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Perspectives

Financing Latin America's Entrepreneurs

Venture capital is a driver of entrepreneurship in Latin America.
BY JERRY HAAR

Venture capital (VC) is one of the most challenging yet promising arenas of finance in the Americas today. While much attention has centered on the U.S. venture capital market, in the wake of the 2008-2010 financial downturn in that country, Latin America is emerging as the next frontier for entrepreneurial funding.

Funding for Private Equity (PE) and VC deals in Latin America more than doubled from 2009 to 2010, topping $8.1 billion. As for the first half of 2011, LAVCA (Latin American Venture Capital Association) reports nearly $7.5 billion in fundraising and investments—impressive performance by any measure. Nonetheless, VC represents only a tiny portion of the PE/VC category in Latin America. Compared with the United States, VC comprises 25 percent of total VC/PE commitments; in Latin America, it is just 5 percent. In 2010, the average PE deal size in the region increased significantly. Deals valued at $100 million and over jumped 100 percent from the previous year. Clearly there is a lot of room for growth in mid-market deals.

The average deal size also increased to about $41 million last year from roughly $19 million in 2009. It can be that private equity investors are beginning to perceive the long-term benefits of investing in Latin America which makes prices go up; or it can also be that capital flows are inflating the local market.

The 2011 edition of the Scorecard on the Private Equity and Venture Capital Environment in Latin America reflects a stable regulatory environment in which the top ranking countries are Chile, Brazil, and Mexico. In the past, Latin American businesses traditionally have been starved for capital, with bank credit tight and shallow public markets. Access to debt financing was just beginning to expand when the credit crisis first hit in 2007. Today, despite macroeconomic turbulence in Europe and the anemic recovery in the U.S., global investors are expanding their presence in major Latin American economies, amidst an increasing awareness of the importance of private equity and venture capital in local markets. At the same time, fund managers have actively engaged regulators on industry-specific rules and regulations. A fundamental distinction between developed world private equity and those that are increasing in Latin America is the relative lack of leverage in Latin American deals.

Turning to forces and factors that are driving VC, political leaders definitely have recognized private equity and venture capital as a means to create, finance and professionalize businesses and have launched campaigns to cultivate domestic fund industries. Latin America’s economic performance is currently quite good with the region’s GDP, private consumption and investment all pointing upward. The region has witnessed an improvement in its capital markets development compared with previous periods and generous tax incentives are contributing comprehensively to the region’s attractiveness for business.

Be that is it may, there are major impediments restraining the proliferation of VC in Latin America. These include the lack of a widespread entrepreneurial culture, thereby delaying the development of new companies; imperfection in credit markets; poor application of the appropriate regulations and laws in several countries; and inadequate investor protection and corporate governance structures in comparison with developed countries. Additionally, there is a high perception of corruption and weak judicial systems in many countries. Also, inflation accelerated in 2010 reaching 6.4 percent; and it will hit 6.9 percent this year. This has been accompanied by nominal and real appreciation of most currencies during the last year.

As to where most VC is heading in the region, in general, the Information Technology sector has attracted the largest number of PE/VC investments--31 last year. Other sectors to attract investment activity included Energy (15), Health and Life Science (14), Clean Tech and Renewables (11) and Financial Services (11).

The majority of seed and early-stage deals occurred in Brazil followed by Chile, Argentina, Mexico, and Colombia.

All and all the outlook for venture capital in Latin America is a bright one. The continuation of neoliberal economic reforms; trade, investment, and financial liberalization; improved access to capital; the proliferation of technology; and growing consumer classes—middle and lower-middle—are fueling boundless opportunities for entrepreneurs and firms of all sizes. If, indeed, Latin America's time has come, venture capital and venture capitalists will prove indispensable.

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