



**BG Consulting**  
*Linking two worlds*

NEWSLETTER

9

Fourth Quarter 2005

# DOING BUSINESS IN LATIN AMERICA AND THE CARIBBEAN

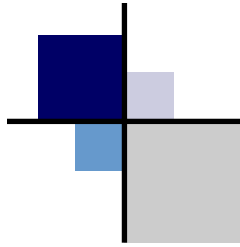
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## NEW FORMAT

As a result of our recent telephone poll, we have changed the format and content of our newsletter.



- Editorial
- Doing Business in LAC
- News

Please send us your comments to [info@bg-consulting.com](mailto:info@bg-consulting.com)

## EDITORIAL

Together the Central American countries make a market of almost 40 million inhabitants. From the business standpoint, Central America as a region is much more appealing to foreign investors than the individual countries.

However, an effort should be made to make laws and regulations pertaining to property both simpler and more consistent throughout the region. Transparent property laws that punish indirect expropriation should be encouraged. Regulatory measures that affect the property for environmental and security reasons should be well defined and fairly implemented. Restrictions to property rights both by law and *de facto* should be minimized. Tenancy laws should be more bal-

anced and abuses by holders of squatters' rights should not be permitted.

In contract law, the legal framework should be modernized in order to provide balanced rules for distribution and agency undertakings and in order to "fill the blanks" for electronic, factoring and leasing arrangements.

The crisis of the judicial systems is hindering the economic development of the Central American region. Reforms of the systems and litigation procedures are paramount. Introducing practices that encourage transparency such as oral procedures is crucial. Likewise, the establishment of a regional court having officially sanctioned appellate powers over com-

mercial disputes between different countries should be considered.

Significantly, the CAFTA agreement itself calls for regional approaches to resolving disputes. This regional approach could be a catalyst to re-energize efforts to promote alternative dispute resolution. Working in cooperation with judges, lawyers, and professional

associations, donors should encourage programs that focus on improving understanding and use of commercial arbitration and mediation.

In the area of company, efforts should be made to set up the framework for regional companies, similar to the *Societas Europaea*.<sup>[1]</sup> For example, a convention could be drafted for regional com-



panies, whereby companies incorporated under the formalities of this convention are treated as a local entity in any Central American country with no more formalities needed. Similarly, a regional registry should be established for these companies.

In sum, CAFTA-DR needs to be complemented with several legal reforms in order to materialize the opportunities it brings about. In that context, the commercial law reforms are essential. They will create the appropriate scenario for investment attraction, business growth, economic development, job creation and poverty alleviation.

## DOING BUSINESS IN LATIN AMERICA

Many mergers and acquisitions with companies in Latin America and the Caribbean (LAC) have fallen short of expectations for reasons that have much to do with the failure of the due diligence process to take note of relevant information. The failure in part lies with the types of people who are often chosen to perform due diligence and in part with structural limitations that frequently characterize due diligence in LAC.

Following are some factors about which those performing due diligence in LAC should take particular care to deliver accurate information about target companies in the region:



**Accounting practices:** Understanding differences in countries' accounting practices, not just principles, is crucial to properly valuing a firm. Generally, LAC companies are more inclined than U.S. firms to adopt creative accounting practices. Although creative accounting is certainly not unique to Latin America, unstable economies and changing tax regimes promote ambiguity and lack of consistency in accounting. As a result, many different interpretations of the GAAP, not necessarily based on the same standards used in the U.S., may coexist in the company's accounting system.

**Ownership and control:** Firm ownership in LAC tends to be concentrated around individuals and families. This situation is not always bad, but caution is recommended since corporate governance rules are less stringent in most LAC countries. Quite commonly the owners have special ways of milking cash from the company. Thus, it is important to understand how the owner makes money as well as how the company makes money.

**Internal auditors:** Commercial laws are outdated in most of the LAC countries. There are few restrictions on who can be an internal auditor of a company. Consequently, it is not unusual for shareholders or the friends and family of shareholders to conduct internal audits. These audits should be given little value in a due diligence.

**External auditors:** External audits are often conducted by firms with conflicts of interest. Frequently, external auditors are simultaneously financial advisors or lawyers for the companies they audit. They may have been involved in many "creative" accounting and tax solutions, which will not be revealed in company reports. While such conflicts of interest are not exclusive to LAC, weak enforcement and outdated legal codes increase their prevalence in the region. When issues of conflict of interest related to auditing show up in the

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## ENERGY

**Petroleos de Venezuela** will be raising its refining capacity by 245,000 barrels per day just with the projects for upgrading and construction of plants in the Caribbean and South America, expected to be ready by 2012. This would mean a 24% increase over current processing capacity. The investment is expected to exceed US\$2,176 million.

### **Petrobras announces investments for US\$ 80 million in 2006**

The company could make a four-fold increase in exploration investment in Colombia, with participation in at least 7 oil wells.

General Manager of Petrobras in Colombia, Dirceu Abrahao said that the oil company's exploration and production investments in the current year are in the order of US\$ 58 million

For 2006, the goal is to increase investment four-fold in exploration. Headquarters has yet to establish the new budget, but the objective is to invest US\$ 80 million.

He said the company is willing to increase the amount of investment in Colombia thanks to the creation of the National Hydrocarbons Agency, and the fact that a strategic plan has been put in place to attract foreign investment for exploration and production.

The President of Ecopetrol, Isaac Yanovich, pointed out that the good performance of Colombian companies in the Andean Community in 2004 was due to the higher sales of mining companies, among which Ecopetrol had a prominent role. He said that high prices have had a key influence on the state oil company results

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## INVESTMENT GENERAL INFO

### **Multinationals Put Their Money in Developing Countries**

Oil, automobiles and electrical/electronic equipment are the three industries that dominated the world's top 100 multinational companies in 2003, classified by value of assets. Although telecommunications did not figure in the table of honor of the sectors, it did show a favorable trend with numerous companies from the sector in the selection.

The ranking, published by UNCTAD in its World Investment Report: *Transnational corporations and the internationalization of research and development activities*, placed the electrical equipment company, General Electric (United States) in first place, closely followed in second place by the Vodafone telecommunications company (UK) and, in third place, Ford Motor Company (United States). The report also includes a parallel ranking for multinationals from developing economies. The first four places were monopolized by Asian companies, but the fifth place went to Latin American leader Cemex (Mexico).

### **Costa Rica has escalated in the services sector**

According to the Global Outsourcing Report 2005, prepared by the organizations Going Global Ventures of the

United States and Horasis of Switzerland, Costa Rica is the third country in the world with the greatest potential to offer information technology and communication outsourcing services. 34 corporations of the services sector that currently have established operations strengthen Costa Rica as a regional center for service operations such as: contact centers, shared services and back office, design and engineering and software development. Companies such as Hewlett Packard, Procter and Gamble, Maersk Americas, Western Union, Sykes, Dole, IBM and Intel LAES have found a destination for the growth of their operations in Costa Rica.

During this year, the Costa Rican Investment Promotion Agency (CINDE) has attended 38 different investors interested in developing service activities in Costa Rica.

### **Sao Paulo Governor invites investment in emerging industrial hub**

Governor of Sao Paulo, Brazil, Geraldo Jose Rodrigues Alckmin today invited Indian investments in Latin America's emerging industrial hub which has been catching the attention from across Europe, United States, Japan and Asia.

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## DOING BUSINESS Cont.

**Boards of directors:** Likewise, conflicts of interest by company board directors in LAC are common. In many companies the boards of directors are largely made up of members of the owner's family, business partners or friends. According to a recent USAID study in Central America, boards of directors tended to vote as management wished. Such conflicts of interest could likely remain an issue if the previous owner retains some control of the company. To make matters more complicated, board members are frequently well connected and useful in facilitating a firm's relations with the government or other third parties. The "connections" of some board members should be considered when considering their removal after an acquisition.

**Real estate:** Special attention must be paid to real estate titles. In many LAC countries, registration procedures make proof of title difficult and time consuming. In addition, ownership of important assets may be questioned due to multiple titles, zoning, squatter rights, and risk of *de facto* expropriation. It is also important to note that in some countries (e.g., Guatemala), foreigners may not acquire land in some parts of the country. Litigation over real estate in the wake of acquisitions in Latin America has been all too common, and usually with poor results for the corporate buyer.

## ENERGY Cont.

He highlighted the fact that investment in the hydrocarbons sector in Colombia has increased two-fold, thanks to an improved environment to do so, and also thanks to better contract terms, which provide better assurances for companies to carry on exploration activities.

**The multinational Endesa will invest a total of US\$ 400 million in Colombia** over the next five years in order to strengthen its power generation and distribution operation, said Luis Rivera, General Director of the company, who expressed his satisfaction with the results obtained in the local market.

It is important to note that Endesa is Spain's largest electric company and number one private electric company in Ibero-America. It is an important operator in Europe, particularly in Italy, and has presence in the Iberian natural gas market.



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## APPAREL

### THE CROCODILE LEGEND IS PRESENT IN EL SALVADOR

Devanlay, based in France, with the exclusive worldwide license and part ownership of the **Lacoste** brand for apparel, has started its manufacturing, logistics and export operations in El Salvador, which will be managed by a its new local subsidiary. This is the successful ending of a two-year search process aimed to identify the best location in the Central American region. Some of the most important factors that influenced this decision were: the excellent business environment in El Salvador and its regional leadership in Central America and the geographical proximity and easy access to the United States market through the CAFTA (Central American Free Trade Agreement) agreement.

## ENERGY Cont.

### US\$ 210 million will be invested to operate El Platanal Hydroelectric Central in Peru

The promoting group of the El Platanal hydroelectric project, lead by Cementos Lima and composed of Cementos Andinos and ARPL (advisor company), will set up Compañía Eléctrica El Platanal S.A. (Celepsa), in order to manage and operate the central. Works will be started by the end of this year or early 2006. A fourth Peruvian firm will join these three companies, related to metal-mechanic sector.

### Petrobrás, Repsol-YPF and Petrotech lead investment in oil exploration

Peru will close this year with 47 oil contracts. This new record adds to the number of contracts that will be subscribed this year (17) for the exploration of a similar number of plots. Petrobras, Repsol YPF and Petrotech are the companies who invested the most in exploration of oil plots this year

## TELECOM

### Peruvian government will call for tender for new operator of fix telephony

With the aim of boosting competition in the fix telephony market, the Ministry of Transport and Communications (MTC) has commissioned ProInversión to prepare the Terms for selecting a new operator. The new operator will be called to offer local fix telephony services in band of 3.400 and 3.600 Megahertz in Lima and Callao provinces. One of the objectives of MTC is to take advantage of international situation with new investors with high potential to enter Peruvian market and bringing in new technology.





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BG Consulting is an international business development consulting firm focused on Latin America and the Caribbean.

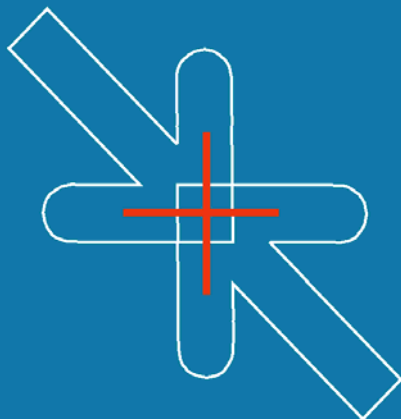
At BG Consulting we help clients do business in Latin America and the Caribbean answering **key questions**:

**“What”**: we identify business opportunities that match the strengths of our clients.

**“Where”**: we identify the appropriate places to do business.

**“Who”**: we find the right partners, distributors or manufacturers.

**“How”**: we suggest the best strategies to do business, based on our clients needs.



## WHAT'S NEW IN BG CONSULTING

- Omar García-Bolívar was interviewed by CNN En Español on October 18th in the “Economía y Finanzas” section. The topic of the interview was Venezuela’s accession to MERCOSUR and the business climate aspects that the Central American countries need to reform in order to maximize the benefits of the agreement.
- Omar García-Bolívar was appointed as chair of the recently created Inter-American Legal Affairs Committee of the Washington, D.C Bar.

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