



## **ENTREPRENEURSHIP IN ARGENTINA AND CHILE**

Report on interviews with 81 Experts  
on Entrepreneurship, Private Equity, and Venture Capital

### ***Executive Summary***

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This report was prepared on behalf of the Institute for Latin American Business at **Babson College**, and the **Multilateral Investment Fund** of the Inter-American Development Bank.

It is based on interviews with 81 experts on entrepreneurship, private equity, and venture capital in Argentina and Chile who were interviewed face-to-face or by telephone. It relies and expands on earlier work in December 1999 by John Edmunds, Associate Professor of Finance, Babson College; Thomas P. McDermott; and Marcos Espinel, Latin American Advisory Board, Babson College.

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## **ENTREPRENEURSHIP IN ARGENTINA AND CHILE**

Report on interviews with 81 Experts  
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This study was carried out during the summer and fall of 2000 under the sponsorship of the Babson College Institute for Latin American Business Studies and the Multilateral Investment Fund (MIF) of the Inter-American Development Bank. It seeks to expand the discussion and knowledge about entrepreneur-driven startup business in Argentina and Chile, and the venture capital organizations that finance them. This discussion takes place against a backdrop of existing knowledge of the extensive growth of private equity capital funds and transactions across Latin America over the past eight years and venture capital fund financing of Internet startups in the past two years.

Being an entrepreneur is never easy. It requires full attention, plenty of persistence and some capital. The process is demanding anywhere, though it is made easier or more difficult by the business environment and the forces at work in the entrepreneur's home markets. This paper attempts to identify those forces, based on interviews with experts on entrepreneurship, private equity, and venture capital. It treats the positive forces in Argentina and Chile as comparative advantages and the counter-forces as barriers or comparative disadvantages. Taken in the context of an environment characterized by the increasing importance of globalization and technology, and the recent emergence of venture capital as a source of funding for technology ventures, this report is intended to aid the process that enhances advantages and lowers barriers, as well as to assist venture capital fund managers and other private equity investors who may be considering entry into the Latin American market.

The major findings from the interviews are outlined below, followed by a brief listing of the major advantages and disadvantages cited by the interviewees for entrepreneurship in each country. The full report plus appendices contains reference material, including lists of active participants in the private equity, venture capital and entrepreneurial business-creation process. The authors extend their sincere thanks to each person who assisted us -most especially the 81 interviewed experts, who shared their time, knowledge and wisdom. We are grateful also to our colleagues at Babson and the Multilateral Investment Fund. Babson College is a leader in entrepreneurship education and shares with the Multilateral Investment Fund a major interest in the growth of entrepreneurship and venture capital development in Latin America.

### **Major Overall Interview Findings**

- Entrepreneurship is alive and well across Latin America and at all levels of business. Brazil, Mexico, Argentina and Chile are the leading economies, accounting for 80%<sup>1</sup> of Latin American GNP and most new entrepreneur-driven startup business.
- Global competition, arising from capital liberalization and privatization, had a major impact on the business status quo in Latin America, including Argentina and Chile, in the past decade.
- Private equity capital, a new asset class in Latin America eight years ago, had an important role in reordering the behavior and ownership of old-economy business. Private equity fundraising grew from virtually zero in 1992 to an annual average of \$4.4 billion in 1997- 2000<sup>2</sup> Private equity funds and their managers obtained most of their funds from US institutional investors, financial institutions and wealthy individuals. Argentina and Chile were major players. The emergence of private equity capital was important to early stage business development in two ways:
  - it opened the way to venture capital during the past two years, and
  - it gave liquidity to some family groups, allowing them to become active in angel investment
- The Inter-American Development Bank through its Multilateral Investment Fund has created 25 private equity funds with total capital of more than \$325 million, all oriented toward small business. This is the largest organized effort at providing risk capital to small business entrepreneurs.
- The Internet opened the door to venture capital 18 months ago, creating another new asset class. Argentina became Latin America's Internet center. Venture capital has reached the surface in a very significant way. It is long-term and low-cost, compared with debt or angel alternatives. New venture capital players have located in Argentina and Chile. Although there was fallout from this year's market correction, venture capital leaders plan to stay in Latin America and expand their vision beyond "born-Internet" to "Internet-related" and "non-Internet" ventures.
- Argentina and Chile offer excellent fundamentals for entrepreneurs, capital accumulation and job creation. Because Argentina's and Chile's populations are small, high-potential new business ideas need to be cross-border from the start.

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<sup>1</sup> Source: US Census and World Bank. PPI is purchasing power parity adjusted GNP.

<sup>2</sup> Latin America Private Equity Review and Outlook 2000/2001. 47.

Argentina and Chile also present major obstacles to the entrepreneur. Argentina's economy is running low on gas, and unemployment is high. Argentina and Chile have no domestic long-term risk capital markets to help fund venture capital and startups. They also have no domestic stock exchanges with liquidity and no local Initial Public Offerings (IPOs). Exit strategies rely on strategic buyers.

- Argentina and Chile have many top-quality entrepreneurs, as well as strong demand for venture capital, experienced fund managers and business counsel. They need local industry coalitions that focus on private and government-sector barriers to entrepreneurship. Also needed are north-south university partnerships for technology transfer and entrepreneurship.
- Economic integration is moving at high speed, yielding unprecedented levels of cross-border business and economic expansion. US-Mexico trade has soared from \$88 billion in 1993 to \$226 billion today. The Western Hemisphere and its 825 million people account for 21% of the world's land surface, 13% of its population and 37% of GNP<sup>3</sup>. However difficult the politics, the opportunity for economic integration should not be missed.

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**Table 1: Overview of Interview Topics**

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Barriers to Entrepreneurship and Venture Financing of Startup Business in Argentina and Chile:

1. VC today (Argentina; Chile)
2. VC access to domestic funds flow from Institutional Investors (Argentina; Chile)
3. Angel investment (Argentina; Chile)
4. Securities markets
5. University programs
6. World organizations interest in VC/early stage financing
7. Legal, term sheets, pricing, due diligence, accounting, etc.
8. Taxation
9. Executive management pool and compensation
10. Internet and impact on VC
11. Western hemisphere economic integration

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*Note: Major insight of the interview outline can be found in the Detailed Report*

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<sup>3</sup> Source: US Census and World Bank. PPI is purchasing power parity adjusted GNP

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### **Major Interview Findings –Argentina**

Findings were based on interviews with 39 persons in Argentina, including 24 in-person and the balance by phone. Each was selected for particular knowledge and experience on one or more important aspects of this subject. Each was supplied with a discussion outline (Table 1), naming two to four subjects to be covered.

The interviewees indicated that Argentina is one of the best countries in Latin America for new business creation, and Argentina's comparative advantages should remain strong in the years of development that lie ahead. It already has a relatively large supply of entrepreneur-driven startup and early-stage business activity. The frequency, size and market reach of new business there has increased, despite new global competition in every industry and the economic changes introduced by the Menem administration in 1991. Some family-owned businesses, which once dominated, were forced to increase efficient practices, while others divested, merged or partnered with multinationals. For some businesses with succession problems in their third or fourth generation, selling out became the best answer.

The following are examples given by our interviewees of qualities that make entrepreneurship easier in Argentina than in competing Latin American locations:

- Highest per-capita GNP.
- Highest number of Internet startups
- Substantial number of new private equity and venture capital funds and players
- History of high tolerance for risk at all economic levels
- Large, well-educated workforce
- Zero capital gains tax for entrepreneurs and investors
- High-quality business professionals
- Assurance of personal and business safety and security
- Zero inflation; currency tied, one-to-one, to the US dollar
- Good social and family environment

But the interviewees cited some comparative disadvantages as well:

- Severe recession with 15.4% national unemployment
- National industrial policy poorly mapped out and understood by business
- No sponsored research and development
- Uncertainty adds to business risk
- No domestic capital market; no local IPO exits
- High cost of equity capital and borrowed capital
- Legal framework, including securities law, outmoded

- Shortage of expertise in new economy areas
- Corruption and bureaucracy in government
- Tax-avoidance widely practiced
- Low domestic computer and Internet penetration

### **Major Interview Findings – Chile**

Findings were based on interviews with 42 people in Chile, including 24 in-person and the balance by phone. Each was selected for particular knowledge and experience on one or more important aspects of this subject. Each was supplied with a discussion outline (Table 1), naming two to four subjects to be covered.

The interviewees indicated that Chile is also very favorable for new business startups. It has a relatively large number of investor groups seeking Internet and other entrepreneur-led business activity. Many family-owned businesses faced challenges to survival in light of increased global competition. Some cashed out, while others increased productivity, merged or brought in international partners. In the reshuffling, some survived while many new players emerged.

Family-owned economic groups changed or were rearranged, but they continue to dominate the Chilean business stage.

The interviewees indicated that Chile's comparative advantages are significant and should remain strong. The interviewees cited the following advantages:

- Second in Latin American per capita GNP
- Slow recovery after one-and-a-half years of recession
- Well-educated workforce; reputation as source of experienced senior managers
- Substantial number of new private equity and venture capital funds and players
- High-quality professional groups serving business; high-quality university education
- Corruption-free government; high-quality, experienced political leaders
- Tax enforcement a high priority; tax-avoidance less common
- Market economy leader and "can-do" innovator
- Nationally-sponsored R&D a high priority
- High-quality telecommunications; high penetration of Visa credit cards, an Internet edge
- Stable currency, low inflation
- First in personal and business safety and security; good social and family environment

The interviewees cited the following comparative disadvantages:

- Very small population and domestic market
- No domestic capital market; no local IPO exits; most long-term risk capital is imported
- Private pension AFPs and FIDEs do not produce institutional risk capital as intended
- Startup entrepreneurs have little access to venture capital
- High cost of angel capital and borrowed capital
- Capital gains tax on foreign investment capital uncompetitive with Argentina, Brazil and US
- Minority shareholders poorly protected
- Securities laws outmoded
- Shortage of expertise in new economy areas
- Education needs more entrepreneurial focus, faculty, curricula and teaching materials
- National distribution infrastructure lacking
- Burdensome bureaucracy
- Low domestic technology and Internet penetration

In sum, the interviewees indicated the following concerning Argentina and Chile:

Entrepreneurship and venture capital are now enjoying greater and more structured attention in both Argentina and Chile. Both countries are excellent places for the entrepreneur, as well as for new job and capital creation. Advantages include a well-educated workforce, a substantial number of new private equity and venture capital funds and players, high quality business professionals, and a good social and family environment. Disadvantages include a high cost of angel capital and borrowed capital, no domestic and long-term risk capital markets, and no local IPO exits.

The Internet has served as an important catalyst for the introduction of venture capital to Latin America, and Argentina became Latin America's Internet center. Importantly, despite the recent tribulations of Internet ventures, venture capital leaders plan to stay in Latin America and expand their vision beyond Internet ventures. One co-founder of a major Internet company with a focus on Latin America described the impacts on new entrepreneurs as "profound change, reaching into different social strata as never before."

Many interviewees indicated that their governments have a responsibility to their constituents to encourage and support entrepreneurial activity and to remove, or at least

lessen, the effects of barriers to new business formation that have been inherited from earlier times. Both countries must realize that they are competing for international private capital that has even more than the usual alternatives when financing Internet and other knowledge-based industries. Many interviewees viewed the governments' task as not only to offer a supportive economic, legal and business climate, but also to assist in the mobilization of national capital resources to support entrepreneurs and early stage small businesses. The examples of other countries that have successfully stimulated venture capital and high value-added industries by means of government guarantees or other inducements are worth investigating.

*We welcome the opportunity to discuss this subject and thank all persons who assisted us in this project by allowing us to interview them. Thanks are also due to individuals at the Multilateral Investment Fund of the Inter-American Development Bank, the Institute for Latin American Business Studies and the International Programs Office of Babson College.*