

ENTREPRENEURSHIP AND THE VENTURE CAPITAL IN SOUTH FLORIDA

By Hernan Pisano, June 2008

For long South Florida has been considered the U.S. capital of Latin America. The significant inflow of Latin American expatriates first from Castro's Cuba during the 60's and 70's and later from other troubled Latin American countries



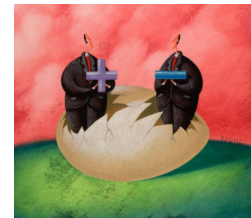
(Colombians fleeing from the guerrillas, Argentineans fleeing from the economic crisis, Venezuelans fleeing Chavez, etc) have created singular social landscape.

Contrasting with other states where Latino immigrants populate the lower paid job bracket, Florida's Latin population has a significant professional and entrepreneurial community, made up by second generation successful Cubans and first generation mid-upper class immigrants with deeply rooted business and familiar connections in the continent's power networks.

Given this wealth of relationships Miami seems to be ideally located to play a pivotal role as a meeting point where big American Venture Capital meets Latin American entrepreneurs. This hasn't happened yet. The root cause of this is two pronged: At the hemispheric level, entrepreneurship in

Latin America faces significant challenges regarding their human capital utilization, the capital allocation processes, the social cost of failure and the economies of scale required for the Venture Capital model to work. At the local level Miami haven't been able to provide the "ecosystem" required to foster economic development through innovative enterprise.

Wasted Human Capital: Latin American societies are extremely stratified. A good proxy of this stratification is the GINI index, used by the United Nations as measure of inequality of income distribution, in which Latin American countries fare dramatically (8 of the 15 most unequal countries in the world are located in Latin America). As a consequence, the same "selected few family names" share powerful



positions in economic, political and legislative positions for generations. One big family name has senators, judges, and board members sparkled across several generations in several of the most prominent institutions. Social mobility is

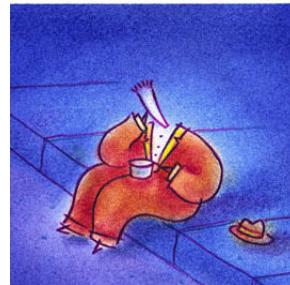
scarce; the “American Dream” is just a dream when it comes to Latin America.

As a significant percentage of the human capital of these nations are excluded socially, they are also excluded from education opportunities, and therefore, are unable to participate in an entrepreneurial ecosystem with their knowledge. Social mobility is a pre-requisite of a healthy entrepreneurial environment. It allows people from all walks of life, from all backgrounds, from all knowledge arenas access to the commodity capital is.

Sub optimal Capital allocation: Social mobility is also the prerequisite of optimal capital allocation. In an environment where the best ideas never come to light because people don’t have a chance, investors look for returns elsewhere exporting capital in the form of foreign accounts, offshore private banking and the like. Mid and big enterprises attract most of the local capital, leaving nothing for high-risk / high-return endeavors and the positive economic externalities innovation brings. This sub optimal financial structure prevents higher growth rates fueled by innovation. For investors to get optimal returns, the economic ecosystem must allow the brightest of the brightest to arise from the shame of social exclusion.

Macroeconomic disadvantages. Cash strapped emerging companies might not overcome their own revenue volatility anywhere in the world. One bad season might wipe the company altogether. If we add the effect of the endemic macroeconomic volatility of Latin America’s economies the challenge is daunting. Even worst: both (company and market volatility) tend to be highly correlated, amplifying the effect of each other.

High social cost of failure. Unlike



American where entrepreneurship is praised, and where the example of a founding father

being broke several times before it “struck it rich” is well known, Latin American entrepreneurs pay a high price if they fail. Failure looms in the family for generations, stringent bankruptcy laws have few clauses protecting the failed endeavor, and social ostracism is the norm in a stratified society where nobody wants to be seen with the failed entrepreneur.

The Sciences dilemma: Scientific research provides the backdrop where many new innovations came from, Unfortunately,

sciences research absorbs significant amount of resources and do not relate directly to any cash flow producing business and therefore is extremely difficult to justify politically. This difficulty is even more pressing for cash strapped countries with “hot” social needs. This is the policy dilemma: on the one hand basic sciences investments are necessary to produce innovation and wealth in order to “enlarge the economic pie”; on the other hand those same resources are needed to fight current pressing problems as starvation and the like.

Economies of scale (1): Venture Capital is a financing industry that has violent statistics; out of 9 financed companies 6 will fail, 2 will generate moderate returns and 1 will be the next big bang. In order for the Venture Capital industry to exist, a multi billion dollar market must be readily available to be tapped on by a billion dollar company. Unfortunately, there is only a few multi billion sectors in Latin America:

Agribusiness, Mining, Telecom, and another couple more. Furthermore, historically there is not a lot of companies that have grown at the pace Venture Capital requires for the model to work. In short,

Latin America faces a scale problem. The only way we can scale is using multinational Pan American approach.

Economies of scale (2): The pan American strategy has challenges in itself: Brazil and Mexico have a different languages providing natural barrier of entry to the retail operators. Legal barriers arise in most of the sectors Financial services, energy, telecom And so to scale the becomes difficult.

The Entrepreneurial ecosystem issue in South Florida: Following professor M. Porter ideas, there is a need for at least three elements to arise simultaneously in order to generate a real Entrepreneurial cluster: there must be a critical mass of interconnected competing business, financing must be available, and academia

must be present providing sciences, innovation and professionals. The vicious circle present in South Florida doesn't help: the lack of companies deters VC's of having a real presence in

Miami, and at the same time, the University does not have a strong output of professionals that might be feeding the nascent companies. The ecosystem is not here.

