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Ago\ra Partnerships Nicaragua: A micro venture capital fund☆

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ABSTRACT

Agora Partnerships is a micro venture capital fund founded by Benjamin Powell in the US and Ricardo T. Teran in Nicaragua. Agora started operations in 2005 with the goal of identifying and supporting entrepreneurs and business plans with high potential for success. The fund faces some unique challenges. First, the size of the businesses that is investing in does not allow for a traditional "management fee" structure. Secondly, traditional investment exits are nearly impossible in Nicaragua. This teaching case includes analysis on sources of investment capital, deal structures, and expected returns. The unresolved dilemma remains how to structure an investment proposal attractive to both investors and entrepreneurs. The case also allows discussing how to adapt the venture capital model to an emerging country like Nicaragua.

Agora Partnerships is a private, not-for-profit organization with the mission to launch and grow socially-responsible companies in poor countries. Agora's founders, Ben Powell and Ricardo T. Teran, believe the time is right to apply the insight of microfinance – that the poor are bankable – to entrepreneurs trying to start businesses in the formal economy. According to Ben "Most aspiring entrepreneurs in poor countries are caught in a development blind spot. Too big for microfinance, too small for traditional lending, they represent perhaps the greatest under-utilized asset of poor countries. These entrepreneurs hold the key to job creation. Countries need to find new ways to unleash them."

Agora's model provides promising entrepreneurs with a comprehensive program that attacks the key barriers to small business development, which Agora management identifies as the lack of: business and social networks, education, financing, and management expertise. They officially piloted officially the model in Nicaragua in 2005. By early 2006, Agora had provided consulting to nine entrepreneurs and six others were identified. Now the volunteer Investment Committee is in the process of deciding which ventures to fund, and on what terms.

Agora management knows that investing in the asset class of early stage, and even pre-incorporation businesses in Nicaragua, is incredibly risky and poses significant challenges. The organization needs to lower transactions costs necessary to find and analyze deals and prepare and educate entrepreneurs for possible investment. Aside from finding great entrepreneurs and great business ideas, Agora needs to find a way to adapt the principles of venture capital (VC) to the context of Nicaragua, the second poorest country in the western hemisphere. What works in the United States or the European Union can provide a guide but certainly not a map to what might work in Nicaragua. For starters, traditional exit opportunities are virtually absent in Nicaragua. Figuring out the most effective way to provide support and investment is a major challenge.

In the end, Ricardo and Ben believe that their organization's fate relies on the success of the firms in which they invest. This conviction is similar to how VC firms in the United States operate and will indicate to Agora's donors whether the organization is succeeding in making an impact on new, Nicaraguan businesses. Adapting the VC model to Nicaragua poses a myriad of challenges due to the many barriers to entrepreneurship in the country. Chief among the challenges for the Agora team is deciding what kind of financial deal Agora should offer to entrepreneurs that show potential for investment: What would the deal look like?

Ricardo Teran Teran, Co-founder and managing partner of Agora Nicaragua, commented: "Finding the right structure for the deals Agora is going to offer to the entrepreneurs is of paramount importance. The investment committee needs to make sure that the entrepreneur will feel in total control of his company, and that he can extract as much value out of the venture as possible. At the same time, the committee needs to make sure Agora can capture at least a share of the upside of the successful companies, since these will have to balance out the negative experiences. Balancing all these competing needs into a single financial structure which is also easily understandable for the entrepreneurs is an enormous challenge."

At the wake of their first Investment Committee meeting, the management team is outlining the numerous questions requiring an

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answer before offering a deal to an entrepreneur. The questions include: How should Agora achieve an exit in the absence of a possible management buyout or sale to a strategic competitor? To what extent should third-party participation from commercial investors be allowed? How will Agora create a deal structure that would give the entrepreneur a fair and transparent deal while also achieving the investment goals? What portfolio Internal Rate of Return (IRR), if any, should Agora commit to the donors or social investors for the fund? What Return on Equity (ROE) should Agora seek from each investment?

As Agora's Investment Committee will meet concurrently in Managua and in New York to discuss these issues, they know the stakes are high. If they can be successful in bringing the VC approach to early stage ventures in the developing word, they can help create a new development model that will open the door to thousands of new jobs and new companies and inspire entrepreneurs from all socio-economic levels to try to start their own businesses. In order to be successful, however, the first few deals need to work – and that requires coming up with a successful deal structure for both Agora and the entrepreneurs.

1. Entrepreneurship in Nicaragua

Nicaragua lies at the heart of Central America, between Honduras and Costa Rica. The country has an area of 129,494 km^2, and a population of 5.3 million. In 2005 the country had a labor force of 1.91 million with 22% unemployment and underemployment estimated at over 40%. Annual per capita income was US$730, and 50% of the population lived in poverty. The minimum wage was $0.42/h, and the market average was $0.67/h.

The Agora Partnerships team invested months determining the key barriers to new enterprise growth in emerging markets, specifically in Nicaragua. They found that start-up costs and timing are prohibitively expensive for the vast majority of Nicaragua's potential entrepreneurs. Start-up costs average about US$1200 or 170% of the country's per capita Gross National Income (GNI), compared to a regional average of 60% and an OECD (Organization for Economic Cooperation and Development) average of 6%. Entrepreneurs taking the least amount of time can legally start a business in Nicaragua in about 45 days (compared to five days in the US). In addition, potential entrepreneurs have fewer than half of the property right protections offered in wealthy countries (IFC, 2005).

According to the Inter-American Development Bank (IADB, 2001) the single largest barrier entrepreneurs face in Nicaragua is access to financing. The formal banking system does not lend to start-ups, and angel investment opportunities are in short supply outside of family networks. Hundreds of microfinance institutions exist to serve the "poorest of the poor," but a gap is clear for the financing of small- and medium-sized enterprises and particularly for young entrepreneurs with great ideas but no collateral assets.

Besides financing, a host of additional barriers make extremely difficult for talented Nicaraguan entrepreneurs to achieve their potential. The key barriers Agora management identified are:

Closed social networks: closed family networks and socio-economic discrimination difficult for even middle-class entrepreneurs to access needed business networks. In turn, this lack of access hinders confidence and imagination, with many talented entrepreneurs not believing they can become successful and, if they do, they usually aspire to own a small family business. They rarely dream of creating a truly new, successful company.

Education: few entrepreneurs have experience with the private equity model and very few have the opportunity to study venture creation. They also lack critical information about market opportunities.

Management expertise: the lack of training and experience means that those few ventures that receive enough capital often stumble at the operational level or fail to manage growth properly.

Management also points that an additional obstacle to new enterprise creation is that institutions linking economic development and VC professionals are scarce. Thus, agents and policy makers usually ignore the possible interdependence between development

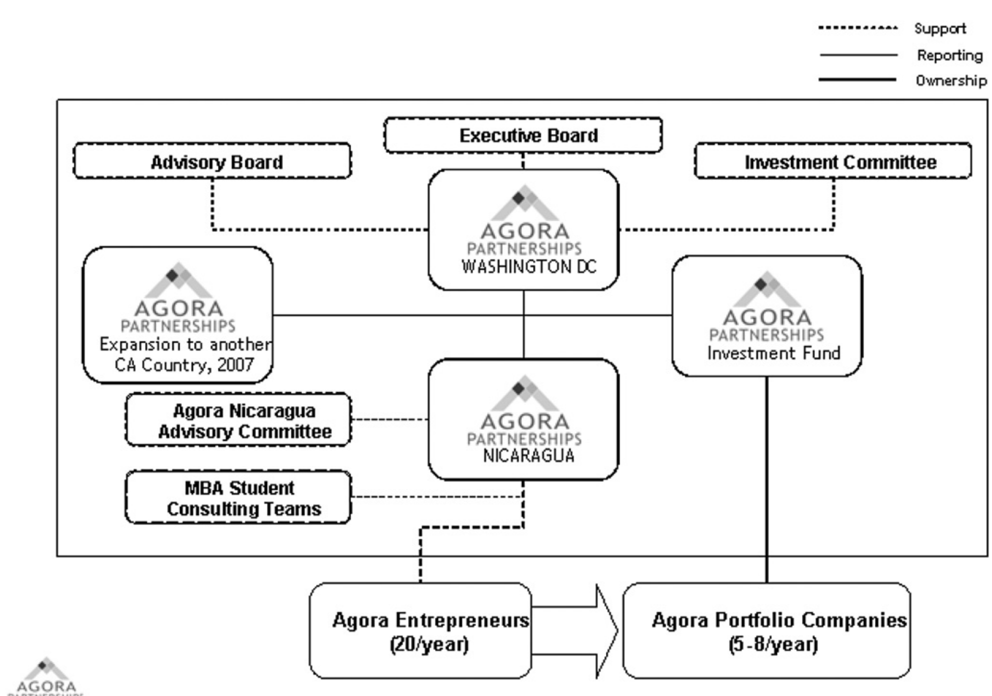

Fig. 1. Organizational structure.