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Colombia: a new frontier for private equity

Despite challenges of financing and scale, the Andean country provides opportunities for investment.

A business park in Bogota.

In Latin America's private equity markets, Brazil tends to capture the most attention, with Mexico a distant, but growing, second. But Latin America's smaller markets are proving an increasingly attractive option. Colombia is seeing a critical moment in the private equity market: after beginning investment a few years ago, a number of private equity investments are scheduled for an exit this year or in 2015. How those exits measure up will determine if the country can successfully attract more investment. LBC met with a number of private equity funds in Bogota to discuss the private equity environment in Colombia, and to learn about some of the opportunities and challenges in that country.

Despite some challenges, the country is an increasingly attractive place to do business and has become something of an "investor darling" for the region. Growth has averaged 4.6 percent in the last few years driven by growth in the country's oil and gas industry, as well as infrastructure, manufacturing and tourism. This growth has increased the size of Colombia's middle class, and attracted new investors: foreign-direct investment (FDI) flows have increased six-fold since 2002, making Colombia one of the top 20 destinations for FDI in the world. In 2007, the country achieved investment grade by the major ratings agencies.

Colombia's private equity market has also grown during this time: there has been compounded annual growth of 62 percent a year in the field since 2005. While in 2012 there were 10 private equity funds with combined capital of $647 million, that number had grown to 38 funds with $3.6 billion in assets in 2013 according to data from Bancoldex, Colombia's entrepreneurial development bank. 2014 should continue to see strong growth. "Colombia has one of the best regulatory frameworks for private equity," says Patricio D'Alpice, chairman of ColCapital and CIO and managing partner at MAS Equity Partners, who says the country's code was based on best practices from throughout the world. The country has also established a number of mechanisms to help private equity investment grow such as ProExport and Bancóldex, which help companies find financing and match them with private equity funds.

At present, private equity investment is focused in infrastructure, oil and gas, and real estate. "The development of Colombia's oil and gas industry in 2004-05 was really the beginning of Colombia's private equity market," says María Angela Córboba Garcés, CEO of LAEFM Colombia. "Large companies didn't want to be involved, so SMEs filled the void for investment." Since 2004, Colombia's oil production has gone from 500 to 1 million barrels per day, and has become an engine for the country's economy. Infrastructure is also a priority for the government, and has attracted investment. "Infrastructure is a game of catch-up," says Juan Pablo Gómez, Vice-president of Investments for Altra. Indeed, infrastructure is the country's major impediment to growth, and lags developed countries by 30-40 years according to information from Invest in Bogota. The present government has put forth a number of infrastructure bids, which should provide opportunities for SMEs in construction, catering, and other industries.

Among the investors LBC spoke to, many also saw potential in tourism, and industries related to the country's growing middle class. Data from ProExport says the middle class could grow to around 30 million people by 2025, providing opportunities for construction of new homes, shopping centers, and other amenities catering to the middle class say investors, such as restaurant chains, gymnasiums, entertainment, healthcare, microfinance, and tourism.BriCapital spoke to LBC about the potential of the tourism industry in Colombia – an industry they refer to as the "third pillar of the Colombian economy." The fund, which has $35 million which can only invest in hotels, points to the growing tourist arrivals, especially cruise ships in the Caribbean coast, and increasing passenger arrivals at Bogota's El Dorado Airport. They predict the next growing touristic regions will be those that are as of yet underdeveloped due to previous security concerns, such as the Amazon and other interior regions.

Beyond this, there are opportunities in nearsourcing manufacturing, business process outsourcing (BPO), and light manufacturing, according to ProExport.

At the moment, the major investors are the country's four major pension funds, as well as two or three major insurance companies.In addition to this, there are venture capital funds founded by some of the country's largest corporations such as Grupo Sura, Grupo Argos, and Nutresa. This is a very small selection of investors, says Córboba Garcés of LAEFM Colombia – two pension funds alone provide 80 percent of the investment. Further, this limits future financing as the industry is still quite young says Francisco José Arboleda, Vice President at Harbour Vest's Bogota office. "Most private equity funds were established only in 2008 or 2009, and results vary," he said. "The pensions are going to want to see results before investing again." He says the Colombian market has tried to diversify its sources of investment with limited success. While international investment has improved, it is still not enough to replace the pensions.

D'Alpice of MAS Equity Partners says this lack of investment and availability of financing is a limitation of the Colombian market. "In Latin America there are limitations in the access to capital markets for initial public offerings (IPOs) or buyouts," he says. "In the United States or Europe you can count on support from the banks – that's less true here." As such, he says a challenge lies in structuring exits. The limited access to capital creates other limitations in terms of scale, says D'Alpice. "The Colombian private equity market tends to focus on mid-size companies, with sales between US$10 million and $50 million a year," he says. "These are more growth capital funds, not buyout funds," he adds.

“International investors usually don’t want to invest in funds that are less than $300 million a year, and that’s huge for Colombia.”

To compensate for the country’s limited market, many firms are now looking to neighboring countries as well said many of the investors LBC spoke with. These are mainly other members of the Pacific Alliance – the new trade bloc consisting of Chile, Colombia, Mexico, and Peru which has a pro-business and pro-investment outlook. Many of the funds spoke of the potential of Peru’s market – with its strong GDP growth and expanding middle class, as a potential growth market for expansion of businesses in Colombia. Chile, universally praised for its stability and ease of doing business, was also mentioned, though many said as a more developed market it can be expensive to enter. Nevertheless, Chileans remain some of the largest investors in Colombian private equity.

All fund managers said this year and next will be key to determining the success of Colombia’s private equity market, as a number of exits are planned. Returns to investors have averaged 4 to 7 percent, depending on the different funds spoken to. Fund managers said they also had an eye on the peace process currently underway between the Colombian government and the guerrilla group Revolutionary Armed Forces of Colombia (FARC). If successful, it could attract more international investment to the country. To be sure, this year will be an important one in determining Colombia’s fortunes.

- **By Mark Keller**