

**ATKearney**

# Mexican Innovation, Entrepreneurship, and Venture Capital Financing

**New York** | September 16-17, 2012

Entrepreneurs, investors, and academics discuss how Mexico can build an innovative business culture.



A.T. Kearney and the United States-Mexico Chamber of Commerce Northeast Chapter (USMCOCNE) recently hosted a conference to discuss the current platform for innovation and entrepreneurship in Mexico.<sup>1</sup> The one-day symposium provided an opportunity for open dialogue about Mexico's progress in creating an entrepreneurial culture and environment—one that can become a significant source of wealth creation through improved productivity and economic growth. More than 80 attendees heard from a distinguished group of professionals—entrepreneurs, investors, and academics—who represent the main stakeholders in the Mexican entrepreneurial ecosystem. In two panel discussions, the speakers shared their experiences and opinions about opportunities for further advancement of Mexican business.

This paper provides a summary of the topics discussed.

## Panel One:

# Innovation and Entrepreneurship in the Mexican Landscape

**Moderator:** Ricardo Haneine, partner, A.T. Kearney

### Panelists:

- **Carlos Marin**, general director, Alltournative
- **Fernando Fabre**, president, Endeavor Global
- **José Manuel Aguirre**, director of Technology Parks Network, Tecnológico de Monterrey
- **Adriana Tortajada**, head of the Entrepreneurs Fund, Nacional Financiera (NAFIN)

Following a brief welcome and introduction to the day's program by USMCOCNE Assistant Director Alejandro Ramos, the panelists discussed their roles in entrepreneurial activities in Mexico, their expectations for future growth, and what they consider the biggest challenges ahead.

### Carlos Marin

#### General Director, Alltournative

After researching the potential for ecotourism in the Riviera Maya area, including unique features such as the Mayan culture and underwater rivers, Marin incorporated Alltournative in 1998 with \$200,000 in startup funding. The company recorded some notable early successes, including accolades from the industry and rapid growth in gross revenues, employees, and products (tours and sites).

Marin segments the life cycle of a startup into three periods: foundation through five years, five to 10 years, and beyond 10 years. Forty percent of Mexican businesses cease operations during their first year. For those that make it through this time period, annual growth rates of 100 percent are not uncommon. Alltournative opened three locations and grew from 10 to 65 employees in its first several years. In these early years, the company was challenged to build a passionate team of employees and find partners willing to sign on to the mission and concept.

<sup>1</sup> This conference continues a series of events jointly conducted by A.T. Kearney and USMCOCNE. Previous topics include Mexico's positioning as a near-shoring destination, the country's role in NAFTA-centered supply chains, Mexico's competitiveness in the global economy, and the importance of human capital development to Mexico's future competitiveness.

A full 80 percent of Mexican companies fail to reach their fifth anniversary. Those that survive typically see annual growth of around 25 percent from years five through 10, though several years of positive net growth are needed before banks will lend to companies at this stage. Alltournative grew at a rate just under 50 percent during this time and saw its employee count reach 200. Marin was challenged to delegate management authority and build a quality organization while rapidly growing.

Only 10 percent of Mexican companies reach the mature stage of 10 years, which is typically when a trusted management team is needed to run the company while the entrepreneurial founder applies energies to forward-looking strategies in the face of an “innovate or die” situation, as imitators look to steal market share. Cost control takes on new importance at this stage, as overhead costs tend to mount for mature businesses. Partners who can inject capital when needed are essential. Corporate governance becomes a priority because of the complexities posed by a larger organization, and effort has to be expended to maintain the corporate culture. Partners demand both a voice and a return on their investments, and they need to be engaged in the long-term vision in the face of potential short-term payout opportunities.

Alltournative now has 266 employees and continues to enjoy double-digit year-on-year growth. It has recently undertaken something of a back-to-basics strategy to reemphasize its core strengths as competitors have emerged. It is also seeking strategic alliances with theme parks and other potential partners in the tourism and recreation segments.

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### **Fernando Fabre** **President, Endeavor Global**

Endeavor Global works with “high-impact entrepreneurs” in Mexico who are seeking to transform entire industries. Venture capital activity in this nation is on the rise, though some potential investors are waiting on the sidelines for a magic bullet that will make Mexico the new Silicon Valley. In fact, Silicon Valley does provide a role model, as entrepreneurs there are known to launch and develop their businesses and shepherd them through the initial public offering (IPO) stage, then give back by using their resources to mentor and invest in other up-and-comers as part of a bottom-up approach to economic development. Endeavor is an active investor that works to bring human capital to entrepreneurs; it values characteristics such as charisma, drive, and the ability to network in entrepreneurs.

While Silicon Valley is “miles ahead of everyone else” in terms of its entrepreneurial culture and results, Mexico has a strong ecosystem in place to help entrepreneurs. This environment continues to strengthen, and Endeavor is very bullish on the nation’s prospects over the next decade. Continued institutional support from investors, effective public policy, and business service providers including mentors, consultants, and the legal community are all essential to moving forward.

Continued enhancements to the entrepreneurial talent pool could be the key to overcoming Mexico's economic challenges. In the United States, 52 percent of IPOs over the past decade were executed by companies that were backed by venture capital. Companies backed by venture capital in the United States generate 20 percent of the nation's gross domestic product and employ 11 percent of the private workforce. Reaching similar levels of performance from the entrepreneurial community in Mexico will require more new companies to be formed, more investment from both governmental and institutional investors, and better fund management.

Endeavor Mexico regularly collaborates with Tecnológico de Monterrey to further Mexico's entrepreneurial culture and currently supports about 60 entrepreneurial ventures in Mexico with combined revenues around \$1 billion. Worldwide, Endeavor is working with about 500 entrepreneurs and enjoying a 35 percent compound annual growth rate.

### **José Manuel Aguirre**

#### **Director of Technology Parks Network, Tecnológico de Monterrey**

A private university founded 70 years ago, Tecnológico de Monterrey now has 30 campuses in Mexico. The school prides itself on its "entrepreneurship DNA," which goes back more than 20 years to a time before entrepreneurship was fashionable. Three-quarters of its graduates ultimately go on to own their own businesses.

The university supports entrepreneurs through three interrelated strategies: education, support, and research. Each semester, some 7,000 Tecnológico de Monterrey students take a mandatory course in entrepreneurship, which is emphasized over business administration throughout the university's curriculum. In terms of support, each of the university's campuses includes an incubator through which faculty and students engage with the local community to develop businesses; 14 accelerators work with the high-potential companies developed in the incubators, and technology parks support these efforts. The university has also launched a research program around entrepreneurship.

In studying entrepreneurial success, Tecnológico de Monterrey employs traditional metrics such as company creation rate, survival and longevity, and job creation. It has around 1,400 projects incubating, though not all will become companies. The support system of incubators, accelerators, and technology parks is working with 300 companies that employ an average of 10 employees each in relatively high-value jobs. More than 500 companies have "graduated" from its supportive ecosystem; 75 percent of them are still operating, compared to fewer than 25 percent of all Mexican companies at similar stages of maturity.

While Mexico has long boasted a solid industrial culture, it has not been geared toward entrepreneurial activity. Neither have local investors. In addition to increasing individuals' entrepreneurial abilities and desire, there is a need to better educate domestic and foreign investors and increase cooperation among all actors in the entrepreneurial ecosystem.

### **Adriana Tortajada**

#### **Head of the Entrepreneurs Fund, NAFIN Entrepreneurs Fund**

NAFIN's \$120 million Entrepreneurs Fund helps align public policies with entrepreneurial ventures and keep the venture capital community informed about them. Mexico's National Development Bank launched a fund of funds for Mexican private equity in 2006 that has predominantly worked with individual investors, as institutional investors question Mexican

innovation ability and the risk such investments could entail. Entrepreneurs Fund has worked with A.T. Kearney since 2009 to develop a national entrepreneurial strategy.

The work that Entrepreneurs Fund engages in centers on four main areas. It has launched a fund of funds for venture capitalists, a new vehicle that brings investors and governmental actors together. It has developed a seed capital investment fund that it hopes will attract public funding. It is working to make capital available for early-stage entrepreneurs and encouraging fund managers to get more involved with them. Most importantly, it is endeavoring to connect and align all potential actors in the local entrepreneurial ecosystem, including academics, the financial sector, investors, and local and state government.

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## There are significant ideas and talent at work in Mexico, but **success will require a strategic approach to innovation.**

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There are significant ideas and talent at work in Mexico, but success will require a strategic approach to innovation. Entrepreneurs must be taught how to launch and manage their businesses and how to attract investors in order to grow. Investors must come to better understand the payback period; direct investors typically see their returns via a strategic partnership buyout or when a larger corporation purchases the entrepreneurial concern. Mexican governmental bodies need to promote better public policies to help entrepreneurs and investors. Mexico is the world's fourteenth largest economy, but the country must become a bigger player in international business through innovative new offerings.

### **Panel Two:**

## Innovation and Entrepreneurial Financing

**Moderator:** Alejandro Ramos, executive director, USMCOE

### **Panelists:**

- **Alonso Diaz**, managing partner, Gerbera Capital
- **Alex Rossi**, managing partner, Latin Idea Ventures
- **Brian Birk**, managing partner, Sun Mountain Capital
- **Fernando Godard**, transactional associate, Baker & McKenzie

During the day's second panel, panelists discussed their experiences and areas of expertise.

### **Alonso Diaz**

#### **Managing Partner, Gerbera Capital**

Mexico's venture capital industry is fairly young, lagging that of the United States by some 40 years. But this gap can be closed quickly, especially with the United States providing a potential model and lessons learned. Because Mexican banks do not typically lend to new companies, other investors are needed to help entrepreneurs launch their businesses. At present, 40 active venture

capital funds totaling around \$700 million are focused on this segment. These numbers have increased rapidly in recent years, and the Mexican government has helped spark the formation of angel investor groups that have been providing early-round funding to new companies. A rough pipeline exists to take a company in Mexico through the process from formation to IPO, but there is not yet sufficient capacity to assist every company that may wish to take this route.

Gerbera Capital takes a disciplined approach to investing that heavily factors in each individual investor's profile to decide whether a fund of funds or direct investment makes better sense. It considers several hundred deals each year but commits to a relatively small percentage of them. Key considerations in its assessment process include the company's business model, whether the entrepreneur is fully aware of his or her limitations and hazards as well as strengths, and the valuation of the potential investee.

Due diligence is a major part of any deal Gerbera takes on; examining the business model and verifying the feasibility of projections are key. Because entrepreneurs are not business administrators, they do not typically excel at documenting performance and projections. Any major red flags or material contingencies must be identified before a deal closes.

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Gerbera also looks for opportunities to add value through a deal by looking at aspects of the business that are not being properly run, knowing that these can be fixed. Gerbera has specialists in functional areas including finance, human resources, and information technology who can improve value by bringing the investee up to best-practice levels in certain performance areas. The company also strives to be an active investor by sitting on boards, developing rolling plans, and working to implement strategies in a hands-on manner.

### **Alex Rossi** **Managing Partner, Latin Idea Ventures**

Government and financial industry funds have both been part of the increase in venture capital activity in Mexico in recent years. Some institutional investors are now also coming on board, such as the new fund from Latin Idea Ventures that includes pension funds. The overall investment picture is evolving, though fund managers themselves may be able to do more by leveraging their personal networks for funding and access to more investors.

Tourism, IT, telecommunications, media, and services are among the more promising sectors for investment in Mexico. Latin Idea Ventures emphasizes sectors that can employ technology to help create value in a new business. For example, the company recently invested in a business that manages advertising in movie theatres, seemingly an "old" industry. But because it was using a proprietary satellite network to create a robust, cost-effective, and broad digital advertising network, this business tripled in value in just a few years by using established technology in a new way.

Latin Idea Ventures takes a hands-on approach with its investments, working with boards and executive committees to help focus on operational issues. It also works with the finance and general administration functions to develop financial and operational metrics and ensure that performance is actively monitored. Time is invested to fix weaknesses within the business by developing budgets and tracking operations and performance against budget. Latin Idea Ventures goes beyond simply giving capital to help its investees perform and grow to develop win-win situations.

### **Brian Birk**

#### **Managing Partner, Sun Mountain Capital**

Both funds of funds and direct investments offer significant promise in the Mexican venture capitalism realm. Direct investments are relatively rare but offer tremendous return potential, similar to what private equity investors were able to achieve in the United States from the mid-1980s through the late '90s. Funds of funds reduce both risks and potential rates of returns but should be able to draw increased investment from abroad with better promotion.

Committing to a fund is a long-term proposition, with a return horizon of a decade or more. Mexico has many relatively new fund managers competing for investors, so a fund's investment strategy should be scrutinized to determine whether it meshes with the investor's perceptions around where opportunities lie.

Sun Mountain Capital's Fund 3 makes investments in the \$2 million to \$6 million range, though the amount that it invests in a company easily doubles over time. The risk-return equation is an area of major focus, and a preferred share structure—last money in, first money out—is employed to protect against risk. Sun Mountain typically takes minority positions in the companies it invests in, but takes multiple seats on investees' boards where possible and gets involved with the human resources and finance departments to verify metrics and numbers.

The risk management aspect of a fund of funds is well understood. But it is worth noting that such a fund has a greater impact on the overall entrepreneurial ecosystem than any individual fund because it invests in multiple companies along the capital structure—from startups to mature businesses. Every dollar invested in a fund of funds brings into those companies an additional \$5 in investment capital.

Knowing when to exit an investment is fundamental to a fund's success. While mergers and acquisitions often mark the point of exit, recapitalization can also be employed to buy out investors. As economic growth in Mexico continues, more opportunities for IPOs will also emerge.

### **Fernando Godard**

#### **Transactional Associate, Baker & McKenzie**

In undertaking due diligence at Mexican entrepreneurial concerns, the single largest concern is typically around outstanding liabilities, such as intellectual property protection and material or labor contracts. Startups are increasingly using a corporate governance structure that is relatively user friendly from the standpoint of potential investors.

The Mexican venture capital industry remains focused on businesses with relatively favorable risk profiles rather than those working in nanotechnology or other high-risk propositions. Optimizing a fledgling business through improved operations, marketing, and other aspects can lead to an investment doubling or tripling without significant risk.

Minority interests must be protected in venture capital situations; frameworks that protect them have helped to encourage investment in Mexican companies. Shareholder agreements are increasingly being incorporated into corporate bylaws early in companies' lifecycles. Increased protections should further help the industry.

Large law firms can play a crucial role in the development of an entrepreneur's business by providing advice and mentoring throughout the formative years. Firms are increasingly willing to invest time in these businesses on a speculative basis, with the understanding that a successful business can become a significant fee-paying client in the future. The Mexican venture capital industry also continues to work closely with law firms on a host of issues.

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## Mexico's venture capital industry focuses on businesses with favorable risk profiles rather than high-risk propositions.

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### The Key Takeaways

In sum, the main messages from the two panel discussions include the following:

- Entrepreneurs in Mexico can receive solid support from different types of organizations, including universities, incubators, and non-governmental organizations (NGOs), from how to launch and manage a business to how to attract investors.
- As an entrepreneur's business matures, managers skilled in more traditional areas of business administration are often needed to oversee day-to-day operations. Cost controls and governance become more important as the company grows.
- One aspect of Silicon Valley's success that Mexican entrepreneurs could emulate is mentoring—those who have achieved success help those still on the road to success.
- Mexico is developing a strong ecosystem to encourage entrepreneurs, but continued support from investors (foreign and domestic), public policies, and service providers is essential.
- Providing funds and serving on boards just scratches the surface of what investors can do. Investors who work directly with the business functions, offering valuable hands-on expertise, can speed the company's ascent to best practice levels of performance.
- Entrepreneurs who find new ways to use established technologies are the ones most likely to deliver a good return on investment.
- Investing in a Mexican fund of funds is a good way to capture a multiplier effect as the funds flow to a variety of entrepreneurial firms.




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