
Event Report

How Investing in the Base Can Bring Investors out on Top

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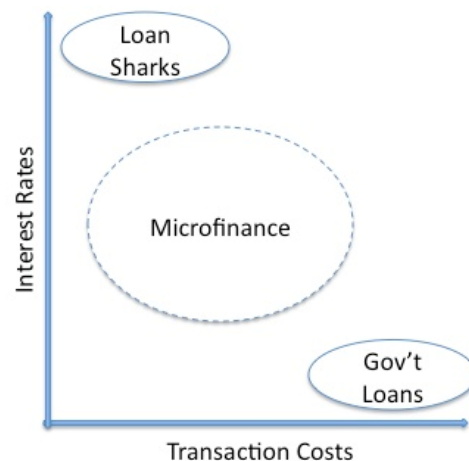
On February 17, Microlumbia presented the lecture Bottom of the Pyramid Investing with Alvaro Rodriguez Arregui. Arregui, co-founder and managing partner of IGNIA Partners, LLC, a \$93 million venture capital fund, discussed how his organization supports the founding and expansion of high-growth social enterprises that serve the base of the socio-economic pyramid in Latin America.

When it comes to combating poverty, Alvaro Rodriguez Arregui argued to a group of Columbia Business School students, the key is scale. After all, 360 million of Latin America's 550 million people earn less than \$3,000 per year. While those living in this "Base of the Pyramid" (BoP) market appear to have very little buying power as individuals, in aggregate they are a market of more than \$510 billion. In Mexico alone, where IGNIA has its headquarters in Monterrey, the BoP market represents \$130 billion and over 70 percent of the population.

With a problem that sizeable, it makes sense that only large-scale organizations can have a large-scale effect on poverty. But how can a venture capital fund address the underserved needs of low-income populations, both as consumers and as entrepreneurs? For Arregui, the answer is to create attractive financial returns for investors. "The traditional approach to attacking poverty is philanthropic capital," said Arregui. "In 2008, Americans gave \$300 billion in philanthropy. The capital markets investment was one hundred times that. So, how do we get access to those capital markets? There is a very clear rule there: achieve profitability."

At IGNIA, achieving profitability is a necessary, but not sufficient, condition for success. Unlike a traditional venture capital firm, IGNIA requires that all of its investments deliver a good

or service that makes an appreciable positive impact on the capacity of base of the pyramid clients to accumulate assets, increase their income, or improve the quality of their daily lives. IGNIA looks to markets such as health, education, housing, nutrition, and clean water, where those who serve the base of the pyramid market do so either inefficiently (in terms of transaction costs) or expensively (in terms of prices or interest rates). As an example, Arregui talked about his experience with microfinance as the chairman of the board of Compartamos Banco, Mexico’s largest microfinance organization: “There was a huge need in the base of the pyramid market for lending. Fifteen years ago, eight out of ten Mexicans had never been to a bank branch, and that was because you had government-controlled access to financial services, which is low-cost but it would take you months just to fill out paperwork, or you had loan sharks, where you could get money immediately, but at a very high cost. In the middle there was a huge space, which is now being filled with microfinance organizations like Compartamos.” In addition, Arregui explained how Compartamos, which loaned to 60,000 clients as an NGO in 2000 and then became a for-profit institution that now lends to 1.5 million people, served as a proof-of-concept for IGNIA. “That is the power of the for-profit model. It is an exponential catalyst for growth.”



Hands-On Management

Arregui and IGNIA do more than just invest in their portfolio companies: They are hands-on managers, involved in all aspects of business from the macro to the micro issues. Arregui acknowledged that entrepreneurs need capital, but often benefit from much more: “The difference between starting a business in a developed versus a developing nation is the amount of friction an entrepreneur faces. There’s a lot of friction in Mexico. It’s very important to bring the entrepreneur into an ecosystem where the chances of their survival are much higher, and we can do that by helping them tackle this friction that often gets in the way.” IGNIA offers assistance – sometimes even dedicating personnel exclusively to one business – in strategy, operations, legal and even finance. In addition, all of the finance and administration of their portfolio companies

are managed through a vehicle owned by the fund, IGNIA Shared Services. “Shared Services allows our entrepreneurs to concentrate on what they do well – operating the business – and it mitigates some of the risk for us,” Arregui said. “When the entrepreneur feels that kind of support, their confidence goes up significantly, and their chance of success goes up, too.”

This idea of placing entrepreneurs in an “ecosystem” where they can succeed has restricted IGNIA’s business investments to Latin American countries within which they have built a strong network. “We’ve had many opportunities all over South America that look wonderful, but we need to set up the infrastructure there with local expertise and talent that is able to replicate the positive ecosystem for entrepreneurship that we’ve created in Mexico for instance. Then we’ll be able to think about investing there.

Requirements for Investments

In addition to the basic requirement of having a positive impact on the base of the pyramid population, Arregui has a gauntlet of criteria that he demands from potential investments. As discussed earlier, profitability is a necessary requirement for any fund, but at IGNIA, there is particular pressure for extremely high returns. In fact, Arregui requires projects to have an internal rate of return of at least 30 percent: “We are only going to be able to create a demonstration effect and draw the capital needed to really solve the poverty problem if we can prove that the base of the pyramid isn’t high-risk. We are not in the camp of compromising financial returns for social impact.” Arregui looks for innovative business models that are scalable, low break-even, and in the “last mile” or consumer-facing end of the value chain. The fund’s total investments typically range from \$2 million to \$11 million per company (primarily in staged disbursements), and it may hold up to 100 percent of the shares of a company, but in general no less than 25 percent. Arregui also has a strict policy on capital structure: “We don’t do loans and we don’t do preferred equity. We come in as partners only. I view these deals as a marriage: We are in it for the long haul. And what type of marriage is it if – when the stuff hits the fan – we say to our entrepreneur, ‘We’re out before you are!’” For Arregui, the only difference between his fund and a typical venture capital is the time horizon: “We are a 12- to 15-year fund because we think these types of projects take a long time to mature.”

In terms of talent, Arregui looks for highly ambitious entrepreneurs with a strong vision for their business, and requires them to be both emotionally and financially invested in the undertaking. “It’s very important that a significant portion of our entrepreneurs’ net worth be invested in the venture. And that’s because we find that the entrepreneur himself or herself is the

key indicator of success: It’s their drive, their passion that makes the business.” Additionally, Arregui has strict minimum levels with respect to know-how – he will not consider a plan from an entrepreneur with less than eight years of experience. “We’ve seen great business plans from people coming out of business school, but we don’t do them. We all make mistakes and we all learn from them, but we’d prefer that our entrepreneurs make mistakes on other people’s dimes,” Arregui said good-naturedly. Still, Arregui encourages MBAs who are considering starting funds just like his to get into the game: “We have a saying in Spanish, *En la tierra de los ciegos, el tuerto es rey*, which means ‘In the land of the blind, the one-eyed man is king.’ Right now, there is nobody else doing this. But I really hope eventually there will be hundreds just like us, because that’s the only way we’re going to provide access to all of the goods and services that the base of the pyramid absolutely requires.”

Until that day, Arregui will work hard to combat the assumption that the base of the pyramid is too risky a place for investors to allocate their dollars. But with established anchor investors (for instance, eBay founder Pierre Omidyar committed \$10 million to the fund), IGNIA hopefully won’t have long to wait.

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