ecosystem



- ▶ Local Governments
- ▶ Multilaterals
- ▶ Corporations
- ▶ Banks
- ▶ Business Angels
- ▶ Family Offices
- ▶ Seed & V.C.

### EARLY STAGE FINANCING SOURCES

- ▶ Accounting, Legal, etc..
- ▶ Advisors
- ▶ Corporations
- ▶ Incubators
- ▶ ICT's, Technical experts

### SUPPORT SERVICES & TECHNOLOGIES

### ENTREPRENEURIAL COACHING, TRAINING & SUPPORT

- ▶ Entrepreneurial Development Agencies
- ▶ Accelerators
- ▶ Business Schools
- ▶ Business Angels Networks
- ▶ Board & Advisory Committee
- ▶ Members
- ▶ Corporations

### LEGAL & REGULATORY ENVIRONMENT

- ▶ Venture friendly legislation
- ▶ Accounting Standards required

### R+D+I

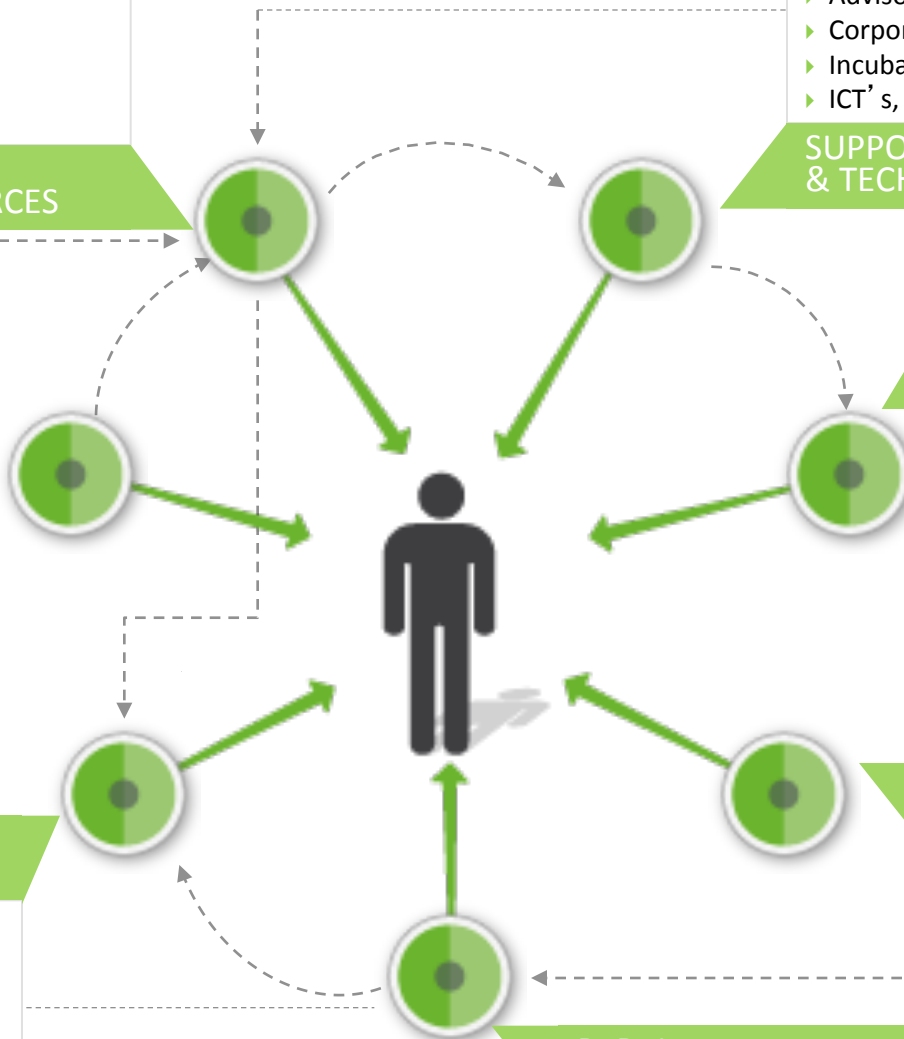
- ▶ Universities
- ▶ Corporations
- ▶ Research Centers & Institutes
- ▶ Technology parks

### HUMAN CAPITAL

- ▶ Talent
- ▶ Leadership
- ▶ Commitment
- ▶ Appetite for Risk
- ▶ Innovation driven

### RAISING AWARENESS

- ▶ Networks, industry events, associations
- ▶ Success stories
- ▶ Web, Media, Press & specialized publications
- ▶ Universities, Business Schools
- ▶ Corporations





- ▶ Government & Multilateral Funds
- ▶ Pension Funds
- ▶ Corporation Funds
- ▶ Banks
- ▶ Business Angels & Family Offices Networks
- ▶ V.C. Funds

### PLAYERS

- ▶ Incubators, Accelerators
- ▶ Business Plans competitions
- ▶ SMEs
- ▶ Spin-offs, spin-outs

### DEAL FLOW

### LEGAL & REGULATORY FRAMEWORK

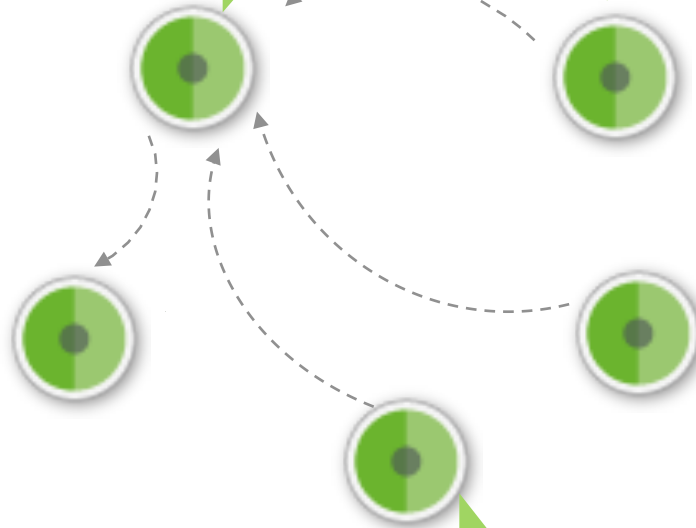
- ▶ Administrative, legal & fiscal incentives in entrepreneurship and R+D+I investments.
- ▶ Minority investor rights
- ▶ Use of International standards

### EXIT SOURCES

- ▶ Junior Capital Markets –IPOs–
- ▶ Strategic buyers
- ▶ Local and International V.C.s, P.E.

### RAISING AWARENESS

- ▶ Local & Regional V.C. Associations
- ▶ B.A.s & F.O. Networks
- ▶ Entrepreneur friendly Associations





## How did the MIF helped develop the VC industry in LAC?

- **Technical Assistance Programs** - The MIF works with entrepreneurs to position their companies
- **Creation of an asset class** - The MIF supports local management teams and provides them with training on international best practices
- **Angel and Venture Capital associations** – The MIF provides grants to start these regional and country associations
- **Focus on networks** – The MIF has acted as a platform for entrepreneurs, fund managers and investors to meet and share experiences
- **Advisory Services** - The MIF advises governments on regulatory issues and VC industry best practices → improve the regulatory environment for the industry
- **Scorecard on VC Environment** - The MIF worked with The Economist and LAVCA to develop a scorecard ranking the environment for VC/PE investment in 13 countries in LAC

## The MIF Value Add in Developing VC

- **Committed Investor** – Has provided capital in 55 seed and VC funds in the LAC region
- **Builder of local capacity** - 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
- **Partner with public and private sector** - The MIF 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)
- **Knowledge Transfer** – The MIF has shared its know-how in due diligence with other investors, creating a pool of knowledge in the region, and shortening the learning curve for this industry
- **Focus on networks** – The MIF has acted as a platform for entrepreneurs, fund managers and investors to meet and share experiences
- **Counter cyclical** - The MIF does not leave the region in spite of volatility, rather, it works harder to convince other investors to stay in the region and have a long-term approach

# Lessons Learned

## • Sustainability

- Means attractive financial returns and a positive social and environmental impact
- Fund size matters (in LAC, minimum USD 30-50 mm) to provide several financing rounds to SMEs and to retain skilled staff at fund management company

## • Skills

- NGOs and government agencies generally do not make good fund managers
- Due diligence should focus on fund management team
- Differentiating factor in fund quality is fund manager's skills
- Fund manager should look for “serial” entrepreneurs

## • Ecosystem

- Silicon Valley model is not a good fit for LAC
- LAC VC is less focused on disruptive technologies and life sciences, and is less likely to obtain attractive returns from one “home run” investment and IPOs

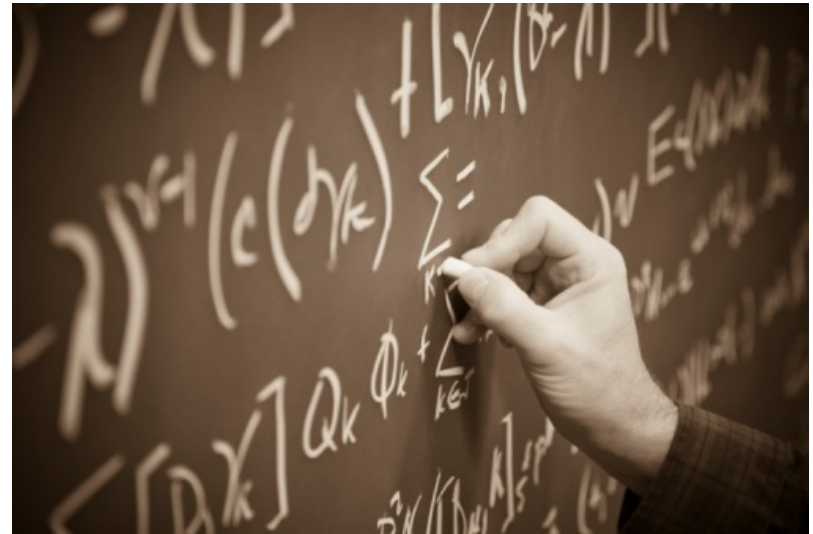
## • Environment

- Improving regulatory and legal environment is essential to attracting investors



# Lessons Learned (Continued)

- **Industry support**
  - Support for VC associations is important to raise awareness and attract investors to LAC
- **VC is an international business**
  - Bridges between LAC and other markets need to be strengthened to facilitate exits and attract foreign investors
- **Financial instruments**
  - Quasi-equity and loans are often a better fit for incipient VC markets than equity
- **Exits**
  - Attractive exits through strategic sales are happening despite size of local capital markets, although IPOs yield better returns
- **Returns**
  - Driven by portfolio company growth and increased efficiency rather than leverage or multiples



# Lessons Learned (Continued)

## • Sector-specific funds

- VC may not be the right tool for environmental and tourism funds; use of grant and mezzanine facilities may be more suitable for these sectors
- VC is right for sector-specific funds in more developed markets in LAC (e.g. technology in Brazil, agribusiness in Chile)
- LAC VC model seems to work better when funds focus on more than one sector
- Base of the Pyramid Funds a new bridge between microfinance and venture capital

## • VC requires full commitment

- Managing VC funds should be fund manager's sole source of income, and fund managers should be fully dedicated to VC
- Incentives should be aligned

## • Evaluation tools

- MIF-funded evaluations have been key to early detection of problems and compilation of what works and what doesn't work in LAC VC



## What role for the Government?

- Governments need to promote the industry through technical assistance grants and innovative programs
- The development of a VC industry takes decades; governments should take a long-term approach and implement it despite who is ruling the country, and remain involved in VC/PE funding throughout crises
- Pension funds' investment in VC is key to develop the industry; government should create schemes to foster favorable pension funds' regulation on asset allocations
- Support for capital markets development to facilitate exits (Jamaica Junior Market)
- Promotion of favorable tax and regulatory legislation governing investment vehicles
- Improvement of business conditions: World Bank's Doing Business Report

## Key Facts:

- 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 (uniqueness of Silicon Valley); 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 institutions

## Considerations

- For emerging countries, integration with developed countries a must
- Study all the fiscal and regulatory issues that can improve the environment for local and international investors
- Improve all business process that can encourage entrepreneurship: time to open and close down companies, patent registration issues, tax breaks, disclosure issues, etc.
- Investment in training, education, and technology is critical
- Governments should promote a culture of entrepreneurship from the early stages of education
- Governments should work with the private sector to better regulatory and business environments; existence of venture capital associations is important to lobby the government in key issues of the industry
- Promotion of local companies and global partnerships