Latin America – An Entrepreneurial Perspective

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Latin America -References

- Latin America (Readings)

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History, Geography and Languages

- Archeologists peg the first migrations from Asia to the Americas at approximately 35,000 years ago, with tribal groups entering South America 25,000 years later.
- Nomadic tribes began small crop development, eventually evolving into city and regional states in many areas.
- By the time of European colonization, two predominant empires had arisen: the **Incas** in what is now Peru and neighboring countries, and the **Aztecs** in modern day Mexico.
- The indigenous populations throughout were severely depleted following the European conquest beginning in the 16th century.
- The early economies resulting from European settlement were labeled hacienda forms of land use. This practice combined Iberian and American Indian systems.
- Many Pre-Columbian Indians were clustered in communal villages loosely governed by absentee aristocratic landlords.
- The Spaniards overlaid this system through huge royal land grants. They imposed taxes, but were expected to protect the natives and educate them in the Catholic faith.

History, Geography and Languages

- Conquest and colonization were led by Spain and Portugal, countries speaking Romance languages derived from Latin, hence the term, Latin America.
- A third Romance-language country, France, bequeathed its language to Haiti, French Guiana and the French West Indies. Despite the decimation of the Indians described above, many tribal groups flourish to this day and use their native languages.
- The large landholding systems survived through revolutionary periods as the various colonies in Latin America won their independence from the Europeans.
- *Criollos*, American-born descendants of Europeans, emerged as the political and economic elite, controlling indigenous populations through the *hacienda* system.

History, Geography and Languages

- Resources for export and domestic use were in the hands of large landowners. Eventually, industrialization began to change the political and economic environments of the continent in the 19th century.
- The map showing the nations of Latin America looks today much as it did in the post-revolutionary period of the 1800s.
- Until recent advances in transportation, communication and information technology, opportunities for entrepreneurs were defined and often restricted by the geography of the location of their enterprise.
- Even today, the dominance of the micro-enterprises in the small business sector results in local firms using local resources to satisfy local needs.

Government and Legal Systems

- Following colonial exploitation, Latin America splintered into multiple nations, often controlled by political, military and economic elites. Failures of initial governments led to **greater centralization** of political power.
- There have been frequent changes; for some, the shape of governance derived from revolution. Examples would be Bolivia, Cuba and Mexico.
- Others have been affected by extended periods of military rule, like Argentina, Brazil and Peru.
- A third force shaping political development is constitutional democracy, with Chile, Columbia and Venezuela as examples (Sigmund, 1970).
- The global depression of the 1930s began a period of aggressive state involvement in economic systems that continues in many Latin American countries to the present. In some countries this resulted in legislation that subordinated property rights to the social needs of the population.
- The 20th century saw a reduced role of the Church, increased nationalism, experiments with various ideologies, including socialism, communism and fascism.
- By the end of the century, some form of democracy prevailed in most countries, with the Communist dictatorship in Cuba an exception.
- Two major factors discouraging entrepreneurs from creating and growing legitimate businesses are
  - 1) the lack of access to capital due to extensive government debt, and
  - 2) perceived unfairness of judicial systems. If a prospective business owner questions whether property rights will be protected and whether contracts will be upheld, the risk associated with the venture is magnified.

Economic Structure

- Preceding the Conquest, economies were primarily agricultural, with some nomadic tribes and hunter-gatherers. Although there were merchants who carried on trade among various peoples and across considerable distances, inter-tribal warfare was endemic and shaped many cultures and economies.
- European conquerors introduced feudal economic systems through which they extracted resources for the benefit of the mother countries. Eventually, a merchant class began to emerge to provide a distribution system both for the silver trade and for the produce of the haciendas. Mercantile economies were built on the backs of slave labor, both Indian and African.
- Spain instituted free trade throughout its possessions in the New World in the latter half of the 1700s. Commercial trade volume increased dramatically at this time, though cause and effect are not clear. Population grew considerably in the region, and industrial growth was expanding the economies of Europe, creating markets for the materials from mines and farms.

Economic Structure Contd.

- Economic growth combined with English control of trade routes to Europe contributed to struggles for independence as the colonies engaged in greater commerce among themselves.
- The revolutions during the first quarter of the 19th century, however, had a devastating effect on the economies of the newly independent nations.
  - Compounding the destruction of lives and property were the foreign debt burdens and lack of infrastructure.
  - All this led to a **shortage of capital** for business investment. In the latter half of the century, the situation reversed with extensive foreign investment focusing both on technological advances for basic industries and on the export of raw materials.
  - A negative consequence: evolution of single-product economies in many countries.
- According to Dietz and Street (1987), the Great Depression of the 1930s was magnified in Latin America due to dependence on export and import markets.
  - Countries suffered successions of balance of trade crises and responded by shifting their political and economic interests from the landed oligarchies toward production by incipient capitalists.
  - Governments erected trade barriers as they instituted import substitution industrialization strategies.

ECLAC

The regional commission of the United Nations, the Economic Commission for Latin America and the Caribbean, labeled the five decades of the second half of the 20th century as indicated below (ECLAC, 2003):

- The 1950s: industrialization through import substitution
- The 1960s: reforms to facilitate industrialization
- The 1970s: reorientation of development “styles” towards social homogeneity and towards diversification as a means of promoting exports
- The 1980s: overcoming the external debt crisis through “adjustment with growth
- The 1990s: changing production patterns with social equity
- In Spanish, the acronym is CEPAL, Comisión Económica para América Latina y el Caribe.

Post WWII and the 1980's

- The post-World War II years were generally good ones for Latin American economies.
- By the 1980s, however, what had been described as economic miracles were turning sour.
- Dietz and James (1990) listed the following as the driving factors in economic development:
  - Science and technology
  - Debt crises
  - Neoliberalism
  - Economic slump

Post WWII and the 1980's

- Dietz and James contended that governments and lenders over-expanded in unrealistic expectations of continued growth.
- Spikes in oil prices in the 1970s helped some countries and hurt others, but in the longer term hurt all due to borrowing.
- The economic slump of the 1980s created debt crises, which were exacerbated by the protectionist policies focused on industrial development.
- Neoliberal policies included credit tightening, which in turn limited capital for prospective entrepreneurs and for business owners.

- In the modern era, “Latin America’s history is replete with economic reforms that have failed due to the lack of credibility” (Edwards, 1991, p. 158).
- Credibility has been lost by the reversals of reforms that have occurred with changes in governments and by the lack of internal consistency of some of the reform strategies.
- Continuing bottlenecks to economic development include
  - inefficient supply systems for food products,
  - rigidity in government tax and expenditure structures,
  - insufficient internal savings, and
  - the lack of supply of intermediate agricultural and industrial inputs.

Economics Contd.

- In a study of Caribbean Island economies, Leo-Paul Dana reported that higher per capita income was associated with pro-business ideologies, as demonstrated by minimal regulation and intervention.
- Unfortunately, economic development for most nations in Latin America is hindered by the following:
  - a lack of legal guarantees for property rights;
  - the failure of judicial systems to enforce contracts
  - absence of recourse resulting from damages or injuries associated with the informal sectors; and
  - inefficiencies of tax systems.

Culture and Religion

- Catholic priests and missionaries were major influencing factors in imposing European values on the indigenous populace.
- Over the centuries, Roman Catholicism waxed and waned in its influence, but by most objective measures would have to be labeled a powerful force across the continent.
- In many Latin American countries, culture and traditions are succumbing to corruption and violence (De Soto,). Public sector corruption extends from petty bribery of low level officials to indictments of elected officials at the highest levels for misappropriation of public funds and other crimes.
- Civil insurrections once associated with political ideologies have degenerated to acts of terrorism, often connected with drug trafficking.

Culture and Religion Contd.

- Thomas Cochran (1960) contended that entrepreneurial activity is more a function of culture than economics.
- He argued that cultures in Latin America were less supportive of economic development, based on the following distinctions:
  - Family interests superseded profit maximization.
  - Social and personal interests take precedence over business obligations.
  - Nepotism preempts able top-management.
  - Managers and workers are less accepting of constructive criticism.
- Additionally, status in Latin American countries is more often associated with professional careers than with entrepreneurship.

Educational Systems

- Few dispute the promise of education in enhancing the quality of life in Latin America, yet the record is dismal by nearly any standard.
- Segments of the population are excluded from higher education by a primary and secondary school system that encourages repetition and dropping out rather than excellence.
- Public primary education has been emaciated as dollars are funneled into public university systems.
- Teachers are poorly trained and managed. (Franko, , p. 374).
- Educational systems in Latin America tend to be centralized under ministries of education.
- Problems that occur among multiple countries include:
  - lack of qualified instructors,
  - high rates of illiteracy,
  - inequality between rural and urban schools,
  - political instability, and
  - inadequate provisions for Indian tribes.

Education Contd.

- Entrepreneurship in Latin America is constrained on two fronts.
  - Because entrepreneurs have higher levels of education than the general population, the failure to educate larger segments of population reduces the supply of business owners.
  - Second, an undereducated workforce limits the availability of a qualified labor force for starting and growing enterprises.
    - The latter is compounded by global competitiveness. Other regions of the world are paying lower wages to workers whose skills exceed those of the Latin Americans.

Demographics and Physical Infrastructure

- Latin America was one of the fastest growing regions of the world during the 20th century, with an annual rate in excess of 3% in many years. As a percentage of world population, Latin America nearly doubled from 4.5% in 1900 to 8.6% in 2000 (Population Reference Bureau, 2003
- The 20th century was also characterized by dramatic rural to urban migrations. From 1950 to 1980, per capita income rose 2.4% per year. Overall, however, the period of import substitution industrialization ended in massive devaluations and a fall in real wages. From 1960 to 1980, life expectancy in the region increased by ten years (Hartlyn and Morley, 1986).
- Rapid industrial growth following World War II created huge demands for new and better roads, schools, telephones, water, and the government bureaucracies to oversee these expansions. This in turn led to tax increases. Tax increases in turn have generated increased tax avoidance by individuals and businesses. As a result, governments do not generate sufficient revenues to satisfy infrastructure demands caused by population growth and technological advancement.
- Despite this bleak picture, wealth is being created in Latin America, though not evenly across the region. There are growing markets for entrepreneurs to penetrate. Multi-national corporations have recognized these opportunities by expanding their marketing efforts in many countries. Locally-owned ventures are serving as suppliers and distributors for these foreign investments. Lagging infrastructure, however, handicaps entrepreneurial companies from expanding in the region.

Industrial Structures

- As explained previously, the economies of Latin American countries were traditionally reliant on single products. The lack of export diversity resulted in declining productivity in industries that had diminishingly lucrative outputs (*Dietz and Street, 1987*). Lip service was paid to free markets, but the political systems did not permit free labor organizations nor free press. Until democratization movements took hold, the concentration of property and income were extreme. Transnational corporations held monopoly power in many industries.
- According to *Dale Story (1983*), stereotypical industrial entrepreneurs in Latin America have been weak and dependent on the national government. As a result, they are much at the mercy of governmental policies, such as when countries reacted to the oil price shock of the 1970s by heavy international borrowing to maintain and expand social programs.
- It is difficult if not impossible for individual entrepreneurs to build successful businesses in industries that lack critical mass. Few start-ups can fulfill all the requirements of a supply chain. Government policies that concentrate on one or a small number of industries inhibit creativity and innovation in alternative arenas. Industrial policies to build complete supply chains for particular products actually foster inefficiencies in global competition, ultimately spelling doom for the smaller companies that may exist only to serve a declining industry.

Trade Agreements and Associations

- Trade agreements received attention in popular media in the 1990s with the formalization of the European Union and the North American Free Trade Agreement.
- Some of the more significant trade agreements and associations affecting Latin America in recent years include those enumerated below.
  - The Latin American Free Trade Association (LAFTA) was formed under the Treaty of Montevideo in 1960. Original members were Argentina, Bolivia, Brazil, Chile, Columbia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela. The purpose of LAFTA was to liberalize trade among the members, eventually leading to a Latin American common market.
  - Progress lagged, and in 1980 LAFTA was replaced with the Latin American Integration Association (LAIA), which continued the goal to reduce trade barriers, but with no goal for a common market.
  - NAFTA has had a huge effect on Mexico in Latin America and has become quite controversial in the recent presidential election.
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Trade Agreements Contd.

- The Andean Community evolved from the Cartagena Agreement, signed in 1969. The Andean Community members are Bolivia, Columbia, Ecuador, Peru, and Venezuela. In 1993, all countries except Peru approved a free trade zone. Peru began phasing into the trade zone in 1997.
- Mercosur is the Common Market of the Southern Cone. It originated with the Asunción Treaty in 1991. Members are Argentina, Brazil, Paraguay and Uruguay. The participating nations agreed to move toward the free movement of goods and services among the members, the establishment of common external tariffs, the coordination of macroeconomic policies, and the harmonization of relevant legislation. Mercosur is the fourth largest economic bloc in the world. It has a bilateral trading agreement with the European Union, its principal trading and investment partner.
- At the 8th Ministerial Meeting of the Free Trade Area of the Americas, held in Miami, Florida in October, 2003, representatives of 34 participating countries issued guidelines for continuing negotiations in an effort to achieve an area of free trade and regional integration. Setting a target date of January, 2005 for an agreement, the FTAA sought to foster economic growth, the reduction of poverty, development, and integration through trade liberalization (Free Trade Area of the Americas, 2003).
- In December, 2003, Mercosur and the Andean Community reached a trade agreement linking 350 million people in countries with more than $1 trillion in gross national product (Wall Street Journal, 2003). In the same month, El Salvador, Guatemala, Honduras, Nicaragua, and the United States concluded the Central American Free Trade Agreement (CAFTA), to reduce trade barriers, eliminate tariffs, open markets, and promote investment and economic growth among the signatories (Office of the United States Trade Representative, 2003).
- Other trade groups include the Association of Caribbean States (ACS), the Caribbean Community and Common Market (CARICOM), the North American Free Trade Agreement (NAFTA), and the System of Central American Integration (SICA). Additionally, there are numerous bi-lateral agreements, associate memberships, and other associations among and between nations in Latin America.

Small Business Practices

- As in other regions of the world, small businesses in Latin America have the advantage of flexibility – flexibility in both decision-making and in production.
- Also as in other regions, the imposition of government, i.e. adherence to regulation, falls disproportionately on small firms.
- The Foundation for Development and Integration, located in Cali, Columbia, calculated that government compliance costs in that country resulted in losses of about 23% for small businesses (CIPE, 1993).
- Alternatively, Pier Abetti and Patricia Wheeler (1990), in a study comparing France, Mexico and the United States, found entrepreneurial success consistently in communities with governments that successfully build infrastructures for technological entrepreneurship.
- Another aspect of Latin American government involvement in the private sector has been the absorption of bank credit by the public sector. Because so many countries have undertaken heavy debt burdens, they divert capital that small businesses might otherwise borrow in order to form and expand (Camp, 1989).
- As the review of cultural influences suggests, family involvement in enterprises permeates the region. “The persistence of family-centeredness is a common feature of (Mexico and) other Latin American countries” (Derossi, 1971, p. 101).

Small Business Practices Contd.

- Another aspect of culture affecting entrepreneurship is risk avoidance. Albert Lauterbach observed almost forty years ago that “this attitude is a far cry from the Schumpeterian entrepreneur whom some contemporary observers consider the mainstay of economic development in less developed areas today” (p. 210).
- Studies have also found that entrepreneurs in Latin America have different demographic characteristics than the general populations of their countries (Lipman, 1965). They are more likely to be higher educated, from wealthier (predominantly middle class backgrounds), and urban.

Extralegal/Black Market

- No discussion of the small business sector would be complete without addressing the economy sometimes labeled informal, extralegal, unauthorized, unlicensed, underground or black market.
- It was recently estimated that in Mexico alone, more than ten million people were engaging in unreported business activity, particularly pirated merchandise (Maquila Portal, 2003).
- In examining failures of capitalism in Latin America, Hernando de Soto recorded estimates that 60 to 70% of all construction in Brazil is never reported and that 80% of all real estate throughout Latin America is held outside of the law.
  - He compared Latin America with Russia: both had strong underground economies, glaring inequalities, pervasive mafias, political instability, capital flight, and flagrant disregard for the law.
  - De Soto concluded that these conditions limit the ability of national economies to produce and use capital efficiently.

Conclusion

- It would appear that a propensity for entrepreneurship exists throughout Latin America, but that several prerequisites are missing that would otherwise increase the number or start-ups and provide an environment for innovative and high-growth potential ventures.
- Obvious gaps are education, capital, and technological expertise. Expanding markets, reduced trade barriers, large labor pools, government support programs and other factors may provide stimuli for small business development in the future.